

Suez

Price EUR14.20

Preview Q3 2016: self-help measures to drive earnings and likely to be strengthened

Fair Value EUR17,5 (+23%)

BUY-Top Picks

Bloomberg	SEV FP
Reuters	SEVI.PA
12-month High / Low (EUR)	18.0 / 12.9
Market Cap (EUR)	8,012
Ev (BG Estimates) (EUR)	19,075
Avg. 6m daily volume (000)	1 144
3y EPS CAGR	-0.8%

Suez is set to report Q3 results on 27th October in the morning. After the poor metrics reported in H1 (2.3% organic decline in EBIT yoy), we expect Suez' performance to return to normal in Q3. As such, we expect Q3 EBIT to grow by 5.2% in organic terms, notably spurred by self-help measures (EUR54m contribution to Q3 EBITDA from the Compass plan) and strong growth in the international division. As a reminder, Suez's FY 2016 guidance for higher organic growth in EBIT than in revenues, which are expected to grow by at least at 2%, implies minimum organic growth of 5% in EBIT in H2. We also expect Suez to unveil new measures as part of its transformation plan. The streamlining of support functions as well as a fine-tuned asset rotation programme should give more visibility on both 2017 and 2018. Buy recommendation and FV at EUR17.5 maintained.

	1 M	3 M	6 M	31/12/15
Absolute perf.	-3.1%	1.4%	-12.3%	-17.8%
Utilities	0.1%	-6.0%	-3.4%	-7.0%
DJ Stoxx 600	0.5%	1.1%	-1.5%	-5.9%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	15,135	15,550	16,191	16,685
% change		2.7%	4.1%	3.0%
EBITDA	2,751	2,681	2,848	2,977
EBIT	1,381	1,286	1,380	1,471
% change		-6.9%	7.3%	6.6%
Net income	559.8	431.0	513.1	567.0
% change		-23.0%	19.0%	10.5%

	2015	2016e	2017e	2018e
Operating margin	9.1	8.3	8.5	8.8
Net margin	3.7	2.8	3.2	3.4
ROE	8.2	6.1	7.3	8.0
ROCE	8.0	7.2	7.6	8.0
Gearing	121.6	118.1	122.4	125.4

(EUR)	2015	2016e	2017e	2018e
EPS	1.04	0.77	0.92	1.02
% change		-25.8%	19.1%	10.5%
P/E	13.6x	18.4x	15.4x	14.0x
FCF yield (%)	3.3%	4.9%	4.6%	5.1%
Dividends (EUR)	0.65	0.65	0.65	0.68
Div yield (%)	4.6%	4.6%	4.6%	4.8%
EV/Sales	1.3x	1.2x	1.2x	1.2x
EV/EBITDA	7.0x	7.1x	6.8x	6.6x
EV/EBIT	13.9x	14.8x	14.1x	13.4x

ANALYSIS

- What to expect from Suez' Q3 publication?** After the **poor H1 metrics** (EBITDA and EBIT down 1.9% and 2.3% yoy in organic terms, respectively), we expect Suez' performance to **return to normal in Q3**. We expect **Q3 2016 EBITDA** to reach **EUR662m** (vs. EUR659m in Q3-15) with **solid growth in the international division** as well as a **strong Compass contribution** (EUR54m in Q3-16) partly offset by **1/a** single digit FX headwind mainly attributable to the GBP but partly made up for by the CLP; **2/a** EUR20m negative one-off in the water business due to higher-than-average temperatures last summer; **3/a** c. EUR10m headwind (EUR20m at the revenues' level) due to the loss of the Lille contract in 2015; **and 4/a** still unsupportive environment in the water business (decreasing trend in volumes and low inflation). We finally expect **5.2% organic growth in EBIT to EUR317m** (vs. EUR305m in Q3-15), which should help Suez to reach its full-year guidance (higher organic growth in EBIT than in revenues i.e. higher than 2%). As a reminder, following the 2.3% organic decrease in H1, **the FY 2016 target for 2%+ implies 5%+ organic growth in EBIT in H2**.
- Note that 1/we did not include** any contribution from the recent increase in stake in Italian environmental services company **ACEA** as the closing of the transaction only occurred in September (positive impact of c. **EUR5m** at both the EBITDA and EBIT levels expected for **Q4**); **2/we** believe the **electricity price headwind** could be lower-than-expected following the recent increase in European power prices (**EUR4m** headwind for Q3-16 vs. EUR30m initially expected for FY-16); **and 3/the** international division should benefit from a **favourable comparison basis** as last year's performance was particularly hurt by high bidding costs and the lag between the start of some D&B contracts and their inherent margin generations.
- Speeding-up the transformation plan...** In addition, Suez is expected to give more colour to its **transformation plan**. With this plan, we understand that **additional savings** could be implemented – on top of the current *Compass* plan the targets of which were already upgraded during H1 2016 results to **EUR180m** for 2016 (vs. **EUR150m initially**) – within Suez's **French activities**, especially for **support functions**. As a reminder, **we estimate the 600 job cuts** said to be announced by the group would generate **about EUR30m in additional savings** (based on an average EUR50k payroll cost per employee). In addition, we expect the group to give an update on its **asset rotation strategy**. We do not think any major move will be announced or even considered for now. **Fine-tuning transactions** are more likely to be unveiled such as the expected disposal of the company's Finnish waste subsidiary which could amount to **EUR50-60m** according to our estimates (assumptions: **EUR70m of revenues and a 8.9x EV/EBITDA multiple based on a 15% discount** – due to lower EBITDA margin - to multiple paid by Fortum for the acquisition of Finnish waste company *Ekokem* earlier this year). In all, we expect these new measures to give **more visibility on 2017 but also on 2018**, which would be well-appreciated as the company is still facing a rather **challenging macro environment** (low inflation and flattish industrial production in Europe, harsher water regulation in France).
- Pending more information on this "enhanced" transformation plan and the extent of the potential new cost-savings measures, **we stick to our Buy recommendation and to our FV of EUR17.5 per share**, which implies a c. **23% upside** vs. company's current share price. Note that **our unchanged full-year estimates are broadly in line with consensus expectations** with FY-16e EBITDA and EBIT expected at **EUR2,681m** (+0.4% BG vs. consensus) and **EUR1,286m** (+1.3% BG vs. consensus) respectively.



VALUATION

- At the current share price, Suez trades at **7.1x** and **6.8x** its **2016e** and **2017e** EV/EBITDA multiples respectively.
- **Buy, FV @ EUR17.5 – Top Picks**

NEXT CATALYSTS

- **27th October 2016: Q3 2016** results

Fig 1. Q3 2016e EBITDA bridge (BG estimates)

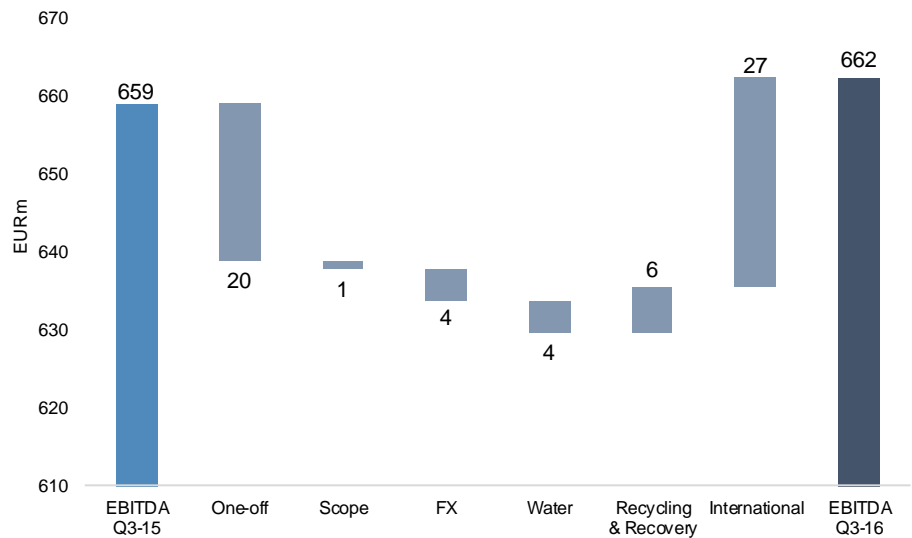
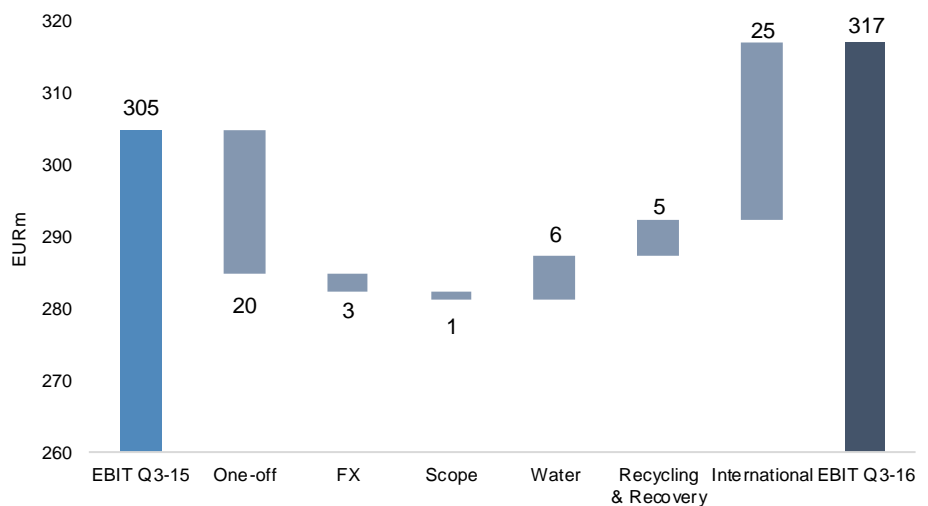


Fig 2. Q3 2016e EBIT bridge (BG estimates)



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Analyst :
Pierre-Antoine Chazal
33(0) 1.56.68.75.06
pachazal@bryangarnier.com

Sector Team :
Xavier Caroen

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Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	Widenmayerstrasse 29	The Imperial Hotel Janpath
15 St. Botolph Street	75008 Paris	New York, NY 10022	80538 Munich	New Delhi 110 001
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Germany	Tel +91 11 4132 6062
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	+49 89 2422 62 11	+91 98 1111 5119
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member		Fax +91 11 2621 9062
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Financial Conduct Authority (FCA)	Autorité de Contrôle prudentiel et de			rue de Grenus 7
	resolution (ACPR)			CP 2113
				Genève 1, CH 1211
				Tel +4122 731 3263
				Fax+4122731 3243
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