GDF Suez (GSZ.PA)

Rating	(from Outperform) **NEUTRAL***
Price (06 Jul 09, Eu)	26.08
Target Price (Eu)	(from 41.00) 31.00[1]
Market cap. (Eu m)	58,904.52
Enterprise value (Eu m)	95,978.6

**Stock ratings are relative to the coverage universe in each analyst's or each team's respective sector.*
[1]Target price is for 12 months.

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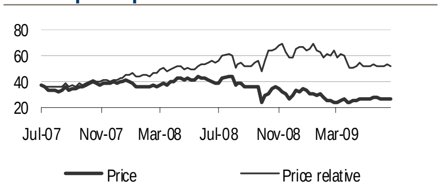
DOWNGRADE RATING

At a standstill

- **Downgrade GDF Suez to Neutral from Outperform due to lack of catalysts:** Despite the steep share price underperformance year-to-date and reasonably supportive valuation, we see neither earnings nor strategic drivers that could justify substantial outperformance going forward.
- **Earnings and strategy at a standstill:** Our analysis shows that higher oil prices do not necessarily mean higher profits, especially as long as power prices do not react—not an opinion shared by the market. In our view the French government's decisions on gas supply tariffs are far more important to earnings than the direction of oil prices. In fact, at the moment we think the company could be better off with falling oil prices, as recent tariff decisions in a falling oil price environment have allowed it to build up a tariff 'cushion', which we estimate at €1.3bn. On the strategic front, we would like clarity on regulation in France and Belgium, the use of the balance sheet and the Group overall; but none of this seems likely to happen any time soon.
- **Results the only key event to look forward to:** With no disposal programme under way, no investor day planned and no regulatory announcement due before year end, the 1H09 results on 27 August should focus investor attention. We see very little likelihood of management significantly increasing guidance or shareholder distribution then.
- **Valuation provides downside protection:** Within this report we are downgrading our earnings estimates and sum-of-the-parts valuation by more than 20%, on average. Our revised SOTP valuation stands at €31.4 per share (from €40.6), giving us a target price of €31, which still offers c20% potential upside to current share price levels. On multiples, the company trades at a 13% discount to the sector on 2010E EV/EBITDA but is broadly in line on P/E and dividend yield.

Share price performance



The price relative chart measures performance against the Europe Dow Jones Stoxx index which closed at 218.02 on 06/07/09
On 06/07/09 the spot exchange rate was Eu .72 /US$1

Performance Over	1M	3M	12M
Absolute (%)	-6.0	5.0	-33.0
Relative (%)	0.0	-2.6	-4.4

Financial and valuation metrics

Year	12/08A	12/09E	12/10E	12/11E
Revenue (Eu m)	83,053.0	82,608.7	82,095.3	85,736.9
EBITDA (Eu m)	13,886.00	14,345.12	15,270.05	16,773.48
Net Income (Eu m)	4,285.9	4,653.4	5,023.6	5,817.3
CS adj. EPS (Eu)	1.98	2.11	2.22	2.58
ROIC (%)	2.15	2.39	2.66	3.13
P/E (adj., x)	13.15	12.34	11.73	10.13
P/E rel. (%)	131.5	98.4	116.6	119.2
EV/EBITDA	6.8	6.7	6.4	5.8

Dividend (12/09E, Eu)	1.47	IC (12/09E, Eu m)	109,616.5
Dividend yield (%)	5.6	EV/IC	0.88
Net debt (12/09E, Eu m)	30,086.1	Current WACC	8.3
Net debt/equity (12/09E, %)	47.2	Free float (%)	50.8
BV/share (12/09E, Eu)	26.4	Number of shares (m)	2,259.04

Source: FTI, Company data, Datastream, Credit Suisse Securities (EUROPE) LTD. Estimates.

Executive summary: at a standstill

‘Fallen angel’

After a strong performance in 2008 when the GSZ shares outperformed the utility sector by 22% and the overall European market by 34%, the stock seems to have fallen from grace. Since the beginning of 2009, the shares have fallen 25%, underperforming the utility sector by 12% and the broader market by 23%.

With this report we are downgrading our rating to Neutral from Outperform, due to the lack of catalysts we see for the shares. Even after the substantial underperformance year-to-date, we see neither earnings nor strategic support that could justify substantial outperformance versus the utility sector in the near term. That said, the valuation is reasonably appealing on both absolute and relative terms, which should provide downside protection to the shares in our view.

Company at a standstill

In order to become substantially more positive about the company’s investment case, we would need one or more of the following things to happen: 1/ a strong signal from management that its €17bn 2011 EBITDA guidance is overly conservative in a rising oil price environment, disregarding French government intervention on gas tariffs; 2/ a move towards more regulatory clarity in France or Belgium; 3/ a clearer statement from management on how much balance sheet flexibility it thinks lies within the business and how it could be used; 4/ a better effort from the company to improve the group’s visibility to the market. None of these looks likely to transpire in the coming months in our view.

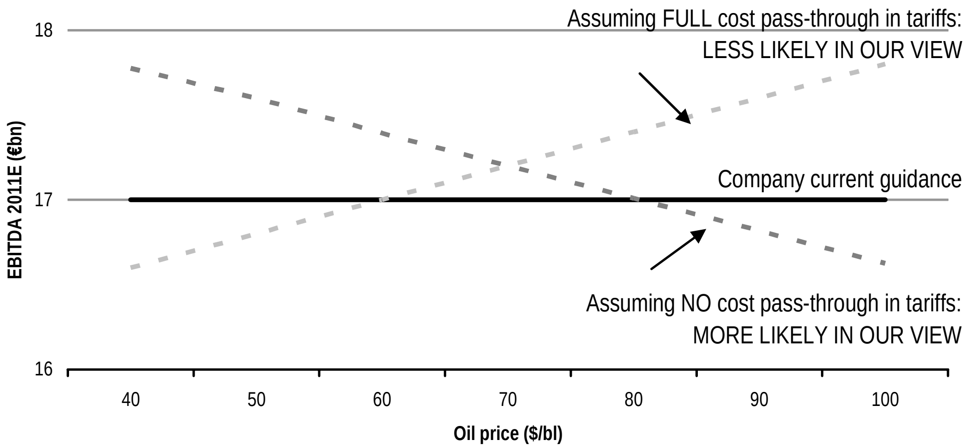
Earnings outlook: higher oil prices do not necessarily mean higher profits

After March 2009’s profit warning and in light of our own >20% earnings estimate downgrade in this report, we have looked at where GDF Suez’s earnings could go next. Our first conclusion is that the new €17bn 2011 EBITDA guidance looks reasonably reliable. Over the next three years, we would expect EBITDA growth to be driven mainly by cost-cutting and the contribution of growth investments (largely organic)—both factors which we view as highly reliable and within management’s control.

That said, we struggle to see very strong drivers for the group to bring its 2011 EBITDA substantially above €17bn. We certainly do not believe that higher oil prices will necessarily translate into higher earnings. GDF Suez’s earnings are perceived by investors as being highly geared to higher oil prices as a result of the company’s involvement in Exploration & Production. However our analysis suggests that the French government’s decisions on gas supply tariffs are far more important to earnings than the direction of oil prices.

In fact, at the moment we think the company could be better off in a falling oil price environment, as we think no cost pass-through is far more likely than full cost pass-through going forward. Our view is based on our calculation that recent tariff decisions have allowed the company to build up a €1.3bn ‘cushion’, which is likely to be used to offset future tariff increases.

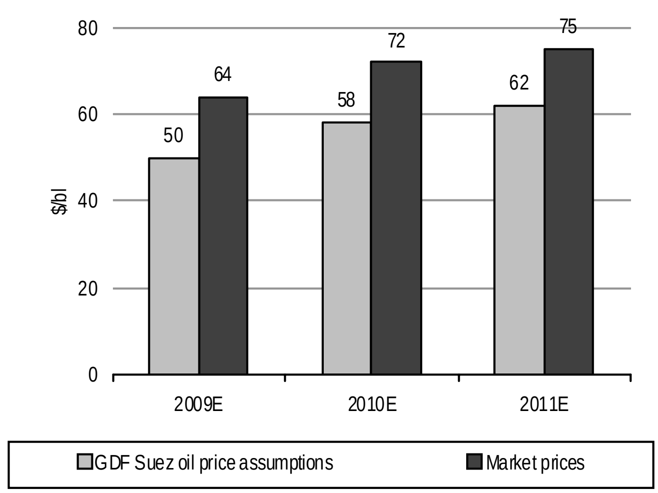
Figure 1: GDF Suez's EBITDA outlook appears highly dependent on tariffs



Source: Credit Suisse estimates

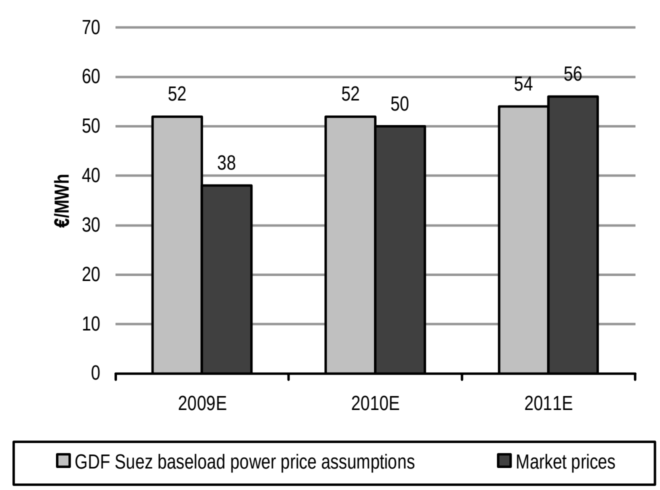
Our view would be different if higher oil prices also meant higher electricity prices. However, throughout the recent oil price rally electricity curves have hardly moved, supporting our sector view that demand does matter for power generation margins (see our report dated 8 April 2009: *Pan European Utilities: Demand Does Matter*, and *German Utilities: Mind the Gap,* dated 22 April 2009).

Figure 2: Oil prices in GSZ guidance vs forward market prices
US$/bl



Source: Company data, © 2008 Reuters Limited

Figure 3: Power prices in GSZ guidance vs forward market prices
€/MWh



Source: Company data, © 2008 Reuters Limited

Strategic value levers: little likelihood they will materialise any time soon

Apart from the outlook on earnings, we think there are three factors which could serve as positive catalysts for the shares: first, improved clarity on regulation in France and Belgium; second, clearer signals from management about the use of the company's balance sheet; and third, better visibility on the overall group financials. However, we do not think any of these is likely to materialise any time soon.

(1) On the regulatory front, the French government is unlikely to relinquish its control of gas tariffs in a rising commodity environment; and the Belgian government could well impose a second nuclear tax on Electrabel without re-opening the nuclear extension debate.

(2) On the balance sheet front, the company's flexibility has reduced substantially and the recent credit crisis suggests that management could take a while to come back to share buybacks and special dividends.

(3) On the visibility front, we think that the market needs at least another full financial (and non pro forma this time) year to get a good understanding of the company.

Valuation should provide downside protection

Within this report we are downgrading our earnings estimates and sum-of-the-parts valuation by more than 20%. Despite this, we think the valuation argument for GSZ is still reasonably appealing, both on an absolute and relative basis.

We have completely rebuilt our model to reflect the new group structure and the additional guidance and information provided for the different divisions. We have also taken a much more prudent approach on numerous assumptions. As a result, our SOTP valuation falls from €40.6 to €31.4 per share, which still represents 20% potential upside versus the current share price.

Figure 4: **GDF Suez summary sum-of-the-parts**

	Value (€m)	Value (€ps)	10E EBITDA	10E EV /EBITDA	Basis
Energy France	9,111	4.0	969	9.4x	DCF for gas supply, capacity multiples for power generation
Energy Benedelux	20,195	8.9	2,262	8.9x	DCF of power plants
Energy Europe	7,219	3.2	1,031	7.0x	7x 10E EV/EBITDA
Energy International	16,591	7.3	2,046	8.1x	Value per MW, market values for TA and Glow, multiples
Global Gas & LNG	13,904	6.2	2,769	5.0x	DCF for E&P and gas supply, 3x EV/EBITDA for trading & optimisation
Infrastructures	26,124	11.6	3,232	8.1x	RAB for D, T and R, new-built cost for storage
Energy Services	6,898	3.1	985	7.0x	7x 10E EV/EBITDA
Environment	12,546	5.6	2,186	5.7x	Market value of Suez Environnement (€12.7 per share)
Corporate centre	-1,467	-0.6	-210	7.0x	
ENTREPRISE VALUE PRE ASSOCIATES	**111,122**		15,270	7.3x	
Associates	5,562	2.5			Sector 10E P/E (11.4x)
Financial assets	6,961	3.1			08A book value
TOTAL GROUP EV	**123,645**				
Net debt, 2010E	-30,270				10E BV
Nuclear provisions	-6,997				10E BV
Pension provisions	-3,936				10E BV
Other provisions	-1,099				Discounted value of GDF deferred tax liability
Minorities	-10,315				SEVI at market value, other at sector 10E P/E (11.4x)
EQUITY VALUE	**71,028**	**31.4**			

Source: Credit Suisse estimates

On a relative basis, the shares are trading at a 13% discount to the utility sector on 2010E EV/EBITDA; while P/E and dividend yields are roughly at sector average. Were the shares to fall around €23 per share however, the P/E discount would get to double-digit territory and the dividend yield closer to 6.5% (more in line with German utilities), which is when we think the valuation could start looking like an attractive catalyst in itself.

Figure 5: **GDF Suez valuation multiples versus the utility sector**

	2009E	2010E	2011E
EV/EBITDA GSZ	6.7x	6.4x	5.8x
Vs the utility sector	-15%	-13%	-18%
PE GSZ	12.3	11.7	10.1
Vs the utility sector	0%	2%	1%
Dividend yield GSZ	5.6%	5.9%	6.0%
Vs the utility sector	1.0x	1.0x	1.0x

Source: Credit Suisse estimates

Earnings: reliable but limited upside

After the March 2009 profit warning and in light of our >20% earnings downgrade in this report, we have looked at where GDF Suez's earnings could go next. Our first conclusion is that management's new €17bn 2011 EBITDA guidance looks reliable, especially after the favourable tariff decisions made by the French government since January 2009 for the gas supply business, which on our estimates have allowed GSZ to build up a €1.3bn tariff 'cushion'. Our second conclusion, however, is that we struggle to see very strong drivers for the group to bring its 2011 guidance for EBITDA substantially above €17bn. Cost-cutting and growth investments are unlikely to bring much incremental growth over and above what is already known. More importantly, in our view the positive correlation of GDF Suez's earnings to higher oil prices is far less straightforward than the market thinks, as higher E&P profits can very quickly be wiped out by unfavourable government decisions on French gas supply tariffs. Rather counter-intuitively, we currently think the company would be better off in the short term in a falling oil price environment.

Four key profit drivers to 2011E

Throughout our modelling exercise, we have tried to identify the key profit drivers for the group between 2008 and 2011E. Despite the complexity of the group, four drivers dominate:

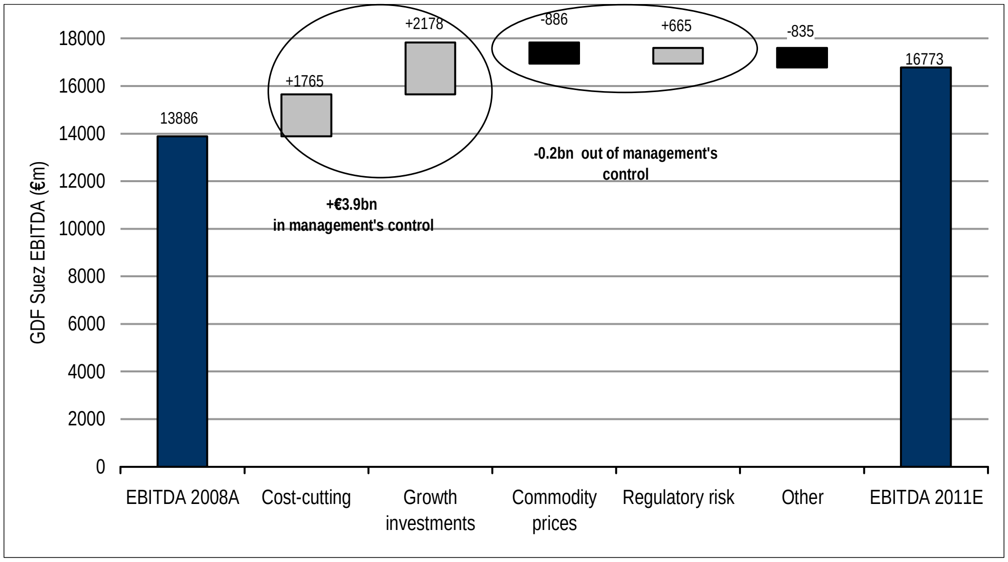
(1) **Cost-cutting**: through its *Efficio* programme, GDF Suez is targeting a c€1.8bn EBITDA uplift between 2008 and 2011, which we view as credible.

(2) **Growth investments**: Management is targeting a €30bn investment programme for the 2008–10 period, which on our estimates would bring in c€2.2bn of additional EBITDA by 2011.

(3) **Commodity prices**: The group profits are dependent upon variations in oil and electricity prices in particular, through its E&P and Energy Europe divisions: based on commodity assumptions that are roughly in line with company guidance, we assess this as having a negative EBITDA impact of c€0.9bn by 2011E.

(4) **Regulatory intervention**: Intervention by the French government on gas supply tariffs still represents a risk in our view, albeit more skewed to the upside in a falling commodity prices environment. We assume a positive c€0.7bn EBITDA impact for 2009E, bringing the business back to break even; and no movement thereafter.

Figure 6: GDF Suez: 2008A–11E EBITDA build-up
€ in millions unless otherwise stated



Source: Company data, Credit Suisse estimates

Cost-cutting and growth investments: high visibility, few incremental opportunities

On our forecasts, cost-cutting and growth investments (largely organic) should be the main drivers of profit growth over 2008–11E, bringing in €3.9bn of incremental EBITDA over the period. We think this additional profitability is very secure, as both factors are fully within management's control—the cost-cutting programme looks credible and most growth investments are identifiable and largely organic. That said, we very much doubt we will see substantial further upside above and beyond this number, as the cost-cutting programme was upgraded only recently and as management has been making conservative noises about delaying rather than accelerating growth projects.

Cost-cutting: €1.8bn looks credible; more is unlikely short-term

On the cost-cutting front, GDF Suez is targeting a €1.8bn positive EBITDA impact by 2011E (excluding implementation costs) through its *Efficio* efficiency programme. *Efficio* is the second efficiency programme since the merger of GDF and Suez was announced in February 2006. The initial synergies from the merger were assessed by management at €970m by 2013 in June 2006, and were only raised in November 2008 when *Efficio* was introduced. Before *Efficio*, we argued that the targets management had highlighted were extremely modest, especially if compared to the achievements of the German utilities (see our report dated 28 August 2008 *French Utilities—Initiating coverage of GDF Suez, Veolia, EDF*).

In this report we have updated our benchmarking analysis, taking into account *Efficio* on GDF Suez's side as well as the new cost-cutting initiatives announced by the German utilities (the *Perform to Win* programme at E.ON in particular). Overall, GDF Suez is still lagging behind its German peers, with total cost-cutting announced since 2000 amounting to 4.4% of 2008 operating costs, versus 6.4% at E.ON and 11.2% at RWE.

Figure 7: Benchmarking of cost-cutting programmes announced since 2000
€ in millions, unless otherwise stated

	GDF Suez	E.ON	RWE
Revenues (2008A)	83,053	86,753	47,500
Operating profit (2008A)	8,561	9,878	7,675
Operating costs (including D&A) (2008A)	74,492	76,875	39,825
Cost saving announced since 2000 (*)	3,308	4,900	4,450
as % of operating costs	**4.4%**	**6.4%**	**11.2%**

(*)For GDF Suez, we have taken the cost cutting initiatives announced by the stand-alone companies between 2000-2006 and by the combined entity thereafter

Source: Company data, Credit Suisse research

GDF reaching similar levels of cost-cutting to E.ON would imply a €1.3bn upgrade to *Efficio*. We do not, however, expect any announcement in the short term, as *Efficio* was announced relatively recently and the subject of cost-cutting is politically sensitive in France in the current difficult economic climate.

Growth investments: we already include the full programme in our forecasts

On the investment front, GDF Suez is targeting an ambitious investment programme of €30bn over the 2008–10 period, two-thirds of which is set to go to growth investments. Looking at the programme in more detail, the company has given target ranges for each division rather than a more precise number, giving a total range for the group of €28.2bn to €34.8bn. Given management's very cautious comments on balance sheet use since the beginning of 2009, we suspect its ambitions are now closer to the bottom than the top of this range.

Figure 8: GDF Suez 2008–10 investment programme
€ in billions, unless otherwise stated

	Investment target per annum		Investment target total	
	Minimum	Maximum	Minimum	Maximum
Energy France	1.0	1.5	3.0	4.5
Energy Europe and International	4.0	4.5	12.0	13.5
Global Gas & LNG	1.0	1.5	3.0	4.5
Infrastructures	1.5	2.0	4.5	6.0
Energy Services	0.4	0.6	1.2	1.8
Environment	1.5	1.5	4.5	4.5
Others	0.0	0.0	0.0	0.0
Total	9.4	11.6	28.2	34.8

Source: Company data, Credit Suisse research

The investment programme has been in place since 2007 and clarity improved substantially at the FY08 results in our view: while acquisitions were potentially in addition to the programme previously, they are now included (net of disposals). The positive implication, in our view, is that this substantially limits acquisition risk until the end of 2010E. The negative implication is that the potential EBITDA upside from further growth is very limited.

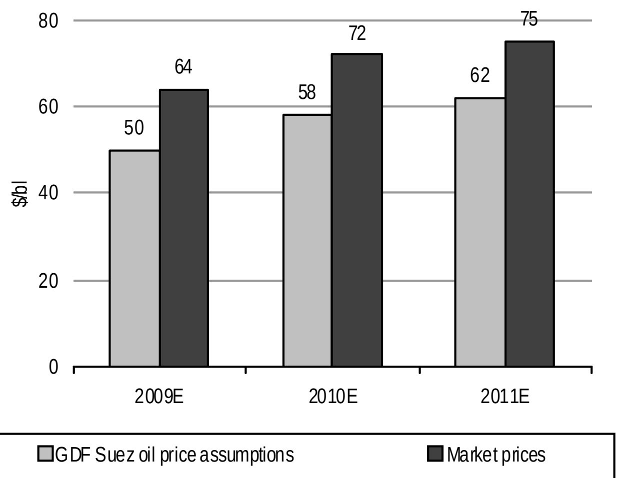
Over 2009E–11E, we estimate a c€2.2bn EBITDA boost from growth investments. Importantly, in our forecasts we have only included the investments we can identify, giving us a total investment spend over 2008–10E of €32.9bn gross or €28.7bn net of disposals (€3.6bn of disposals in 2008 and €0.6bn in 2009). This net amount is in line with the bottom of the investment range targeted by the company and c€6bn below the top of the range. Assuming that GSZ reaches the top of its targeted investment range and that a third of the investments we are currently excluding from our model come on stream by the end of 2011E (as apart from acquisitions, most projects have a >2 years lead time), a 10% pre-tax ROIC and 20-year life would imply €300m incremental change in EBITDA—a bit less than 2% potential upside versus the company's €17bn 2011 EBITDA target. This is not significant enough to be seen as a key earnings driver in our view.

Commodity prices and French gas tariffs: high volatility but offsetting effects

On our forecasts, the combined effect of commodity prices and government intervention on the French gas tariff translates into a net €0.2bn drag on EBITDA between 2008 and 2011E—very small versus the estimated effects of cost-cutting and growth investment. This amount does not, however, reflect the potential high volatility of both factors, which is what we have tried to assess in this section of the report.

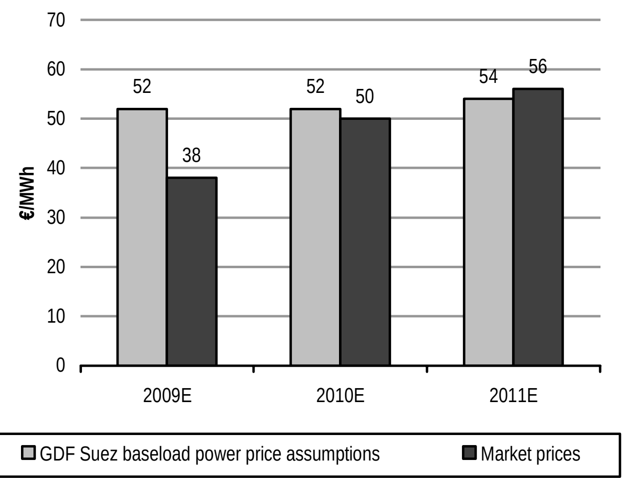
GDF Suez's guidance is based on an oil curve which is substantially below the current market. The company has indicated that every $1/bl change in the oil price moves EBITDA by €20m (c€0.06 EPS), which suggests that the company should benefit strongly from rising oil prices, mainly through its Exploration & Production division.

Figure 9: **O Oil prices in GSZ guidance vs forward market prices**
US$/bl



Source: Company data, © 2008 Reuters Limited

Figure 10: **Power prices in GSZ guidance vs forward market prices**
€/MWh



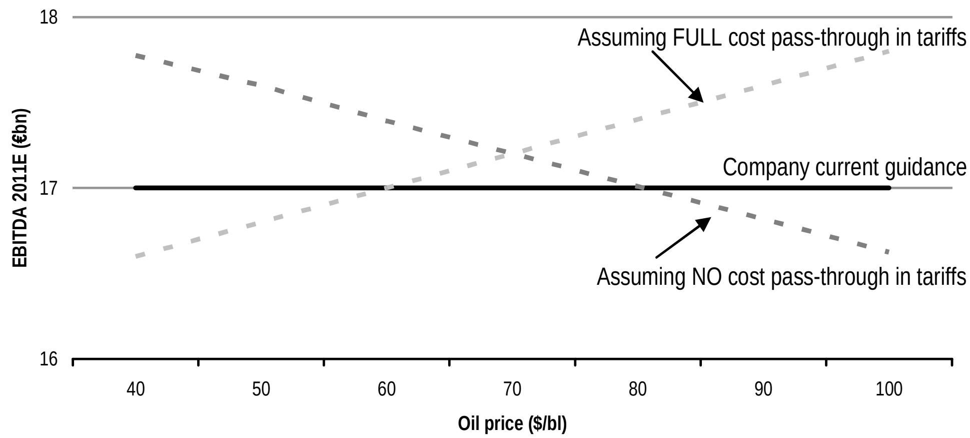
Source: Company data, © 2008 Reuters Limited

Our analysis suggests that the correlation of GDF Suez's earnings to oil prices is by no means as straightforward as it may seem, especially as long as electricity prices do not follow the rise in oil prices—and we think it unlikely that they will due to the effect of demand destruction on power generation margins (see our report dated 8 April 2009 *Pan European Utilities: Demand Does Matter*, and *German Utilities: Mind the Gap,* dated 22 April 2009).

In fact, we think that GDF Suez's profits would currently be much more positively geared to falling oil prices, for the short term at least. Favourable tariff decisions made by the French government since January 2009 have on our estimates enabled the company to build up a €1.3bn tariff 'cushion' in its French gas supply business, which should allow the government to keep gas tariffs flat in October. In a rising oil price environment, this cushion would very quickly disappear (we estimate at around $70/bl); while in a falling oil price environment, the company could probably retain at least some of it.

Disregarding the €1.3bn 'cushion', the correlation of GSZ's profits to oil prices is likely to remain blurred by French government intervention on gas supply tariffs, as shown in Figure 11. Since 2005, the government has consistently refused to pass on fully gas procurement costs to end customers, creating a substantial earnings deficit for the gas supply business. We think this would be very likely to continue in a rising oil price environment and could fully cancel out any rise in E&P profits. On the other hand, in a falling oil price environment the government would be likely to let gas supply margins expand, compensating for lower profits from the E&P division.

Figure 11: GDF Suez's EBITDA outlook is highly dependent on tariff decisions
€ in billions, unless otherwise stated

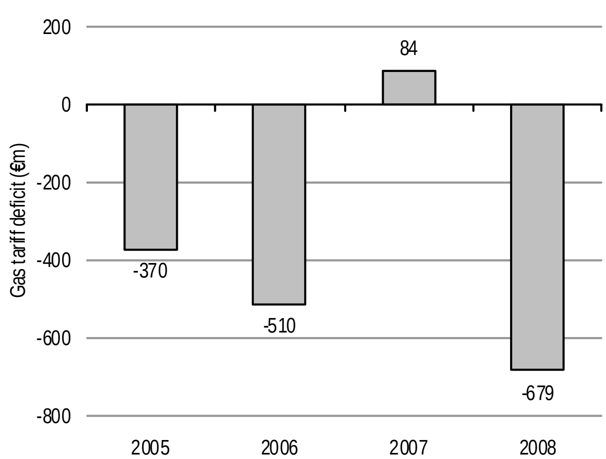


Source: Company data, Credit Suisse estimates

French gas tariffs: the big unknown but an estimated €1.3bn 'cushion' built up year-to-date

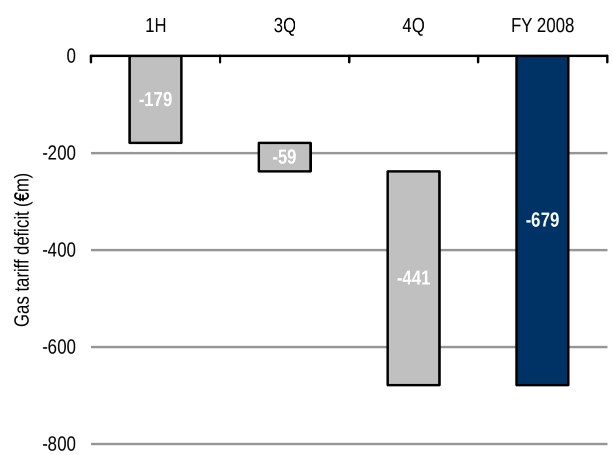
GDF Suez's regulated French supply business is generally perceived by investors as a source of substantial volatility and downside risk to the group's overall profitability. This negative perception of the regulated French gas supply business is understandable, in our view. Since Gaz de France's IPO in August 2005, investors have experienced steeply rising oil (and hence gas procurement) prices, which the French government has been unwilling to pass on fully to end customers. This has led to substantial negative impacts on GDF and then GDF Suez's account, cumulating in a €1.5bn earnings deficit over the 2005–08 period. 2008 in particular was striking in that respect: despite tariff rises in January, April and July, the absence of a tariff rise in October led to a deficit of €441m over the fourth quarter.

Figure 12: Gas tariff deficit, 2005–08
€ in millions, unless otherwise stated



Source: Company data

Figure 13: Gas tariff deficit over 2008
€ in millions, unless otherwise stated

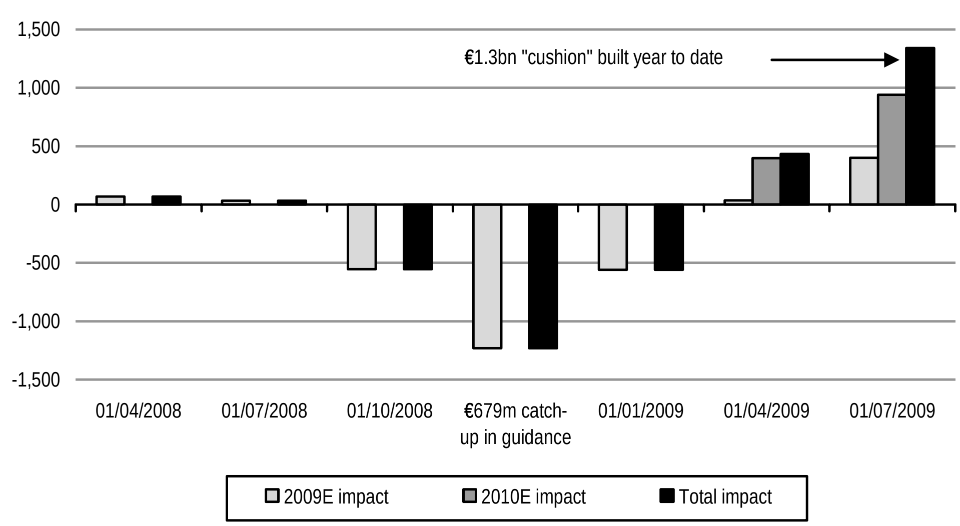


Source: Company data

For 2009 and 2010 however, we would argue that the risk from French tariffs is limited, even in a rising oil price environment. This view is in no way linked to the somewhat naïve belief we had at the time of GDF's IPO that the French government would pass on all costs in an objective way; or that it would allow past tariff losses to be recouped. It is more linked to the fact that oil prices decreased significantly over 2H08, feeding into lower gas procurement costs over 1H09, while tariffs were not reduced proportionally over this period.

On our calculations (detailed in Figure 14), this suggests that the recent favourable tariff decisions have allowed GDF Suez to build up €1.3bn of headroom against potential future unfavourable tariff decisions. In more optimistic terms, were the tariff situation to freeze as of today, with full pass-through of procurement costs thereafter, the company would generate €1.3bn of profits from its supply business over 2009E–10E, over and above management guidance for break even.

Figure 14: GDF Suez has built an estimated €1.3bn 'cushion' from recent tariff decisions
€ in millions, unless otherwise stated



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse estimates

The last tariff decision of 2009, due to be taken on 1 October, will be key in determining the profitability profile of 2009E and, maybe more importantly, the direction of 2011E EBITDA.

What could happen in an ideal world? Full cost pass-through

In theory, GDF Suez is positively exposed to rising commodity prices. During its Investor Day in November 2008, the company indicated that an increase of $1/bn in the oil price would translate into €20m of additional EBITDA (excluding, on our understanding, the indirect effect of rising oil prices on electricity prices and assuming full pass-through of gas procurement costs).

The company's guidance is based on oil price assumptions of $/bl 50/58/60 for 2009/10/11, respectively. The French government fully passing on increases in GDF Suez's procurement costs to end customers from now on suggests that in a rising oil price environment, the company would benefit from both the impact of the estimated €1.3bn tariff reserve built up year-to-date and the impact of rising prices on its business, mainly the E&P division. In a falling oil price environment, the €1.3bn reserve could serve as a substantial cushion for lower E&P profits.

That said, this scenario sounds very unrealistic to us, as we see no reason why the French government would have built up a cushion on the gas tariff and then not use it in a higher oil price environment. We think a more realistic full pass-through scenario would involve the government using up the cushion first and then passing on commodity costs fully. In this scenario, we see GSZ being positively—and very predictably—exposed to rising oil prices.

Figure 15: **Where management's €17bn 2011 EBITDA guidance could go with FULL pass-through in tariff**
€ in billions, unless otherwise stated

	Oil price from now onward ($/bl)						
	40	**50**	**60**	**70**	**80**	**90**	**100**
Initial 2011 EBITDA management guidance	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Supply business incremental EBITDA from cushion	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Supply business incremental EBITDA from tariff decisions	0.0	0.0	0.0	0.0	0.0	0.0	0.0
E&P incremental EBITDA	-0.4	-0.2	0	0.2	0.4	0.6	0.8
Potential 2011 EBITDA guidance	16.6	16.8	17.0	17.2	17.4	17.6	17.8

Source: Company data, Credit Suisse estimates

What is more likely to happen? The Government is unlikely to allow any tariff increase next October

With the steep rise in the oil price over the past few months, we think it is very unlikely that the government will fully pass on higher gas procurement costs to end customers at the next tariff decision in October.

We have looked at what could happen were French gas tariffs to be frozen until the end of 2011:

- Oil price up to $70: the €1.3bn 'cushion' that has been built up since January 2009, on our estimates, is progressively consumed, leaving the supply business at break even at around $70/bl. GDF Suez's overall EBITDA guidance would be skewed to the upside as it would likely benefit from additional profits from the E&P business.
- Oil prices from $70 to $80: the supply business starts building an earnings deficit but this is offset by more profits from the E&P business.
- Oil price >$80: the deficit in the supply business is no longer offset by improved E&P profits and management's guidance for €17bn EBITDA for 2011 is at risk.

Figure 16: **Where management's €17bn 2011 EBITDA guidance could go with NO pass-through in tariff**
€ in billions, unless otherwise stated

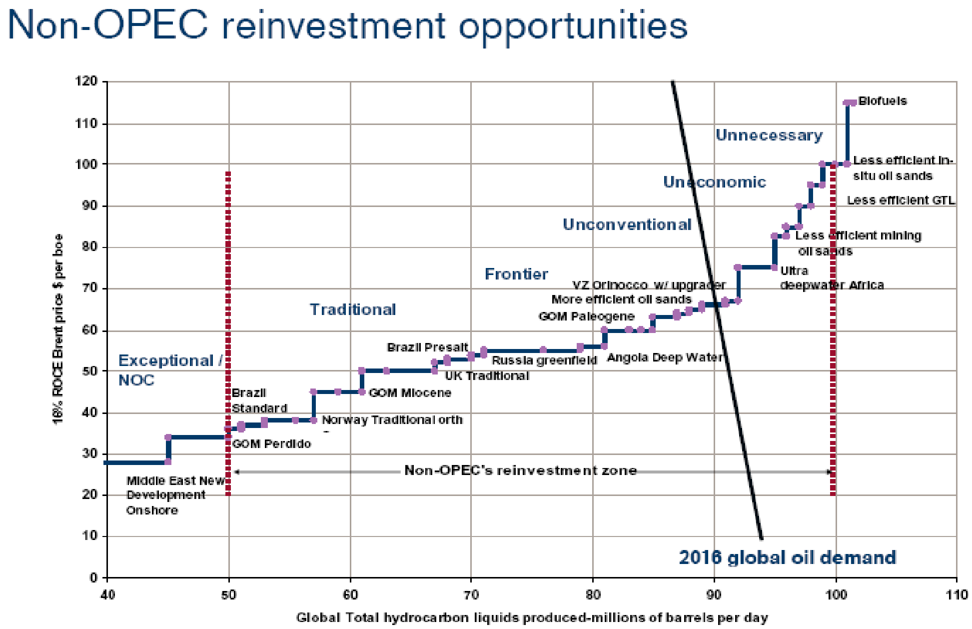
	Oil price from now onward ($/bl)						
	40	**50**	**60**	**70**	**80**	**90**	**100**
Initial 2011 EBITDA management guidance	17.0	17.0	17.0	17.0	17.0	17.0	17.0
Supply business incremental EBITDA from cushion	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Supply business incremental EBITDA from tariff decisions	-0.1	-0.5	-0.9	-1.3	-1.7	-2.1	-2.5
E&P incremental EBITDA	-0.4	-0.2	0	0.2	0.4	0.6	0.8
Potential 2011 EBITDA guidance	17.8	17.6	17.4	17.2	17.0	16.8	16.6

Source: Company data, Credit Suisse estimates

In conclusion, assuming no tariff rise from October 2009, the €17bn 2011 EBITDA guidance would start being at risk with an oil price about $80/bl, on our estimates. However we think this is a rather unlikely scenario for two reasons.

First, Credit Suisse's oil team have recently moved their long-term oil price forecasts to $68/bl (*Oil Market Update*, 16 June 2009), based on the view that oil demand has been permanently impaired.

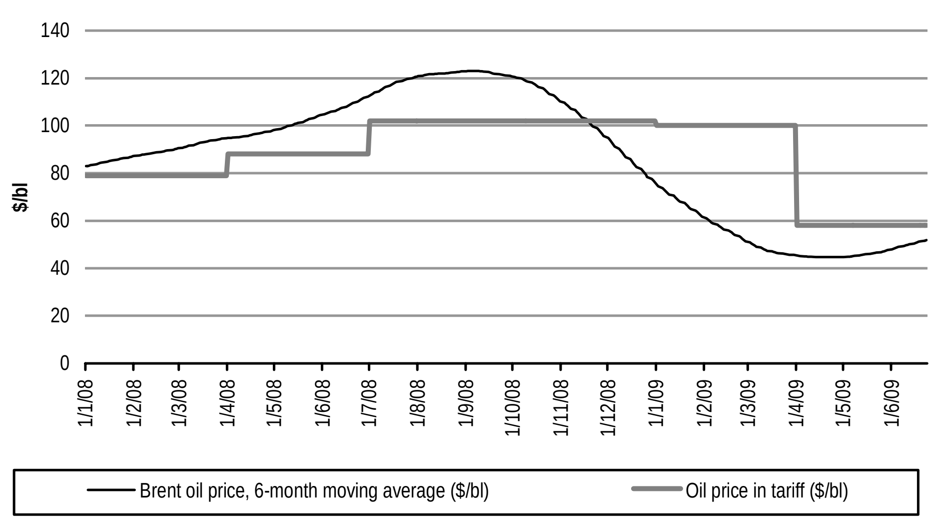
Figure 17: Credit Suisse's oil team now sees a long-term Brent oil price at €68/bl



Source: Credit Suisse Oil Team estimates

Second, to assume no tariff increases from now on is overly conservative in our view. We believe that the French government is more concerned about smoothing the evolution of tariffs than by their absolute levels. The French Industry Ministry now publishes the level of oil price implied by the level of tariffs. If we compare this data to the actual oil price, it appears the government has been ready to grant rises in the past; but in a fast-rising oil price environment, these rises have tended to lag the oil price rise. Therefore, were oil prices to rise to above $80/bl in the short term and stay there until the end of 2011, it is likely that the government would pass on the rise progressively into the tariff, at least partly.

Figure 18: Oil price assumption embedded in the tariff versus the oil price
US$/bl



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No strategic catalyst short-term

Apart from the outlook on earnings, we think there are three factors which could serve as positive catalysts for the shares: first, improved clarity on regulation in France and Belgium; second, clearer signals from management about the use of the company's balance sheet; and third, better visibility on the overall group financials. However, we do not expect any of these to materialise any time soon. On the regulatory front, the French government is unlikely to relinquish its control of gas tariffs in a rising commodity environment; and the Belgian government could well impose a second nuclear tax on Electrabel, without re-opening the nuclear extension debate. On the balance sheet front, GSZ's flexibility has reduced substantially and the recent credit crisis suggests that management could take a while to come back to share buybacks and special dividends. On the visibility front, we think the market needs at least another full financial (and non pro forma this time) year to get a good understanding of the company.

Regulation: clarity unlikely to emerge

GDF Suez is exposed to two main sources of regulatory risk in our view: regulation of the gas supply tariffs by the government in France; and nuclear taxes imposed by the Belgian government. We do not expect either risk to alleviate in the coming months. In France, while the government seemed ready to relinquish its control over gas tariff a few months ago, this now seems very unlikely in a rising oil price environment. In Belgium, the risk of a second nuclear tax is still very possible and is unlikely to be linked at this stage to an extension of nuclear plants' lives.

French government unlikely to give up tariff control in a rising oil price environment

Earlier this year, three events occurred which gave us hope that the French government may be more willing to relinquish its control over gas tariffs; or at least that forthcoming decisions would become more predictable at last:

- On 11 March, the French energy regulator CRE published the formula that was supposed to determine the evolution of the commodity component of the tariff for quarterly revisions. With commodity costs accounting for more than half of the tariff and being by far its more volatile component, this gave much more visibility to investors on tariff expectations and should in particular help stop speculation every quarter on whether the tariff change covers or does not cover underlying fuel costs.
- On 19 March, an article in *Les Echos* suggested that as part of the discussion on GDF's Public Service Contract, the government was showing willingness to become less involved in the tariff setting mechanism—either through non-intervention and delegation of the tariff decision to French regulator CRE, or by defining a range of movement for the year.
- In early April, the Champsaur Commission issued its conclusions on the organisation of the French electricity market. Its report advocates that baseload electricity tariffs should cover the cost of the fleet (existing and new-build) and therefore effectively implies far less government intervention on tariff setting. Gas is not mentioned but were the electricity market to move towards more liberalisation, it would be reasonable, in our view, to expect the gas market eventually to do the same. Champsaur's proposals are currently being discussed in parliament.

This news flow followed a decision by the State Council in December 2007 that the government should at least allow GDF to pass on its costs in the tariff—a recommendation that had been largely ignored by the government throughout 2008 but had seemed to be gaining a bit more weight over 2009.

However, all this happened in a much lower oil price environment and since the oil price rebound, there has been no more speculation in the press surrounding the liberalisation of gas tariffs. We therefore suspect that the oil price would need to stabilise at a much lower level before the idea re-emerges.

Another nuclear tax in Belgium is still a risk and nuclear life extension discussions do not seem a priority

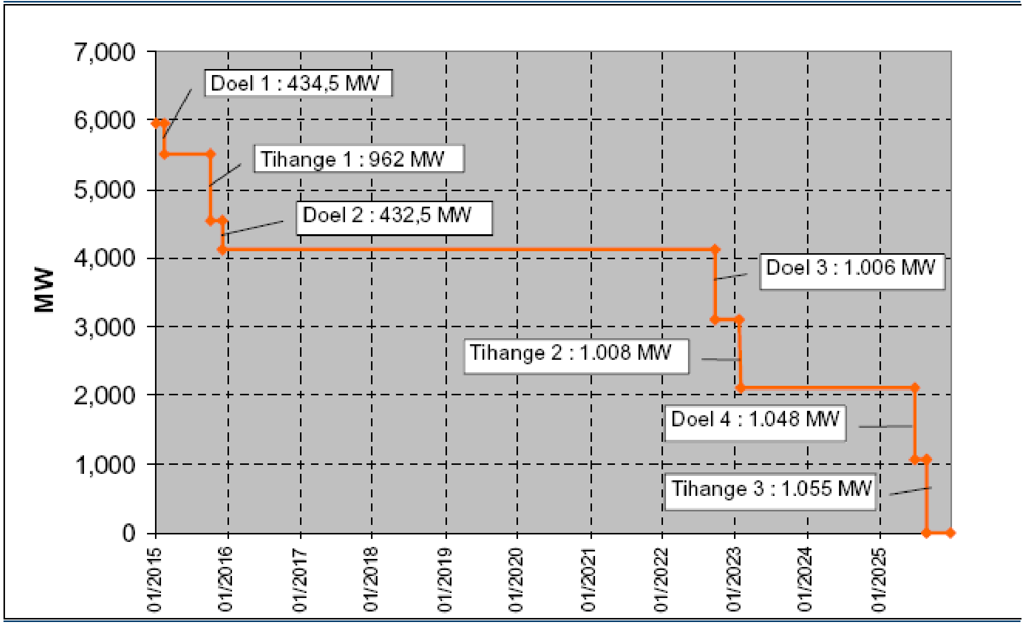
In 2008, Electrabel was required by the Belgian government to pay a €222m nuclear tax, with no clear reason given. This created among investors a perception of substantial risk from this side of the business as well.

We doubt this risk will dissipate in the near term—on the contrary the danger is that another nuclear tax will be imposed on the company, with management mentioning earlier this year discussions about a €500m payment in 2009.

GDF Suez started legal procedures against the 2008 nuclear tax in January 2009, and SPE (Belgium's second electricity producer) followed suit in June. This should put pressure on the government not to impose a second tax. More importantly in our view, the discussions about nuclear taxes should in theory have been linked to a broader discussion about nuclear life extensions—but for the time being this has not been the case.

In common with Germany, Belgium has committed to closing its nuclear power stations through a 2003 law. The law leaves open the possibility of reopening the nuclear debate in the case of a "force majeure", for example, risks to security of supply. With nuclear accounting for a third of Belgian generation capacity, the first closure due in 2015 and fuel costs rising, the law has been questioned ever since it was published. The debate was particularly active in 2007, with the publication of two reports—one commissioned by the government, one by the Belgian energy regulator CREG—which both reached the same conclusion, i.e., that nuclear phase-out should be reconsidered.

Figure 19: **Belgian nuclear plant closure schedule**



Source: CREG

Since then however, the debate seems to have dissipated. In our view this is partly related to the political situation in Belgium, where the governing coalition took months to be agreed upon in 2H 2007 and where no party seems sufficiently powerful to impose a decision on such a sensitive subject. Another explanation may come from the CREG-commissioned report itself, which mentioned 2012 as the deadline for a decision on life extension.

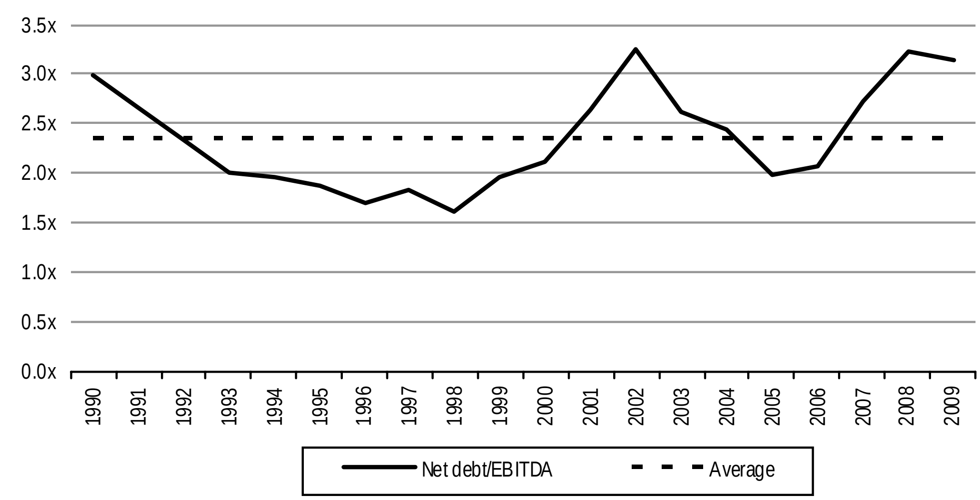
Although the German general elections at the end of September should eventually lead to a reopening of the nuclear debate there, we do not expect Belgium to take the lead as the time pressure is definitely more on Germany (with the first nuclear plant due for closure in 2010).

Balance sheet: Less flexibility than before and management seemingly unwilling to use it

Financial position: healthy but less comfortable than we previously thought…

GDF Suez has one of the strongest balance sheets in the utility sector, with 2009E unadjusted net debt/EBITDA standing at 2.1x versus the sector average at 3.1x. The company did not take an active part in the 2006–08 acquisition spree in the industry, which led to very high gearing levels in the sector versus the historical average.

Figure 20: **Utility sector historical net debt/EBITDA evolution**



Source: Credit Suisse estimates

GSZ is rated A by Standard & Poor's, with a positive outlook (last update in July 2008) and management's stated target is to maintain a "strong single A" rating. Looking at the S&P rating criteria for utilities, GDF Suez's balance-sheet flexibility has deteriorated since we last ran the analysis (August 2008), partly owing to our reduced profit expectations but also owing to the steep decline in the company's market capitalisation—although this should be noted in the context of the current high volatility in equity markets. We believe GDF Suez now has maximum flexibility of €7bn—down from €15bn at our last assessment.

Figure 21: **Assessing GDF Suez's balance-sheet flexibility**

	A according to S&P	Strong A according to Credit Suisse	GDF Suez in 2010E	Implied firepower (€bn)
EBIT interest cover	2.5 to 4.5	4.0 to 4.5	7.1x	€18bn to €24bn
FFO to total debt	15 to 35%	25 to 35%	30%	None to €7bn
Total debt to total capitalisation	40 to 60%	40 to 50%	66%	None

Source: Company data, Credit Suisse estimates

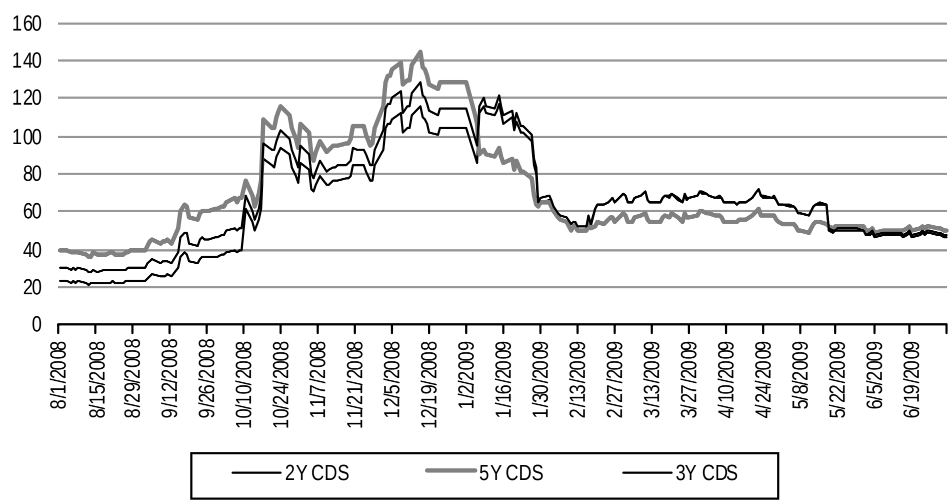
...and management seemingly less willing to use it

Since the beginning of 2009, management has also being making rather negative noises on the balance sheet front through:

- several bond issuances in the first few months of 2009, which more than covered the refinancing needs of the group. Management took this step as a precautionary measure to cover financing needs for the next few years in case the corporate bond market access was reduced again.
- cancelling the share buy-back programme at the release of FY08 results—after having previously delayed its completion from year end 2008 to 1H 2009; and
- commenting at the FY08 results release that the €30bn 2008–10E capex programme was not to be scaled down but that projects that potentially could be delayed, would be.

This caution seems to be lagging events however, as since the beginning of 2009 the company's CDS have substantially contracted versus their end of 2008 highs.

Figure 22: GSZ's CDS have contracted substantially since the beginning of 2009



Source: © Datastream International Limited ALL RIGHTS RESERVED, Credit Suisse research

We therefore believe it will take management a while to readjust to more relaxed credit conditions and look at the potential uses of its balance sheet. While it more or less appears to rule out acquisitions, we believe it also makes extra returns to shareholders (through share buy-backs and special dividends), very unlikely this year and next as the main focus until the end of 2010E is likely to be the completion of the investment programme.

Better visibility on overall group: Another FY needed

We believe one of the key reasons behind the sharp decline in GDF Suez's share price is the sheer complexity of the group.

We already considered Suez and Gaz de France to be quite complex as stand-alone entities—Suez because of its wide business and geographic mixes and its conglomerate structure and GDF because of the volatility of its profits related to procurement and trading on one side and government intervention on gas supply on the other. We believe combining both businesses through a merger has only increased the complexity by taking away some sub-divisional visibility.

The FY results release in 2008 did improve the visibility of the group somewhat, giving two years of pro-forma financial accounts (2007 and 2008) and quite detailed divisional information. However, given that 2008 was not a normal year for the group with the merger occurring in mid-July, the notes to the accounts are of limited use at the P&L level in particular as they discuss the actual accounts (full year of Suez + just under six months of GDF) rather than the pro-forma ones.

We therefore believe we will have to wait until the next full-year reports in March 2010 to get the clarity we need. By this point, the structure of the group should be settled (asset disposals required by the merger completed, limited acquisitions in sight, decision on purchase price accounting stabilised) and the notes to the accounts will be more relevant.

Valuation should provide downside protection

While we are downgrading our earnings estimates and SOTP valuation by more than 20% on average, the valuation still looks reasonably appealing, both on an absolute and relative basis.

Sum of the parts

We have completely rebuilt our model to reflect the new group structure and the additional guidance and information provided by management for the various divisions. We have also taken a much more prudent approach towards the contribution of growth investments and cost-cutting, and have a more pessimistic outlook on demand in line with our latest utility sector review (see our report *Pan European Utilities: Demand Does Matter*, dated 8 April 2009). As a result, our EBITDA forecasts are now just below the company's downgraded guidance (€17bn in 2011E rather than 2010E) and our SOTP valuation has fallen from €40.6 to €31.4 per share. This still represents 20% upside potential versus the current share price.

Figure 23: **GDF Suez: SOTP valuation**

	Value (€m)	Value (€ps)	10E EBITDA	10E EV /EBITDA	Basis
Energy France	9,111	4.0	969	9.4x	DCF for gas supply, capacity multiples for power generation
France gas supply	1,242	0.5	77	16.1x	DCF, assuming 3% margin on regulated customers from 2015E
French electricity generation	7,869	3.5	891	8.8x	Capacity multiples
Energy Benedelux	20,195	8.9	2,262	8.9x	DCF of power plants
Energy Europe	7,219	3.2	1,031	7.0x	7x 10E EV/EBITDA
Energy International	16,591	7.3	2,046	8.1x	Value per MW, market values for TA and Glow, multiples
Power generation North America	5,334	2.4	408	13.1x	Assumed value per MW of generation capacity - €0.5/MW on average
Tractebel Energia (Brazil)	5,063	2.2	771	6.6x	Market value - Suez owns 70%
GLOW (Thailand)	1,629	0.7	215	7.6x	Market value - Suez owns 67%
LNG	3,455	1.5	494	7.0x	7.0x 10E EBITDA
Other	1,110	0.5	159	7.0x	7.0x 10E EBITDA
Global Gas & LNG	13,904	6.2	2,769	5.0x	DCF for E&P and gas supply, 3x EV/EBITDA for trading & optimisation
E&P	6,025	2.7	1,189	5.1x	DCF, implies 7.7$/bl valuation of reserves
Gas supply	254	0.1	55	4.6x	DCF, assuming a 2% LT margin
Procurement, trading and optimisation	7,625	3.4	1,525	5.0x	5x 10E EV/EBITDA
Infrastructures	26,124	11.6	3,232	8.1x	RAB for D, T and R, new-built cost for storage
French Distribution	13,893	6.1			Y/E 10E RAB
French Transmission	6,934	3.1			Y/E 10E RAB
French Regasification	965	0.4			Y/E 10E RAB
Storage	4,332	1.9			New-built cost
Energy Services	6,898	3.1	985	7.0x	7x 10E EV/EBITDA
Environment	12,546	5.6	2,186	5.7x	Market value (€12.7 per share)
Corporate centre	-1,467	-0.6	-210	7.0x	
ENTREPRISE VALUE PRE ASSOCIATES	**111,122**		15,270	7.3x	
Associates	5,562	2.5			Sector 10E P/E (11.4x)
Financial assets	6,961	3.1			08A book value
TOTAL GROUP EV	**123,645**				
Net debt, 2010E	-30,270				10E BV
Nuclear provisions	-6,997				10E BV
Pension provisions	-3,936				10E BV
Other provisions	-1,099				Discounted value of GDF deferred tax liability
Minorities	-10,315				Suez Environnement at market value, other at sector 10E P/E (11.4x)
EQUITY VALUE	**71,028**	**31.4**			

Source: Company data, Credit Suisse estimates

Multiples

On a relative basis, the shares are trading at a 13% discount to the utility sector on 2010E EV/EBITDA, while the dividend and P/E are largely in line with the sector average. Were the shares to fall below €23 per share, the P/E discount would be in double-digit territory and the dividend yield closer to 6.5% (more in line with the German utilities E.ON and RWE), at which point, in our view, the valuation could start to be seen as an attractive catalyst in itself.

Figure 24: GDF Suez valuation multiples versus the utility sector

	2009E	2010E	2011E
EV/EBITDA			
GSZ	6.7x	6.4x	5.8x
Utility sector	7.9x	7.3x	6.9x
GSZ vs utility sector	-15%	-13%	-18%
P/E			
GSZ	12.3	11.7	10.1
Utility sector	12.4	11.4	10.1
GSZ vs utility sector	0%	2%	1%
Dividend yield			
GSZ	5.6%	5.9%	6.0%
Utility sector	5.5%	5.8%	6.1%
GSZ vs utility sector	1.0x	1.0x	1.0x

Source: Credit Suisse estimates

Forecasts

We have rebuilt our GDF Suez model to take into account the new divisions, new guidance and improved visibility on some of the new sub-divisions (and worse visibility on others). We have also taken a much more conservative approach to many of our underlying assumptions—including economic growth outlook, demand outlook, contribution of new projects to earnings (both size and timing).

Overall, this results in a deep cut to our numbers, with our EBITDA forecasts falling by 5–10% and our EPS forecasts by 16–30% for 2009E–2011E. Our 2011E EBITDA now sits just below the company's downgraded 2011E €17bn guidance but so do our capex forecasts. We no longer adjust recurrent EPS for concession accounting, as concession accounting within the group has changed, making the adjustment much more difficult.

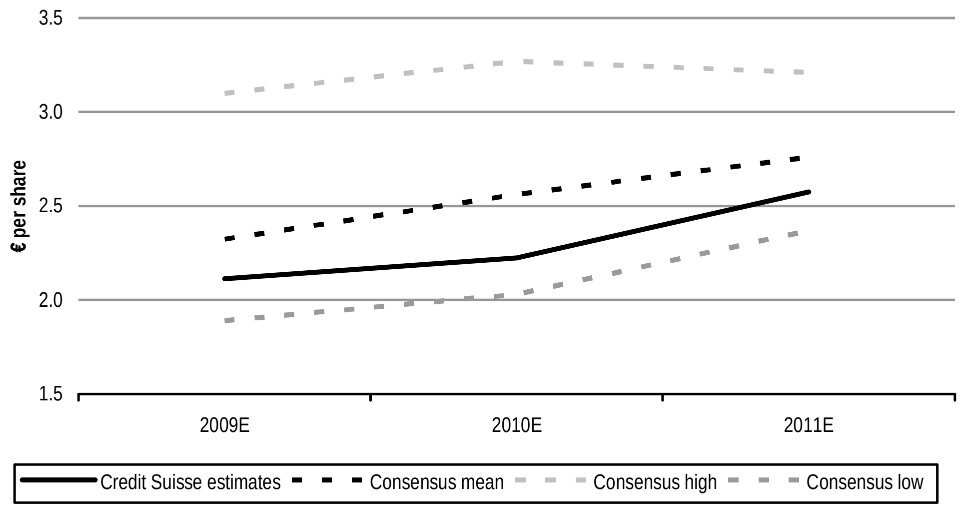
Figure 25: Change in our GDF Suez estimates
€ in millions, unless otherwise stated

	2009E	2010E	2011E
EBITDA			
New	14,345	15,270	16,773
Old	15,167	16,992	18,476
New vs Old	-5%	-10%	-9%
Reported EPS (€ ps)			
New	2.11	2.22	2.58
Old	2.51	3.18	3.57
New vs Old	-16%	-30%	-28%
Recurrent EPS (€ ps)			
New	2.11	2.22	2.58
Old	2.62	3.16	3.55
New vs Old	-19%	-30%	-28%
DPS (€ ps)			
New	1.47	1.54	1.57
Old	1.52	1.68	1.76
New vs Old	-4%	-8%	-11%

Source: Credit Suisse estimates

Our forecasts are now c10% below the consensus mean at the recurrent EPS level, although we would highlight that the range of consensus estimates is very wide and therefore not that representative.

Figure 26: GDF Suez: Range of consensus estimates is extremely wide



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse estimates

Figure 27 and Figure 28 summarise our new estimates for the group.

Figure 27: GDF Suez divisional EBITDA forecasts

€ in millions, unless otherwise stated

	2008A	2009E	2010E	2011E	08-09E (% chg yoy)	09-10E (% chg yoy)	10-11E (% chg yoy)	11-12E (% chg yoy)	4Y CAGR
Group EBITDA	13,886	14,345	15,270	16,773	3.3%	6.4%	9.8%	2.0%	5.4%
Energy France	246	781	969	1,179	217.7%	23.9%	21.7%	2.3%	48.8%
Energy Benedelux	1,752	2,182	2,262	2,424	24.6%	3.6%	7.2%	-0.5%	8.3%
Energy Europe	844	1,004	1,031	1,059	18.9%	2.7%	2.7%	0.0%	5.8%
Energy International	1,799	1,879	2,046	2,257	4.4%	8.9%	10.4%	3.2%	6.7%
Global Gas & LNG	3,715	2,713	2,769	3,078	-27.0%	2.0%	11.2%	1.8%	-4.2%
Infrastructures	2,878	3,002	3,232	3,455	4.3%	7.7%	6.9%	1.2%	5.0%
Energy Services	904	931	985	1,025	3.0%	5.8%	4.0%	3.0%	3.9%
Environment	2,102	2,153	2,186	2,272	2.4%	1.5%	3.9%	5.4%	3.3%
Others	-354	-300	-210	25					

Source: Company data, Credit Suisse estimates

Figure 28: GDF Suez: Summary financial forecasts

€ in millions, unless otherwise stated

Key data	2008A	2009E	2010E	2011E	08-09E (% chg yoy)	09-10E(% chg yoy)	10-11E (% chg yoy)	3Y CAGR
Reported EPS (€)	3.01	2.11	2.22	2.58				
Pre-exceptional EPS (€)	1.98	2.11	2.22	2.58	7%	5%	16%	9%
DPS (€)	2.20	1.47	1.54	1.57	-33%	5%	2%	-11%
DPS payout ratio on clean EPS (€)	111%	70%	69%	61%				
Net debt as reported	-28,936	-30,086	-30,270	-29,338	4%	1%	-3%	0%
(Net debt+LT provisions)/EBITDA	2.8x	2.8x	2.7x	2.4x				

Group Income Statement	2008A	2009E	2010E	2011E	08-09E (% chg yoy)	09-10E (% chg yoy)	10-11E(% chg yoy)	3Y CAGR
Revenues	83,053	82,609	82,095	85,737				
EBITDA as reported (excl. associates)	13,886	14,345	15,270	16,773	3%	6%	10%	6%
Depreciation, amortisation and provisions	-4,885	-5,136	-5,289	-5,383				
Other non-cash charges	-440	-470	-487	-510				
Current operating income	8,561	8,739	9,494	10,880	2%	9%	15%	8%
Impairment, mk-to-mkt, restructuring, disposals	-307	0	0	0				
Operating result	8,204	8,739	9,494	10,880				
Financial result	-1,611	-1,631	-1,687	-1,693				
PBT	6,593	7,107	7,807	9,187	8%	10%	18%	12%
Income tax	-1,765	-2,132	-2,459	-3,032				
Associates	447	469	488	549	5%	4%	12%	7%
Discontinued operations	2,141	0	0	0				
Minority interest	-911	-791	-812	-887	-13%	3%	9%	-1%
Reported net income	6,505	4,653	5,024	5,817	-28%	8%	16%	-4%
Recurrent net income	4,286	4,653	5,024	5,817	9%	8%	16%	11%

Group Cash Flow Statement	2008A	2009E	2010E	2011E	08-09E (% chg yoy)	09-10E (% chg yoy)	10-11E (% chg yoy)	3Y CAGR
Gross cash flow	9,130	11,234	11,305	12,233	23%	1%	8%	10%
Change in working capital	-3,030	-192	624	-268				
Cash flow from operations	6,100	11,042	11,929	11,966	81%	8%	0%	25%
Capital expenditures	-10,498	-9,042	-8,406	-7,205				
Acquisitions and investments	-4,628	0	0	0				
Disposals	950	629	0	0				
Other	0	0	0	0				
Net investing cash flow	-14,176	-8,413	-8,406	-7,205	-41%	0%	-14%	-20%
Minority dividends	-403	-340	-295	-303				
Dividends	-4,734	-3,438	-3,411	-3,525				
Other	976	0	-0	0				
Change in net debt	-12,237	-1,150	-184	932				

Group Balance Sheet	2008A	2009E	2010E	2011E	08-09E (% chg yoy)	09-10E (% chg yoy)	10-11E(% chg yoy)	3Y CAGR
Total fixed assets	115,184	118,649	121,961	124,003				
Current assets	42,206	44,105	42,473	42,641				
Cash and marketable securities	9,818	1,000	1,000	1,000				
Total assets	167,208	163,754	165,435	167,644				
Financial liabilities	-38,841	-31,173	-31,357	-30,424				
Provisions	-12,607	-18,873	-19,573	-20,316				
Other liabilities	-47,871	-50,033	-49,033	-48,961				
Net assets	67,889	63,676	65,472	67,943				
Minority interests	-5,071	-5,566	-6,074	-6,630				
Shareholders' funds	62,818	58,110	59,397	61,313				

Source: Company data, Credit Suisse estimates

Companies Mentioned *(Price as of 06 Jul 09)*
RWE (RWEG.F, Eu54.66, UNDERPERFORM, TP Eu49.00, MARKET WEIGHT)
Suez Environnement (SEVI.PA, Eu12.14, UNDERPERFORM [V], TP Eu9.70, MARKET WEIGHT)
Tractebel Energia (TBLE3, $9.87, NEUTRAL, TP $11.00)
E.ON (EONGn.DE, Eu23.66, NEUTRAL [V], TP Eu28.00, MARKET WEIGHT)
GDF Suez (GSZ.PA, Eu26.08, NEUTRAL, TP Eu31.00, MARKET WEIGHT)
Glow Energy PCL (GLOW.BK, Bt32.25, OUTPERFORM, TP Bt35.00)

Disclosure Appendix

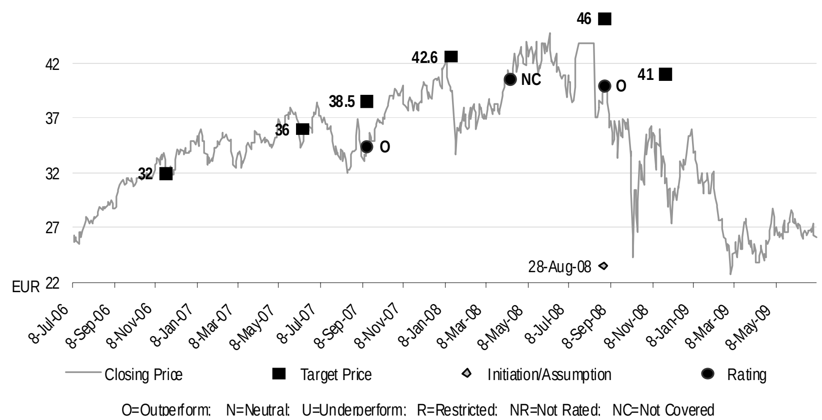
Important Global Disclosures

The analysts identified in this report each certify, with respect to the companies or securities that the individual analyzes, that (1) the views expressed in this report accurately reflect his or her personal views about all of the subject companies and securities and (2) no part of his or her compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

See the Companies Mentioned section for full company names.

3-Year Price, Target Price and Rating Change History Chart for GSZ.PA

GSZ.PA Date	Closing Price (EUR)	Target Price (EUR)	Rating	Initiation/ Assumption
21-Nov-06	33.18	32		
11-Jun-07	34.62	36		
14-Sep-07	34.34	38.5	O	
15-Jan-08	39.7	42.6		
11-Apr-08	40.48		NC	
28-Aug-08	39.88	46	O	X
27-Nov-08	31.355	41		



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Market Weight: Industry expected to perform in-line with the relevant broad market benchmark over the next 12 months.
Underweight: Industry expected to underperform the relevant broad market benchmark over the next 12 months.
**An analyst's coverage universe consists of all companies covered by the analyst within the relevant sector.*
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Underperform/Sell*	19%	(48% banking clients)
Restricted	2%	

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Price Target: (12 months) for (GSZ.PA)
Method: We value GDF Suez using a Sum-of-the-Parts analysis, applying a variety of methods to the different parts of the business: market values when available; DCFs for the Benelux generation and French gas supply businesses; NAV for the E&P business; regulated asset base for regulated businesses; and sector multiples for the rest. Our target price is directly derived from our SOTP valuation.
Risks: We see three key risks to our SOTP. First, reinvestment risk: we assess that GDF Suez has **€**7bn of financial flexibility and this money could be spent unwisely. Second, regulatory risk: there is a chance that the French government will not to grant sufficient gas tariff rises to cover the company's procurement costs, especially in a rising oil price environment. Third, risk on the procurement and trading business: we have very limited visibility on this division hence value it on an EV/EBITDA multiple but EBITDA could be volatile going forward.

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