29th September 2016

Sector View

Utilities

Top Picks Q4 -2016: SUEZ

	1 M	3 M	6 M	31/12/15
Utilities	-0.6%	3.6%	0.5%	-5.6%
DJ Stoxx 600	-0.3%	8.2%	2.2%	-6.4%

*Stoxx Sector Indices

Companies covered

ALBIOMA		**BUY**	**EUR16**
Last Price	EUR15,43	*Market Cap.*	EUR466m
E.ON		**BUY**	**EUR10,2**
Last Price	EUR6,275	*Market Cap.*	*EUR12,556m*
EDF		**BUY**	**EUR13,6**
Last Price	EUR10,825	*Market Cap.*	*EUR21,793m*
EDP RENOVAVEIS		**NEUTRAL**	**EUR7,65**
Last Price	EUR7,115	*Market Cap.*	*EUR6,206m*
ENGIE		**BUY**	**EUR16,5**
Last Price	EUR13,71	*Market Cap.*	*EUR33,388m*
PENNON GROUP		**SELL**	**830p**
Last Price	896p	*Market Cap.*	*GBP3,699m*
RWE		**NEUTRAL**	**EUR9,5**
Last Price	EUR14,935	*Market Cap.*	*EUR9,027m*
SUEZ		**BUY**	**EUR17,5**
Last Price	EUR14,77	*Market Cap.*	*EUR8,336m*
VEOLIA ENVI		**BUY**	**EUR23,5**
Last Price	EUR20,47	*Market Cap.*	*EUR11,532m*
VOLTALIA		**BUY**	**U.R.**
Last Price	EUR9,1	*Market Cap.*	*EUR239m*

LOOKING BACK ON Q3 2016

The Utilities sector performed worse than the Stoxx 600 during Q3 2016 (-3.7% for SX6P vs. 3.1% for the Euro Stoxx 600). Since the beginning of the year, the Stoxx 600 Utilities has dropped 5.6% vs. a 6.4% decline for the Euro Stoxx 600. Since our initiation of coverage in July 2014, we have recommended staying out of the sector as a whole and playing it safe through stocks offering strong earnings growth stories based on restructuring efforts. As a reminder, **we played Veolia in Q3 2016** as we were notably convinced by **1/**the resilience of the company's EBITDA margin thanks to **strong costs-savings and 2/**a potential catalyst with the **expected disposal of Transdev**. In the end, **Veolia performed well during the quarter (+3.9%)**, outpacing both the Stoxx 600 utilities (-3.7%) and the Euro Stoxx 600 (+3.1%). **Veolia's H1 2016 cost-savings were higher than expected** (EUR121m vs. EUR100m) while **the disposal of Transdev was initiated** with a 20% disposal out of the 50% stake Veolia owned (*with a c. 20% premium vs. book value which partly led us to slightly increase our FV by EUR0.5 last August*). Note that the 22.5m shares sold by the CDC *(i.e. c. 4% of Veolia's share capital*) last Thursday has logically exercised **downward pressure on the stock** following the **1.7% implied discount** in the operation. Inside the BG universe, the **top performers** were **Albioma** (+10.8%) and **EDPR** (+5.1%) while the **worst performers** were **Pennon** (-6.3%) and **Engie** (-6.1%). **We excluded E.ON** (-29.5%) whose absolute performance was logically impacted by the spin-off of its Uniper subsidiary in September. **During the quarter, European power prices surged by 6.4%** on average while **gas (TTF) and coal prices respectively decreased by 4.5% and increased by 10% over the period**.

WHAT WE SEE FOR Q4 2016

We still do not expect any short-term recovery in commodity prices in Europe. As a reminder, our models are marked-to-market and therefore integrate no upside from any price recovery as yet. **In Q4 2016, we see two main catalysts** in the sector with **1/**the unveiling of **Suez's transformation plan** during its Q3 2016 results and **2/**the upcoming **listing of Innogy**, RWE's subsidiary, which could trigger fresh appetite for utilities' companies. However, we are **still cautious** on the sector given the **lack of visibility** we have on both the macro and commodity prices environment.

At this stage, we remain Neutral on the sector.

CONCLUSIONS AND TOP PICKS

We have chosen to put Suez (*Buy, FV @ EUR17.5*) **on our BG Top Pick list for Q4 2016** as we believe the upcoming **speeding-up of the company's transformation plan** (whose details are expected to be unveiled during Q3 2016 results on October 27th) could reinsure investors over the **resilience of the company's margins** and trigger a **potential rerating** following **poor performance of the stock YTD** (-14.7% vs. -5.6% for the SX6P and -7.5% for Veolia). With this plan, we understand that **additional savings could be implemented – on top of the current Compass plan** whose targets were already upgraded during H1 2016 results with a EUR180m savings' target for 2016 vs. EUR150m initially forecasted – within Suez's French activities, especially for support functions. We estimated a c. 3% cut in French full-time employees - in line with recent job cuts announced by Veolia - could **save about EUR50-60m**. After having put aside its 2017 EUR3bn EBITDA ambition (inc. M&A), **we believe Suez will now keep focusing on delivering cost-savings in which the Group has a strong track record**: we calculated that since 2010 the Group has exceeded its initial savings' target by c.**25%** on average. We also expect the group to provide an update on its **asset rotation strategy**. We do not think any major move will be announced or even considered for now. **Fine-tuning is more likely to be unveiled**. Suez has already started the **disposal process for its Finnish waste subsidiary** which could amount to **EUR60m**, according to our estimates (*assumptions: EUR70m of revenues and 8.9x EV/EBITDA i.e. a 15% discount – due to lower EBITDA margin - vs. multiple paid by Fortum for the acquisition of Finnish waste company Ekokem earlier this year*). In all, we expect the new plan to give **more visibility on 2017 but also on 2018** which would be well-appreciated as the group, just like Veolia, is still facing a **challenging macro environment** (low inflation in mature economies, spluttering European industrial production).

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