ENGIE

Price EUR11.55

Still betting on the company's transformation despite lowering our 2016-18e estimates

Fair Value EUR15.6 vs. EUR17 (+35%) **BUY**

Bloomberg	ENGI FP
Reuters	ENGIE.PA
12-month High / Low (EUR)	16.6 / 11.3
Market Cap (EUR)	28,115
Ev (BG Estimates) (EUR)	66,791
Avg. 6m daily volume (000)	5 771
3y EPS CAGR	-2.0%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-12.6%	-19.0%	-16.2%	-29.3%
Utilities	-7.5%	-9.8%	-12.4%	-14.7%
DJ Stoxx 600	-0.2%	0.1%	-1.8%	-6.4%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	69,883	65,666	64,457	65,535
% change		*-6.0%*	*-1.8%*	*1.7%*
EBITDA	11,261	10,794	10,593	10,881
EBIT	6,327	6,182	5,900	6,095
% change		*-2.3%*	*-4.6%*	*3.3%*
Net income	2,589	2,409	2,334	2,443
% change		*-6.9%*	*-3.1%*	*4.7%*

	2015	2016e	2017e	2018e
Operating margin	9.1	9.4	9.2	9.3
Net margin	3.7	3.7	3.6	3.7
ROE	5.3	5.0	4.9	5.1
ROCE	6.8	4.3	4.1	4.2
Gearing	61.5	55.5	60.0	60.2

(EUR)	2015	2016e	2017e	2018e
EPS	1.08	1.01	0.97	1.02
% change	-	*-7.1%*	*-3.1%*	*4.7%*
P/E	10.7x	11.5x	11.9x	11.3x
FCF yield (%)	0.9%	29.3%	11.3%	14.0%
Dividends (EUR)	1.00	1.00	0.70	0.70
Div yield (%)	8.7%	8.7%	6.1%	6.1%
EV/Sales	1.1x	1.0x	1.0x	1.0x
EV/EBITDA	6.6x	6.2x	6.3x	6.1x
EV/EBIT	11.8x	10.8x	11.3x	11.0x

Following the company's 9M-16 results, we revised downward our estimates for 2016e and beyond, with slightly lowered EBITDA expectations. We also adjusted our minorities and tax rate assumptions which implies a harsher cut to our EPS estimates. We now expect recurring net income to be broadly flat (+0.7%, actually) over 2016-18e (vs. a 3.9% CAGR expected before). These adjustments have led us to lower our FV from EUR17.0 to EUR15.6. However, we maintain our Buy rating as we still believe the ongoing transformation plan could pave the way for a significant rerating of the stock with the E&P disposal remaining the main short-term catalyst.

ANALYSIS

- **Lowering our estimates:** Following the company's 9M-16 results, **we revised downward our estimates for 2016e and beyond**. We decreased our EBITDA expectations by **0.5%/1.2%/1.7%** for 2016e/2017e/2018e and our recurring net income by **6.4%/10.7%/12.2%** over the same period. **We now stand at the very low-end of the company's guidance for 2016e for both EBITDA** (EUR10,794m vs. guidance between EUR10.8bn-11.4bn) **and recurring net income** (EUR2,409m vs. guidance between EUR2.4bn-2.7bn. As a consequence of these adjustments, we expect **Engie's recurring net income to be broadly flat (+0.7%) between 2016e and 2018e.**
- At the EBITDA level, we notably integrated: **1/**a **different phasing regarding the deconsolidation** of the US thermal assets with the impact now expected to almost complete in 2017e; **2/**the integration of the impact of the **outages in the Tricastin and Tihange 1** nuclear reactors, in 2016e only; **3/the closure of the Australian 1.6GW Hazelwood coal-fired power plant** which negatively impacts our 2017e and 2018e EBITDA estimates; **4/higher expected load factors for Engie's European CCGT fleet** which should positively impact the company's FY-17e EBITDA; **and 5/a weaker-than-expected performance in the LNG** business due to challenging market conditions.
- The discrepancy between our EBITDA and our net recurring income revisions mainly came from **two adjustments** as **1/we revised upward our minorities forecasts** for 2016e and beyond (EUR700m/EUR660m/EUR663m in 2016e/2017e/2018e vs. EUR600m/EUR606m/EUR612m initially) following a notably higher-than-expected contribution from E&P International (30% minorities) and Engie Energia Chile (47% of minorities); **and 2/we revised upward our tax rate assumption**, for 2017e and beyond, by 150bps as larger net losses are expected to be posted in the Benelux segment (price headwind) with no tax shield option any more, which would mechanically increase the Group's tax rate to above our initial expectations.

Table 1: Changes to estimates (2016e-2018e)

	New			Old			Var (%)		
	2016e	2017e	2018e	2016e	2017e	2018e	2016e	2017e	2018e
EBITDA	10,794	10,593	10,881	10,852	10,723	11,065	(0.5%)	(1.2%)	(1.7%)
Net recurring income	2,409	2,334	2,443	2,575	2,614	2,784	(6.4%)	(10.7%)	(12.2%)
Recurring EPS	1.01	0.97	1.02	1.08	1.09	1.16	(6.4%)	(10.7%)	(12.2%)
Dividend per share	1.00	0.70	0.70	1.00	0.70	0.70	0.0%	0.0%	0.0%

Source : Bryan Garnier & Co. ests.

- **Conclusion**: Despite lowering our estimates, **we maintain our Buy rating**. Indeed, we still believe the ongoing transformation plan implemented by Engie could pave the way for a **significant rerating** of the stock following company's **increased focus on contracted and regulated activities** as well as the expected reduced exposure to commodities.
- We additionally believe the **poor performance of the stock** since the beginning of the year (-30.0% vs. -15.4% for SX6P) and since the beginning of Q4-16 (-17.2% vs. -10.9% for SX6P) implies that **the market has already integrated**, to a certain extent, **this "no-growth scenario"** as well as the risk inherent to the nuclear provisions.
- In our view, **the main short-term catalyst remains the disposal of the company's E&P assets.** The recent speculation over a potential interest of Neptune Oil & Gas Ltd., despite a lower implied valuation vs. our SOTP (EUR3.8bn vs. EUR5.4bn), confirmed that **1/Engie appears to be well on-track to deliver its EUR15bn disposals' programme by 2018** (EUR6bn completed or about to be completed as of today, excluding the E&P potential disposal and the negotiations over disposals in Poland, Chile and Australia); **and that 2/investors would see this disposal as positive for the company's overall transformation** as shown by the solid stock's performance (+2.4% vs. +0.7% for

SX6P) following the unveiling of Neptune's interest.

- Note that **the E&P disposal would obviously have a significant downsizing impact on our EBITDA expectations** (about EUR1.2bn), **but is likely to be more marginal at the bottom line level** due to high D&A, high minorities (E&P International is 30% owned by Chinese CIC since 2011) and high tax rate.

VALUATION

- **Impact on our FV**: All in all, these adjustments have led us to **decrease our FV from EUR17.0 to EUR15.6 per share** which implies c.35% theoretical upside. This decrease is attributable to both the cut in our EBITDA estimates and the increase in our tax rate assumption.
- Note that **further information over nuclear provisions** – especially over their updated discount rate – are expected to be unveiled in the coming weeks. Everything else being equal, a **100bps** decrease in the discount rate (currently standing at 4.8%) would imply a c. **EUR1.1bn** increase in provisions – hence an **EUR0.5** per share negative impact on our FV – and a c. **EUR100m** headwind at the pre-tax income level (linked with higher dismantling provisions). **The 10-year extension, last year, of Doel 1 and Doel 2 nuclear reactors could, however, have a positive impact on the overall provision.**
- **Buy, FV @ EUR15.6**
- At current share price, the stock trades at **6.2x** its 2016e EV/EBITDA multiple

NEXT CATALYSTS

- **Further disposals** including notably the exploration & production (E&P) assets, the Polaniec power plant in Poland (for which three bids, ranging between EUR200m and EUR400m, are said to have been received by Engie), the remaining thermal assets in Australia (Loy Yang B and Kwinana power plants) or the port project in northern Chile and the IEM2 power plant project, still in Chile.
- **Update on nuclear provisions** (particularly on the discount rate) which could occur by the end of the year
- **March 2nd 2017:** FY-16 results

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