3rd October 2016

Sector View

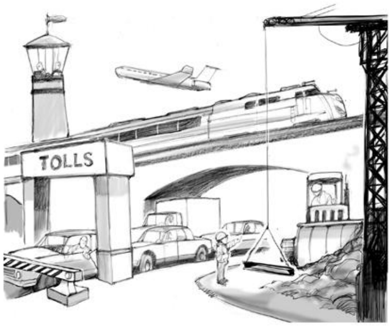
Construction & Materials

Top Picks: LafargeHolcim ahead of the capital market day, Imerys ahead of decent Q3.

	1 M	3 M	6 M	31/12/15
Cons & Mat	0.6%	12.3%	6.8%	5.7%
DJ Stoxx 600	-0.2%	4.0%	1.6%	-6.3%

*Stoxx Sector Indices

Companies covered			
CRH		**BUY**	**EUR30**
Last Price	EUR29.76	*Market Cap.*	EUR24,709m
EIFFAGE		**BUY**	**EUR77**
Last Price	EUR69.16	*Market Cap.*	*EUR6,783m*
HEIDELBERGCEMENT		**BUY**	**EUR86**
Last Price	EUR84.09	*Market Cap.*	*EUR16,685m*
IMERYS		**BUY**	**EUR72**
Last Price	EUR64.29	*Market Cap.*	*EUR5,116m*
LAFARGEHOLCIM		**BUY**	**CHF60 vs. 50**
Last Price	CHF52.5	*Market Cap.*	*CHF31,863m*
SAINT GOBAIN		**BUY**	**EUR46**
Last Price	EUR38.47	*Market Cap.*	*EUR21,349m*
VICAT		**NEUTRAL**	**EUR56**
Last Price	EUR57.48	*Market Cap.*	*EUR2,581m*
VINCI		**BUY**	**EUR72**
Last Price	EUR68.12	*Market Cap.*	*EUR40,650m*



LOOKING BACK ON Q3 2016

The third quarter was a very good one for cyclical, risky, large cap heavy materials stocks, LafargeHolcim leading the herd with an impressive +30% performance, followed by Heidelberg (+24%) and CRH (+17%). Other building materials stocks also performed well though, with a double-digit performance for Vicat (13%), Saint-Gobain (+12%) and Imerys (+12%), all in line with the sector. Vinci and Eiffage share prices made positive absolute gains (+6% and 8%, resp.) but underperformed versus the sector. The US Construction market has been very strong so far this year and combined with better sentiment towards Emerging Markets, probably explain theses Q3 performances.

WHAT WE SEE FOR Q4 2016

We are not especially worried regarding Q4. Toll roads traffic in France is likely to be healthy, in line with the H1 performance, while French Construction should be fairly good, with some positive news on the roadworks side (the sector reported a 15% increase of revenues in August), strong new residential and positive momentum (Grand Paris). Public infrastructure investment should start to strengthen in Indonesia, while India has benefited from a very good Monsoon apparently. Of course, everything is not rosy. LatAM is still complicated.

Besides, corporates will be busy this Q3. HeidelbergCement organises it Capital Market day on 10th November and LafargeHolcim on 18th November.

CONCLUSIONS AND TOP PICKS

We have selected two cyclical stocks for our top picks in Q4. Imerys as in Q3 and LafargeHolcim.

We believe Imerys will continue to benefit from decent positive momentum. Q3 results, expected on 28th October, are likely to be satisfactory again. Reported Q1 EBIT margin improved by 30bps and by 70bps in H1. Additionally, comparison bases should improve a lot, with top line organic growth starting to deteriorate beyond -5% in Q3 and Q4 last year (-5.6% and -5.1%, resp.). In addition, proppant sales in 2015 were mostly generated in Q1 and losses were mostly reported as of Q2 last year. Finally, we might get some positive news on the oil price side – maybe – although we don't include any improvement in our Imerys forecast and valuation model.

LafargeHolcim is our second top pick. Contrary to last year, we think the Capital day is likely to be a positive catalyst. However, management's guidance is not expected to change a lot, but the macro background has changed. First, Emerging Markets macro sentiment has improved a lot (it is worth underlying that flows invested in the EM Equities have returned since last February). The outlook for India is solid (the good monsoon impact will be positive but more in 2017 though), China's hard landing doesn't seem to be a hot subject anymore, even if the cement market still needs to be downsized and Indonesia investments into public infrastructures might kick-off eventually. Of course, not all macro situations in EM are rosy, but at least LHN provides the highest degree of geographical diversification in the sector. The risk is still there, but diluted. Secondly, the group has been particularly busy: efforts on prices, costs and synergies were reflected in stronger Q2 earnings (Adj. EBITDA margin +210 bps); multiple divestments deals have been secured, which will lower debt and the influence of China (a complicated cement market) and streamline the organisation. The group has set up a new CHF5bn target by end 2017 (CHF3.5bn 2016 target exceeded). Last but not least, the group has received the green light to restructure its Indian operations. This means additional synergies, which has prompted us to fully take into account the CHF1.1bn synergies target (vs 88% previously). Finally, helped by a more promising outlook on EM, combined with intense reorganisation at the moment, we consider confidence is likely to return on the stock. In this context, we have decided to be more aggressive in our valuation approach with a roll-over to 2018. Our new FV stands at CHF60 Vs CHF50. See our note issued today for additional details.

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