

ENGIE EPS (DJSTOXX:EPS PA)

BUY

Share Price (as at close: 14/03/2019)	€11.3
Target Price	€15.5 (from €17.0)
Upside to TP	37.9%

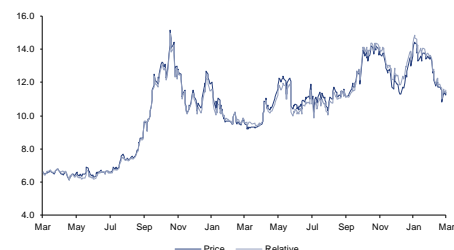
Market Cap (€'m)	143.6
Net Debt (€'m)	3.1
Enterprise Value (€'m)	146.8

Shares in Issue (m)	12.8
Free Float (%)	27.7%
Average Daily Volume (000, -3m)	9.0

12 month high/low 14.45 c/9.1976 c

(%)	1m	3m	12m
Absolute	-14.6	-1.3	+19.1
FTA relative	-15.3	-8.7	+17.0

Price & price relative (-2 year)



Source: Datastream

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Transition and refocusing

ENGIE EPS faces a transition year in 2019 as it refocuses towards technology delivery and makes more use of ENGIE Solar for project development. This plays to its strengths in our view but there will be slower growth during the transition and we reduce our forecasts to reflect this and a shorter term adjustment for the impact of outsourced EPC costs. This is partly offset in our cashflow forecasts from better payment terms and the overall impact is to trim our valuation to €15.5 from €17. With potential upside as the transition is executed we reiterate our BUY recommendation.

Revenue up but outsourcing costs weigh on profit

ENGIE EPS reported full year results with revenue ahead of expectations but EBITDA hit by the costs of outsourcing EPC costs in the final quarter. Revenue grew 57% to €15.5m, ahead of our €14.9m forecast. This was despite the externally driven delay in completion at the Cormoros project as already signalled. EBITDA loss widened to -€4.6m from -€1.7m in FY 2017, below our forecast of -€2.2m. This was due to a significant cost burden of €2.6m incurred in Q4 from outsourcing EPC on projects. ENGIE EPS is working with its partner ENGIE to move to a relationship where a large proportion of these costs can be undertaken by ENGIE Solar at a sensible level.

Focus on technology

While the project backlog at €52.4m has now more than doubled since March 2018, the company used Friday's conference call to reign back expectations on the €100m medium term sales target suggesting that hitting it in 2020 is now less likely. This is largely driven by a shift in focus as the company seeks to benefit more from its relationship with ENGIE. It hopes to de-emphasise a full project development offering to concentrate on being a technology provider, leaving development to its larger partner. ENGIE projects now represents 67% of the backlog and 79% of the pipeline. With solar plus storage projects growing as a source of demand, the shift in focus should see ENGIE EPS exposed to more business even if its share of that business is somewhat reduced.

Working capital benefit from partnership

While the refocusing and changed revenue expectations are in our view the right approach to maximising the value of the ENGIE partnership in the long run they do impact earnings in the short term. However cashflow is already benefiting from the ENGIE relationship and the company saw improvements in debtor days resulting in a €4m working capital inflow in the year. We expect debtor days to remain at this level or improve going forward resulting in an improved working capital position in our forecasts.

Year end December	Revenue (€'m)	EBIT (€'m)	PBT (€'m)	Tax (%)	EPS (FD) (c)	PER EV/EBITDA (x)	Div Yield (x)	Div Yield (%)
2016A	7.1	-6.8	-6.9	0.6	-87.6	-12.8	-24.7	0.0
2017A	9.9	-6.0	-6.7	12.1	-72.6	-15.5	-29.3	0.0
2018A	15.7	-9.0	-9.7	0.8	-91.2	-12.3	-18.9	0.0
2019E	39.9	-6.5	-6.6	0.0	-51.5	-21.8	-49.8	0.0
2020E	70.0	8.9	8.7	25.0	50.8	22.1	10.4	0.0
2021E	91.9	14.4	14.2	25.0	83.5	13.5	7.1	0.0

Source: Company data, CFE Research estimates

Figures exclude exceptional items

Forecast and valuation changes

We have assumed that the EPC outsourcing charge in FY 2018 was split out at 79% of the R&D and industrial operations figure. We then assume that this cost in H1 2019 is twice that level based on the assumption that most of the 18 number was for Q4. For H2 2019 and beyond we have assumed that EPC costs will be 10% of CoGS in line with international norms for microgrid projects. We have also scaled back overall sales volume assumptions so that the company's €100m target is not hit until 2022, although we assume that the company shoots through it in that year. We have also forecast working capital based on the FY 2018 stockturn, debtor and creditor day ratios. For FY 2019 revenue reduces to €40m from €83m and EBITDA to -€2.7m from €18.5m. FY 2020 sees revenue drop to €70m from €105m and EBITDA to €13.3m from €31.5m. We continue to see the company beating €100m of revenue but this now happens in FY 2022 in our model when we see the company hitting €134m.

We value the company using a DCF model with a WACC of 12%. The reduced EBITDA forecasts are partly offset by less onerous working capital assumptions so that our valuation falls to €15.5 from €17. The key risks to our valuation are failure to gain traction in target markets, competitor response and minority disenfranchisement.

Financial model

Income Statement

Year end December	2016A	2017A	2018A	2019E	2020E	2021E
Goods	6.7	9.5	15.3	39.5	69.5	91.4
Services	0.4	0.4	0.4	0.4	0.4	0.4
Other	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0
Group revenue	7.1	9.9	15.7	39.9	70.0	91.9
Goods	1.4	-3.4	4.3	13.3	27.2	35.8
Services	0.4	0.4	0.4	0.4	0.4	0.4
Grants and other income	0.2	0.0	0.0	0.0	0.0	0.0
Other	-8.8	-3.0	-13.7	-20.3	-18.7	-21.7
Adjusted operating profit	-6.8	-6.0	-9.0	-6.5	8.9	14.4
Associates and other income	0.0	0.0	0.0	0.0	0.0	0.0
Adjusted EBIT	-6.8	-6.0	-9.0	-6.5	8.9	14.4
Finance Costs	0.0	-0.7	-0.7	-0.1	-0.3	-0.2
Adjusted PBT	-6.9	-6.7	-9.7	-6.6	8.7	14.2
Exceptional items	-1.7	-3.1	0.9	0.0	0.0	0.0
Reported PBT	-8.5	-9.8	-8.8	-6.6	8.7	14.2
Reported tax	0.0	0.8	0.1	0.0	-2.2	-3.6
Adjusted tax rate	0.6%	12.1%	0.8%	0.0%	25.0%	25.0%
Reported PAT	-8.6	-9.0	-8.7	-6.6	6.5	10.7
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Discontinued businesses	0.0	0.0	0.0	0.0	0.0	0.0
Earnings attributable to shareholders	-8.6	-9.0	-8.7	-6.6	6.5	10.7
Shares in issue (m)	7.9	8.2	12.8	12.8	12.8	12.8
Average weighted capital (FD) (m)	7.9	8.2	10.5	12.8	12.8	12.8
Adjusted EPS (FD) (c)	-87.6	-72.6	-91.2	-51.5	50.8	83.5
Reported EPS (FD) (c)	-108.6	-110.5	-83.0	-51.5	50.8	83.5
DPS (payable) (c)	0.00	0.00	0.00	0.00	0.00	0.00

Source: Company data, CFE Research estimates

Performance Metrics

Year end December	2016A	2017A	2018A	2019E	2020E	2021E
Revenue growth (%)	n.a.	39.7	58.2	154.5	75.5	31.3
Adjusted EBITDA growth (%)	n.a.	n.a.	n.a.	n.a.	n.a.	46.8
Adjusted EBIT growth (%)	n.a.	n.a.	n.a.	n.a.	n.a.	62.2
Adjusted PBT growth (%)	n.a.	n.a.	n.a.	n.a.	n.a.	64.3
Adjusted EPS growth (%)	n.a.	n.a.	n.a.	n.a.	n.a.	64.3
DPS payable growth (%)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Dividend cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Adjusted EBITDA margin (%)	-79.0	-47.7	-46.7	-7.0	19.0	21.3
Adjusted EBIT margin (%)	-96.2	-60.6	-57.4	-16.3	12.7	15.7
Interest cover (x)	150.7	8.0	13.0	98.1	34.8	63.4
Net cash/(debt)/adjusted EBITDA (x)	0.2	2.6	-0.9	1.1	-0.2	0.3
Net cash/(debt)/equity (%)	-19.6	-850.3	39.4	-29.3	-12.4	22.2
Net working capital/revenue (%)	13.7	75.2	34.7	29.5	29.7	29.8
Operating cashflow conversion (%)	63.4	159.9	82.4	139.5	47.7	89.5
Return on assets employed (%)	-104.2	-41.5	-61.0	-36.0	37.8	55.7
Return on equity (%)	-126.2	-408.8	-55.5	-61.4	37.7	38.3

Source: Company data, CFE Research estimates

Cashflow Statement (€'m)

Year end December	2016A	2017A	2018A	2019E	2020E	2021E
Operating profit	-6.8	-6.0	-9.0	-6.5	8.9	14.4
Depreciation and amortisation	1.2	1.3	1.7	3.7	4.4	5.1
Other non-cash movements	0.2	0.2	-4.1	0.0	0.0	0.0
Change in working capital	1.1	-5.1	4.0	-6.3	-9.1	-6.6
Other cash movements	0.0	0.0	0.0	0.0	0.0	0.0
Operating cashflow	-4.3	-9.6	-7.4	-9.1	4.2	12.9
Taxation paid	0.0	0.0	0.0	0.0	-2.2	-3.6
Finance costs	0.0	0.0	0.0	-0.1	-0.3	-0.2
Investment income	0.0	0.0	0.0	0.0	0.0	0.0
Capitalised intangibles	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditure (net)	-0.3	-0.1	-0.8	-0.8	-0.8	-0.8
Free cashflow	-4.7	-9.7	-8.2	-10.0	1.0	8.3
Other investing activities	0.0	0.0	0.0	0.0	0.0	0.0
Acquisitions/disposals (net)	-5.0	-2.6	-3.1	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0
Shares issued/(repurchased)	1.4	0.0	30.3	0.0	0.0	0.0
Other financial	-1.4	1.1	0.2	0.0	0.0	0.0
Movement in net cash/(debt)	-9.6	-11.3	19.1	-10.0	1.0	8.3
Net cash/(debt) b/fwd	8.6	-1.1	-12.3	6.8	-3.1	-2.1
Movement in net cash/(debt)	-9.6	-11.3	19.1	-10.0	1.0	8.3
Net cash/(debt) c/fwd	-1.1	-12.3	6.8	-3.1	-2.1	6.2

Source: Company data, CFE Research estimates

Balance Sheet (€'m)

Year end December	2016A	2017A	2018A	2019E	2020E	2021E
Goodwill	0.0	0.0	0.0	0.0	0.0	0.0
Intangible fixed assets	4.8	6.3	8.0	8.0	8.0	8.0
Tangible fixed assets	0.8	0.8	1.3	-1.6	-5.2	-9.5
Net working capital	1.0	7.4	5.4	11.7	20.8	27.4
Assets employed	6.5	14.5	14.7	18.1	23.6	25.9
Other assets/(liabilities)	0.0	0.0	0.0	0.0	0.0	0.0
Net cash/(debt)	-1.1	-12.3	6.8	-3.1	-2.1	6.2
Pension deficit	0.0	0.0	0.0	0.0	0.0	0.0
Deferred tax	0.0	0.0	0.0	0.0	0.0	0.0
Provisions	0.0	-0.7	-4.2	-4.2	-4.2	-4.2
Net assets	5.5	1.4	17.3	10.7	17.2	27.9
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0
Shareholders funds	5.5	1.4	17.3	10.7	17.2	27.9

Source: Company data, CFE Research estimates

Valuation Metrics

Year end December	2016A	2017A	2018A	2019E	2020E	2021E
EV / Revenue (x)	19.5	14.0	8.8	3.5	2.0	1.5
EV / Adjusted EBITDA (x)	-24.7	-29.3	-18.9	-49.8	10.4	7.1
EV / Adjusted EBIT (x)	-20.3	-23.0	-15.4	-21.2	15.5	9.6
PER (x)	-12.8	-15.5	-12.3	-21.8	22.1	13.5
Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0
FCF yield (%)	-3.5	-7.2	-6.1	-7.4	0.7	6.2
NAV/Share (c)	69.4	17.8	135.5	84.0	134.8	218.3

Source: Company data, CFE Research estimates

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ENGIE SA (ENGI SA)	None

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Company Name	Previous recommendation	Date of change of recommendation
Electro Power Systems (EPS FP)	BUY from HOLD	21/08/2018

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