18th August 2016

Sector View

Environmental Services

Q2 earning season review: toward strategies' convergence…again

	1 M	3 M	6 M	31/12/15
Utilities	-2.7%	0.4%	4.3%	-4.5%
DJ Stoxx 600	1.6%	2.6%	7.2%	-6.1%

*Stoxx Sector Indices

Companies covered

AMOEBA			
Last Price	EUR29,6	*Market Cap.*	EUR177m
PENNON GROUP		**SELL**	**830p**
Last Price	890,5p	*Market Cap.*	*GBP3,676m*
SUEZ		**BUY**	**EUR17,5**
Last Price	EUR13,945	*Market Cap.*	*EUR7,592m*
VEOLIA ENV		**BUY**	**EUR23,5**
Last Price	EUR19,685	*Market Cap.*	*EUR11,090m*

As expected, both Suez and Veolia are still bearing the brunt of a challenging macro environment which has negatively impacted their traditional water and waste businesses in H1-16. We however still appreciate the resilience of the company's margins whose main driver remains companies' abilities to deliver their respective cost-savings programme. We believe these savings combined with strong international developments will be the two pillars of a new strategies' convergence between both companies. We maintain our Buy rating on both stocks while leaving our FV unchanged (EUR17.5 for Suez and EUR23.5 for Veolia).

ANALYSIS

- **Cost-savings as main growth driver**: as expected, cost-savings remain the main driver for both companies' EBITDA growth. We have been quite impressed by **Veolia**'s performance over the first half of the year as the company reached EUR121m of costs-savings, ahead of its annual objective (EUR200m per year in 2016, 2017 and 2018). As for **Suez**, we appreciate the additional EUR30m cost-savings announced by the company which increases the company's annual objective upgrade to EUR180m for 2016 (still EUR150m for 2017). Suez also announced it aims to **speed up its transformation plan** whose details should be unveiled during Q3 2016 results, which could create a **positive momentum** on the stock. We understand from management that mobility and formation actions could be envisaged without any additional details disclosed for now.
- **Strong international developments**: Both companies are on their way to offset the rather challenging macro environment in their traditional European water (low inflation) and waste (still flattish industrial production) businesses by strong international developments. **We bet on a stronger growth for Veolia in H2-16 and in 2017** as the company will benefit from new international revenues' sources from **a mix of bolt-on acquisitions** (Chemours assets, Kurion) **and contracts** (industrial water with Sinopec) which should represent c. 2.0% of the company's 2017e revenues. Suez still expects to annually grow by 6% to 8% in its international businesses between 2016 and 2018. The company posted a 11.6% organic growth in the division in H1-16, which led us to revise upward our estimates (+9.7% and +7.5% organically in 2016 and 2017 in the division vs. + 6.7% and +6.8% before) in our previous note.
- **Conclusion**: As Suez put aside its 2017 EBITDA ambition – which were based on M&A – **we believe both companies' strategies will now converge again through self-help measures and strong international developments**. Additionally, we remain confident over the ability of both companies to **reach their respective guidance for 2016**: (EUR600m of adjusted net income for Veolia; revenues' organic growth higher than 2% and EBIT's organic growth higher than revenues' growth for Suez). **We maintain therefore our Buy rating on Suez** (FV @ EUR17.5) **and Veolia** (FV @ EUR23.5). **Veolia remains our Top Pick within the sector for Q3-16.**

VALUATION

- At current share price, **Suez** and **Veolia** are respectively trading at **7.0x** and **6.6x 2016e EV/EBITDA**.
- **Suez**: Buy, FV @ EUR17.5
- **Veolia**: Buy, FV @ EUR23.5 – Top Picks

NEXT CATALYSTS

- **27th October:** Suez's Q3 2016 results
- **3rd November:** Veolia's Q3 2016 results

Click here to download

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Distribution of stock ratings

BUY ratings 72% NEUTRAL ratings 0% SELL ratings 28%

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