Automotive

Valeo

Price EUR52.61

Well equipped

Fair Value EUR49 (-7%) **NEUTRAL**

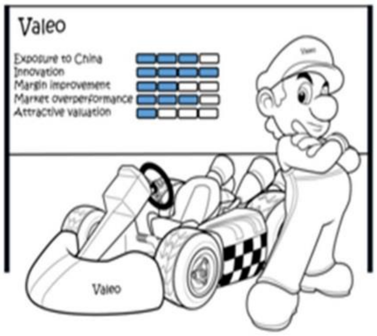
Bloomberg	FR FP
Reuters	VLOF.PA
12-month High / Low (EUR)	54.4 / 34.9
Market Cap (EUR)	12,581
Ev (BG Estimates) (EUR)	13,872
Avg. 6m daily volume (000)	786.9
3y EPS CAGR	14.4%

	1 M	3 M	6 M	31/12/15
Absolute perf.	0.2%	13.4%	16.4%	10.7%
Auto & Parts	-1.0%	1.9%	0.7%	-12.6%
DJ Stoxx 600	0.9%	-0.4%	-1.6%	-6.5%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	14,544	16,372	18,469	20,049
% change		*12.6%*	*12.8%*	*8.6%*
EBITDA	1,847	2,071	2,221	2,605
EBIT	1,060	1,260	1,414	1,556
% change		*18.8%*	*12.2%*	*10.0%*
Net income	729.0	883.7	985.5	1,098
% change		*21.2%*	*11.5%*	*11.4%*

	2015	2016e	2017e	2018e
Operating margin	7.3	7.7	7.7	7.8
Net margin	5.0	5.4	5.3	5.5
ROE	21.0	21.8	20.9	20.2
ROCE	23.7	22.9	19.7	20.3
Gearing	0.5	7.9	25.0	15.2

(EUR)	2015	2016e	2017e	2018e
EPS	3.11	3.75	4.18	4.66
% change	-	*20.6%*	*11.5%*	*11.4%*
P/E	16.9x	14.0x	12.6x	11.3x
FCF yield (%)	4.4%	4.0%	2.8%	5.2%
Dividends (EUR)	1.00	1.20	1.34	1.49
Div yield (%)	1.9%	2.3%	2.5%	2.8%
EV/Sales	0.9x	0.8x	0.8x	0.7x
EV/EBITDA	7.3x	6.7x	6.7x	5.6x
EV/EBIT	12.8x	11.0x	10.6x	9.4x



Yesterday we hosted Valeo (*Head of IR*) during a lunch meeting organised with French investors. Most questions were related to the group's positioning vis-à-vis PHEV/BEV and self-driving vehicles market expansion over coming years. Thanks to its presence in four different businesses, Valeo should be able to easily adapt to the new world, allowing the group to be considered as a long term growth story by investors. We like the group but recommend playing it at a cheaper price. At this stage we confirm our Neutral recommendation with a FV unchanged at EUR49.

ANALYSIS

- **Welcome to the new world**: The automotive sector is today facing massive changes imposed by strict regulations on CO_2 / NOx emissions and by a race for innovation. While it is hard at this stage to precisely forecast the share of new registrations that PHEV/BEV and semi-autonomous/full autonomous vehicles will represent over coming years, we believe Valeo is well equipped to easily adapt to this world.

- **Focus on Comfort & Driving Assistance business**: Thanks to its presence in this business, Valeo should benefit from the gradual development of self-driving vehicles within new registrations thanks to its expertise in sensors. The group indicated it delivered **560m ADAS sensors** (*ultrasonic systems, rain sensor, front camera, laser scanners…*) between 1990 and 2015 (*implying an average of >22m per year*) and unveiled it will deliver **140m in 2016**. With a **45%** market share (*MS*) in the ultrasonic systems market last year and a **30%** MS in the viewing camera market, Valeo is clearly well established in this market. Its partnerships with **Safran**, **Mobileye** and **IAV**, combined its internal expertise on this market should allow Valeo to benefit over coming years from the rise in **content per car value** linked to the deployment of **Level 2/Level 3** and **Level 4/5 self-driving car equipment** within new vehicles. According to the group, **Level 4/5 ADAS** equipment could represent up to **EUR5k** vs. only **EUR0.5k** for **Level 2 vehicles** (*for Valeo*). As a reminder, for its CDU business (*18% of group's sales and 26% of group's EBITDA*) the group is targeting a sales CAGR of **8%** leading **to EUR4bn**, and growth in **EBITDA margin of 300bp to 17.5%**.

- **Focus on Powertrain Systems business**: The group elaborated on the growth potential this business unit that should benefit from a **higher penetration rate of electrification** within new car registrations (*trend driven by stricter regulations on CO_2 / NOx emissions but also the VW scandal*). First, Valeo through its historical presence in transmissions components for ICE should continue to benefit from higher ICE vehicle demand (*notably for automatic transmission where value is twice more important compared with manual transmission*) while its expertise on **12V** and **48V** and now on **60V** electrical systems (*through its new JV with Siemens*) would allow it to enjoy the rising share of **BEV** (*Battery Electric Vehicle*) and **PHEV** (*Plug-in Hybrid Vehicle)* with new car demand. The group's current base scenario implies that by 2026 **conventional ICE vehicles** (*including Stop & Start*) will still represent **57%** of car production, while **Mild Hybrid** (*equipped with 12V & 48V electrical systems*) will represent roughly **20%** of the market and full hybrid/PHEV and HP BEV will represent respectively **18%** and **4%** of the market. Given the higher average content per car for Valeo between PHEV/BEV vehicles and traditional ICE vehicles in electronics and transmission components the group expects to easily outperform global automotive production over coming years in this business unit. As a reminder Valeo is targeting a **40%** MS in 2020 on **48V Mild Hybrids** vehicles market thanks notably to its **25 contracts signed** in China and in Europe, and a **60%** MS when including superchargers. On this business which represents **26%** of group's sales and **26%** of group's EBITDA, Valeo aims to post a **sales CAGR of 9.5%** while boosting its EBITDA margin by **70bp** to **13.5%. R&D and capex will continue to grow on short term**:

- **A group well positioned but which could miss its 2020 EBIT margin target**: Valeo is clearly one of the most innovative companies within the automotive sector with **Continental, Bosh** or **Delphi**, and is definitively the most innovative stock in our coverage. We appreciate the group's positioning as well as its strategy, but see very limited upside for group's margin in the short term, putting the group's 2020 EBIT guidance potentially at risk. To generate a **5pp sales outperformance vs the market every year** the group has no choice but to innovate and to develop new products as well as to spend more capex, to the detriment of both margin and CF evolution. We believe the group will have difficulties in maintaining R&D expenses at **5.5%** and capex expenses at **5% of sales** in the short term. The group could also suffer from the full consolidation of Ichikoh once the acquisition deal is finalised in Q1 2017 as the entity will have a dilutive impact on Valeo’s EBIT margin by around **20-30bp**. The margin improvement at Ichikoh (*from 2-3% today to potentially 7-8% like Valeo*) could take longer than expected while altering the group’s mid term organic sales growth target.

- **Neutral rating confirmed with FV unchanged at EUR49/sh**: We integrate into our model the full consolidation of Ichikoh for 2017 while delayed the integration of FTE in group’s P&L and CFS by more than six months following yesterday’s group announcement to withdraw its merger notification to address the European Commission’s concerns about this acquisition. All in all we lifted up our 2017 and 2018 sales and EBIT assumption by 4% but cut our 2017-18 EPS by 1.5% on average. **We now expect the group to generate an EBIT margin (Valeo def) of 8.1% by 2018 vs. 8.4% previously expected.**

VALUATION

- At the current share price Valeo trades at **10.1x** its 2017e EBIT and at **12.3x** its 2017e EPS
- **Neutral**, FV @ **EUR49/sh**

NEXT CATALYSTS

- **16th February** - 2016 results

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