

DESCRIPTION

Verallia is the 2nd largest glass packaging manufacturer in the world, behind Owens-Illinois (US). The company is part of Saint-Gobain, which decided to float Verallia to focus on the housing market, and also to satisfy the request of its largest shareholder, Wendel. Verallia has 47 plants and employs approx. 15,000 people.

Share Price	32.75€
Nb of shares	66.5m
Market Capitalization	€2,178m
Net Debt 2011e	€1,997m
Enterprise Value	€4,175m

FAIR @ €15
Valuation Range
[€30-€54]

IPO Process

The offering begins on June 7, 2011 - Ends on June 20, 2011 at 5:00pm (Paris time)
The final offering price is to be set on June 21, 2011. Trading should begin on NYSE Euronext in Paris (compartiment A) on June 22, 2011. Settlement and delivery of the shares is expected on June 24, 2011.

Lock-up agreement

Saint-Gobain, Vertec and other subsidiaries of St-Gobain have agreed, subject to certain exceptions, to hold their shares during 365 days following the date of settlement.

Financial intermediaries

BNP Paribas, JPMorgan, Merrill Lynch (global coordinators); Santander, Credit Agricole, Société Générale, RBS (co-bookrunners); Banca IMI, BBVA, Commerzbank, ING, Mitsubishi UFJ (co-lead managers).

Nb of shares offered to the public

26.6 million (40%) sold by controlling shareholders up to 30.6 million (44.9%) if overallotment option is exercised.

Market profile

Range of IPO €29.50/€36.00
Average Price €32.75

Free float (post IPO) 40%
Insiders (St-Gobain) 60%
before over-allotment/share sale to employees

Shareholders (after IPO)

Saint-Gobain 60.0%
of which:
Vertec 20.7%
Spafi 12.5%
SG Cristaleria 26.8%

Valuation ratios

(based on €32.75)

P/E 2011e/2012e 9.6x/8.7x
P/CF 2011e/2012e 4.6x/4.3x
P/B 2011e/2012e 7.6x/4.8x
EV/EBITDA 2011e/2012e 5.9x/5.5x
Divid. Yield 2011e/2012e 4.2%/4.6%
FCF Yield 2011e/2012e 3.9%/4.8%
Gearing 2011e/2012e 10%/425%

5 year-forecast (CAGR)

Revenue 2.9%
EBIT 5.1%
EPS 4.8%
DPS 4.8%

Why not buy the share ?

We see significant risk on Verallia due to the excessive leverage put on the company by its controlling shareholder, right before its IPO. This leverage overshadows all the intrinsic qualities of the stock (competitive market positioning, improvement of margins, ability to generate strong and stable free cash flow, solid ROCE evolution).

On our estimates, the net debt to EBITDA ratio for 2011 will be 2.8x and will slowly decline to 1.8x by 2015, if the company holds its 40% pay-out ratio target announced during the IPO presentation.

We think this IPO is being done exclusively in favor of the controlling shareholder (Saint-Gobain), which will gain on the share sale, the cash-flow generated by Verallia through the high pay-out ratio and the transfer of financial obligations.

Catalysts

- 1) Ability to outperform its financial objectives (EBITDA €700m in 2011; EBITDA margin of 20% by 2013; organic sales growth of 3% to 5% per annum by 2013);
- 2) Faster deleveraging process than currently anticipated;
- 3) Accretive external growth deals.

Risks

- 1) Excessive leverage (net debt estimated close to €2 billion by end-2011);
- 2) Share overhang (after 1 year lock-up);
- 2) Lack of financial transparency on the pro-forma financial figures, after the balance sheet reorganization.

Valuation

On a DCF valuation model, due to the excessive leverage, we estimated the intrinsic value of Verallia at €30. Taking into account a margin of safety of 50%, we think the share might be considered attractive around €15/share.

Were Verallia able to solve its excessive leverage problem, the share could quickly rise to a more normal price of €40-45 (determined using an EVA model).