28th July 2016

Utilities

Suez

Price EUR14.01

H1-16 results – first take: 2016 guidance confirmed thanks to deeper cost cutting

Fair Value EUR17.5 (+25%) **BUY**

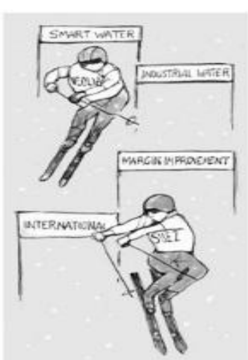
Bloomberg	SEV FP
Reuters	SEVI.PA
12-month High / Low (EUR)	18.0 / 12.9
Market Cap (EURm)	7,627
Ev (BG Estimates) (EURm)	18,712
Avg. 6m daily volume (000)	1 252
3y EPS CAGR	-2.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	8.6%	-11.4%	-17.1%	-18.8%
Utilities	12.8%	1.0%	1.8%	-0.6%
DJ Stoxx 600	11.0%	-1.6%	0.7%	-6.3%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	15,135	15,456	16,066	16,557
% change		*2.1%*	*3.9%*	*3.1%*
EBITDA	2,751	2,653	2,791	2,932
EBIT	1,381	1,287	1,355	1,459
% change		*-6.8%*	*5.3%*	*7.7%*
Net income	559.8	402.8	463.9	527.1
% change		*-28.1%*	*15.2%*	*13.6%*

	2015	2016e	2017e	2018e
Operating margin	9.1	8.3	8.4	8.8
Net margin	3.7	2.6	2.9	3.2
ROE	8.2	5.9	6.8	7.7
ROCE	8.0	7.3	7.5	8.0
Gearing	121.6	124.2	129.0	132.0

(EUR)	2015	2016e	2017e	2018e
EPS	1.04	0.75	0.86	0.98
% change	-	*-28.0%*	*15.2%*	*13.6%*
P/E	13.5x	18.7x	16.3x	14.3x
FCF yield (%)	3.4%	5.7%	4.6%	5.2%
Dividends (EUR)	0.65	0.65	0.65	0.66
Div yield (%)	4.6%	4.6%	4.6%	4.7%
EV/Sales	1.2x	1.2x	1.2x	1.2x
EV/EBITDA	6.8x	7.1x	6.8x	6.6x
EV/EBIT	13.6x	14.5x	14.1x	13.3x



This morning, Suez posted H1-16 metrics that came in slightly above market expectations. EBITDA is down 1.9% LfL to EUR1.27bn vs. EUR1.26bn expected by market, while net income came in at EUR174m, up 24% thanks to a provision reversal and lower minorities. 2016 targets are confirmed thanks to a deeper costs cutting program (+EUR30m), but 2017 EBITDA "ambition" was not reiterated. The macro environment in Europe remains difficult. This is not new, but it has obliged the group to adapt its costs cutting program, which we believe the market should appreciate. Positive.

ANALYSIS

- **Main H1-16 metrics**: H1-16 sales are up **2.2%** YoY to **EUR7.45bn** and up **2.7%** on a LfL basis, thanks only to the strong growth generated by International division *(+11.6% LfL*). Both Water Europe and Waste Europe businesses posted flat LfL sales performance. As a reminder, the group's Q1-16 sales were up **1.8%** organically, with sales International division being up **10%**, implying an acceleration in Q2 vs Q1. EBITDA is down **1.9%** organically to **EUR1.27bn** and comes in slightly ahead of market expectations (*EUR1.26bn*) due - as expected - to a significant margin decline at the Water Europe division (*EBITDA down 4.6% LfL*) which was affected by unfavourable weather conditions as well as by the adverse impact of the lower inflation environment. Waste Europe division's performance declined by **4%** organically, due mainly to the negative electricity price effect while the International division reported **12.8%** LfL growth over the period. When excluding the **EUR36m** provision reversal for risk related to the 2015 revaluation of the Chongqing Water stake, the group's EBITDA is down **4.5%** YoY and not down **1.7%.** EBIT cames out at **EUR598m**, representing an **8%** margin and a **30bp** margin decline compared with last year and declined **2.3%** organically compared with last year. Net income is, however, up strongly, by **23.7%** to **EUR174m** ahead of both market and BG estimates (*EUR147m expected*), helped by the provision reversal and also by a decline in minorities following the buyout of the Sembita minority. Net debt is up **EUR682m** vs end 2015 to **EUR8.76bn** due to dividend payment and a negative change in WCR. **Net debt/EBITDA ratio is 3.2x, slightly ahead of the group's 3x target.**
- **What to retain from this publication**: **1/**Compass cost reduction program is lifted by **EUR30m** in 2016 to **EUR180m** in response notably to the sluggish macroeconomic environment in Europe, allowing the group to confirm its 2016 targets. Without this lift, Suez admitted it would have missed its 2016 targets. **2/**The group indicated that it intends to increase its stake in ACEA to **23.3%** from **12.5%** by acquiring ACEA shares from the Caltagirone Group. This transaction is expected to be carried out through a **3.5%** capital increase at Suez (*representing EUR265m*). This is in line with group's ambition to expand within water sector in Southern Europe. **We estimate higher costs cutting for 2016 combined with capital increase to finance higher stake in ACEA have a -0.4% impact on our 2016e EPS and a +0.4% impact on our 2017e EPS.**
- **First conclusion**: **H1-16 metrics are poor as expected**, reflecting the poor macro environment in Europe affecting both water and waste business. Yet this is not new. **The EUR30m additional costs-savings measures should be well-appreciated** as well as the stronger than expected performance in the international division. **We still expect the company to give an update on its M&A strategy as well as on its 2017 ambition**.

VALUATION

- At the current share price, the stock is trading at **7.1x** its 2016e EBITDA and offers a **4.6%** yield
- Buy, FV @ EUR17.5

NEXT CATALYSTS

- 27th October 2016: Q3-16 results

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