

Pennon Group

Price 810.00p

Solid H1 2016/17 metrics thanks to SWW

Fair Value 830p (+2%)

SELL

Pennon has posted solid H1 2016/17 metrics this morning, ahead of market expectations, thanks to a good performance at SWW and a positive scope effect at Viridor. Landfill businesses continued to suffer but the group benefited from solid costs efficiencies at its recycling business. Positive. We expect a positive share price reaction.

ANALYSIS

- Main metrics:** H1 2016/17 sales decline of **0.5%** to **GBP685m** with the group benefiting from solid growth at its water business (+3.1% to GBP288m) as a result of **1.3%** higher demand, tariff increases of **1.4%** (with RPI of 1.1%) and increased new connections but is within regulatory tolerances for revenue controls. On the contrary Viridor's revenue decreased by **3.0%** to **GBP398m** due to the expected decrease in construction spend on service concession arrangements as plants come onstream and lower landfill volumes, partly offset by the growing contribution of operational ERFs. EBITDA surged by **5.9%** to **GBP245m** driven mainly by the SWW business (+5.4% on EBITDA) while Viridor's EBITDA was only up by **3.8%**. Costs efficiencies combined with higher revenues allowed the group to post solid EBITDA growth at SWW, while EBITDA at Viridor benefited mainly from the ramp-up of ERFs. As a reminder, the group still has three further ERFs under construction. EBITDA contribution from Landfill and Landfill gas continued to decline (-29% and -19% respectively) while contribution from Recycling strongly surged (+53%) due to the significant progress made by the group on reducing costs base and improving assets utilisation. All in all group's operating profit was up **14%** to GBP154m, ahead of consensus (GBP145m) while EPS was only up **1.7%** ahead also of market expectation (-7.7% expected by the market).
- What to retain from this publication? 1/** The group's performance for H1 was driven mainly by SWW business, which outperformed as usual the regulatory contract while Viridor's earnings were only up thanks to a scope effect. **2/** Metrics came out above market expectations (+3.6%) on EBITDA and EBIT with a good surprise coming from SWW business. **3/** Cost efficiency continued to deliver solid earnings growth with Totex' outperformance resulting from cumulative savings of GBP80m and financing outperformance of **GBP48m** in the first 18 months of K6. As a reminder SWW is targeting **GBP27m** of net synergies over K6 following the integration of Bournemouth Water. **4/**The board has made the decision to commit to a further GBP252m ERF at Avenmouth near Bristol to be completed in 2020/21, talking the portfolio to 12 plants.
- Conclusion:** Results reported by the group are quite solid especially compared with peers (SVT posted yesterday a +3.2% YoY growth in PBT, that needs to be compared with +20% posted by Pennon today). **We expect a positive share price reaction.**

VALUATION

- At the current share price the stock is trading at **13.3x** its 2017e EBITDA and at **21.5x** its 2017E EPS
- Sell, FV @ 830p**

NEXT CATALYSTS

- 9th February – Trading statement

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	PNN LN
Bloomberg	PNN.L
Reuters	PNN.L
12-month High / Low (p)	945.5 / 769.0
Market Cap (GBPm)	3,352
Ev (BG Estimates) (GBPm)	6,177
Avg. 6m daily volume (000)	1 128
3y EPS CAGR	8.3%

	1 M	3 M	6 M	31/12/15
Absolute perf.	-2.2%	-8.2%	-3.7%	-5.9%
Utilities	-8.3%	-10.6%	-12.2%	-15.4%
DJ Stoxx 600	-0.7%	-0.9%	-0.7%	-6.6%

YEnd Mar. (GBPm)	03/16	03/17e	03/18e	03/19e
Sales	1,352	1,403	1,466	1,564
% change		3.8%	4.5%	6.7%
EBITDA	448	464	496	552
EBIT	251.6	267.6	285.5	315.3
% change		6.3%	6.7%	10.4%
Net income	152.1	155.3	169.4	193.0
% change		2.1%	9.1%	13.9%

	03/16	03/17e	03/18e	03/19e
Operating margin	18.6	19.1	19.5	20.2
Net margin	11.2	11.1	11.6	12.3
ROE	10.2	10.3	11.1	12.4
ROCE	5.5	5.3	5.6	6.1
Gearing	167.0	175.3	175.9	170.6

(p)	03/16	03/17e	03/18e	03/19e
EPS	36.97	37.75	41.17	46.91
% change	-	2.1%	9.1%	13.9%
P/E	21.9x	21.5x	19.7x	17.3x
FCF yield (%)	NM	NM	3.2%	5.5%
Dividends (p)	33.58	35.53	37.84	40.30
Div yield (%)	4.1%	4.4%	4.7%	5.0%
EV/Sales	4.5x	4.4x	4.2x	3.8x
EV/EBITDA	13.5x	13.3x	12.5x	10.9x
EV/EBIT	24.0x	23.1x	21.8x	19.1x



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