14 January 2014 │ 19 pages

Gas Distribution Utilities
Western Europe │ France

GDF Suez (GSZ.PA)

Stuck In A Moment; Can It Get Out Of It? Stay Neutral

- Estimate Change
- Target Price Change

- **Global Uncertainty** — Will and what 2030 climate change targets will the EU adopt? Will countries launch capacity markets? Where next could shale gas be developed? What fuel mix will Japan pursue? Is Chinese coal demand plateauing? Never in the last decade has the global energy picture posed more questions in our view, complicating decisions and clouding the returns outlook from new investments
- **GDFSuez doesn't have balance sheet issues** — as although on our numbers it is FCF negative under the current €7-8bn p.a. capex and €1.5 DPS, net debt/EBITDA should stabilise at healthy levels and even decline as management pursues its asset rotation plan with c.€2bn p.a. in 'recurring' disposals of mature or underperforming assets. Still, discretion over capex has fallen with a number of projects moved into development in the last six months and ~€7bn of annual spend already identifiable.
- **We believe the market's dividend fixation** — is forcing the group into a capital allocation decision prematurely. At ~9% yield (sector at ~5%), investors don't seem to consider the DPS to be sustainable. Cutting it to in-line with the sector would free up capital. However, with a commitment to reduce exposure in Europe and already undergeared vs peers, the released money would likely have to be used to step up capex higher than current targets; anything else could cause a credibility gap to the strategy. Given the uncertainty over future returns on new investments, returns on past investments yet to crystalise and ongoing pressure in European generation, investors might not get the 'relief' re-rating they hope for, if a DPS cut comes.
- **Our 2014+ EPS is ~5% below consensus** — despite lower D&A on the back of a >€2bn assumed PP&E writedown at Q4 '13. We price in a DPS cut to €1 but not a capex increase. We believe maintaining the DPS at €1.5 through 2015 but signalling a move to a conditional policy (e.g. payout) thereafter, when visibility improves, is the right strategy and safeguards the hard-earned management credibility and still see a meaningful probability of that scenario. We continue our preference of France over Germany and GDFSuez over EON and RWE, but this primarily reflects our outlook on the latter two. We have tweaked our estimates for latest commodity and macro assumptions resulting to a lower €18 price target from €19 previously.

Neutral	2
Price (13 Jan 14)	€16.81
Target price	€18.00
from €19.00	
Expected share price return	7.1%
Expected dividend yield	6.0%
Expected total return	13.1%
Market Cap	€40,548M
	US$55,426M

Price Performance
(RIC: GSZ.PA, BB: GSZ FP)

GDF Suez (EUR)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Sales (€M)	90,674.0	97,038.0	90,610.1	82,627.8	85,327.7
Net Income (€M)	3,500.0	3,831.0	3,474.9	3,118.7	3,223.1
Diluted EPS (€)	1.58	1.69	1.44	1.29	1.34
Diluted EPS (Old) (€)	1.58	1.69	1.42	1.28	1.29
PE (x)	10.7	10.0	11.7	13.0	12.6
EV/EBITDA (x)	5.9	6.2	6.5	6.7	6.5
DPS (€)	1.50	1.50	1.50	1.00	1.02
Net Div Yield (%)	8.9	8.9	8.9	6.0	6.1

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

GSZ.PA: Fiscal year end 31-Dec — Price: €16.81; TP: €18.00; Market Cap: €40,560m; Recomm: Neutral

Profit & Loss (€m)	2011	2012	2013E	2014E	2015E
Sales revenue	90,674	97,038	90,610	82,628	85,328
Cost of sales	-59,470	-65,411	na	na	na
Gross profit	31,204	31,627	na	na	na
Gross Margin (%)	34.4	32.6	na	na	na
EBITDA (Adj)	16,525	17,026	14,687	12,541	12,873
EBITDA Margin (Adj) (%)	18.2	17.5	16.2	15.2	15.1
Depreciation	-6,885	-6,863	-6,056	-5,064	-5,252
Amortisation	-230	-250	-250	-250	-250
EBIT (Adj)	8,978	9,520	8,171	7,068	7,212
EBIT Margin (Adj) (%)	9.9	9.8	9.0	8.6	8.5
Net interest	-2,605	-2,756	-2,041	-1,885	-1,890
Associates	462	433	481	585	622
Non-op/Except	706	-2,387	-100	-100	-100
Pre-tax profit	7,541	4,810	6,510	5,667	5,844
Tax	-2,119	-2,054	-1,279	-1,864	-1,914
Extraord./Min.Int./Pref.div.	-1,418	-1,205	-3,629	-915	-937
Reported net profit	4,004	1,551	1,602	2,888	2,993
Net Margin (%)	4.4	1.6	1.8	3.5	3.5
Core NPAT	3,500	3,831	3,475	3,119	3,223

Per share data	2011	2012	2013E	2014E	2015E
Reported EPS (€)	1.80	0.68	0.66	1.20	1.24
Core EPS (€)	1.58	1.69	1.44	1.29	1.34
DPS (€)	1.50	1.50	1.50	1.00	1.02
CFPS (€)	5.44	5.23	4.42	4.33	3.77
FCFPS (€)	1.43	1.19	1.30	1.43	1.22
BVPS (€)	27.94	24.76	24.61	24.81	25.03
Wtd avg ord shares (m)	2,221	2,271	2,413	2,413	2,413
Wtd avg diluted shares (m)	2,221	2,271	2,413	2,413	2,413

Growth rates	2011	2012	2013E	2014E	2015E
Sales revenue (%)	7.3	7.0	-6.6	-8.8	3.3
EBIT (Adj) (%)	2.1	6.0	-14.2	-13.5	2.0
Core NPAT (%)	-15.0	9.5	-9.3	-10.3	3.3
Core EPS (%)	-16.3	7.0	-14.6	-10.3	3.3

Balance Sheet (€m)	2011	2012	2013E	2014E	2015E
Cash & cash equiv.	14,675	11,383	14,049	17,920	16,973
Accounts receivables	23,135	25,034	23,376	21,316	22,013
Inventory	5,435	5,423	5,064	4,618	4,769
Net fixed & other tangibles	95,583	92,204	79,559	76,195	78,086
Goodwill & intangibles	44,588	43,055	35,742	35,742	35,742
Financial & other assets	29,992	28,399	28,419	27,249	27,645
Total assets	213,408	205,498	186,208	183,041	185,228
Accounts payable	18,387	19,481	19,097	17,827	18,239
Short-term debt	13,213	11,962	10,474	10,474	10,474
Long-term debt	43,372	45,591	37,199	37,199	37,199
Provisions & other liab	58,166	57,257	53,684	50,993	51,903
Total liabilities	133,138	134,291	120,453	116,493	117,815
Shareholders' equity	62,930	59,745	59,378	59,852	60,383
Minority interests	17,340	11,462	6,377	6,695	7,030
Total equity	80,270	71,207	65,755	66,548	67,413
Net debt	41,910	46,170	33,624	29,753	30,700
Net debt to equity (%)	52.2	64.8	51.1	44.7	45.5

Valuation ratios	2011	2012	2013E	2014E	2015E
PE (x)	10.7	10.0	11.7	13.0	12.6
PB (x)	0.6	0.7	0.7	0.7	0.7
EV/EBITDA (x)	5.9	6.2	6.5	6.7	6.5
FCF yield (%)	8.5	7.1	7.7	8.5	7.3
Dividend yield (%)	8.9	8.9	8.9	6.0	6.1
Payout ratio (%)	95	89	104	77	76
ROE (%)	6.4	2.5	2.7	4.8	5.0

Cashflow (€m)	2011	2012	2013E	2014E	2015E
EBITDA	16,093	16,633	14,477	12,381	12,713
Working capital	-426	-995	1,633	1,236	-436
Other	-3,594	-3,762	-5,439	-3,165	-3,182
Operating cashflow	12,073	11,876	10,671	10,453	9,096
Capex	-8,898	-9,177	-7,540	-7,000	-6,143
Net acq/disposals	715	564	1,200	0	0
Other	279	162	0	0	0
Investing cashflow	-7,904	-8,451	-6,340	-7,000	-6,143
Dividends paid	-4,363	-2,117	-4,340	-3,054	-3,118
Financing cashflow	-4,324	2,526	-16,261	-4,940	-5,008
Net change in cash	-155	5,951	-11,930	-1,487	-2,055
Free cashflow to s/holders	3,175	2,699	3,131	3,453	2,953

For definitions of the items in this table, please click here.

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Cash & Dividends vs Growth

GDFSuez has previously guided the market for 2014 recurring net income to be in the €3.1-3.5bn range, flat vs the 2013 guided range, but with the expectation that earnings growth should resume from 2015.

Capex programme

At its December 2012 investor day management announced the reduction of its annual capex programme to €7-8bn vs €9-11bn previously, with part of the decline relating to the deconsolidation of the ~€1.3bn capex spend by Suez Environnement.

Figure 1. GDFSuez planned growth investments

Project	Country	Division	Construction(e)	Commissioning (e)	Investment(€m)
Jirau	Brazil	International	2008	2015	~7,500
Tihama	Saudi Arabia	International	2012	2015	~320
Roemerberg	Germany	Global Gas	2009	2016	~280
Cygnus	UK	Global Gas	2012	2016	~1,700
Touat	Algeria	Global Gas	2009	2017	~2,300
Eridan	France	Infrastructures	2012	2016	~490
Hauts De France II & Arc de Dierrey	France	Infrastructures	2012	2015	~1,100
Ilo	Peru	International	2013	2017	~370
CHP5	Mongolia	International	2014	2017	~920
Safi	Morocco	International	2014	2017	~1,340
West Coast One	South Africa	International	2013	2015	~160
Tarfaya	Morocco	International	2013	2014	~360
Dedisa & Avon	South Africa	International	2013	2016	~780
Nabucco West	Austria	Global Gas	2014	2020	N/A
Jangkrik	Indonesia	Global Gas	2013	2016	~1,100
Az Zour	Kuwait	International	2013	2015	~2,300
Meenakshi	India	International	2013	2017	~800
Mifra	UAE	International	2014	2017	~2,000
Sao Manuel	Brazil	International	2015	2018	~1,400
Sao Luiz do Tapajos	Brazil	International	2015	2018	~7,800
Nugen	UK	International	2018	2028	~16,000
Haute Normandie	France	Energy Europe	2014	2018	~1,750
Pays de la Loire	France	Energy Europe	2014	2018	~1,750
Cameron LNG	USA	Global Gas	2014	2017	~5,200
Bonaparte LNG	Australia	Global Gas	2015	2019	~8,300
Cameroon LNG	Cameroon	Global Gas	2015	2018	~3,800
Tavan Tolgoi	Mongolia	International	2015	2017	~750
Hydro projects	Laos	International	N/A	N/A	N/A
Block 3F	Malaysia	Global Gas	N/A	N/A	N/A
Block 2F	Malaysia	Global Gas	N/A	N/A	N/A
Jangkrik	Indonesia	Global Gas	2014	2017	~1,400

Source: Company Reports and Citi Research Estimates. Note: Shaded rows indicate projects were final investment decisions are yet to be made. Investment magnitude quoted is for 100% of the project, not GDFSuez's equity participation.

Including all the projects that GDFSuez has already committed to and those that it is bidding for (e.g. French offshore wind) or analysing their economic potential (e.g. LNG exports) and when considering the regulated capex (France T&D) and maintenance investment requirements (including nuclear life extension in Belgium) of the group, we estimate ~€7bn of annual investment can already be accounted for. That figure could well end up being higher as a number of the projects, e.g. Bonaparte LNG, Nugen UK nuclear plants or Nabucco West, if they do go ahead could end up costing above the original budget.

We therefore estimate that there is little room for GDFSuez to develop more projects without upping its already stated target capex envelope.

We do not believe that higher than targeted spend is required in the medium term but particularly with regards to the Upstream Oil& Gas and the LNG assets, given the depletion rates in the North Sea and the group's global footprint ambitions, we expect an increased pace of investment will be required from 2017 onwards.

Disposals

GDFSuez plans an €11bn net debt reduction through changes in scope including debt deconsolidation from selling minority stakes in assets it will no longer control (equity stake to drop below 50%) by the end of 2014 vs 2012-end levels. Primarily through asset sales in Brazil, Australia, New York and Portugal, GDFSuez should have delivered c.€5bn from its target in 2013. Our model assumes another €5bn to be delivered this year, i.e. €1bn short of the group's target.

Regardless of the group's capex outlook, we do not expect the disposal programme to be materially altered as it primarily sets to address the portfolio composition rather than the balance sheet.

GDF Suez has clarified at presentations that the €11bn programme includes c.€2bn of 'recurring' annual disposals as part of the group's efforts to constantly refresh its portfolio and exit mature or underperforming assets. Indeed, if we look back over the last six years, GDFSuez has delivered on average ~€4bn of annual debt reduction through disposals.

Depreciation

A key reason on why GDFSuez's balance sheet and cash flow generation has historically been stronger than what one could infer from simply looking at the group's P&L statement has been the high level of depreciation as the group has been investing (organic and inorganic) heavily.

When management underlined during the 9M '13 results that the asset value of its generation portfolio was re-evaluated, market expectations were raised, as can be seen by most recent consensus revisions, that potential asset impairments – highly possible, particularly due to the ongoing difficult power market environment across Europe – would result in ongoing lower depreciation and therefore accrete EPS.

In the last three years, GDFSuez has written down c.€1.6bn of the PP&E value of its European generation portfolio. We estimate c.20GW of primarily thermal capacity (mainly gas plants) is the pool of assets from which further impairments could come, of which ~15GW relates to gas fired generation. In total, we assume c.€3bn of remaining carrying value for these assets, which yields c.€400m of annual depreciation. We have removed €330m of depreciation from our models as of 1 January 2014, effectively pricing in c.€2.4bn of impairments to be taken with the Q4 '13 results (excluding any goodwill writedown).

We note however that we believe we are more cautious than consensus on our outlook for E&P depreciation, with an increasing number of projects looking more capital intensive than the ones already in operation and given the group's aspiration to grow overall production levels, we believe that P&L depreciation for that division will be on the rise.

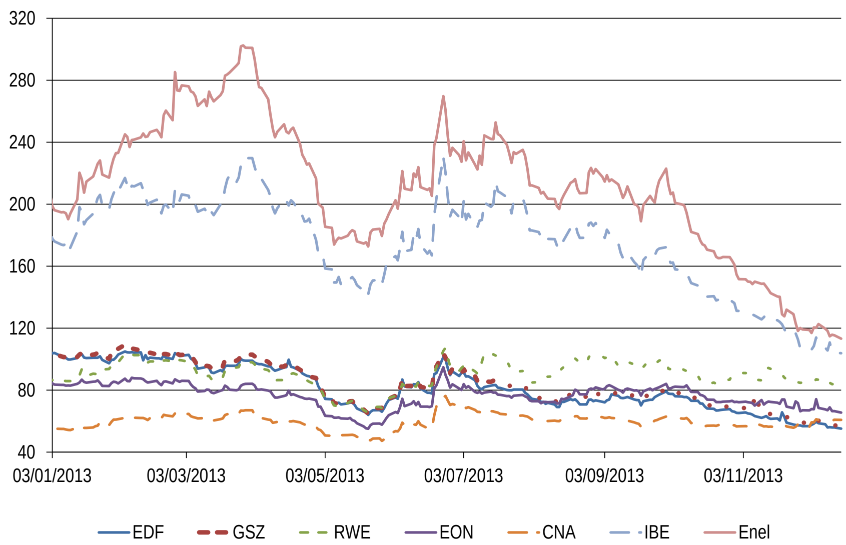
Financial Expenses

GDFSuez's strong balance sheet and credit rating has allowed the group to lower its cost of financial debt substantially to 3.6% by end-2013 on our estimates (excluding the cost of hybrid debt).

Citi economists forecast short-term interest rates in the euro area to not rise until 2018. Our own forecasts point to stability in GDFSuez's credit metrics in the medium term and that should probably translate to stability of credit spreads, which means that GDFSuez's 5 year CDS is likely to stay the tighter – alongside EDF – of the vertically-integrated utilities in the sector as shown in Figure 2.

Our model assumes that through ongoing refinancing and persistent low rates, embedded cost of gross debt for GDFSuez drops to 3.3% by 2016E. This compares to about 2.7% that the all in marginal cost of new 10 year bond issuance stands at for the group.

Figure 2. Vertically Integrated Utilities 5 year CDS



Source: Bloomberg

With our estimates already pricing in lower for longer rates, the risk to earnings is on the downside, were rates to rise from here either sooner or higher than our economists anticipate.

An increase in the cost of debt by 100bps, equivalent to a return to the average 2012 levels, would see our earnings forecasts reduce by c.6%.

Earnings estimates

We tweak our earnings estimates with reductions in expected operating performance – lower commodity prices, lower generation volumes, adverse FX – offset at the bottom line by lower assumed depreciation because of expected PP&E impairments and by further, modest, reductions in cost of finance.

We are ~5% below the most recent consensus estimates for 2014-15 EPS.

We believe the outlook remains more appealing than most other integrated utilities as growth from international markets offsets pressures in Europe to deliver flat earnings in 2016 vs 2013, as opposed to a declining earnings power for most of its direct peers.

Figure 3. GDFSuez – New vs Old earnings estimates (€m, apart from EPS in €)

	2013E	2014E	2015E	2016E
New EBITDA	14,698	12,541	12,873	13,221
Old EBITDA	14,683	12,924	13,247	13,887
% change	*0.10%*	*-2.96%*	*-2.82%*	*-4.80%*
New COI	8,182	7,068	7,212	7,452
Old COI	7,960	6,870	7,005	7,535
% change	*2.80%*	*2.88%*	*2.96%*	*-1.10%*
New adjusted EPS (GDFSuez definition)	1.44	1.29	1.34	1.42
Old adjusted EPS (GDFSuez definition)	1.42	1.28	1.29	1.40
% change	*1.59%*	*0.62%*	*3.70%*	*1.52%*

Source: Citi Research

Although we see some upside risks to these estimates – a technical increase in the CO2 price due to backloading, further cost-cutting, higher-than-assumed asset impairments lowering D&A further, easing up of corporate taxation in France – we also see some concrete downside risks – rising interest rates, delay in project delivery or cost overruns, FX weakening, output slowdown in E&P.

Above all however, we think the biggest downside earnings risk remains around the European energy markets. We have assumed that GDFSuez accelerated its forward hedging during the second half of 2013 before the decline in power prices in December 2013-January 2014. If that is not the case then our €45/MWh achieved price (blended across Belgium, Holland, France and Germany) assumption for 2014 and €42.5/MWh for 2015 could prove optimistic.

The dilemma

What the only-small changes in our earnings forecasts mask is the growing dilemma that GDFSuez finds itself in.

If GDFSuez is to pursue its strategy of internationalisation, increased exposure in emerging markets and to its growth businesses of gas and efficiency, it will have to start stepping up its investments again from 2017 onwards, on our estimates.

However, the type of projects that are relevant for these businesses tend to be larger, more complicated, in partnerships and with generally large budgets. As a result the investment period could be lengthy and the earnings contribution much further in the future and therefore, in the mind of shareholders at least, of higher uncertainty.

Increased capex would also mean increase in depreciation, with the market already underestimating in our opinion the depreciation headwind coming from the E&P business.

As a result although stepping up investments above the current envelope, which is already reflected in consensus estimates, will be helpful to earnings in the back end of the decade – all else equal – it could well put downward pressure to near-term earnings or best case leave the earnings profile flat for the medium term. So although the earnings multiple that investors will be willing to apply could rise to reflect the growth potential, the earnings on which it is applied on could be lower. Furthermore, uncertainty over whether these new investments will indeed generate the appropriate returns could cap the re-rating of the PE multiple.

On the other hand, GDFSuez has the option to continue to just reap the benefits of the very successful strategic and financial decisions made over the last 7-8 years in the form of growing free cash flow used to support a superior dividend yield to

peers. In such a scenario, letting the business age somewhat and the balance sheet to degear, i.e. lower ongoing depreciation and financial expenses, would be accretive to medium-term earnings but would result in a lower applied PE multiple due to lower longer term growth potential.

Matters are complicated further by the fact that GDFSuez owns a ~36% stake in Suez Environnement, which at today's prices is worth c.€2.4bn. Although at the time of the expiry of the control agreement (July 2013) management stated that it plans to remain a reference shareholder in Suez Environnement over the longer term, a timeframe was not specified and the growth in the size of the energy part of the business causes the financial stake in Suez Environnement to appear less and less relevant to GDF Suez's portfolio. So decisions over capital structure, dividend level and capex also need to take into consideration potential monetisation of that stake, either directly or perhaps, for example, through a convertible.

Finally, the French government is GDFSuez's largest shareholder and therefore any dividend decisions would also need to take into consideration implications for the state budget.

Figure 4. FCF generation pre disposals to remain negative even with DPS reduction to €1.0 and 70-75% payout thereafter (€m?)

	2015E	2016E	2017E	2018E	2019E	2020E
Cash Flow from Operations post tax and Working Capital	10,982	10,729	10,684	10,964	10,909	10,854
Interest Expense	(1,447)	(1,414)	(1,384)	(1,377)	(1,369)	(1,362)
Identified capex	(7,273)	(7,132)	(7,162)	(7,008)	(5,729)	(4,513)
Free Cash Flow pre unidentified growth capex	2,261	2,183	2,138	2,579	3,810	4,980
Dividends incl. to minorities	(3,400)	(3,560)	(3,790)	(4,031)	(4,291)	(4,555)
Cash generation /(debt reduction)	(1,138)	(1,377)	(1,652)	(1,452)	(481)	425
FCF coverage of dividends (incl. to minorities)	-66.5%	-61.3%	-56.4%	-64.0%	-88.8%	-109.3%

Source: Citi Research

We therefore see growth vs value as a dilemma inherent within GDF Suez's business model. The uncertainty prevailing in the Global energy space, the most crucial of which we identified in our cross-sector report *Energy Darwinism - The evolution of the energy industry*, means that in our view 2014 is not the year that such a dilemma, even if successfully addressed, can lead to material re-rating of the shares.

The solution

We see no reason for GDFSuez's management to cut the dividend from the current €1.5 per share without an associated increase in the investment plan. Our reasoning is as follows:

GDFSuez has one of the strongest standalone credit ratings in the industry and one of the lowest costs of financing. Therefore we don't believe cutting the dividend to shore up the balance sheet is necessary on a 2-3 year view. Particularly so when the industry-wide popular instrument of hybrid bonds remains available at attractive prices as seen from recent examples.

On the one side, the current dividend policy implies an earnings payout ratio of more than 100% for the coming years. Furthermore it yields a c.€2.5bn negative FCF for the group after all capex and before any proceeds from disposals. However management is determined to continue rotating the portfolio, looking at ~€2bn of annualised disposals of mature or underperforming assets. Delivery on that front

would leave the group on a path of flat debt against a modestly growing EBITDA and therefore net debt/EBITDA would be declining even further.

On the other side, we estimate cutting the dividend to what the market would consider a more sustainable level of €1/share, i.e. ~70% earnings payout, would still leave the group c.€1bn FCF negative each year before disposals but €1bn FCF positive post disposals, leading to even more aggressive degearing.

Without another available use for the freed up cash, a dividend cut would then have to be linked with an equivalent increase in the capex programme, in our view.

We believe such an announcement could disappoint the market, which on a "trough earnings" scenario has grown more comfortable with the prospect of a one-off dividend cut and the resulting increase in cash flow, as we understand from our discussions with investors.

Instead, an increase in the capex programme as we've described could lead to depression in near-term earnings as well as higher risk associated with the longer term earnings. Furthermore, moving from a fixed dividend policy to a payout policy might not resolve the market's fixation with GDFSuez's dividend as any further earnings pressure would likely once again raise questions about a possible dividend reduction in the future.

We have factored in our numbers a dividend cut as of this year to €1/share without an associated increase in capex as we do not know yet in which projects management would choose to re-invest the freed up capital. We nevertheless see a substantial probability that management delays the dividend cut to 2015/16, i.e. closer to the time that ramp up in capex is anyway required and when the regulatory and commodity outlook should have improved and become more predictable.

A clear signal on the dividend policy beyond 2015, e.g. moving to a stated payout ratio, whilst maintaining the DPS unchanged at €1.5 until then, is our preferred solution. This way, investors continue to be remunerated for their patience over the last decade when substantial investments were being made by the group and as they are coming onstream now. This way also by the time the dividend is lowered (as our 2016 EPS is flat vs 2013 but the group is unlikely to employ a >100% payout policy, dividend would have to be lowered under such a scenario) investors will have greater visibility into what level of returns and earnings contribution they can expect from the new investments.

Valuation

We lower our price target back down to €18 per share from €19, as lower valuation in the European generation and supply business more than offsets an increased valuation for the international generation business.

Although relative to peers at 13% expected total return to our new price target is attractive, in a market context it is not outright compelling.

We therefore maintain our preference for GDFSuez over direct peers such as EON (EONGn.DE; €13.10; 3), RWE (RWEG.DE; €25.53; 3) and EDF (EDF.PA; €25.16; 2) but see more value in the Southern European vertically integrated names, and in the context of a balanced to cautious view on the sector as we present it in our outlook report today European Utilities - Risk Remains but Opportunities are Rising we maintain our Neutral rating on the stock.

Figure 5. GDFSuez – SOP price target lowered to €18 per share from €19 per share

Division	Enterprise Value	Method	2014 EV/EBITDA
Energy France	7,925	DCF	6.2x
International Generation	27,682	Tractebel Energia at our TP, rest on 8x 2015E EV/EBITDA	6.5x
Europe generation excl. France	7,529	DCF @ 7.0% WACC	5.3x
Global Gas & LNG	7,824	Reserves valuation	3.7x
Infrastructures	24,857	RAB multiples	7.8x
Energy Services	7,937	at 7x 2014 EV/EBITDA	7.0x
Core Enterprise Value	83,754		6.7x
Financial assets / Equity Assets	15,644	Book value & market value estimates incl. Suez Environnement stake	
Group Enterprise Value	99,398		7.9x
Net debt	29,199	2014 year-end incl. hybrids	
Provisions	16,291	2014 year-end	
Minorities	9,488	at fair value	
Total EV adjustments	54,978		
GDFSuez target equity value	44,420		
per share	18.0		

Source: Citi Research

GDF Suez

Company description

GDF Suez is a utility with global presence in: electricity generation and supply, gas supply, oil and gas E&P, LNG, transmission and distribution, energy services and environment. It was created in July 2008 from the merger of Suez and GDF.

Investment strategy

We rate GDF Suez Neutral as, although we find the balanced mix of defensiveness and growth attractive vs peers, we consider the stock fairly valued in absolute terms. We see headwinds to its earnings growth profile mitigated in the equity story through a strong and sustainable through cash flow dividend. We estimate the stock trades at a premium to the sector, which we believe is justified by its asset and geographical mix but it has little room for further re-rating, in our view.

Valuation

We use a combination of DCF and multiples (premium to RAB, ROCE-WACC, EV/EBITDA, capacity) to derive our SOP, which gives us a target price of €19 per share. We value Europe Generation using a DCF with a 6.2% WACC. We also value Energy France using DCF. We value International Generation on 8x 2015e EV/EBITDA, except for Tractebel Energia, which we value at our target price for that stock. Within Global Gas & LNG, we value E&P on $5/bbl of 2015e reserves, and the remaining business on 2013e EV/EBIT multiples of 5-6x. Within Infrastructures, we use RAB-based valuations for the Transmission and Distribution businesses, and value LNG terminals at 7x 2014e EV/EBITDA.Finally, we value Energy Services at 7x 2014e EV/EBITDA.

Risks

We identify these risks to our thesis and achievement of our target price: 1) government intervention - the French government owns a 35% stake in the company and has influence over key regulatory decisions, most notably the gas supply tariffs, 2) balance sheet utilisation - although the company has a visible project pipeline, its strong cash flow generation, relative to its peers, might tempt management to larger scale transactions, 3) commodities - although the company guidance is based on reasonable commodity assumptions, if the oil/gas and electricity prices carry on declining, we could see further derating of utilities like GDF Suez

E.ON AG

(EONGn.DE; €13.12; 3)

Valuation

We use a sum-of-parts method to derive our target price of €11.5, applying a variety of valuation techniques to the various divisions. We rely chiefly on a mix of DCF valuations, regulatory asset basis and EV/EBIT(DA) multiples. Pension provisions are deducted at book value and the majority of the book value of "other" provisions is also subtracted. Equity assets, minorities and financial assets are included at market value.

Risks

Risks that may affect the achievement of our target price include a rise in power and gas prices and/or execution of the disposal / re-investment program at more attractive multiples than we price in. Downside risks include regulatory and political developments in energy policy, no resolution in the midstream gas contracts issues and / or further pressure on clean dark spreads.

RWE AG

(RWEG.DE; €25.60; 3)

Valuation

We use a sum-of-parts method to derive our target price of €22.5, applying a variety of valuation techniques to the various divisions. We rely chiefly on a mix of DCF valuations, regulatory asset basis and EV/EBIT(DA) multiples. Pension provisions are deducted at book value and the majority of the book value of "other" provisions is also subtracted. Equity assets, minorities and financial assets are included at market value. Our price target is consistent with our group "run-for-cash" DCF at 6.1% WACC

Risks

Any re-rating of the market or the sector could lead the share price to exceed our target price. Other risks that may affect the achievement of our target price include a rise in power and gas prices and/or removal of the nuclear taxes, while downside risks also include regulatory and political developments in energy policy.

Electricite de France

(EDF.PA; €25.16; 2)

Valuation

We set our EDF target price at €24.55. We value the T&D French business on a 4% premium to RAB and use DCF to value the generation and supply business in France. We assume that by 2015E EDF will achieve ~€44/MWh for the output regulated by the government. For the remaining business, which represents 35% of group EBITDA, we use a mixture of DCF, earnings multiples, book value and RAB valuations. Our target price incorporates €2.5/share for a 10-year life extension across 50% of the company's French nuclear fleet. We also assume full recovery in an NPV-neutral manner of the CSPE deficit as of 2013. The group WACC we use is 5.7%.

Risks

The biggest risk to the equity story is the regulatory situation, as it is driven by the government, but also cost of finance given the absolute size of the debt. Government overhang is also of concern, albeit much smaller.

If the impact on the company from any of these factors proves to be greater or less than we anticipate, the stock will either likely have difficulty achieving our target prices or materially outperform our target price.

Appendix A-1

Analyst Certification

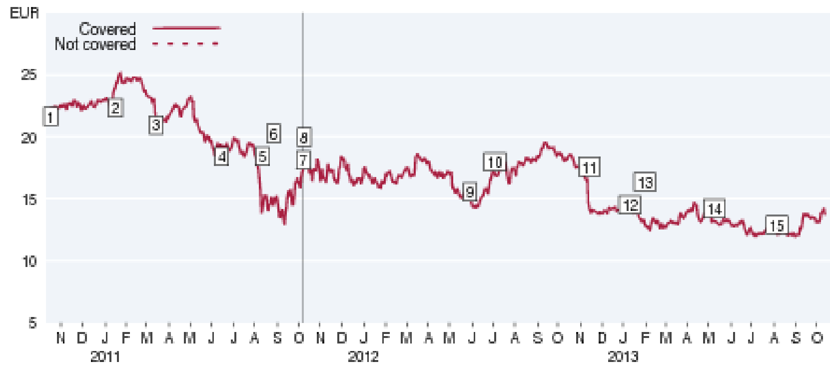
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

E.ON AG (EONGn.DE)

Ratings and Target Price History
Fundamental Research

Analyst: Sofia Savvantidou



	Date	Rating	Target Price	Closing Price
1	13-Oct-10	*3H	*19.00	21.63
2	17-Jan-11	3H	*20.00	23.97
3	15-Mar-11	3H	*19.00	21.25
4	15-Jun-11	*2H	19.00	19.13
5	11-Aug-11	2H	*15.50	14.13
6	26-Aug-11	2H	*16.00	14.43
7	7-Oct-11	Stock rating system changed		
8	8-Oct-11	*2	16.00	17.40
9	30-May-12	2	*14.50	14.92
10	4-Jul-12	*3	*15.00	16.92
11	14-Nov-12	3	*13.50	14.19
12	10-Jan-13	3	*12.00	14.35
13	31-Jan-13	3	*11.50	12.81
14	9-May-13	3	*12.00	13.18
15	6-Aug-13	3	*11.50	12.07

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

E.ON AG (EONGn.DE)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Sofia Savvantidou

	Date	Rating	Target Price	Closing Price
1	17-Jul-12	*ADD LP	-	17.82
2	2-Nov-12	*REM LP	-	17.55
3	2-Nov-12	*ADD LP	-	17.55
4	19-Nov-12	*REM LP	-	14.10
5	1-Nov-13	*ADD LP	-	13.40

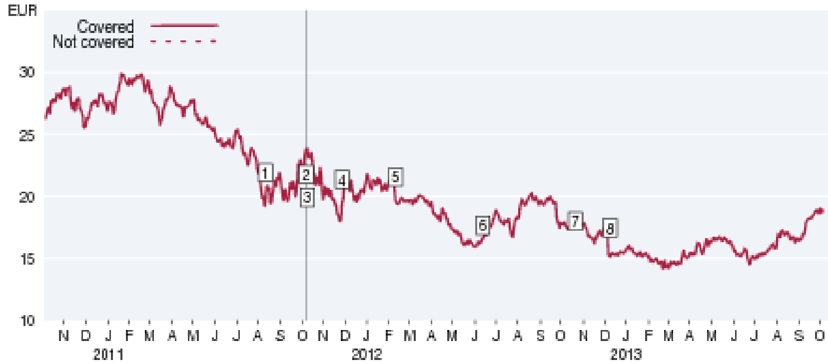
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

GDF Suez (GSZ.PA)

Ratings and Target Price History
Fundamental Research

Analyst: Sofia Savvantidou



	Date	Rating	Target Price	Closing Price
1	11-Aug-11	1M	*29.00	19.63
2	7-Oct-11	Stock rating system changed		
3	8-Oct-11	*1	29.00	23.81
4	28-Nov-11	1	*26.00	19.53
5	10-Feb-12	1	*25.00	19.55
6	13-Jun-12	1	*22.50	16.62
7	22-Oct-12	1	*22.00	17.82
8	10-Dec-12	1	*18.00	15.10

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

GDF Suez (GSZ.PA)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Sofia Savvantidou

	Date	Rating	Target Price	Closing Price
1	12-Aug-11	*ADD MP	-	20.76
2	11-Nov-11	*REM MP	-	20.50
3	17-Jul-12	*ADD MP	-	17.94
4	2-Nov-12	*REM MP	-	17.82
5	2-Nov-12	*ADD MP	-	17.82
6	6-Feb-13	*REM MP	-	14.78
7	25-Sep-13	*ADD MP	-	18.69
8	8-Oct-13	*REM MP	-	18.90

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Electricite de France (EDF.PA)

Ratings and Target Price History
Fundamental Research

Analyst: Sofia Savvantidou

	Date	Rating	Target Price	Closing Price
1	13-Dec-10	2H	*33.00	31.83
2	15-Mar-11	2H	*32.00	28.56
3	5-Apr-11	2H	*31.00	28.45
4	29-Sep-11	2H	*22.00	22.14
5	7-Oct-11	Stock rating system changed		
6	8-Oct-11	*2	22.00	22.23
7	1-Feb-12	2	*19.00	18.14
8	17-Feb-12	2	*20.00	18.89
9	12-Jul-12	2	*19.00	16.74
10	6-Nov-12	2	*17.50	16.25
11	13-Nov-12	2	*16.50	15.23
12	6-Feb-13	2	*15.00	13.78
13	1-May-13	2	*16.00	16.97
14	15-Jul-13	2	*20.00	19.81

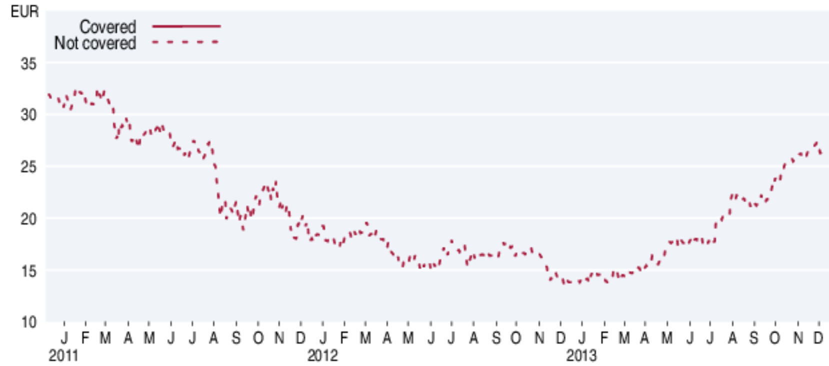
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Electricite de France (EDF.PA)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Sofia Savvantidou



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

RWE AG (RWEG.DE)

Ratings and Target Price History
Fundamental Research

Analyst: Sofia Savvantidou

	Date	Rating	Target Price	Closing Price
1	13-Oct-10	*3H	*43.00	48.58
2	17-Jan-11	3H	*44.00	53.69
3	28-Feb-11	3H	*41.00	48.24
4	15-Mar-11	3H	*39.00	44.00
5	15-Jun-11	3H	*33.00	37.91
6	11-Aug-11	3H	*23.50	26.22
7	26-Aug-11	3H	*25.00	24.66
8	7-Oct-11	Stock rating system changed		
9	8-Oct-11	*3	25.00	29.74
10	7-Mar-12	3	*28.00	35.05
11	30-May-12	3	*27.00	29.49
12	1-Mar-13	*2	27.00	28.64
13	6-Mar-13	2	*29.00	28.48
14	16-May-13	2	*28.00	27.27
15	6-Aug-13	2	*22.50	20.84
16	12-Sep-13	*3	22.50	25.89

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

RWE AG (RWEG.DE)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Sofia Savvantidou

	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD LP	-	53.47
2	17-Jul-12	*REM LP	-	34.07
3	19-Nov-12	*ADD LP	-	32.01
4	6-Feb-13	*REM LP	-	26.99
5	25-Sep-13	*ADD LP	-	25.05
6	1-Nov-13	*REM LP	-	26.96

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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	12 Month Rating			*Relative Rating*		
Data current as of 31 Dec 2013	Buy	Hold	Sell	Buy	Hold	Sell
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