21st December 2016

Utilities

ENGIE

Price EUR12.34

Recently mentioned Suez's takeover by Engie : what-if analysis

Fair Value EUR14.8 (+20%) **BUY**

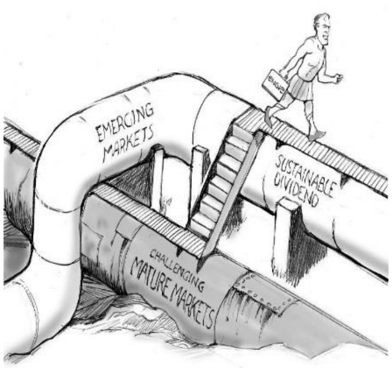
Bloomberg	ENGI FP
Reuters	ENGIE.PA
12-month High / Low (EUR)	16.5 / 11.3
Market Cap (EUR)	30,039
Ev (BG Estimates) (EUR)	70,493
Avg. 6m daily volume (000)	5 772
3y EPS CAGR	-20.6%

	1 M	3 M	6 M	31/12/15
Absolute perf.	9.6%	-9.7%	-14.8%	-24.4%
Utilities	7.8%	-3.2%	-6.4%	-9.5%
DJ Stoxx 600	6.5%	6.0%	7.0%	-1.2%

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	-3,243	6,182	5,900	6,095
% change		*NS*	*-4.6%*	*3.3%*
Net income	2,589	2,409	2,204	2,313
% change		*-6.9%*	*-8.5%*	*5.0%*

	2015	2016e	2017e	2018e
Operating margin	-4.6	9.4	9.2	9.3
Net margin	3.7	3.7	3.6	3.7
ROE	10.2	5.0	4.6	4.8
ROCE	6.8	4.3	4.1	4.2
Gearing	61.5	55.5	60.0	60.2

(EUR)	2015	2016e	2017e	2018e
EPS	2.04	1.01	0.97	1.02
% change	-	*-50.7%*	*-3.1%*	*4.7%*
P/E	6.1x	12.3x	12.7x	12.1x
FCF yield (%)	0.8%	27.4%	10.6%	13.1%
Dividends (EUR)	1.00	1.00	0.70	0.70
Div yield (%)	8.1%	8.1%	5.7%	5.7%
EV/Sales	1.1x	1.1x	1.1x	1.1x
EV/EBITDA	6.7x	6.5x	6.7x	6.5x
EV/EBIT	NS	11.4x	11.9x	11.6x



BFM Business reported yesterday that Engie could consider a full takeover of its 33.7%-owned Suez subsidiary. We believe this transaction is unlikely to happen in the short-term, as both companies are deeply involved in their restructuring programmes until 2018. However, we have tried to model the potential implications of such a deal at both balance sheet and P&L levels for Engie. While net debt/EBITDA ratio would rise significantly, we estimate the buyout would be accretive for Engie's EPS assuming no capital increase is launched to fund it. The "ideal" scheme (acquisition and disposal of the waste business) would, however, imply enhanced exposure to French water business whose fundamentals do not appear well-oriented.

ANALYSIS

- Yesterday, BFM Business reported that **Engie could consider a full takeover of its 33.7%-owned Suez subsidiary**. According to the media, Engie could consider allocating part of the resources from its expected EUR15bn disposals programme in order to buy Suez. A disposal of Suez's waste business (ex-SITA) could also be considered to help funding the operation. **This caused Suez's stock price to climb 4.6% yesterday** (vs. +0.8% for SX6P).

- In our previous report on Engie, we stated that **such an operation was unlikely to happen in the short-term, as we believe both companies are already deeply involved in their restructuring programmes until 2018**. In addition, we considered that this would be viewed as **a step backwards** following both companies' efforts to strengthen their respective commercial developments through new business organisations and the ongoing homogenisation of their structure. **In the long-term, an acquisition of Suez could potentially make sense for Engie,** as the company aimed at focusing on more contracted and regulated activities including customer solutions and particularly on the *"business-to-territories"* sub-segment.

- Independently of such strategic considerations, **we tried to model a potential 100% takeover of Suez by Engie with a full integration in 2018**. We assumed **three different scenarios** while excluding a debt-funding scheme (which is likely to be dilutive at the EPS level due to the inherent higher financial expenses). Based on a 10% premium vs. Suez's average share price over the last three months, we estimated Engie's cash-out would amount to c.**EUR5.6bn**. The acquisition would therefore lead to a sharp increase in Engie's 2018e debt net over EBITDA ratio due to the consolidation of Suez's debt, **from 2.4x** (current BG estimates) **to 3.2x**. Assuming a financing through **capital increase** – and based on a 10% discount to TERP hence a 12% discount vs. current Engie's share price – we estimate the ratio would be more comfortable for Engie, at **2.8x**, but still significantly higher than the current expected one. Finally, **assuming a disposal of Suez's current waste business,** we estimated Engie's net debt over EBITDA would amount to **2.9x** – based on an EUR860m 2018e EBITDA for waste activities and a 7.0x normative EV/EBITDA multiple.

- **Our three scenario therefore imply ratios well above Engie's current objective at 2.5x,** which is mainly explained by Suez's strong **exposure to regulated activities** in the US and in Chile (22.5% of 2015 company's EBITDA).

Table 1: expected impact on Engie's 2018e net debt/EBITDA ratio

	2018e			
	No acquisition	Acquisition		
	Current BG estimates	No capital increase	Capital increase	No capital increase and ex-SITA's disposal
EBITDA	10,881	13,672	13,679	12,819
Net debt	26,475	43,661	38,056	37,641
Net debt/EBITDA	**2,4x**	**3,2x**	**2.8x**	**2.9x**

Source : Bryan Garnier & Co. ests.

- **At the P&L level, a capital increase funding scheme does not make sense**, in our view, as it would imply **c.4% dilution on 2018e EPS** due to the new shares to be created. Assuming no capital increase, we estimated **the operation would be accretive in 2018 by 17% and 7%** for Engie depending on whether the waste business is disposed of or not. Note that as for the waste business, we assumed a 3.5% net margin, in line with sector's standards. Note also that we do not consider additional financial expenses as we assumed they would be offset by financial synergies' linked with the takeover. We however do not include in our assumptions any revenues' and costs' synergies from the operation for now in order to be on the safe side.

Table 2: expected impact on Engie's 2018e P&L

	2018e			
	No acquisition	**Acquisition**		
	Current BG estimates	**No capital increase**	**Capital increase**	**No capital increase and ex-SITA's disposal**
EBITDA	10,881	13,679	13,679	12,819
EBIT	6,095	7,388	7,388	6,998
Net income	2,313	2,698	2,698	2,472
# shares	2,396	2,396	2,915	2,396
EPS	**0.97**	**1.13**	**0.93**	**1.03**

Source : Bryan Garnier & Co. ests.

- **Conclusion:** in our view, the **capital increase funding scheme appears unlikely** to be set given the implied EPS dilution. **No capital increase would imply a strong accretion but it would significantly increase the company's credit metrics** with net debt/EBITDA ratio above 3.0x while Engie's objective remains 2.5x. **A disposal of Suez's current waste business would create a more comfortable in-between configuration** with reasonable accretion (c. +7%) and net debt/EBITDA ratio at 2.9x. **This would, however, infringe on current Suez's diversification strategy by increasing the exposure of the new structure to French water activities** which is still bearing the brunt of a low inflation environment (flat tariff indexation), poor trend in volumes and new regulatories headwind inherent to the Brottes law.

VALUATION

- At current share price, the stock trades at **6.5x** its 2016e EV/EBITDA multiple
- **Buy**, **FV @ EUR14.8** per share
- Note that **Suez** (Buy, FV @ EUR17.5 per share) currently trades at **6.8x** its 2016e EV/EBITDA multiple

NEXT CATALYSTS

- **Further disposals** including notably the exploration & production (E&P) assets, the Polaniec power plant in Poland, the remaining thermal assets in Australia or the port project in northern Chile and the IEM2 power plant project, still in Chile
- **March 2nd 2017:** FY-16 results

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