BRYAN, GARNIER & CO

INDEPENDENT RESEARCH

16th November 2016

Utilities

Veolia Environnement

EBITDA growth remains the key driver

Fair Value EUR22 vs. EUR23.5 (price EUR16.24) **BUY**

Bloomberg	VIE FP
Reuters	VIE.PA
12-month High / Low (EUR)	22.9 / 16.2
Market capitalisation (EURm)	9,149
Enterprise Value (BG estimates EURm)	16,570
Avg. 6m daily volume ('000 shares)	1 965
Free Float	76.8%
3y EPS CAGR	10.1%
Gearing (12/15)	83%
Dividend yields (12/16e)	5.01%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (EURm)	24,965	24,578	25,587	26,185
EBIT(EURm)	1,315	1,364	1,521	1,646
Basic EPS (EUR)	0.80	0.90	1.34	1.50
Diluted EPS (EUR)	1.03	1.07	1.22	1.37
EV/Sales	0.64x	0.67x	0.64x	0.62x
EV/EBITDA	5.4x	5.4x	5.0x	4.7x
EV/EBIT	12.2x	12.1x	10.7x	9.9x
P/E	15.8x	15.2x	13.3x	11.8x
ROCE	6.4	6.3	6.7	7.1

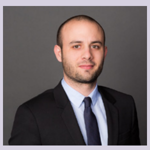
Following the tepid 9M-16 performance recently posted by Veolia, we reviewed our model in order to integrate the lower than expected growth in revenues. We, however, believe the market has negatively overreacted since the 9M-16 publication. The EBITDA generation remains strong and the valuation is attractive, in our view. Buy rating maintained with FV lowered to EUR22.0 (vs. EUR23.5).

- Veolia posted a **tepid Q3-16 performance** with revenues down 3.2% yoy. This led the group to **revise downward its full-year revenue guidance** (*from growth to stable*) which drove the poor performance of the stock since the 9M-16publication (**-16%** vs. -6% for the Stoxx 600 Utilities).

- **Undeniably, growth has been weak over the past couple of years. Revenues have grown only once over the past seven quarters** on the back of, notably, a challenging environment in the French water business, unsupportive energy prices and difficulties in selected end-markets (Oil & Gas, Mining) and geographies (the USA, Australia).

- **We, however, believe the market has negatively overreacted**. Despite the unsupportive macro environment, **the EBITDA generation remains resilient** and should continue with its 4% to 5% organic cruising speed in the next couple of years. **Self-help measures are still being implemented with a quicker path than initially expected** and should remain the main EBITDA and EPS drivers by 2018.

- Despite the negative adjustments we made to our estimates (-1.9%/-2.7%/-2.9% at the EBITDA level for 2016e, 2017e and 2018e respectively) in order to reflect this lower-than-expected growth, **we maintain our buy rating with a lowered FV at EUR22.0 per share** (vs. EUR23.5 before). We still appreciate the attractive dividend yield as well as the **strong EBITDA growth potential**, spurred on by the savings implemented, and believe the recent derating implies a rather **attractive valuation** (22% discount vs. historical FY2 EV/EBITDA multiple).



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Company description

Former subsidiary of Vivendi Universal, Veolia Environment is the leading company in the environmental services sector. The group operates in water (45% of sales), waste (35%) and energy services (20%). Amongst the major shareholders are: Caisse des Dépôts (4.6%) and the Dassault familly (4,8%).

Income Statement (EURm)	**2013**	**2014**	**2015**	**2016e**	**2017e**	**2018e**
Revenues	22,315	23,880	24,965	24,578	25,587	26,185
Change (%)	*-24.2%*	*7.0%*	*4.5%*	*-1.5%*	*4.1%*	*2.3%*
EBITDA	1,796	2,164	2,997	3,086	3,293	3,452
EBIT	901	1,052	1,315	1,364	1,521	1,646
Change (%)	*-17.7%*	*16.8%*	*25.0%*	*3.7%*	*11.5%*	*8.2%*
o/w JVs net result	NM	NM	NM	NM	NM	NM
Financial results	(538)	(558)	(418)	(442)	(399)	(383)
Pre-Tax profits	79.5	521	751	779	1,129	1,269
Exceptionals	NM	(41.2)	(176)	(150)	(30.0)	(30.0)
Tax	(128)	(167)	(200)	(210)	(285)	(322)
Profits from associates	(51.5)	665	145	147	137	132
Minority interests	(114)	(85.3)	(101)	106	111	114
Net profit	(135)	246	450	508	759	847
Restated net profit	223	326	580	606	692	777
Change (%)	*-43.4%*	*46.2%*	*77.9%*	*4.5%*	*14.3%*	*12.2%*
Cash flow statement (EURm)						
Operating cash flows	1,829	1,600	1,980	2,360	2,429	2,613
Change in working capital	(4.3)	94.1	203	(49.4)	(104)	(31.6)
Income tax paid	0.0	0.0	0.0	0.0	0.0	0.0
Capex, net	(1,227)	(1,380)	(1,347)	(2,141)	(1,624)	(1,666)
Financial investments, net	895	524	474	345	151	161
Dividends	(191)	(329)	(512)	(501)	(437)	(485)
Other	(1,861)	(1,815)	73.2	(586)	(686)	(593)
Net debt	8,177	8,311	8,170	8,678	8,441	8,442
Adjusted net debt (ex-loans to JVs)	NM	NM	NM	NM	NM	NM
Free Cash flow	602	219	1,061	218	804	948
Balance sheet (EURm)						
Tangible fixed assets	4,161	6,638	6,820	7,597	7,804	8,020
Intangibles assets	2,819	990	2,796	3,714	3,714	3,714
Cash & equivalents	4,274	3,149	4,176	3,905	3,904	4,002
current assets	12,864	10,157	10,182	9,972	10,287	10,437
Other assets	12,125	13,791	11,914	10,996	10,996	10,996
Total assets	36,242	34,725	35,889	36,185	36,706	37,168
L & ST Debt	9,497	8,325	8,022	8,022	8,022	8,022
Others liabilities	26,559	25,265	26,385	26,180	26,483	26,693
Shareholders' funds	9,683	9,459	9,503	10,005	10,223	10,476
Total Balance sheet	36,242	34,725	35,889	36,185	36,706	37,168
Capital employed	12,211	13,421	12,595	18,199	18,419	18,574
Ratios						
Operating margin	4.13	4.64	4.50	5.55	5.95	6.29
Tax rate	161	32.14	26.57	26.97	28.00	28.00
Net margin	(0.61)	1.03	1.80	2.07	2.97	3.24
ROE (after tax)	(1.56)	1.30	4.00	6.06	6.77	7.42
ROCE (after tax)	5.53	5.76	6.39	6.34	6.71	7.13
Gearing	84.01	86.47	82.56	81.13	79.41	76.57
Pay out ratio	(242)	320	108	76.00	73.00	71.00
Number of shares, diluted (000)	523	562	562	566	566	566
Per Share data (EUR)						
EPS	(0.26)	0.44	0.80	0.90	1.34	1.50
Restated EPS	(0.29)	0.22	1.03	1.07	1.22	1.37
% change	*-136%*	*-%*	*370%*	*4.0%*	*14.3%*	*12.2%*
BVPS	15.69	14.75	14.83	15.61	16.00	16.44
Operating cash flows	3.50	2.85	3.52	4.17	4.29	4.62
FCF	1.15	0.39	1.89	0.39	1.42	1.67
Net dividend	0.70	0.70	0.73	0.81	0.89	0.97

Source: Company Data; Bryan, Garnier & Co ests.

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1. Investment Case

Why the interest now?

The reason for writing now

Following tepid 9M-16 performance, **Veolia's stock has been strongly under pressure** with a -16% performance since publication (vs. +2% for CAC40 and -6% for SX6P). **We believe this reaction**, mainly due to the lack of organic growth, **has clearly been overplayed**. Undeniably, growth has been weak over the past couple of years. **However, the company's self-help measures** – which have been reinforced – **still ensure a solid pace of growth at the EBITDA level** while its **financial flexibility** could foster new bolt-on acquisitions which would (at least) partly compensate for this poor growth.

Cheap or Expensive?

Valuation

We valued Veolia through a **SOTP** and using a **6.5% WACC** – notably including a 1.2 weighted average beta – and a 1.07% average long-term growth. Our valuation implies a c. **7.0x 2016e EV/EBITDA** multiple and **an EUR22.0 equity value per share** – *down c. 6% vs. our previous FV at EUR23.5 per share-* i.e. c. 34% above company's current share price. The v**aluation appears attractive** with a **c. 22**% discount vs. the company's historical FY2 EV/EBITDA multiple and **c. 18%** discount vs. historical FY2 P/E multiple

When will I start making money?

Catalysts

We believe Veolia could return to growth (at constant FX) **as soon as in Q4-16** with the expected contribution of the company's recent international developments (acquisitions and contracts awarded) as well as the catch-up in construction contracts. This would clearly reassure investors about the **long-term viability of the company's growth**.

What's the value added?

Difference from consensus

We stand between 1.5% and 2.5% above consensus' expectations for both EBITDA and current EBIT for 2016e, 2017e and 2018e.

Could I lose money?

Risks to our investment case

We identified **several risks** including: **1/** further unpaid bills due to the Brottes law in the French water business; **2/** no recovery in the European industrial production with a +/- 1% change in waste volumes having a c. +/- EUR30m impact on the company's EBITDA; **and 3/** a macro downturn in the UK following Brexit as Veolia generates about 10% of its revenues in the UK.

2. Summary

Veolia posted a rather poor 9M-16 performance with 9M-16 revenues were **down 3.2%** yoy which led **the company to revised downward its full-year revenue guidance** (from growth to flat). Veolia is suffering from a still unfavourable environment in its French water business (on top of the unsupportive climatic conditions leading to weak water volumes) as well as in its US and Australian businesses (difficulties in the Oil & Gas and Metals & Mining end-markets). Looking at the company's top line over the past couple of years, **it clearly appears that Veolia's organic growth has been weak** with revenues having grown only once over the past seven quarters. All in all, **this poor performance led us to revised downward our revenue estimates** by c. 2.0%, 2.0%, and 2.3% for 2016, 2017 and 2018, respectively. **Similarly, our EBITDA estimates have been lowered** by 1.9%, 2.7% and 2.9% for 2016, 2017 and 2018, respectively.

However, **we believe this lack of organic growth is not alarming**. Recent international developments (acquisitions of Kurion, Chemours' sulphuric acid division, contract with Sinopec, for instance), as well as still booming hazardous waste and industrial water businesses, should boost the company's growth in Q4-16, 2017 and beyond. Additionally, **we believe Veolia's financial flexibility** (our net debt/EBITDA ratio stands at 2.7x/2.6x/2.4x for 2016e/2017e/2018e) **should enable the group to continue with its bolt-on acquisitions' strategy in the years to come**.

All in all, we believe the market negatively overreacted following Veolia's 9M-16 publication (-16% since November 3rd) and **we still appreciate the company's solid EBITDA generation and attractive dividend policy**. By 2018, EBITDA will keep being driven by **self-help measures.** The company indicated that FY16 savings should amount to between **EUR220m** and **EUR240m** (we stand at EUR230m) which therefore implies that **the EUR600m initial target** (for 2016-2018) **is now likely to be exceeded.** The acceleration in the downsizing and in the restructuring of the company's construction activities (Veolia Water Technologies & SADE subsidiaries) should notably contribute to the expected increase in the EBITDA margin by 2018.

Following the recent stock derating, **Veolia's valuation now appears very attractive** as the stock currently trades at **5.2x** its FY2 EV/EBITDA multiple, c.**22% below** its 6-year historical average at **6.7x**. Similarly, Veolia's FY2 P/E multiple reaches **13.5x** , **c.18% below** than its 6-year historical average (at 16.5x).

Our adjustments, mainly at the top-line level, led us to lower our FV from EUR23.5 per share to **EUR22.0 per share**, which still implies a c. **34% theoretical upside** vs. the company's current share price. **Our confidence on the company's ability to deliver self-help measures as well as the attractive valuation implied by the recent stock derating notably** led us to **maintain our BUY rating.**

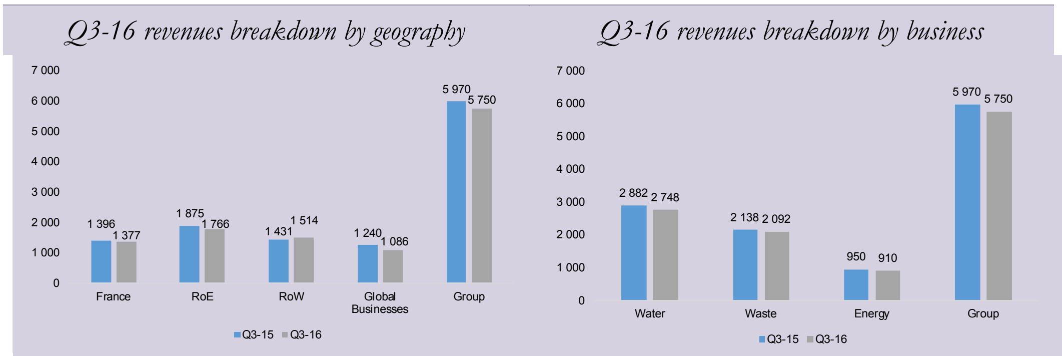
3. A quick look in the mirror

3.1. A tepid 9M-16 performance

Veolia posted a rather **tepid 9M-16 performance** with revenues reaching **EUR17,708m** over the period, down **3.2%** yoy and **1.2%** at constant exchange rates. Q3-16 revenues reached **EUR5,750m** down **3.7%** yoy and down **3.1%** on an organic basis.

Over the first months of the year, the company bore the brunt of various factors including: 1/**FX headwind** (for c. **EUR354m**, half of it being attributable to the EUR/GBP); **2/the downsizing of the company's construction activities** (SADE and Veolia Water Technologies) implying a c. **EUR315m** negative impact on revenues; **3/a weak performance in the company's French water** business (adverse climatic conditions, hence lower-than-average volumes at -1.7% ytd) **and in the US** (-3.5% at constant FX) **and Australian** (-4.2% at constant FX) **sub-divisions** due to a challenging macro environment in industrial services for both the Oil & Gas and the Metals & Mining end-markets. Fortunately, recent commissioning in the UK helped the waste business to post **1.3%** organic growth in Q3-16, above the 0.2% figure reached in H1-16. Waste volumes increased by **0.8%** over the first nine-months of the year.

Fig. 1: Q3-16 revenue breakdown vs. Q3-15

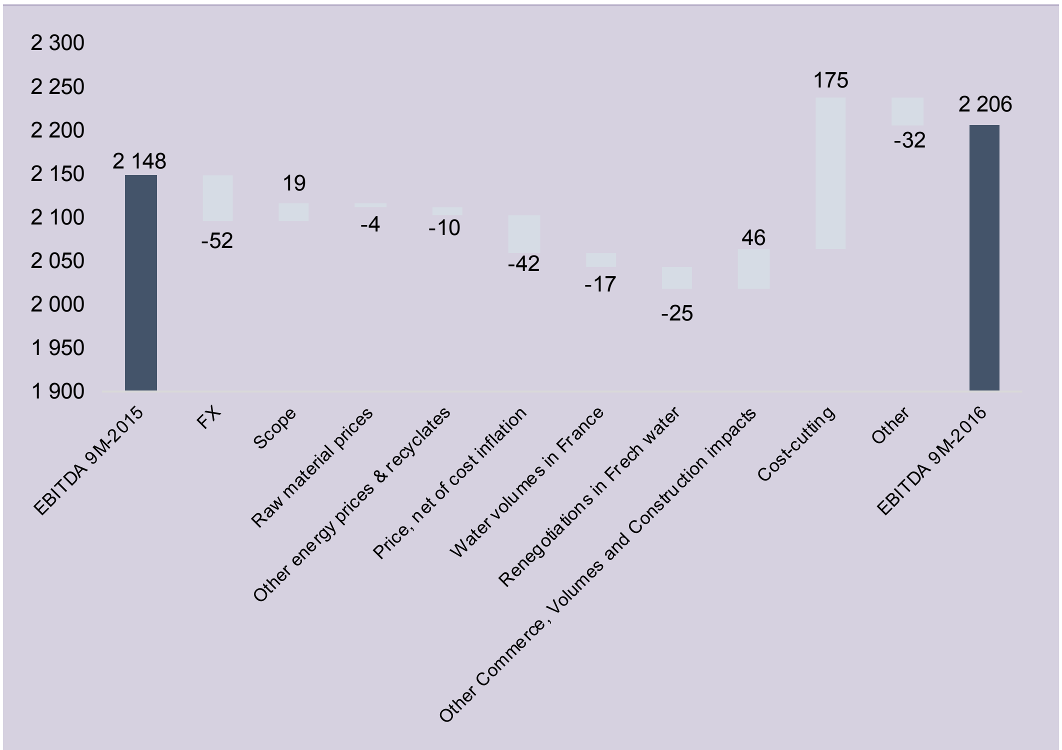


Source: Company Data; Bryan, Garnier & Co ests.

Despite this sharp drop in revenues, **the company's EBITDA growth remains resilient**. 9M-16 EBITDA reached **EUR2,206m,** up 5.1% yoy at constant exchange rates. When deducting the c.**EUR20m** positive scope impact, mainly due to the recent acquisition of the assets of Chemours' sulphuric acid division, and the FX headwind (EUR52m with EUR22m attributable to the EUR/GBP), **EBITDA grew 4.2% organically over the first nine months of the year.**

As expected, the main driver of this growth has been the company's cost-savings programme with an **EUR175m** positive contribution over the period. This implies that Veolia is ahead of its initial savings target (EUR600m over 2016-2018 hence EUR200m per year). **The company announced that full-year cost-savings, for 2016, should amount to between EUR220m and EUR240m, implying the EUR600m 3-year target is likely to be exceeded**. Cost-savings more than offset the weak performance reported in French water (adverse climate conditions and the unsupportive regulatory impact with the Brottes law) as well as the negative impact from energy prices (decline in heat and electricity prices).

Fig. 2: 9M-16 EBITDA bridge



Source: Company Data; Bryan, Garnier & Co ests.

The company's current EBIT reached **EUR979m**, broadly in line with consensus' expectations. Note that it includes industrial capital gains of **EUR20m** (vs. EUR9m over the same period in 2015). The company's current net income finally reached **EUR421m**, up 8.8% at constant exchange rates, on the back of both EBIT growth and a lower cost of debt. When excluding capital gains, current net income is up **21.5%,** at constant FX. As a reminder, the 9M-15 capital gains amounted to **EUR71m** vs. **EUR33m** for 9M-16.

3.2. Full-year revenue guidance adjusted downward

The group adjusted downward its full-year guidance on revenues. Veolia now expects its top line to be **stable**, at constant exchange rates, compared to 2015 (vs. growth before). **The rest of the guidance remains unchanged** with: **1/** EBITDA growth (at constant FX); **2/** at least **EUR650m** of FCF (before divestments and acquisitions); **and 3/** current net income of at least **EUR600m**, still at constant exchange rates.

Veolia also confirmed its perspectives for 2016-2018 including: **1/** average annual revenue growth between 2% and 3%; **2/** average annual EBITDA growth of around 5% per year; **3/** more than EUR600m in cost-savings over the period; **4/** current net income greater than EUR800m in 2018; **and 5/** net free-cash flow of EUR1bn in 2018. However, during the 9M-16 results' conference call, management admitted that **the FY18 EUR27bn revenues' objective will be hard to achieve.**

4. True, the top-line growth is weak…

We do believe **the market has overreacted** *(16% stock's decrease since results' publication)* following Veolia's poor performance in Q3-16 and guidance downgrade. EBITDA generation is still strong and resilient, notably spurred on by cost-saving measures, despite the unfavourable macro environment in both its water (low inflation in mature countries, weak volumes and adverse regulations evolutions) and waste (negative impact from energy prices and still spluttering European industrial production) businesses. It is, however, easy to notice that **three out of the four company's divisions posted an organic decline over the first nine months of the year**, while the Rest of the World division grew by only 0.5%.

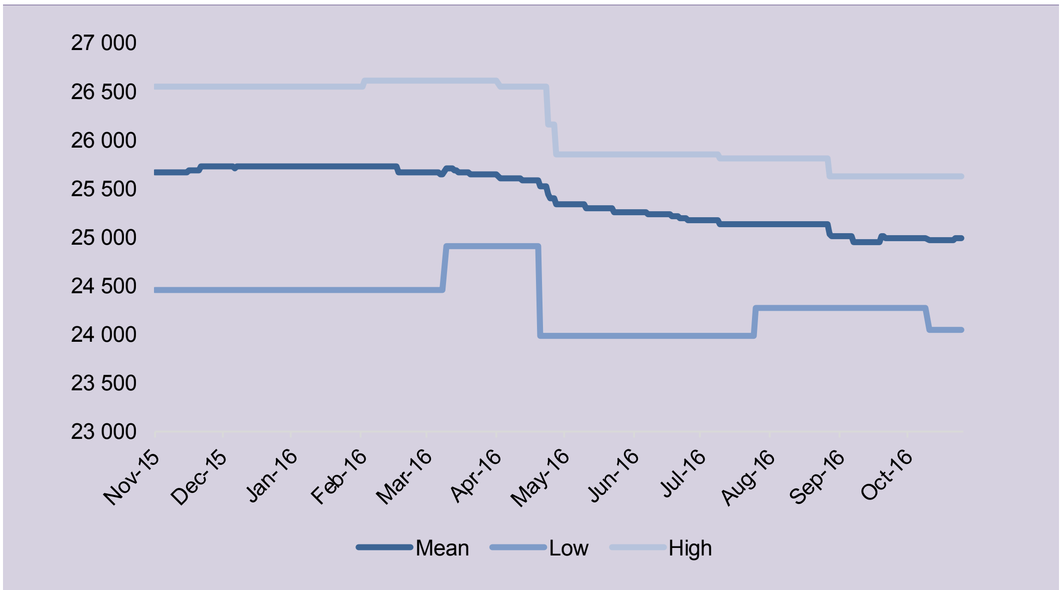
Fig. 3: Breakdown of top line growth since Q1-16

France	**Q1-16**	**Q2-16**	**H1-16**	**Q3-16**	**9M-16**
Revenues (EURm)	1323	1365	2688	1377	4065
YoY growth (%)	0,2%	-0,7%	-0,3%	-1,4%	-0,6%
Organic growth (%)	**-0,5%**	**-1,2%**	**-0,9%**	**-1,6%**	**-1,1%**
FX impact (%)	0,0%	0,0%	0,0%	0,0%	0,0%
Scope impact (%)	0,7%	0,5%	0,6%	0,2%	0,5%
Rest of Europe	**Q1-16**	**Q2-16**	**H1-16**	**Q3-16**	**9M-16**
Revenues (EURm)	2265	1938	4203	1766	5969
YoY growth (%)	-2,0%	-2,8%	-2,4%	-5,8%	-3,4%
Organic growth (%)	**-0,7%**	**-1,1%**	**-0,9%**	**-0,9%**	**-0,9%**
FX impact (%)	-1,1%	-3,1%	-2,1%	-5,2%	-3,0%
Scope impact (%)	-0,2%	1,4%	0,6%	0,3%	0,5%
Rest of the World	**Q1-16**	**Q2-16**	**H1-16**	**Q3-16**	**9M-16**
Revenues (EURm)	1426	1407	2833	1514	4347
YoY growth (%)	-5,6%	-2,8%	-4,2%	5,8%	-0,9%
Organic growth (%)	**-2,5%**	**1,9%**	**-0,3%**	**2,1%**	**0,5%**
FX impact (%)	-3,2%	-4,7%	-3,9%	-0,5%	-2,8%
Scope impact (%)	0,1%	0,0%	0,0%	4,2%	1,4%
Global Businesses	**Q1-16**	**Q2-16**	**H1-16**	**Q3-16**	**9M-16**
Revenues (EURm)	1068	1151	2219	1086	3305
YoY growth (%)	-4,0%	-2,8%	-3,4%	-12,4%	-6,5%
Organic growth (%)	**-4,3%**	**-3,6%**	**-3,9%**	**-12,8%**	**-7,0%**
FX impact (%)	-1,1%	-1,9%	-1,5%	-1,0%	-1,3%
Scope impact (%)	1,4%	2,7%	2,0%	1,4%	1,8%
Group - Veolia	**Q1-16**	**Q2-16**	**H1-16**	**Q3-16**	**9M-16**
Revenues (EURm)	6089	5867	11956	5750	17706
YoY growth (%)	-3,4%	-2,4%	-2,9%	-3,7%	-3,2%
Organic growth (%)	**-1,7%**	**-0,9%**	**-1,3%**	**-3,1%**	**-1,9%**
FX impact (%)	-1,3%	-2,5%	-1,9%	-2,0%	-2,0%
Scope impact (%)	-0,4%	1,0%	0,3%	1,4%	0,7%

Source: Company Data; Bryan, Garnier & Co ests.

Following the weak performance posted by the company in Q1-16 (-3.4% revenue decline vs. Q1-15), **the consensus adjusted significantly downward its estimates for FY2016 revenues with a 2.4% cut between April 2016 and November 2016.** Assuming an EUR350m FX headwind at the 2016 revenue level, we reckoned that **consensus' expectations were, however, about 1.5% too high vs. the new company's guidance for FY2016e revenues** (*stable top line, at constant exchange rates*).

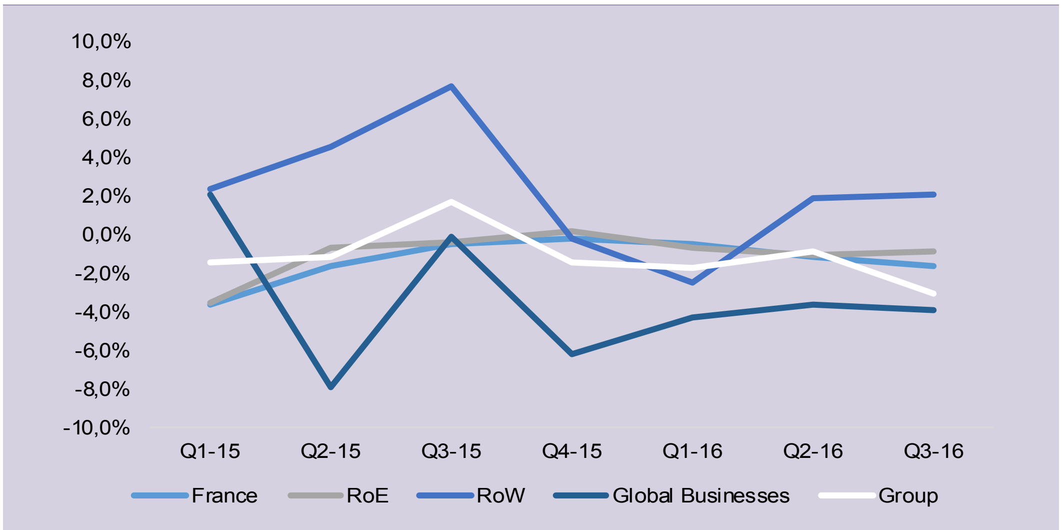
Fig. 4: FY16e consensus' expectations for Veolia's revenues



Source: Thomson Reuters

Looking deeply into Veolia's top-line generation, we observed that the company's revenues have grown only once, on an organic basis, over the seven last quarters. This was in Q3-15 (+1.7%), on the back of very strong growth in China and Latin America. In the other six quarters, Veolia's revenues organically decreased, with the largest organic decline having been reported in Q3-16 (-3.1%). **The France division posted seven organic top-line decrease in a row**, while the Other Europe and the Global Businesses divisions grew only once, in Q4-15 and in Q1-15, respectively.

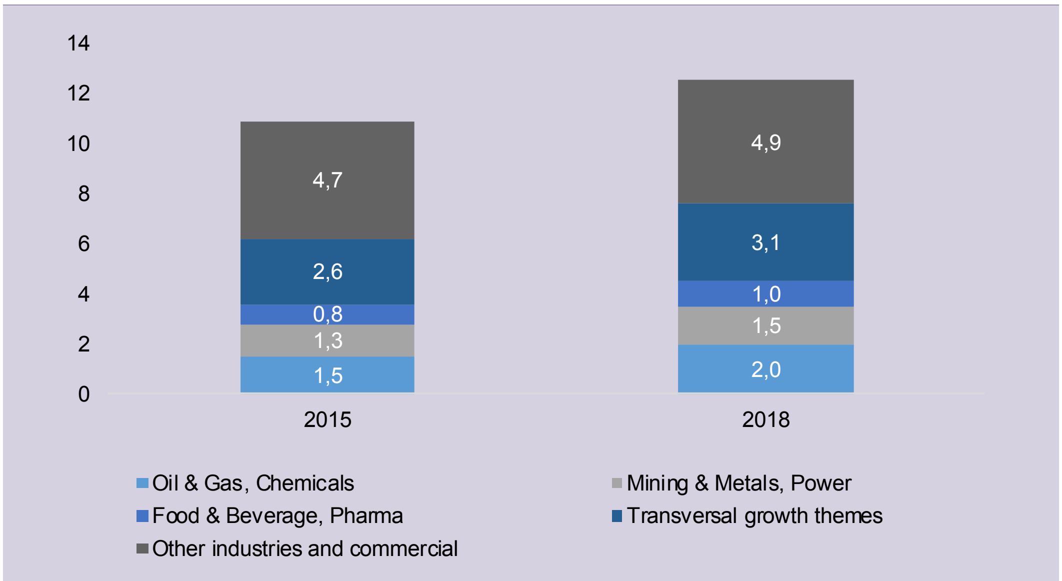
Fig. 5: Over the seven last quarters, Veolia's revenues have grown only once



Source: Company Data; Bryan, Garnier & Co ests.

These figures and this performance contrast with the message provided by Veolia's management during the company's Investor Day, back in 2015. At that time, **Veolia was targeting a strong increase in revenues from several end-markets including two strategic ones: Oil & Gas and Metals & Mining**. In 2015, Veolia reported revenues of c. EUR1.5bn in the Oil & Gas segment and of c. EUR1.3bn in the Metals & Mining segment. **The company targeted a 10% and a 5% CAGR in these two end-markets between 2015 and 2018** in order to increase these revenues to EUR2.0bn and EUR1.5bn respectively.

Fig. 6: Veolia's initial industrial revenue target 2018 vs. 2015 (EURbn)



Source: Company Data

Veolia does not disclose its 2016 revenue breakdown by *end-markets* but we understand that the US (-3.5% at constant FX) and the Australian (-4.2% at constant FX) branches are clearly impacted by a weak performance in industrial services for Oil & Gas (mainly in the US) and for Metals & Mining (in Australia) customers. **Veolia notably unveiled that a large part of the weak performance in the US has been attributable to industrial cleaning services, an activity with a 40-50% oil & gas**

clients base. We estimated revenues "at stake", i.e. coming from industrial services, amount to up to **EUR300m in the USA** and up to **EUR250m in Australia.**

The previously mentioned targets, notably in the O&G segment, appear clearly too ambitious right now. **However, we expect Veolia to post a c. EUR80m increase in revenues in the segment in 2016e**, at constant FX, notably thanks to the completed acquisition of Chemours' sulphuric acid division and the revenues generated from the contract with Antero.

Fig. 7: c. EUR80m increase in Oil & Gas revenues expected for 2016e

Estimated O&G revenues' evolution	2016e
End of the Carmon Creek Project	c. EUR(80)m
Antero Project	c. EUR60m
Sinopec contract	c. EUR50m
Chemours' sulfuric assets acquisition	c. EUR95m
US industrial services business	c. EUR(45)m
Total	**c. EUR80m**

Source: Company Data; Bryan, Garnier & Co ests.

All in all, we adjusted downward our revenue estimates for 2016 and beyond. For 2016, we now stand at EUR24,578m, broadly **flat** on an organic basis, and down **2.0%** vs. our previous estimates. Our new estimates for 2017e and 2018e stand **2.0%** and **2.3%** below our previous forecasts.

Fig. 8: Change in revenue estimates (2016e-2018e)

EURm		New			Old			Chg. (%)		
	2015	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e
Revenues	24,965	24,578	25,587	26,185	25,080	26,116	26,801	(2.0%)	(2.0%)	(2.3%)

Source: Bryan, Garnier & Co ests.

We therefore expect revenues to grow at 2.1% per year, on average, between 2015 and 2018e, at constant FX, at the low-end of the 2016-2018 outlook provided by Veolia (2-3%). **We believe the five international developments recently highlighted by the group** (Prague's heating network, the Kurion and Chemours' sulphuric acid division acquisitions, the Pereira landfill acquisition in Brazil, and the dubbed giant contract with Sinopec) **will bring in more than EUR530m of revenues on a full-year basis,** i.e. 2.1% of our new revenue estimates for 2017e. These developments should bring about **EUR85m at the EBITDA level** and on a full-year basis, according to our estimates, as we notably expect recently-acquired companies to have an EBITDA margin higher than that of the group.

Fig. 9: Expected full-year contribution from new selected international developments

	Revenues (EURm)	EBITDA margin (%)	EBITDA (EURm)
Prague Left Bank district heating network (Czech Republic)	50	22,0%	11
Kurion (USA)	87	17,3%	15
Sinopec Contract (China)	132	12,0%	16
Pereira Landfill (Brazil)	30	12,0%	4
Chemours' sulphuric acid division (USA)	236	16,9%	40
Total	**535**	**16,0%**	**85**

Source: Bryan, Garnier & Co ests.

We therefore believe **these developments should help the company's revenues to pick up by 2018 and to compensate for the lack of organic growth**. We additionally consider that Veolia has sufficient financial flexibility (our net debt/EBITDA ratio stands at 2.7x, 2.6x and 2.4x for 2016e, 2017e and 2018e respectively) to **target new bolt-on acquisitions** in the years to come and continue offsetting the lagging growth in mature markets and economies by well-thought out moves in new booming businesses, technologies and know-hows. We estimated that **Veolia's overall firepower**, based on our current EBITDA forecast for 2017e (at EUR3,293m), and assuming a maximum **3.0x** net debt/EBITDA ratio, could **amount to c. EUR870m**.

5. … but EBITDA growth remains resilient

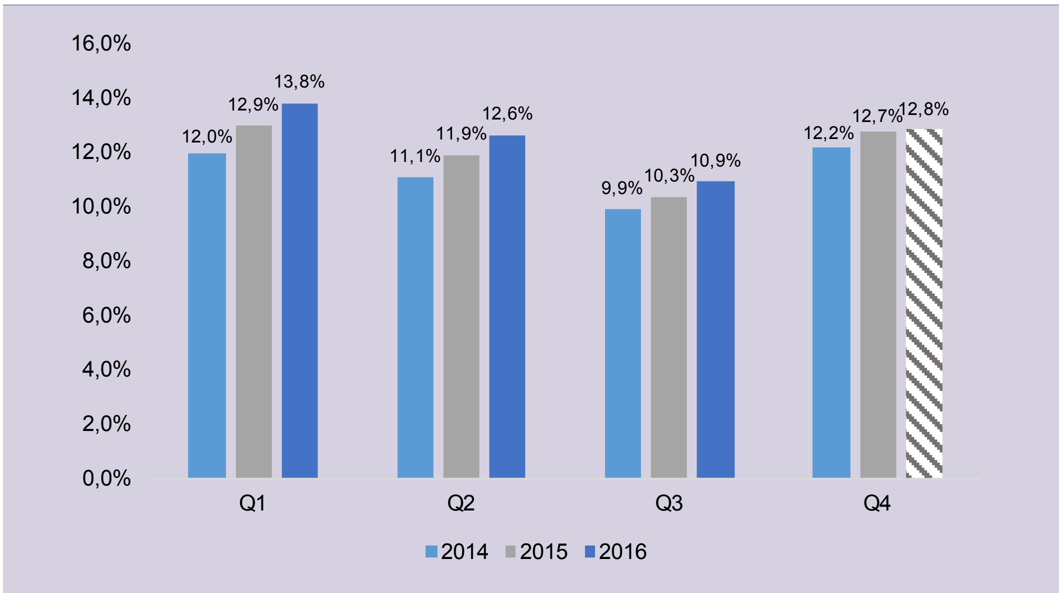
5.1. EBITDA to keep growing thanks to self-help measures

We do believe this clear lack of organic growth is paradoxically not alarming.

Despite the previously mentioned drop in revenues, **the company's EBITDA growth remains resilient**. 9M-16 EBITDA reached **EUR2,206m,** up 5.1% yoy at constant exchange rates. When deducting the c. **EUR20m** positive scope impact, mainly due to the recent acquisition of the assets of Chemours' sulphuric acid division, and the FX headwind (EUR52m with EUR22m attributable to the EUR/GBP), **EBITDA grew 4.2% organically over the first nine months of the year. We are therefore still impressed by the company's strong EBITDA generation**.

Veolia's EBITDA margin has increased *qoq* in each quarter since 2014. For instance, the Q1-14 EBITDA margin reached 12.0% vs. 12.9% in Q1-15 and 13.8% in Q1-16. The same trend can be noticed in Q2/Q3/Q4 for 2014/2015/2016. Note that we expect a **12.8% EBITDA margin for** Q4-16, up 10bps vs. Q4-15, and 60bps vs. Q4-14.

Fig. 10: EBITDA margin quarterly evolution (2014-2016e)



Source: Company Data; Bryan, Garnier & Co ests.

The main driver of this growth obviously remains **the company's cost-savings programme**. As a reminder, Veolia is targeting at least **EUR600m** of savings between 2016 and 2018, hence about **EUR200m** of savings per year. Given the strong level of savings achieved since the beginning of the year (EUR175m contribution to the EBITDA), **this EUR600m target is now very likely to be exceeded.** For 2016, Veolia announced it targets a positive contribution of **EUR220-240m. We stand in the middle of this range, at EUR230m.** Note that 31% of the 9M-16 savings have been achieved in the France division (mainly related to the French water departure plan), 29% in the Rest of the World division and 25% in the Rest of Europe division.

We noticed that the implementation of cost-savings in the Global Businesses division has sped up in Q3-16 with a c. EUR11m positive EBITDA impact in Q3-16 vs. c. EUR4m and c. EUR6m in Q1-16 and Q2-16 respectively. **As a reminder, the Global Businesses division groups together Veolia's construction activities** (mainly through two subsidiaries: Veolia Water Technologies and SADE) and **hazardous waste activities**. In 2015, about three-quarters of the division's revenues came from the construction business. In Q1-16, **Veolia started the progressive downsizing of these activities as well as their overall restructuring in order to foster the subsidiaries' EBITDA margin**. We estimate Veolia Water Technologies' (VWT) and SADE's EBITDA margins were about 2% and 2.5%, respectively, in 2015. Through SG&A reductions and standardisation measures, **Veolia notably aims at increasing VWT's EBITDA margin to about 5% in the mid-term.** We believe this level could be achieved by 2018 for which we forecast a 5.3% EBITDA margin. We adopted a more cautious trend for SADE with a 3.0% EBITDA margin reached in 2018.

Fig. 11: VWT's and SADE's revenue and EBITDA forecasts (BG estimates)

	2016e	2017e	2018e
Veolia Water Technologies			
Revenues	1,953	1,982	2,012
EBITDA	69	85	106
EBITDA margin	**3,5%**	**4,3%**	**5,3%**
SADE			
Revenues	1,185	1,191	1,197
EBITDA	26	34	35
EBITDA margin	**2,2%**	**2,8%**	**2,9%**

Source: Bryan, Garnier & Co ests.

As **construction subsidiaries have a rather low EBITDA margin, their decline in revenues' are likely to have a marginal impact on Veolia's EBITDA.** Assuming a c. 2% normative EBITDA margin, we estimated the EUR400m decline in construction's revenues – over the first nine months of the year – implied "only" a c. **EUR10m** headwind at the EBITDA level. This discrepancy between revenues and EBITDA generation partly explained why Veolia's EBITDA growth is still resilient despite the c. 3% decline in revenues.

Note additionally that the **recent disposal of Bartin Recycling** (acquired by Derichebourg) should enable Veolia to reduce its exposure to scrap metal prices (the exposure was almost only linked to Bartin) as well as to gain visibility on both the company's revenues and earnings. We estimated Bartin's revenues at c. **EUR150m**, the top line being highly dependent on the evolution of scrap metal prices. As a reminder, **Veolia disclosed last year that a 10% variation in scrap metal prices implies an EUR16m change in revenues and an EUR4m change in EBITDA**. **The closure of the deal is expected by end-November 2016.**

5.2. Change in estimates

As previously mentioned, we lowered our revenue estimates by 2.0%/2.0%/2.3% for 2016e/2017e/2018e respectively. **Similarly, our EBITDA estimates are lowered by 1.9%/2.7%/2.9% over the same period.** As a consequence, our EBITDA margin estimates remain broadly unchanged. We now expect Veolia's 2 016e EBITDA to reach **EUR3,081m,** up c. 3% yoy. **Note that we have integrated the EUR150m restructuring charges for FY16** as announced by Veolia during the 9M-16 conference call. **This negatively impacts the company's reported**

metrics contrary to the company's current EBIT and current net income, on which Veolia's guidance is based. Our 2016e/2017e/2018e current net income estimate stands at **EUR606m/EUR692m/EUR777m**, respectively. Our 2016e net income forecast integrates an EUR35m capital gain and a c.EUR30m FX headwind.

Fig. 12: Change in estimates 2016e-2018e

EURm	2015	New			Old			Var (%)		
		2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e
Revenues	24,965	24,578	25,587	26,185	25,080	26,116	26,801	(2.0%)	(2.0%)	(2.3%)
EBITDA	**2,997**	**3,086**	**3,293**	**3,452**	**3,147**	**3,386**	**3,554**	**(1.9%)**	**(2.7%)**	**(2.9%)**
YoY growth (%)	-	3.0%	6.7%	4.8%	5.0%	7.6%	5.0%	-	-	-
EBITDA margin	12.0%	12.6%	12.9%	13.2%	12.5%	13.0%	13.3%	-	-	-
Current EBIT	**1,315**	**1,364**	**1,521**	**1,646**	**1,404**	**1,584**	**1,713**	**(2.8%)**	**(4.0%)**	**(3.9%)**
YoY growth (%)	-	3.7%	11.5%	8.2%	6.8%	12.8%	8.1%	-	-	-
EBIT margin	5.3%	5.5%	5.9%	6.3%	5.6%	6.1%	6.4%	-	-	-
Current net income	**580**	**606**	**692**	**777**	**632**	**728**	**821**	**(4.1%)**	**(4.9%)**	**(5.4%)**
YoY growth (%)	-	4.5%	14.2%	12.3%	9.0%	15.2%	12.8%	-	-	-
Current EPS (EUR)	1.03	1.07	1.22	1.37	1.12	1.29	1.45	(4.1%)	(4.9%)	(5.4%)

Source: Bryan, Garnier & Co ests.

Fig. 13: Revenue and EBITDA breakdown 2016e-2018e (BG estimates)

EURm	2015	2016e	2017e	2018e
Revenues - Group	**24,965**	**24,578**	**25,587**	**26,185**
o/w France	5,471	5,326	5,179	5,169
o/w RoE	8,575	8,506	9,057	9,301
o/w RoW	5,926	6,075	6,607	6,898
o/w GB	4,881	4,557	4,627	4,698
EBITDA - Group	**2,997**	**3,086**	**3,293**	**3,452**
o/w France	816	769	777	796
o/w RoE	1,104	1,173	1,228	1,271
o/w RoW	805	869	981	1,046
o/w GB	226	254	287	320

Source: Bryan, Garnier & Co ests.

6. Valuation

6.1. SOTP valuation

We valued Veolia via a SOTP valuation which implies an **EUR22.0 equity value per share** - down EUR1.5 per share vs. our previous fair value – which led to a c. **34% theoretical upside** vs. the company's current share price. Note **our WACC amounts to 6.5%**, our average beta to 1.2 and our weighted average long-term growth rate to 1.07%.

Veolia SOTP Valuation	Value (EURm)	Implied EV/EBITDA 2016e	EBITDA 2016e	Method	% weight of EV	Value per share
France	6,099	7.9x	769	DCF	28.7%	10.8
RoE	7,026	6.0x	1173	DCF	33.0%	12.4
RoW	6,010	6.9x	869	DCF	28.2%	10.6
Global Businesses	2,032	8.0x	254	Multiples	9.5%	3.6
o/w Hazardous waste	1,236	9.0x	137	9x EV/EBITDA	5.8%	2.2
o/w Veolia Water Technologies	481	7.0x	69	7x EV/EBITDA	2.3%	0.8
o/w SADE	184	7.0x	26	7x EV/EBITDA	0.9%	0.3
o/w Others	131	6.0x	22	6x EV/EBITDA	0.6%	0.2
Others	120	6.0x	20	6x EV/EBITDA	0.6%	0.2
Implied EV	**21,287**	**6.9**	**3,086**		**100**	**37.6**
Net debt at end 2015	(8,170)					(14.4)
Acquisitions not yet included in our 2015 net debt, (net of disposals)	(567)					(1.0)
Transdev disposal	220					0.4
Integration of hybrid @ 100%	(1,500)					(2.6)
Provisions @ book value (end 2015)	(2,547)					(4.5)
Minority interests @ Market value (14x)	(1,415)					(2.5)
Financial assets	5,220					9.2
o/w Other financial assets (@ 2015 Book value) including Transdev loan	626					1.1
o/w Repayment of Transdev loan in 2016, not included in our 2015 net debt	345					0.6
o/w Non-operating financial assets (@ Book value)	1,926					3.4
o/w Chinese concessions - Transdev equity value + Other associates (@ Book value)	2,323					4.1
Total implied Equity Value	**12,527**					**22.1**
Number of shares	566.2					
Equity Value per share (rounded)	**22.0**					
Current share price	*17.3*					
Upside/Downside	*27.2%*					

Source: Company Data; Bryan, Garnier & Co ests.

6.2. One of the most attractive div. yield in the sector

The previously mentioned strong EBITDA generation should enable Veolia to reach its 2016 current net income guidance. As a reminder, the group is targeting at least EUR600m of current net income, at constant FX, which includes about EUR10m of capital gains. **We believe Veolia is clearly ahead of its yearly target** as, assuming a EUR25m FX headwind at the net income level (in line with 9M-16 figure), the company's guidance would imply a c. 10% decrease in Q4-16 current net income, which appears unlikely to happen in our view. **We expect FY16 current net income to reach EUR606m** (EUR635m at constant exchange rates), **up 4.0%** yoy, notably on the back of: **1/ a lower cost of debt** following recent debt issuances; **2/** the impact of the **recent international developments** previously mentioned; **3/ higher capital gains** that the ones initially included in the company's guidance (EUR35m expected vs. EUR10m in the company's guidance); **and 4/the company's cost-savings** programme (EUR55m expected to be achieved in Q4-16).

Veolia also confirmed its 2016-2018 outlook with the aim of reaching at least **EUR800m** of current net income by 2018. **The company's dividends are expected to grow c. 10% per year, on average, between 2015 and 2018** which would imply a **EUR0.97 per share 2018 DPS**.

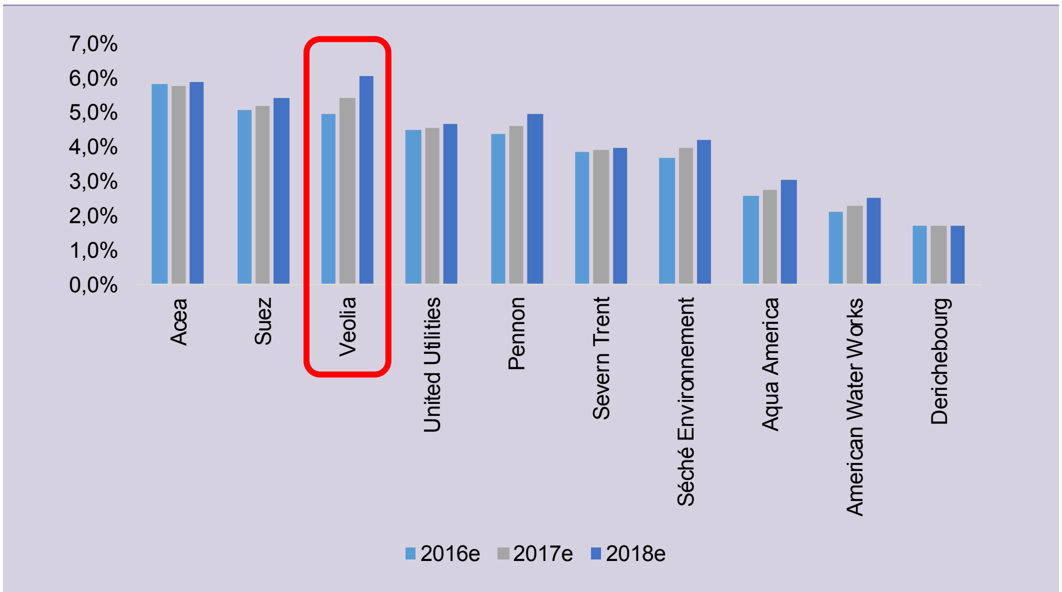
Fig. 14: An expected 10% growth in DPS by 2018

EUR	2015	2016e	2017e	2018e
EPS	1.03	1.07	1.22	1.37
DPS	0.73	0.81	0.89	0.97

Source: Bryan, Garnier & Co ests.

All in all, **Veolia's dividend yield remains one of the most attractive in the environmental services sub-sector.** Based on current share price and consensus' expectations for 2016e/2017e/2018e, **the company's implied dividend yield reached 5.0%/5.4%/6.0%** respectively vs. 3.9%/4.0%/4.2% on average for the sub-sector.

Fig. 15: Dividend yields comparison within the environmental services sub-sector

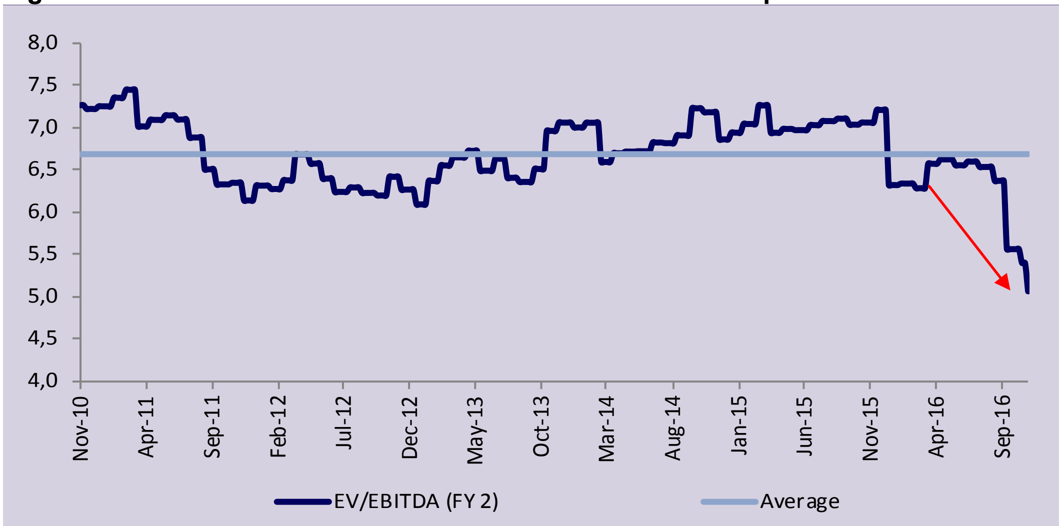


Source: Thomson Reuters; Bryan, Garnier & Co ests.

6.3. A c. 22% discount vs. historical FY2 EV/EBITDA multiple

Following the recent derating of the stock (-16% since the 9M-16 publication), we believe Veolia's current implied **valuation is attractive with a c. 22% discount vs. the company's historical EV/EBITDA** (over the last six years, based on consensus' estimates) **multiple**. Indeed, Veolia used to be valued at **6.7x** its FY2 EV/EBITDA multiple while the current multiple for 2017e only stands at c. **5.2x.**

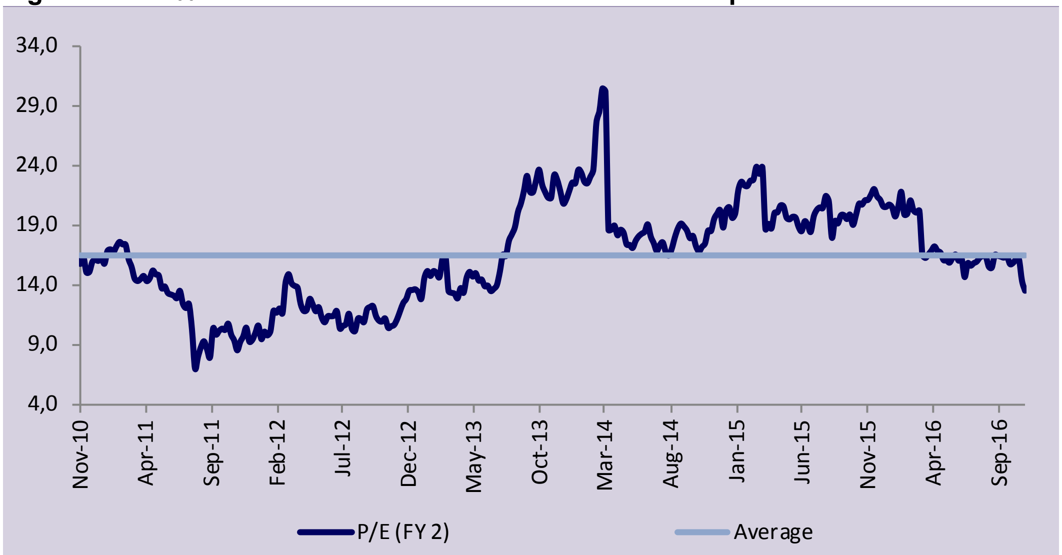
Fig. 16: A 22% discount vs. historical FY2 EV/EBITDA multiple



Source: Thomson Reuters; Bryan, Garnier & Co ests.

Similarly, **the stock currently trades at a c. 18% discount vs. its historical FY2 P/E multiple**. The current implied FY2 P/E ratio stands at 13.5x, well below its historical levels at 16.5x.

Fig. 17: A 10% discount vs. historical FY2 P/E ratio multiple



Source: Thomson Reuters; Bryan, Garnier & Co ests.

7. Conclusion

Despite this lack of top-line growth – which led us to revise downward our estimates for 2016 and beyond as well as our FV - **we still appreciate the company's ability to sharply increase both its EBITDA** (by 4-5% on average on an organic basis) **and its EBITDA margin**. This has been driven by Veolia's cost-cutting strategy which continues bearing fruit and whose objectives have recently been upgraded. **Our SOTP valuation still implies a significant upside** vs. the company's current share price (c. 30-35%). We additionally believe the **current implied valuation** (c. 20% discount vs. Veolia's historical multiple) is **attractive**. **Buy rating maintained.**

Focus: what could be the impact of an interest rates' increase for Veolia ?

■ **Veolia has no exposure to regulated assets in the US**

Since the election of D. Trump as new president of the USA, 10Y US rate had risen to c. 2.2% up 84bps vs. the low point reached in July 2016. Obviously, in a context of higher interest rates, **dividend-paying stocks – like Utilities – which are notably held for their high yield become relatively less attractive** (vs. bonds). Since the election of Trump, the Stoxx 600 Utilities has consequently decreased by c. 7% while Veolia's stock price decrease by 7.4%. As a reminder, in contrast with **Suez** (**which owns US regulated water company United Water), Veolia** is not exposed to regulated assets in the US. We therefore believe the potential impact of an increase in interest rates or any potential inflationist impact of the future policy implemented by D. Trump would have a **marginal impact** on the company's business, by itself, in the US.

■ **Net debt almost entirely borrowed at fixed rate**

Additionally, as of FY-15, **Veolia's net financial debt after hedging was borrowed at 95% at fixed rates and at "only" 5% at variable rates**. For comparison purpose, note that Suez and Engie net debts borrowed at fixed rates reached 84% and 83% in 2015, respectively.

Fig. 18: 95% of the company's net debt borrowed at fixed rate

	Veolia	Suez	Engie
Fixed rate	95%	84%	83%
Variable rate	5%	16%	17%

Source: Companies

Additionally, **Veolia successfully refinanced its EUR1.3bn bonds maturing in 2017** with the issuance last month of 2 bonds for **EUR1.1bn** with **1/**an EUR600m bond maturing in October 2023 (i.e. a 7-year maturity) and bearing a 0.314% coupon; **and 2/**and EUR500m bond maturing in January 2029 (i.e. 12-year maturity) and bearing a 0.927% coupon. These are all-time low coupon for Veolia.

Fig. 19: About EUR1.3bn of bonds were expected to matured by H1-17

Maturity	Interest rate	Net carrying amount (EURm)
16/01/2017	4,375%	633
19/05/2017	Euribor 3-month + 0,25%	350
28/06/2017	4,500%	71
29/06/2017	5,700%	255
Total		**1,309**

Source: Company Data; Bryan, Garnier & Co ests.

Only 10% of the company's revenues exposed to emerging markets

Other implied impact could be on **FX** with the increased interest rates potentially leading to an **appreciation of the US dollar and a depreciation of emerging countries' respective currencies**. Veolia's revenues are actually not that much exposed to emerging markets. We estimated this exposure to be only **10%** of the company's 2015 revenues (vs. c. 18% for Suez) with main exposures being Latin America (around EUR650m of revenues), Asia (c. EUR520m in Asian emerging markets while the remaining EUR500m are being reported in Japan, South Korea, Taiwan, Hong Kong and Singapore) and about EUR1.2bn in Africa and Middle East. Here below, **we estimated the impact** – at both revenues and EBITDA levels – **of a c. 5% change in various currencies** (US dollar, Yuan renminbi, Brazilian real, Mexican Peso and Argentinian peso).

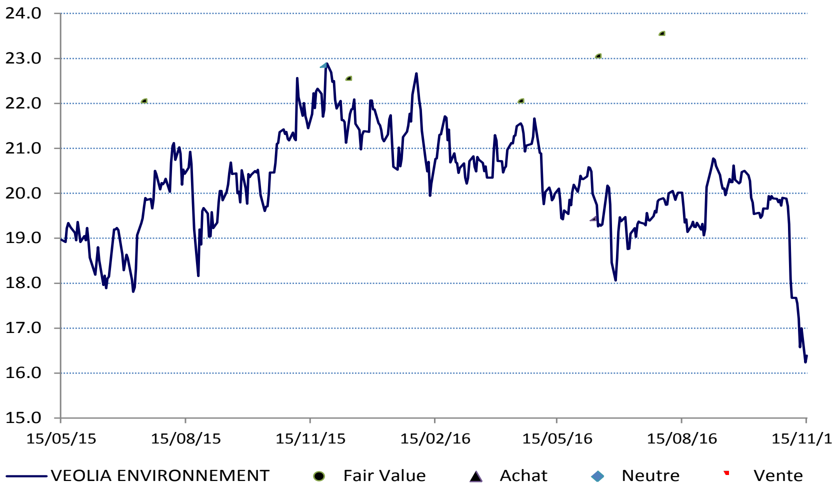
Fig. 20: Estimated impact of a +/- 5% change in various currencies

Currencies	Revenues	EBITDA
US dollar	+/- EUR115m	+/- EUR15m
Yuan Renminbi	+/- EUR30m	+/- EUR10m
Brazilian Real	+/- EUR6m	+/- EUR2m
Argentinian Peso	+/- EUR7m	+/- EUR2m
Mexican Peso	+/- EUR10m	-

Source: Bryan, Garnier & Co ests

Price Chart and Rating History

Veolia Environnement



Ratings		
Date	**Ratings**	**Price**
16/06/16	BUY	EUR19.3
30/11/15	NEUTRAL	EUR22.765
30/09/14	BUY	EUR13.625

Target Price	
Date	**Target price**
02/08/16	EUR23.5
16/06/16	EUR23
20/04/16	EUR22
15/12/15	EUR22.5
17/07/15	EUR22
02/04/15	EUR20
13/03/15	EUR19
11/02/15	EUR18
30/09/14	EUR17

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Bryan Garnier stock rating system

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Stock rating

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NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 55.4% NEUTRAL ratings 33.1% SELL ratings 11.5%

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