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Rating: **1**

Daiwa Capital Markets Europe

Ashley Thomas

(44) 020 7597 8456

ashley.thomas@uk.daiwacm.com

Suez Environnement (SEV FP)

Utilities: France

“Decarbonated” water to become more popular as less likely to explode

- We initiate on Suez Environnement (SEV) with a Buy (1) rating and a DCF-derived Fair Value of €17.1, offering 23% upside to the current share price. We believe the water/waste sector offers three key advantages over the power sector which should support the SEV share price:
 - 1) In Europe, water and waste investment is supported by regulatory targets, whilst budgetary constraints will increase the share of private sector investment (through outsourcing and privatisations). This is in contrast to the power sector, which is already largely privatised and where improved reserve margins have resulted in new generation capacity deferrals.
 - 2) Against a backdrop of increased government/regulatory interference in the European power sector, the broad geographic spread (French capital employed <25% of group total) and relatively fragmented nature of SEV's water/waste customer base (no single contract accounts for >1% group EBITDA) offer relative stability.
 - 3) Unlike the power sector, the absence of material carbon costs eliminates any 2013 earnings hit and offers improved visibility. We forecast SEV to grow EBITDA by 8% CAGR 2009-2013, with 6% year-on-year growth in 2013.

Market Data

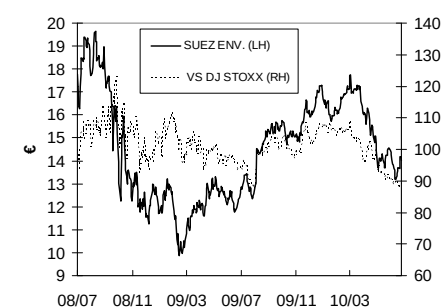
Share price	(€; 16 Jul)	13.9
Market cap	(€ mil; 16 Jul)	6,809
EV	(€ mil; 16 Jul)	17,564
Shares outstanding	(m; 12/09)	489.7
Net debt : EBITDA	(x; 12/09)	3.1
Post tax ROCE	(%; 12/09)	7.3
ROE	(%; 12/09)	11.0
Free float	(%; 12/09)	52.0

Investment Indicators

P/E	(X; 12/10 E)	15.0
	(X; 12/11 E)	16.0
P/CF	(X; 12/10 E)	4.2
	(X; 12/11 E)	3.8
EV/EBITDA	(X; 12/10 E)	7.7
	(X; 12/11 E)	7.0
P/B	(X; 12/09)	1.9
Dividend yield	(%; 12/10 E)	4.7
Website	http://www.suez-environnement.com	

E: Daiwa CM Europe estimates.

Adjusted Share Price



Source: Compiled by Daiwa CM Europe.

Income Summary (€ mil; y/y)											
Year to	Sales		EBITDA ¹		Op profit		Net income		EPS (€)	CFPS (€)	DPS (€)
12/08	12,364	NA	2,102	NA	1,059	NA	533	NA	1.09	2.77	0.65
12/09	12,296	-1%	2,060	-2%	926	-13%	403	-24%	0.82	3.05	0.65
12/10 E	13,590	11%	2,286	11%	1,071	16%	453	12%	0.93	3.30	0.65
12/11 E	14,555	7%	2,520	10%	1,236	15%	425	-6%	0.87	3.66	0.65
12/12 E	15,330	5%	2,672	6%	1,353	9%	505	19%	1.03	3.81	0.65
12/13 E	16,165	5%	2,826	6%	1,473	9%	605	20%	1.24	4.07	0.65

E: Daiwa CM Europe estimates. Notes: 1) Company defined EBITDA (stated pre concession renewal costs and employee share based compensation)

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Suez Environnement Overview

Suez Environnement is (along with Veolia) one of the two main global environmental service companies. It is the leading water company in Spain and the number 2 in France, Europe and the world.

Whilst Suez Environnement remains a global market leader (the combined population served by SEV and Agbar of 120m is in line with that of Veolia at 122m), as result of market growth outside of its core markets, its global market share (if we fully consolidate Agbar) has reduced from 32% in 1991 to 15% in 2009. This market share loss is an experience shared by all of the top five operators as although the global PSP market has increased from 350m people to 802m in 2009, the total population served by the historical “top 5” operators has remained relatively stable as a result of non-core disposals and international market growth not captured by the established operators.

In the waste sector it is the second largest in France and in Europe and the fourth largest worldwide.

The division is split into three main business units – Water Europe, Waste Europe and International. In 2009 roughly half the group’s revenue was earned in the water segment and half in waste, whilst geographically Europe accounts for around 80% of revenues.

Longer term growth drivers of the water and waste management services sector include:

- population growth
- increased urbanisation
- per capita GDP growth
- increased scarcity of resources which results in:
 - commodity price inflation (recovered materials / energy recovery)
 - an increased emphasis on climate change/the environment (particularly for water but also for landfill)

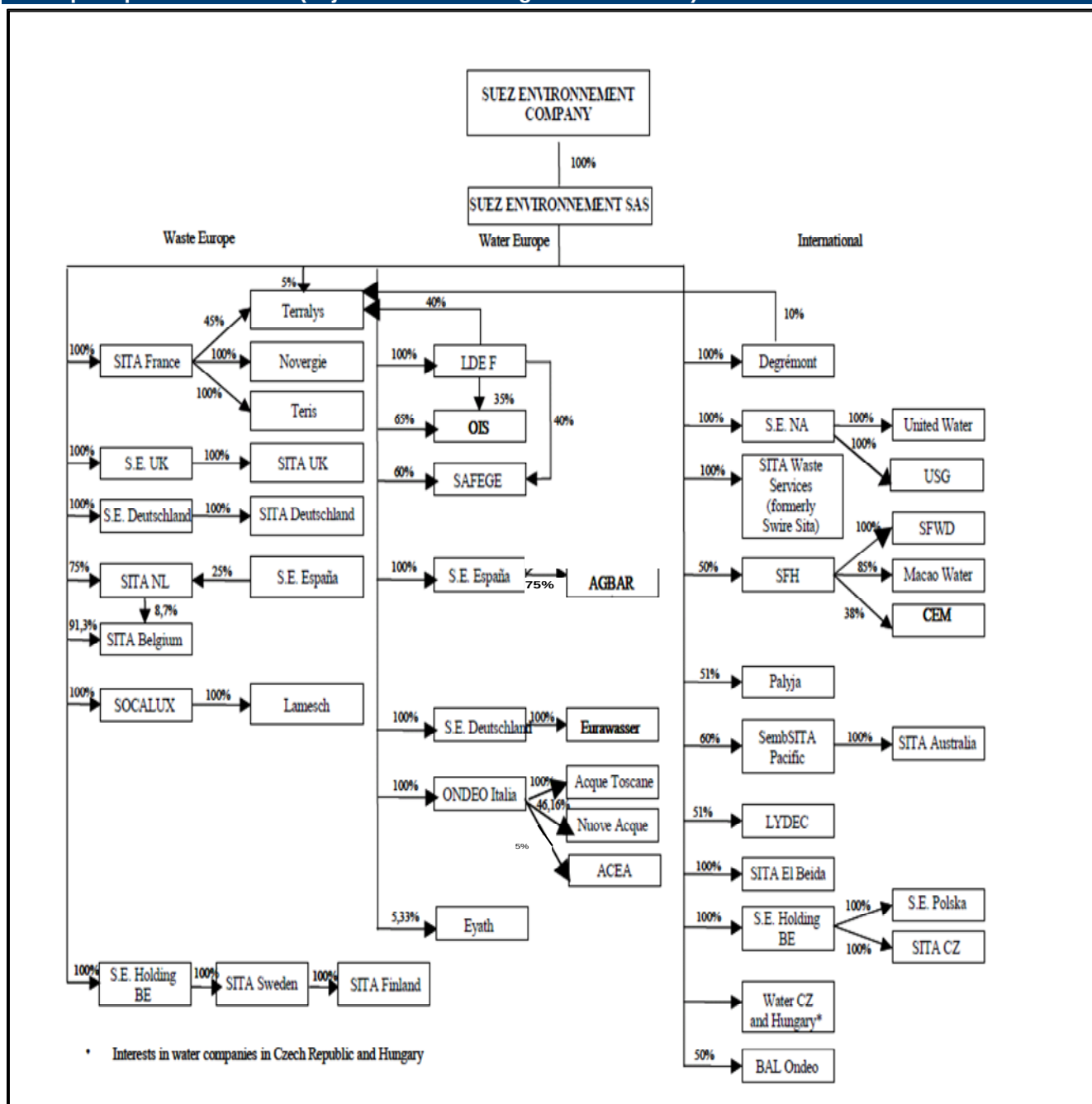
According to a European Commission report conducted by ECORYS, the European water and waste management sectors grew at a compound rate of 8.1% between 2004 and 2008, representing an inflation-adjusted growth rate of around 4.8% or more than double the overall real GDP growth rate.

EU27 water and waste market growth 2004-2008			
€bn	2004	2008	CAGR
Waste management	70.5	92.2	7.0%
Water supply	48.3	63.2	6.9%
Waste water management	30.4	34.3	3.1%
Recycle materials	30.0	54.8	16.3%
Total	179.2	244.6	8.1%
Nominal GDP			5.4%
Real GDP			2.1%

Source: ECORYS; compiled by Daiwa CM Europe.

In the future, Suez Environnement estimates European water and wastewater spending will increase at a rate of GDP+2%/3% (suggesting market growth of around 4% pa).

Group corporate structure (adjusted to reflect Agbar transaction)



Source: Suez Environnement; compiled by Daiwa CM Europe

2010 guidance and Q1 performance

2010 EBITDA and FCF to be supported by Agbar acquisition, FX and raw material pricing benefits.

Suez Environment has set 2010 guidance at revenue growth of at least 5% and EBITDA growth of at least 8%, both at constant currencies. This forecast assumed the Agbar transaction closes in mid-2010 (it closed in June having received European Commission clearance in late April), which should boost 2010 EBITDA by around €100m or 5% on 2009.

The Agbar acquisition reinforced Suez Environnement's position in the Spanish water market (27% market share) as well as providing material exposure to the Chile (Essal) and UK (Bristol Water) markets.

In October 2009 Agbar launched a delisting tender offer for the 10% of shares held by minority shareholders at a price of €20 per share (~€300m) and Suez Environment announced the acquisition of Agbar shares held by Criteria at €20 per share to reach a final stake of 75% (~€650m). Linked to this transaction SEV also disposed of the Adeslas health insurance activities to Criteria for a sum of €687m.

SEV has identified operational synergies of between €20m to €30m pa and financial synergies of around €15m pa (with a €15m one-off integration cost). This suggests an acquisition multiple of around 7.9x 2010 EV/EBITDA. The disposal of Adeslas was made at a 2008 EV/EBITDA multiple of 11.0x (or 9.1x 2010 assuming 10% pa EBITDA growth).

The acquisition is expected to be value creative (i.e. IRR > hurdle rate) and earnings accretive from 2011. We estimate a post synergy return of around 8.5% (based on a 30% tax rate) - some 200 bps above the estimated 6.5% hurdle return (discount rate used for Agbar fair value test in GDF Suez's 2009 annual report & accounts).

Because of the shift from proportional (51%) to full consolidation (with 25% minorities), we estimate the acquisition will have a full year positive impact on reported EBITDA of around €200m, of which we estimate around €125m is purely a presentational issue.

Suez Environnement's 2010 guidance is also based upon 1% eurozone GDP growth (Bloomberg consensus forecast for eurozone GDP growth is currently 1.1% whilst the OECD forecast is 1.2%) and stable average prices for secondary raw materials (vs Dec 31 2009) which have subsequently experienced a material rise in pricing (although down from recent peaks achieved in April 2010).

Whilst guidance has been provided on a constant currency basis, the material weakness experienced in the euro year-to-date will have a beneficial impact on the reported EBITDA growth. We estimate that should year-to-date average exchange rates be maintained throughout the rest of the year the positive translation benefit will total around €19m EBITDA (or about 1% to group EBITDA growth).

However should current exchange rates be more reflective of the 2010 average (requiring some additional weakness throughout the rest of the year) then we estimate the positive EBITDA impact would be around €35m or about 2% on the full year growth rate. The positive FX effect on group EBITDA growth in the Q1 2010 results totalled 1.5%. Our forecast of 11% EBITDA growth in 2010 would therefore be marginally (~1%) ahead of management guidance adjusting for the FX benefit.

Estimated FX translation impact

	2009	2010 to-date	% change	Estimated €m EBITDA impact	Estimated €m interest impact	Estimated €m PTP impact
€/\$ FX rate	1.39	1.34	-4%	4.5	-0.3	4.2
£/€ FX rate	1.12	1.15	2%	3.0	-0.3	2.7
€/AUD rate	1.77	1.49	-16%	6.5	-0.5	6.0
€/HKD rate	10.81	10.38	-4%	1.5	-0.1	1.4
€/Chile Peso	777.07	699.04	-10%	3.4	-0.3	3.2
Total				18.9	-1.5	17.4
	2009	Current	% change	Estimated €m EBITDA impact	Estimated €m interest impact	Estimated €m PTP impact
€/\$ FX rate	1.39	1.27	-9%	9.4	-0.7	8.7
£/€ FX rate	1.12	1.20	7%	10.4	-1.1	9.3
€/AUD rate	1.77	1.45	-18%	7.4	-0.5	6.8
€/HKD rate	10.81	9.90	-8%	3.1	-0.2	2.9
€/Chile Peso	777.07	678.50	-13%	4.4	-0.3	4.0
Total				34.6	-2.9	31.8

Source: Company materials; compiled by Daiwa CM Europe.

Suez Environnement has also targeted FCF equal to or in excess of €0.7bn in 2010 (similar to the 2009 level adjusting for a €76m tax refund and €105m accrued but not paid interest). We forecast €742m FCF in 2010 with maintenance capex of €670m (up from €569m in 2009).

Q1 2010 performance

Total Q1 2010 revenues grew by 8.7% yoy¹, with 6.0% organic revenue growth.

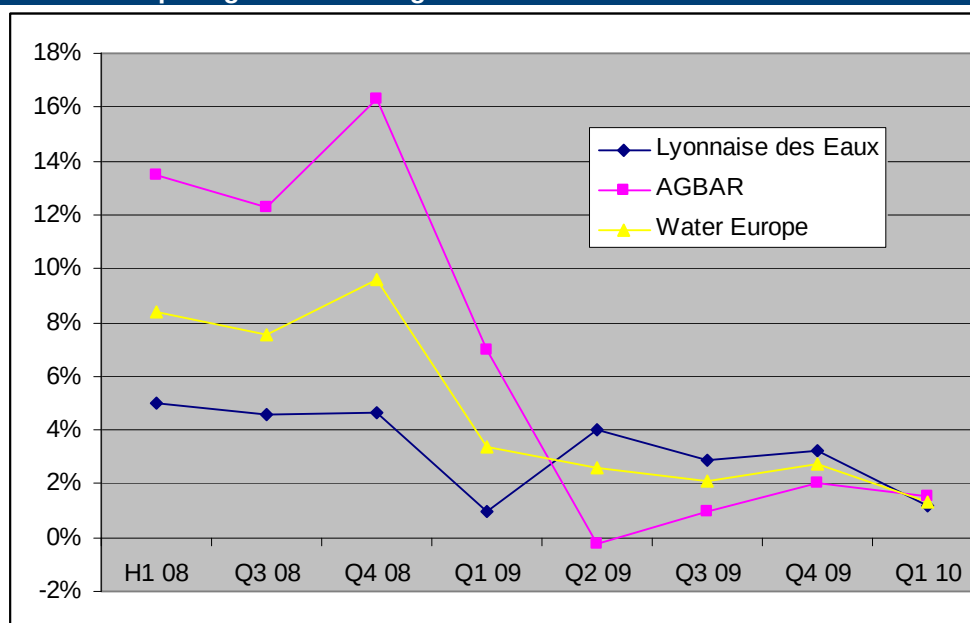
Q1 EBITDA increased by 5.5% in total from €436m to €460m, representing 4.0% growth at constant currencies (roughly in line with the constant FX revenue growth excluding the rise in the price of secondary raw materials) and 0.5% organic growth.

The EBITDA margin declined from 15.4% Q1 2009 to 15.0% Q1 2010 as a result of the dilutive impacts of the secondary raw material price increase and the Degremont Melbourne design and build contract.

In Water Europe, the division reported 4.5% total Q1 revenue growth and 1.3% organic revenue growth. Organic revenue growth slowed from the estimated 2.7% achieved in Q4 09 as a result of the loss of the Paris contract and a negative price effect in Chile.

¹ all growth comparisons in this note are year-on-year unless otherwise stated

Water Europe organic revenue growth trend



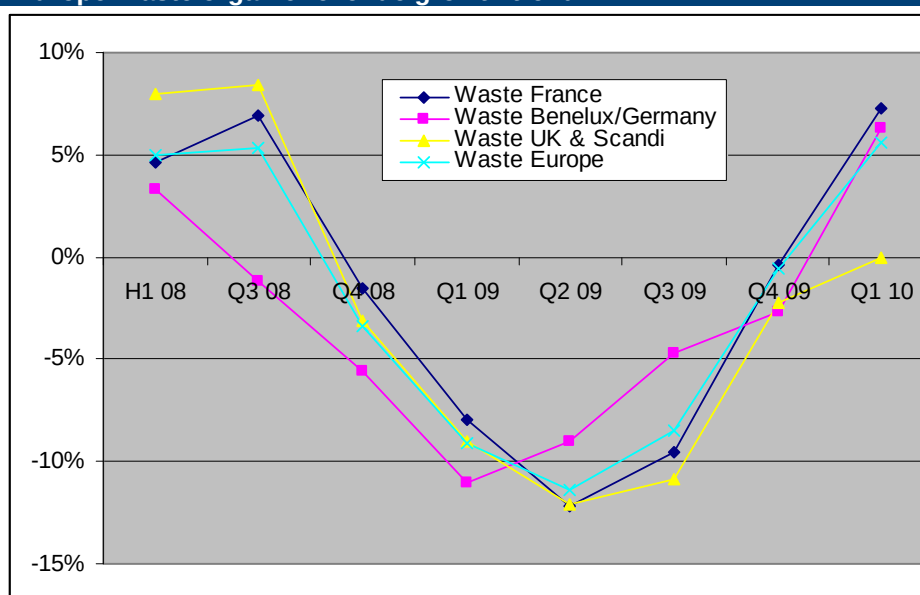
Source: Daiwa CM estimates.

Lyonnaise des Eaux recorded 1.2% organic revenue growth in Q1 10, with stable drinking water volumes (excluding the impact of the Paris contract) and a slight increase in prices resulting from the indexation formulas.

Agbar reported organic revenue growth of 1.5%, with lower volumes and work activities in Spain and a tariff reduction in Chile offset by growth in the UK and China and tariff increases in Spain.

Waste Europe revenues increased by 7.2% in total or 5.6% on an organic basis. Organic revenue growth was largely inflated by the price increase in secondary raw materials with collection and treatment activities impacted by the adverse weather conditions in January and February.

Europe Waste organic revenue growth trend



Source: Daiwa CM estimates.

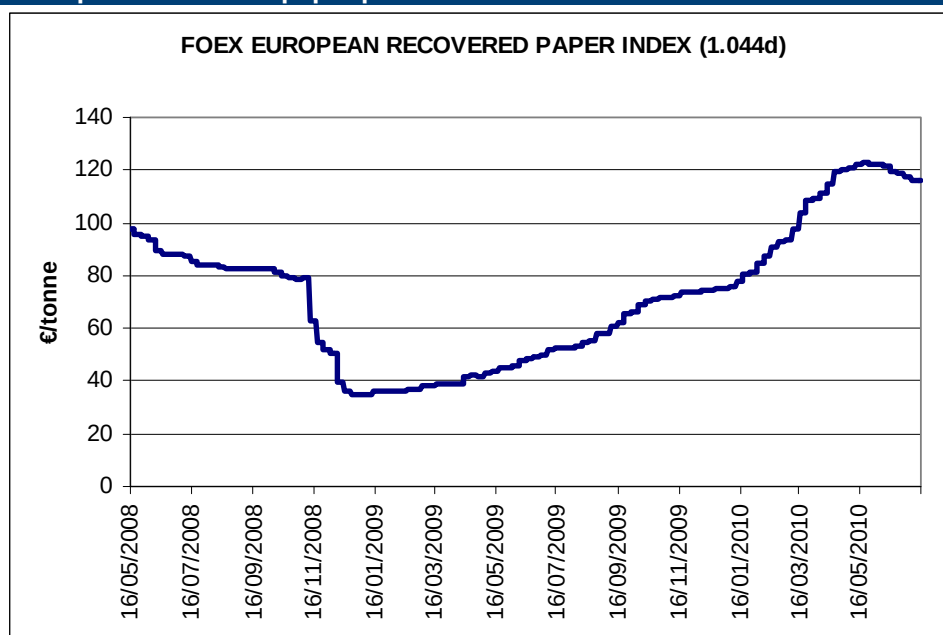
The strong Q1 performance of secondary raw material prices can be seen from the following trends in recovered paper, scrap aluminium and HDPE plastic pricing, which in general have increased significantly over the past year (particularly in the case of recovered paper).

Secondary raw material pricing

	2009 average	Dec 31 09	Current
Recovered paper (€/t)	52	75	116
Aluminium scrap (\$/t)	725	985	1225
HDPE (£/t)	854	930	1065

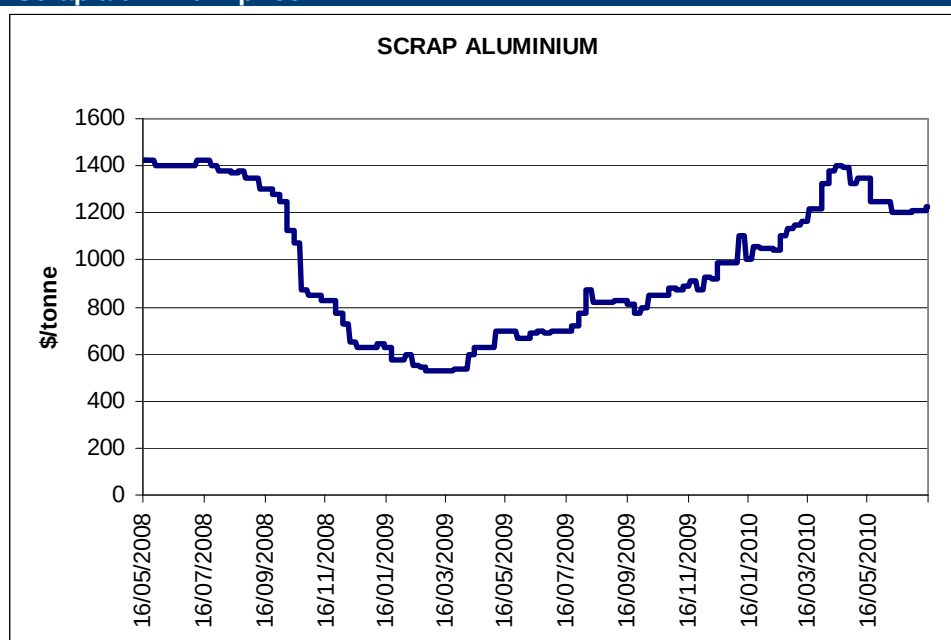
Source: Bloomberg; compiled by Daiwa CM Europe.

European recovered paper prices



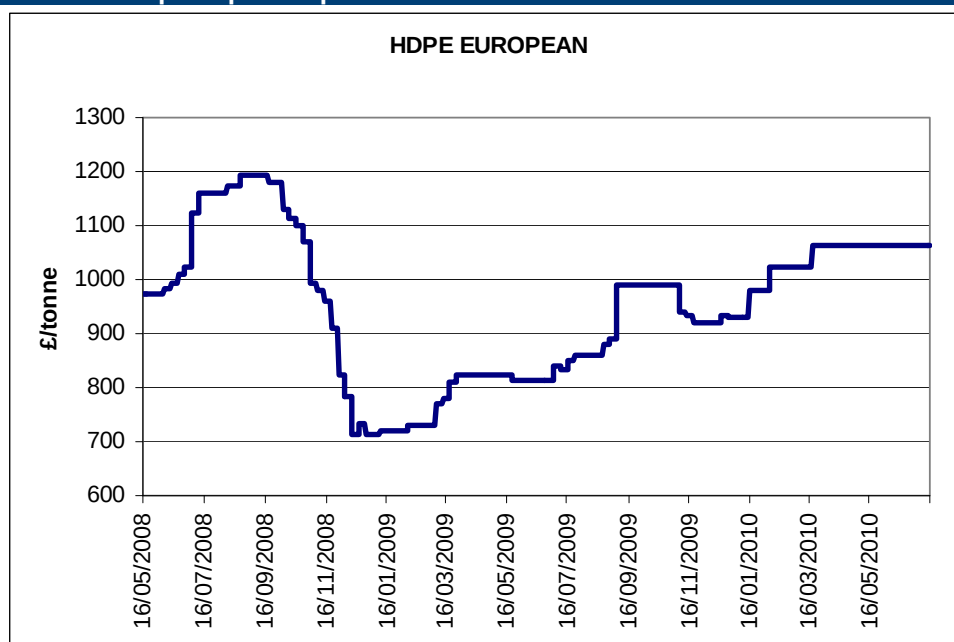
Source: Bloomberg; compiled by Daiwa CM Europe.

Scrap aluminium price



Source: Bloomberg; compiled by Daiwa CM Europe.

HDPE European plastic price

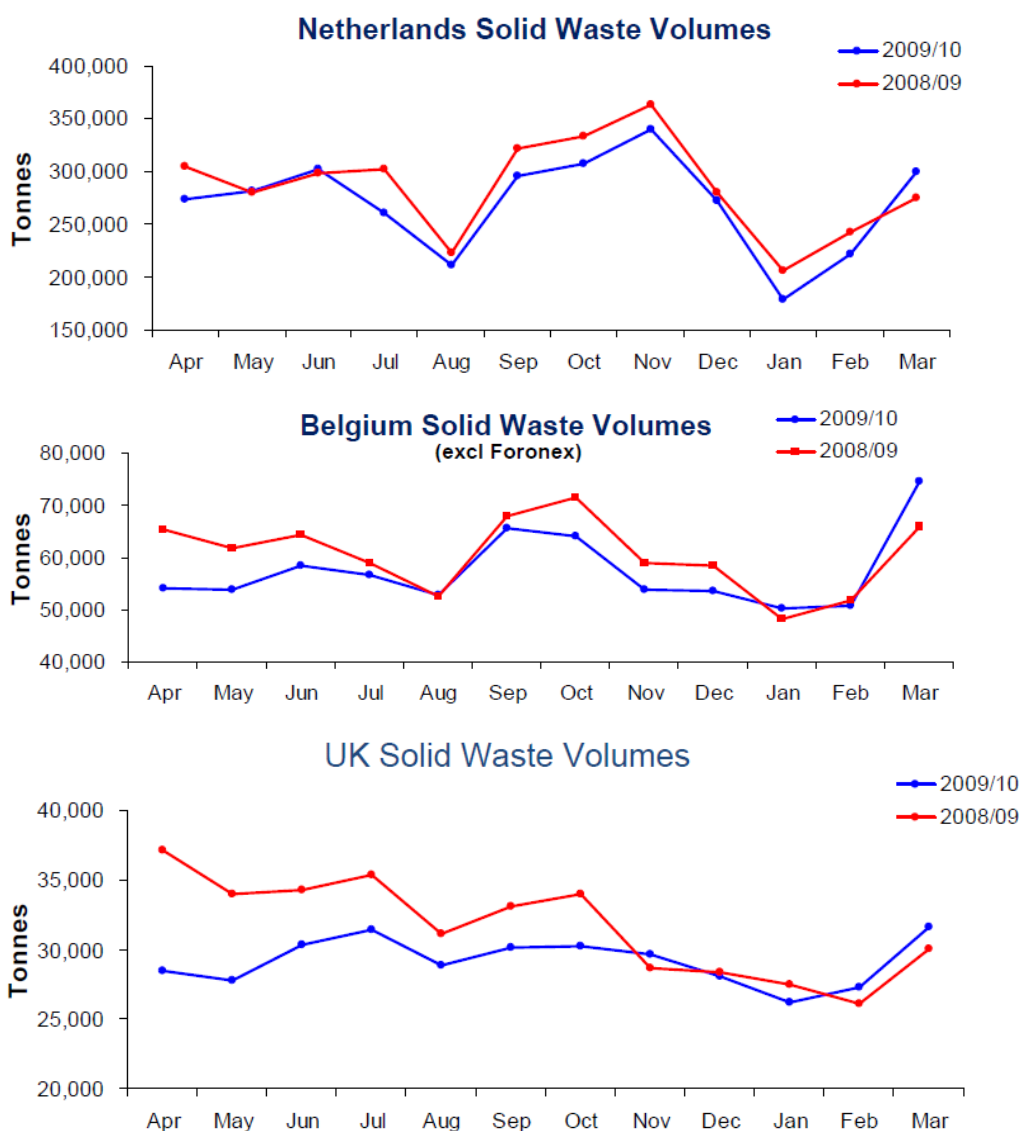


Source: Bloomberg; compiled by Daiwa CM Europe.

Whilst Suez Environnement will have market price exposure for secondary raw materials during the 4 to 6 weeks period it takes to process the waste (i.e. buy waste at one price and sell recovered material about a month later), the majority of the commodity price move has a marginal profit impact and profitability is more dependent on recycling volumes that have remained subdued (although higher end prices should stimulate recycling demand).

Whilst SEV has not disclosed the Q1 volume decline, it has stated that market conditions in March were better than January/February and April improved on March. However waste competitor Shanks plc (SKS LN) has disclosed its Q1 monthly volume trend which illustrates the negative impact of the weather during January and February and indicates volumes in March above last year in all of its geographic markets (Netherlands, Belgium, UK).

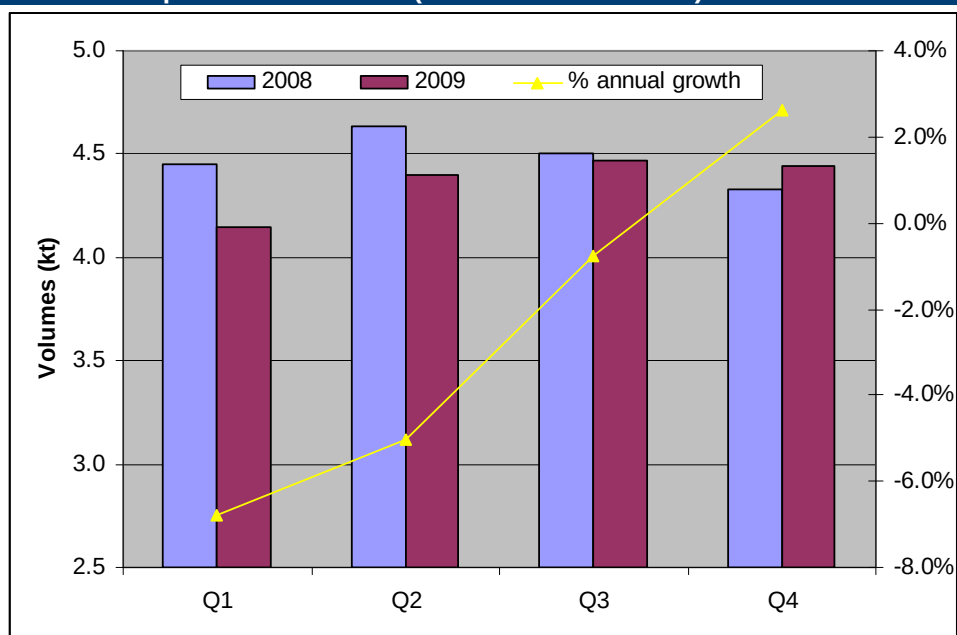
Shanks Q1 2010 Solid Waste Volumes



Source: Shanks plc; compiled by Daiwa CM Europe.

We estimate that had Suez Environnement's treated waste volumes in Q1 2010 maintained their Q4 2009 level (Q4 generally quieter due to factory closures), given the soft comparative of Q1 2009 the year-on-year volume growth rate would have been +7%.

Waste Europe treated volumes (non-hazardous waste)

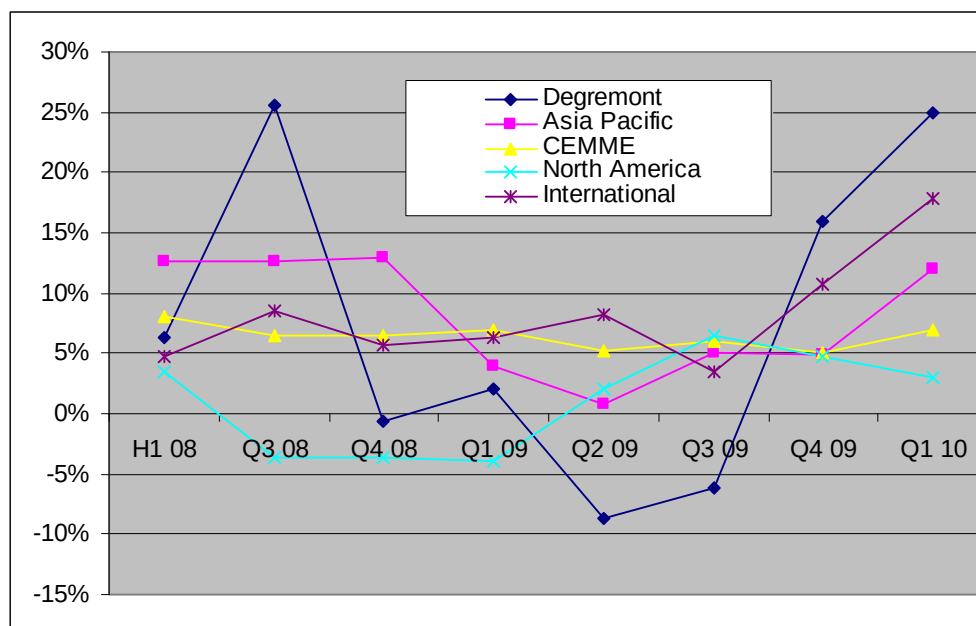


Source: Daiwa CM estimates.

France Waste grew revenues by 7.3% organically, boosted by the price increase in secondary raw materials with volumes impacted by the weather. UK/Scandi volumes felt the greatest weather impact but organic revenues were stable as a result of the increase in the UK landfill tax. Benelux/Germany achieved 6.3% organic revenue growth with stable volumes and the benefit from secondary raw material pricing.

The International division reported 17.8% total Q1 revenue growth and 13.3% organic revenue growth, driven largely by China and Australia.

International division organic revenue growth trend



Source: Daiwa CM estimates.

Degremont revenues increased organically by 25%, supported by the commencement of the Melbourne desalination contract awarded in August 2009.

This contract should generate around €650m in revenues for Degremont over a three year period (material contribution from Q4 09), roughly half of the total €1.2bn project contract value (operation and maintenance revenues to be reported in Asia Pacific division and spread over 30 years). However the EBITDA impact is muted, with design and build contracts typically achieving a 5% EBITDA margin (vs 15.8% EBITDA margin achieved by International in 2009).

Degremont's other businesses (both in France and internationally) also achieved organic revenue growth.

North America achieved 3% organic revenue growth, largely from tariff increases in the regulated water activities (drinking water volumes declined), offsetting price and volume declines in the non-regulated (largely wastewater) activities.

Asia Pacific achieved 12% organic revenue growth with a broad based recovery in demand and the commissioning of two new organic waste treatment units. The Chinese water business benefited from increased volumes and major tariff increases as of 1 Jan 2010 (+25% in Chongqing and +29% in Changshu).

The Central Europe, Mediterranean, Middle East (CEMME) region achieved 7% organic revenue growth with strong growth in Morocco, Poland and Czech Republic.

Divisional forecasts

Suez Environnement divisional forecasts						
€m	2008	2009	2010E	2011E	2012E	2013E
Water Europe						
AGBAR revenues	1,623	1,717	2,088	2,411	2,476	2,550
Lyonnaise des Eaux revenues	2,230	2,276	2,345	2,403	2,476	2,550
Water Europe Revenues	3,853	3,993	4,433	4,815	4,952	5,100
Water Europe EBITDA	812	866	981	1,104	1,149	1,183
Water Europe D&A	-233	-242	-300	-326	-326	-326
Water Europe concession fees/stock option charge	-164	-191	-195	-212	-218	-224
Water Europe EBIT	415	433	486	567	606	633
Water Europe post concession/stock option EBITDA	648	675	786	893	931	959
Maintenance capex	-182	-198	-244	-265	-272	-281
Development capex	-116	-157	-220	-240	-50	-51
Total capex	-298	-355	-464	-505	-322	-332
Waste Europe						
French Waste revenues	2,961	2,872	3,073	3,205	3,366	3,534
Benelux/Germany Waste revenues	1,430	1,351	1,432	1,494	1,568	1,647
UK/Scandi Waste revenues	1,336	1,096	1,129	1,177	1,236	1,298
Waste Europe Revenues	5,728	5,319	5,634	5,876	6,170	6,479
Waste Europe EBITDA	924	798	817	864	919	978
Growth		-14%	2%	6%	6%	6%
Waste Europe D&A	-433	-457	-460	-463	-467	-471
Waste Europe concession fees/stock option charge	-22	-27	-25	-26	-27	-29
Waste Europe EBIT	469	314	332	375	425	479
Waste Europe post concession/stock option EBITDA	902	771	792	838	892	950
Maintenance capex	-369	-256	-282	-294	-309	-324
Development capex	-190	-207	-220	-220	-210	-210
Total capex	-559	-463	-502	-514	-519	-524
International						
Degremont revenues	1,014	1,053	1,316	1,447	1,592	1,751
North America revenues	458	561	618	668	692	719
Asia/Pacific revenues	538	595	738	812	894	983
CEMME revenues	755	759	835	918	1,010	1,111
International Revenues	2,765	2,969	3,506	3,845	4,188	4,564
International EBITDA	419	468	548	607	664	728
International D&A	-125	-137	-150	-163	-178	-194
International concession fees/stock option charge	-12	-22	-23	-25	-27	-30
International EBIT	282	309	376	419	459	504
International post concession/stock option EBITDA	407	447	525	582	637	698
Maintenance capex	-111	-110	-140	-154	-168	-183
Development capex	-173	-150	-180	-197	-215	-234
Total capex	-284	-260	-320	-351	-382	-417
Other						
Other Revenues	17	15	17	19	21	22
Other EBITDA	-53	-72	-60	-55	-61	-64
Other D&A	-2	-2	-2	-2	-2	-2
Other Concessions/Stock option fees	-52	-56	-61	-68	-74	-78
Other EBIT	-108	-130	-123	-124	-137	-143
Other post concession/stock option EBITDA	-105	-128	-121	-123	-135	-142

Source: Daiwa CM Europe estimates.

Suez Environnement group forecasts						
Suez Environnement Total €m	2008	2009	2010E	2011E	2012E	2013E
Revenues	12,364	12,296	13,590	14,555	15,330	16,165
EBITDA	2,102	2,060	2,286	2,520	2,672	2,826
D&A	-792	-838	-911	-954	-972	-992
Other provisions	16	-13				
Share based payments	-53	-56	-50	-50	-50	-53
Disbursements under concession contracts	-213	-227	-254	-281	-297	-308
Current operating income	1,059	926	1,071	1,236	1,353	1,473
Total post concession/stock option EBITDA	1,835	1,777	1,982	2,189	2,325	2,465
Maintenance capex	-664	-569	-670	-716	-753	-791
Development capex	-480	-515	-620	-657	-475	-486
Acquisition capex	-1,532	-376	-600	0	0	0
Total capex	-2,676	-1,459	-1,890	-1,374	-1,228	-1,277
Marked to market on operating financial instruments	3	2				
Impairment	-2	-85				
Restructuring costs	-21	-60	-50	-50	-50	0
IPO costs	-51					
Profit on disposal	47	84	100			
Income from operating activities	1,036	867	1,121	1,186	1,303	1,473
Financial expenses	-421	-359	-451	-474	-454	-455
Debt related financial income	91	73	70	70	70	70
Other financial income	0	26	0	0	0	0
Net financial income	-330	-260	-381	-404	-384	-385
PTP	706	607	740	782	919	1,088
Income tax	-93	-129	-192	-235	-276	-326
Tax rate	0	0	0	0	0	0
Share in net income of associates	34	38	40	45	51	57
Net income	647	516	587	592	694	819
Minority interests	-114	-113	-134	-167	-190	-214
Net income group share	533	403	453	425	505	605
Reported EPS (€)	1.09	0.82	0.93	0.87	1.03	1.24
Estimated recurring EPS (€)	1.14	0.95	0.82	0.97	1.14	1.24
DPS (€)	0.65	0.65	0.65	0.65	0.65	0.65
Payout	60%	79%	70%	75%	63%	52%
Cover (x)	1.68	1.27	1.43	1.34	1.59	1.90

Source: Daiwa CM Europe estimates.

COMPASS cost savings

The original COMPASS efficiency programme covered the period 2008-2010 and initially targeted €125m of net savings, subsequently revised up to €180m with the 2008 results. The group exceeded these targets achieving €190m of savings over 2008-2009, with €135m of this benefit derived in 2009 (of which Waste derived €70m). The 2009 savings were broadly spread including €32 million in purchases, €56 million in operating gains, €43 million in SG&A and €4 million in health, safety and risk management.

The new COMPASS plan (COMPASS 2) covers the period 2010-2012 and has a target of €250 million in net EBITDA gains versus 2009. As with the original programme, procurement savings will play a significant role and the new initiative directly addresses purchase volumes of €2.1 billion out of a total base of €5 billion in 2009. In addition, the regrouping of the head offices of the main French entities (Suez Environnement, SITA France, Lyonnaise des Eaux, Degremont and OIS) at a single site in La Defense is expected to produce significant savings in 2010.

Balance sheet

For 2010 SEV has guided to net investments of less than €1.3bn (€1.9bn adjusting for the impact of the Agbar transaction) – in line with our forecasts. Suez Environnement has provided guidance of €0.7bn FCF generation in 2010 and we forecast FCF to be €742m, driven in part by a higher forecast of EBITDA.

Suez Environnement group free cashflow forecasts						
Free cashflow calculation €m	2008	2009	2010E	2011E	2012E	2013E
Cashflow from operations before financial income and taxes	1,789	1,797	2,021	2,234	2,376	2,575
Total maintenance capex	-664	-569	-670	-716	-753	-791
Change in working capital	-52	-77	-82	-86	-90	-94
Tax paid	-205	-115	-190	-192	-235	-276
Financial interest paid	-353	-218	-381	-404	-384	-385
Financial interest received	41	22	0	0	0	0
Interest received on non-current financial assets	4	4	4	0	0	0
Dividends received on non-current financial assets	33	40	40	40	40	40
Other	0	7	0	0	0	0
FCF	594	891	742	876	955	1,068

Source: Daiwa CM Europe estimates.

The Agbar acquisition will increase group reported net debt : EBITDA from 3.1x in 2009 to around 3.3x in 2011 (3.5x in 2010 but with only H2 contribution from Agbar).

SEV is targeting a reduction in this net debt : EBITDA ratio to around 3.0x in 2012, although we forecast a ratio of 3.1x as a result of FX translation effects. Adjusting for the concession renewal costs would suggest an underlying level of net debt : EBITDA in 2011 of 3.8x – above the level of many European power companies although this higher level of debt can be supported given there is no 2013 carbon related profit impact. The forecast adjusted net debt : EBITDA level in 2013 of 3.4x is only marginally above the 3.0x level targeted by many European power companies.

Moodys currently rates Suez Environnement's senior unsecured debt as A3 with a negative rating outlook.

Suez Environnement net debt : EBITDA multiple

€m	2008	2009	2010E	2011E	2012E	2013E
Net debt	-5972	-6282	-8082	-8345	-8369	-8314
Reported EBITDA	2102	2060	2286	2520	2672	2826
Net debt : EBITDA	2.84	3.05	3.54	3.31	3.13	2.94
Adjusted (concessional renewal) EBITDA	1835	1777	1982	2189	2325	2465
Adjusted net debt : EBITDA	3.3	3.5	4.1	3.8	3.6	3.4

Source: Daiwa CM Europe estimates.

Suez Environnement group cashflow forecasts

	2008	2009	2010E	2011E	2012E	2013E
EBITDA	2,102	2,060	2,286	2,520	2,672	2,826
Net disbursements under concession contracts	-213	-227	-254	-281	-297	-308
Impairment of current assets	-24	-16	0	0	0	0
Impact of restructuring	-78	-46	-50	-50	-50	0
Dividends received and share in net income/loss of associates	22	31	40	45	51	57
Net allocation to provisions for employee benefits	-20	-6	0	0	0	0
Cash generated from operations before income tax and financial expense:	1,789	1,797	2,021	2,234	2,376	2,575
Tax paid	-205	-115	-190	-192	-235	-276
Working capital	-52	-77	-82	-86	-90	-94
Cash generated in operating activities	1,532	1,606	1,749	1,956	2,052	2,205
Maintenance capex	-664	-569	-670	-716	-753	-791
Development capex	-480	-515	-620	-657	-475	-486
Capex	-1,144	-1,083	-1,290	-1,374	-1,228	-1,277
Disposal of property plant and equipment	40	17	0	0	0	0
Acquisitions	-1,419	-206	-600	0	0	0
Disposals	-18	8	80	0	0	0
Acquisition of available for sale securities	-36	-124	0	0	0	0
Disposal of available for sale securities	145	327	0	0	0	0
Interest received on non-current financial assets	4	4	4	4	4	4
Dividends received on non-current financial assets	33	40	40	40	40	40
Change in loans and receivables issued by the company	-23	-6	0	0	0	0
Net Agbar debt consolidation			-600			
Cashflow from investing activities	-2,419	-1,024	-2,366	-1,330	-1,184	-1,233
Ordinary dividends paid	-318	-318	-318	-318	-318	-318
Minority dividends paid	-178	-113	-135	-168	-190	-214
Dividends paid total	-497	-431	-452	-485	-508	-532
Repayment of debt	-494	-1,912				
Change in fair value of financial assets	129	-1,084				
Financial interest paid	-353	-218	-381	-404	-384	-385
Financial interest received	41	22	0	0	0	0
Increase in borrowings	2,326	4,053				
Increase in capital	1	13				
Change in shareholders equity	0	16				
Cashflow from financing activities	1,155	458	-834	-889	-892	-917
Impact of FX / other	-66	4	-350	0	0	0
Total cashflow	202	1,043	-1,800	-263	-24	55

Source: Daiwa CM Europe estimates.

Shareholders

The largest shareholder of Suez Environnement is GDF Suez with a 35.4% shareholding. GDF Suez has effective control over Suez Environnement with the appointment of nine of the eighteen board members (including the Chairman with the casting vote).

In addition, GDF Suez has pre-emption rights pertaining to a further 13% of Suez Environnement's shares through a shareholder agreement with five other French institutions/corporates entered into in June 2008 (for a duration of five years). We believe this structure effectively prohibits the parties from acquiring shares which could result in an obligation to file a tender offer (i.e. the members could be deemed a concert party).

Suez Environnement shareholder agreement structure	
Shareholders	Holding
GDF Suez	35.4%
GBL	7.2%
Caisse des Depots	2.0%
Areva	1.4%
CNP Assurances	1.3%
Sofina	0.8%
Sub-total	48.0%

Source: Bloomberg; compiled by Daiwa CM Europe.

Whilst the shareholder agreement would still permit the disposal of shares by a member within this five year period (most likely being acquired by another agreement member), favourable tax treatment on the distribution of Suez Environnement shares at the time of the demerger requires the shares to be held for a period until at least July 2011 (3 years following the listing).

Whilst there has been some press speculation (subsequently denied) regarding a potential combination of GDF's Energy Services division with Suez Environnement (to create a Dalkia-style energy/water service group), we do not expect any material equity changes from GDF Suez ahead of next July and envisage a joint venture operation could extract combination synergies from the two operations in the interim.

Valuation – Group

Our divisional DCF model arrives at a Fair Value of €17.1 per share for the Suez Environnement group. This represents around 23% upside from the current share price of €13.9 per share.

At our Fair Value, Suez Environnement would trade on a “headline” 2011 EV/EBITDA (MV+Net debt+Minorities / headline EBITDA) of 6.2x – still below the Bloomberg consensus forecast for Veolia of 6.8x.

Roughly 40% of the estimated value of the group is derived from the European Water activities, with about a third derived from the European Waste activities and around 25% from the International activities.

Suez Environnement group sum-of-the-parts valuation (€m)					
	Value	2011 EV/EBITDA	2011 EBITDA	2011 adj EV/EBITDA	2011 adj EBITDA
Water	8,394	7.6	1,104	9.4	893
Waste	6,442	7.5	864	7.7	838
International	4,714	7.8	607	8.1	582
Other	-418	7.6	-55	3.4	-123
Total	19,131	7.6	2,520	8.7	2189
Acea stake	91				
Aguas de Valencia	135				
Eyath	8				
Eastern Europe water	96				
Other associates	267				
Total estimated associates	597				
Less					
Pension provisions	-105				
Sector related risks	-41				
Warranties	-133				
Disputes, claims, tax risk	-491				
Site rehabilitation	-35				
Restructuring costs	-142				
Provisions	-1,389				
Minorities	-1,880				
Net debt	-8,082				
Equity fair value	8,376				
Equity fair value per share	17.1				

Source: Daiwa CM Europe estimates.

Valuation – Water Europe

We value the Water Europe division at €8.4bn, equivalent to a 2011 EV/EBITDA of 7.6x based on reported EBITDA and 9.4x adjusted for concession renewal costs / share based compensation. The 7.6x reported EV/EBITDA is in line with the pre-synergy acquisition multiple paid for Agbar (indicative ~7.9x 2010 post synergy), whilst the 9.4x adjusted EV/EBITDA is in line with UK water multiples.

We have used a WACC of 6.2%, with a 4.2% risk free rate derived from 3.3% 30 year euro interest rate swaps and 94 bps CDS-implied French sovereign credit risk. We have applied a Beta of 1.0x and a market risk premium of 4.5%. We have assumed a pre-tax cost of debt of 5.1% and a 50/50 ratio of debt to equity. We have applied a 20 year forecast horizon and a zero percent terminal growth rate.

Our 6.2% discount rate compares to the 6.5% applied by Suez Environnement in 2009 to test Agbar's goodwill carrying value. Applying a 6.5% discount rate would reduce the divisional valuation to €7.9bn and reduce our group equity Fair Value by €1.0 per share.

Water Europe discounted cashflow model																						
Year	€m	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24	Dec-25	Dec-26	Dec-27	Dec-28	Dec-29	Dec-30
NOPLAT Calculation																						
EBIT		486	567	606	633	661	689	717	746	775	804	834	864	895	927	959	992	1,025	1,060	1,095	1,131	1,167
Depreciation Addback		300	326	326	326	327	329	331	334	337	341	346	351	356	362	369	376	383	391	399	408	418
Taxes on EBIT		(146)	(170)	(182)	(190)	(198)	(207)	(215)	(224)	(232)	(241)	(250)	(259)	(269)	(278)	(288)	(298)	(308)	(318)	(328)	(339)	(350)
Others		-27	-28	-29	-30	-31	-32	-33	-34	-36	-37	-38	-40	-41	-43	-44	-46	-48	-50	-52	-54	-56
NOPLAT		613	694	720	739	759	779	800	821	844	867	891	916	942	968	995	1,024	1,053	1,083	1,114	1,146	1,179
Growth of NOPLAT			13.21%	3.77%	2.63%	2.62%	2.63%	2.68%	2.71%	2.73%	2.73%	2.77%	2.78%	2.80%	2.81%	2.83%	2.84%	2.85%	2.86%	2.87%	2.88%	2.89%
EBIT tax rate		30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
Free Cash Flow Calculation																						
NOPLAT		613	694	720	739	759	779	800	821	844	867	891	916	942	968	995	1,024	1,053	1,083	1,114	1,146	1,179
Capital Expenditure		(464)	(505)	(322)	(332)	(342)	(352)	(363)	(374)	(385)	(396)	(408)	(421)	(433)	(446)	(460)	(473)	(488)	(502)	(517)	(533)	(549)
Free Cash Flow		149	189	398	407	417	427	437	448	459	471	483	495	508	522	536	550	565	581	597	613	631
Growth of FCF			26.77%	110.10%	2.33%	2.31%	2.37%	2.42%	2.46%	2.51%	2.53%	2.58%	2.60%	2.63%	2.65%	2.68%	2.70%	2.72%	2.74%	2.76%	2.77%	2.79%
Year		Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24	Dec-25	Dec-26	Dec-27	Dec-28	Dec-29	Dec-30
WACC Valuation																						
Free Cash Flow		149	189	398	407	417	427	437	448	459	471	483	495	508	522	536	550	565	581	597	613	631
WACC		6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%	6.17%
Discount Factor		1.000	0.942	0.887	0.836	0.787	0.741	0.698	0.658	0.619	0.583	0.550	0.518	0.488	0.459	0.433	0.407	0.384	0.361	0.340	0.321	0.302
Discounted Free Cash Flow		149	178	353	340	328	316	305	294	284	275	265	256	248	240	232	224	217	210	203	197	190
PV of Free Cash Flow							5,307															
PV of Terminal Value					+		3,087															
Minorities							-															
Net Debt Value					-		-															
Net Equity Value							8,394															

Source: Daiwa CM Europe estimates.

Valuation – Waste Europe

We value the Waste Europe division at €6.4bn, equivalent to a 2011 EV/EBITDA of 7.5x reported EBITDA and 7.7x adjusted for concession renewal costs / share based compensation. The 7.5x reported EBITDA (main adjustments are share based compensation related) would represent around a 10% premium to the 2011 EV/EBITDA multiple of about 6.7x for peers such as Shanks, Seche Environnement and the US waste operators WMI and Republic Services.

We have used a WACC of 6.8%, with a 4.2% risk free rate derived from 3.3% 30 year swaps and 94 bps CDS-implied French sovereign credit risk. We have applied a Beta of 1.3x (greater economic sensitivity) and a market risk premium of 4.5%. We have assumed a pre-tax cost of debt of 5.1% and a 50/50 ratio of debt to equity. We have applied a 20 year forecast horizon and a 1.5% terminal growth rate (greater long term growth potential due to increasing requirement to recycle – FCC (Fomento de Construcciones y Contratas) applies a higher terminal growth rate to waste vs water).

Our 6.8% discount rate compares to the 5.8% and 6.0% applied by SEV in 2009 to respectively test SITA France and SITA UK's goodwill carrying values. The German and Dutch waste operations had 6.0% and 6.1% discount rates applied respectively. Applying a 6.0% discount rate to our Waste Europe valuation would increase our divisional valuation to €7.8bn and increase our group Fair Value by €2.7 per share.

Waste Europe discounted cashflow model

Year	€m	Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24	Dec-25	Dec-26	Dec-27	Dec-28	Dec-29	Dec-30
NOPLAT Calculation																						
EBIT		332	375	425	479	535	593	653	724	774	826	879	935	992	1,051	1,113	1,177	1,244	1,314	1,386	1,462	1,541
Depreciation Addback		460	463	467	471	476	483	491	501	512	525	539	554	572	590	611	633	657	682	709	738	769
Taxes on EBIT		(100)	(112)	(128)	(144)	(160)	(178)	(196)	(217)	(232)	(248)	(264)	(280)	(298)	(315)	(334)	(353)	(373)	(394)	(416)	(439)	(462)
Others		-34	-35	-36	-38	-40	-42	-45	-47	-50	-53	-56	-59	-62	-66	-70	-74	-78	-83	-88	-93	-98
NOPLAT		658	691	728	768	810	855	904	961	1,004	1,050	1,099	1,150	1,204	1,260	1,320	1,383	1,449	1,519	1,592	1,669	1,750
Growth of NOPLAT			4.96%	5.42%	5.46%	5.49%	5.57%	5.64%	6.31%	4.54%	4.58%	4.62%	4.65%	4.68%	4.71%	4.74%	4.76%	4.78%	4.80%	4.82%	4.83%	4.85%
EBIT tax rate		30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%	30%
Free Cash Flow Calculation																						
NOPLAT		658	691	728	768	810	855	904	961	1,004	1,050	1,099	1,150	1,204	1,260	1,320	1,383	1,449	1,519	1,592	1,669	1,750
Capital Expenditure		(502)	(514)	(519)	(524)	(530)	(578)	(607)	(637)	(669)	(702)	(737)	(774)	(813)	(853)	(896)	(941)	(988)	(1,037)	(1,089)	(1,144)	(1,201)
Free Cash Flow		156	177	210	244	260	278	297	324	335	348	361	376	391	407	424	442	461	481	503	525	549
Growth of FCF			13.10%	18.51%	16.38%	6.56%	6.78%	6.96%	8.97%	3.62%	3.75%	3.87%	3.93%	4.03%	4.11%	4.19%	4.26%	4.32%	4.37%	4.43%	4.47%	4.51%
Year		Dec-10	Dec-11	Dec-12	Dec-13	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22	Dec-23	Dec-24	Dec-25	Dec-26	Dec-27	Dec-28	Dec-29	Dec-30
WACC Valuation																						
Free Cash Flow		156	177	210	244	260	278	297	324	335	348	361	376	391	407	424	442	461	481	503	525	549
WACC		6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%	6.84%
Discount Factor		1.000	0.936	0.876	0.820	0.767	0.718	0.672	0.629	0.589	0.551	0.516	0.483	0.452	0.423	0.396	0.370	0.347	0.325	0.304	0.284	0.266
Discounted Free Cash Flow		156	166	184	200	200	199	200	204	198	192	186	181	177	172	168	164	160	156	153	149	146
PV of Free Cash Flow																						
PV of Terminal Value																						3,710
Minorities																						2,732
Net Debt Value																						-
Net Equity Value																						6,442

Source: Daiwa CM Europe estimates.

European peer valuations

Suez Shareholdings/Subsidiaries													
Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	2011 DY	Price/Book
CHINA	6.7	3641	3468	-	23.4	22.1	27.7	25.0	22.9	0.0%	0.0%	0.9%	4.0
CHONGQING WATER GROUP-A													
CHILE	232.0	1816	2606	8.9	8.3	8.1	12.6	13.0	13.1	2.3%	2.3%	8.6%	2.2
AGUAS ANDINAS SA-A													
MOROCCO	430.0	309	367	4.2	-	-	15.5	-	-	4.2%	-	-	2.6
LYDEC													
THESSALONIKI WATER & SEWAGE	4.2	154	138	5.7	4.2	3.8	11.6	7.7	6.8	2.8%	4.0%		1.5
GREECE													
SPAIN	65.1	39	80	11.3	-	-	19.5	-	-	1.8%	-	-	1.2
AIGUES DE SABADELL													
Global peers													
Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	2011 DY	Price/Book
FRANCE	20.1	10007	27693	8.1	7.3	6.8	15.1	15.6	13.5	6.0%	6.1%		1.2
VEOLIA ENVIRONNEMENT													
FRANCE	14.0	6861	13830	7.8	6.2	5.6	17.1	16.3	14.2	4.6%	4.8%		1.9
SUEZ ENVIRONNEMENT CO													
European diversified peers													
Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	2011 DY	Price/Book
ITALY	8.6	1821	4397	9.7	7.1	6.3	-	13.0	10.7	0.0%	4.8%		1.4
ACEA SPA													
ITALY	1.4	1600	3616	-	6.0	5.6	21.1	13.9	12.1	5.6%	6.2%		1.0
HERA SPA													
ITALY	1.3	1631	3616	10.3	8.1	7.1	9.8	10.4	9.3	6.7%	5.5%		0.9
IREN SPA													
ITALY	4.5	245	697	7.5	6.5	6.1	21.1	14.1	12.2	2.0%	4.4%		0.7
ACEGAS-APS SPA													
European water peers													
Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	2011 DY	Price/Book
GREECE	5.4	576	768	13.3	9.4	8.3	121.8	14.7	12.4	0.3%	2.4%		0.7
ATHENS WATER SUPPLY & SEWAGE													
ITALY	3.0	229	284	8.0	-	-	27.0	-	-	2.0%	-	-	0.7
MEDITERRANEA DELLE ACQUE SPA													
ESTONIA	8.0	160	219	7.4	6.2	6.6	8.1	7.4	8.6	20.0%	10.0%		2.0
AS TALLINNA VESIA EQUITY													
GREECE	4.2	154	138	5.7	4.2	3.8	11.6	7.7	6.8	2.8%	4.0%		1.5
THESSALONIKI WATER & SEWAGE													
ITALY	1.6	57	99	8.7	-	-	-	-	-	0.0%	-	-	0.5
ACQUE POTABILI SPA													
SPAIN	65.1	39	80	11.3	-	-	19.5	-	-	1.8%	-	-	1.2
AIGUES DE SABADELL													
UK water peers													
Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	2011 DY	Price/Book
BRITAIN	558.0	4539	10348	7.7	9.4	9.1	9.4	13.8	13.4	6.1%	5.4%		2.5
UNITED UTILITIES GROUP PLC													
BRITAIN	1293.0	3658	8097	8.6	8.9	8.5	12.2	15.3	14.4	5.6%	5.0%		3.3
SEVERN TRENT PLC													
BRITAIN	326.9	2024	4582	10.4	9.9	9.0	13.8	13.7	11.8	4.1%	4.3%		5.4
NORTHUMBRIAN WATER GROUP PLC													
BRITAIN	581.0	2451	4579	9.8	9.9	9.2	14.6	16.2	14.6	3.9%	4.1%		3.1
PENNON GROUP PLC													
BRITAIN	6.7	159	321	6.8	-	-	9.3	-	-	1.3%	-	-	1.4
CASCAL N.V.													
BRITAIN	1003.0	55	99	7.4	-	-	8.9	14.2	-	5.5%	5.7%		2.4
DEE VALLEY GROUP PLC													
European waste peers													
Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	2011 DY	Price/Book
BRITAIN	101.5	481	861	7.1	7.1	6.5	21.1	15.6	12.4	3.0%	3.1%		1.0
SHANKS GROUP PLC													
FRANCE	54.0	466	712	7.1	7.1	6.7	18.6	14.1	11.7	2.4%	2.6%		1.3
SECHE ENVIRONNEMENT													
FINLAND	13.4	518	624	6.8	6.9	6.2	16.6	14.4	13.2	4.1%	4.3%		2.6
LASSILA & TIKANOJA OYJ													
ITALY	1.4	47	166	13.2	4.8	4.3	12.6	8.1	6.3	2.5%	2.9%		1.1
BIANCAMANO SPA													

Source: Bloomberg (Data as at 15/7/10)

International peer valuations

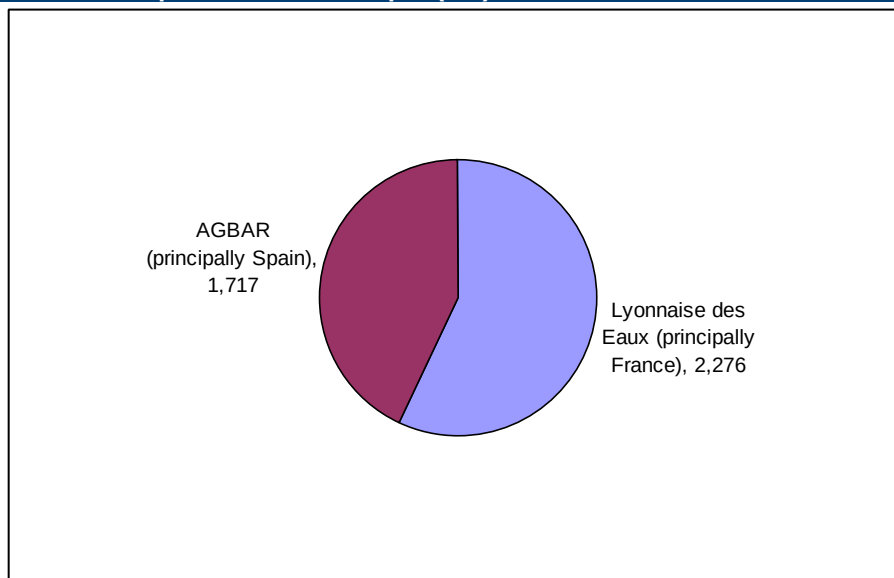
US water peers	Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	Price/Book
AMERICAN WATER WORKS CO INC	UNITED STATES	21.4	2888	6928	9.5	9.5	8.3	17.4	15.3	13.8	0.0	4.0%	0.9
AQUA AMERICA INC	UNITED STATES	19.0	2014	3107	11.4	10.3	9.4	24.1	21.7	19.9	0.0	3.1%	2.3
CALIFORNIA WATER SERVICE GRP	UNITED STATES	36.3	585	882	8.5	9.1	7.7	18.8	18.2	16.0	0.0	3.3%	1.8
AMERICAN STATES WATER CO	UNITED STATES	34.9	502	740	8.0	8.0	7.4	19.3	17.5	16.1	0.0	3.0%	1.8
SWJ CORP	UNITED STATES	24.7	353	546	10.6	10.6	-	29.0	20.5	18.0	0.0	-	1.8
SOUTHWEST WATER CO	UNITED STATES	10.8	230	335	36.1	36.1	-	-	-	-	0.0	-	2.3
MIDDLESEX WATER CO	UNITED STATES	16.2	191	318	14.0	14.0	-	22.2	17.8	17.6	0.0	-	1.6
CONNECTICUT WATER SVC INC	UNITED STATES	21.9	146	245	14.3	14.3	-	21.5	19.9	18.7	0.0	4.3%	1.7
ARTESIAN RESOURCES CORP-CL A	UNITED STATES	18.6	108	204	11.2	11.2	-	19.1	17.3	16.6	0.0	4.1%	1.5
YORK WATER CO	UNITED STATES	14.2	138	198	11.7	11.7	-	21.5	21.2	20.0	0.0	3.6%	2.0
CADIZ INC	UNITED STATES	13.3	141	164	-	-	-	-	-	-	0.0	-	22.4
PENNICHUCK CORP	UNITED STATES	22.7	82	125	13.1	13.1	-	33.8	29.1	28.0	0.0	-	1.9
CONSOLIDATED WATER CO-ORD SH	CAYMAN ISLANDS	11.4	129	110	-	-	-	14.8	14.6	14.0	0.0	-	1.3
Latin water peers	Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	Price/Book
CIA SANEAMENTO BASICO DE SP	BRAZIL	34.2	3406	5780	4.6	4.4	4.1	5.5	15.3	6.0	0.0	4.1%	0.7
AQUAS ENVIAS S.A.	CHILE	232.0	1816	2806	8.9	8.3	8.1	12.6	13.0	13.1	0.0	8.6%	2.2
AGUAS ENVIAS S.A.	BRAZIL	25.4	1261	1351	15.1	15.1	4.0	5.8	6.2	6.1	0.0	8.7%	0.5
EMPRESA OBRAS SANITARIAS VALP-A	CHILE	0.0	1267	1388	15.6	-	-	23.9	-	-	0.0	-	1.2
L'VEC	MOROCCO	430.0	309	367	4.2	-	-	15.5	-	-	0.0	-	2.6
Asian water peers	Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	Price/Book
CHONGQING WATER GROUP-A	CHINA	6.7	3641	2468	-	-	22.1	27.3	25.0	22.9	0.0	0.9%	1.0
SHANGHAI CHENGTOU HOLDING-A	CHINA	8.1	2111	2486	14.7	14.7	14.0	22.0	15.7	6.9	0.0	1.2%	1.6
BEIJING CAPITAL CO LTD-A	CHINA	5.5	1365	1814	13.6	13.6	12.4	25.0	25.1	21.9	0.0	2.9%	2.4
CHINA EVERBRIGHT INTL LTD	HONG KONG	3.4	1218	1340	19.3	14.0	11.0	29.4	22.4	17.7	0.0	0.7%	2.7
PUNCAK NIAGA HOLDINGS BHD	MALAYSIA	2.6	262	1254	6.1	4.4	4.3	6.0	6.5	6.0	0.0	4.3%	0.7
HYFLUX LTD	SINGAPORE	3.2	1009	1153	17.7	17.6	13.9	21.7	20.9	17.2	0.0	1.5%	4.3
TIANJIN CAPITAL ENVIRON-H	CHINA	2.3	912	1088	13.3	14.1	14.1	11.3	11.8	12.1	0.0	3.0%	0.9
SOUND ENVIRONMENTAL RESOUR-A	CHINA	19.3	912	1014	25.1	25.1	19.7	50.8	38.2	27.8	0.0	0.2%	7.2
BEIJING ENTERPRISES WATER GR	HONG KONG	2.4	809	1054	25.5	13.8	8.6	38.9	19.7	13.4	0.0	0.5%	3.0
MANILA WATER COMPANY	PHILIPPINES	17.3	570	680	5.8	5.8	4.8	13.0	11.4	10.3	0.0	2.6%	2.1
GUANGDONG GOLDEN DRAGON DE-A	CHINA	17.3	598	638	-	-	-	24.1	-	-	0.0	-	6.9
THAI TAP WATER SUPPLY PCL	THAILAND	4.9	467	649	8.1	8.1	7.8	12.2	10.1	9.4	0.1	6.3%	2.2
CHINA WATER AFFAIRS GROUP	HONG KONG	2.6	332	506	10.2	10.2	8.8	5.9	13.2	10.9	0.0	0.0%	1.5
SOUND GLOBAL LTD	CHINA	0.8	340	430	11.7	11.7	7.0	17.0	13.7	11.4	0.0	2.3%	3.0
NANHAI DEVELOPMENT CO LTD-A	CHINA	13.1	398	431	6.9	6.9	9.1	33.8	11.4	22.4	0.0	4.2%	3.4
ANHUI WATER RESOURCES DEV	CHINA	8.7	213	292	-	-	-	41.8	13.7	12.6	0.0	-	3.0
EASTERN WATER RESOURCES DEV	THAILAND	5.2	206	253	6.6	5.9	5.7	10.1	9.0	8.5	0.1	7.1%	1.4
JIANGXI HONGCHENG WATERWOR-A	CHINA	14.4	225	242	-	-	-	97.2	37.6	25.2	0.0	-	4.0
SINOMEN TECHNOLOGY LTD	SINGAPORE	0.5	145	145	8.1	8.1	5.7	9.7	7.4	6.6	0.0	2.6%	1.0
ASIA WATER TECHNOLOGY LTD	SINGAPORE	0.1	81	137	-	-	-	-	-	-	0.0	-	0.5
ASIA ENVIRONMENT HLDS LTD	CHINA	0.2	36	128	11.2	8.5	8.8	9.3	7.5	9.6	0.0	4.0%	1.5
TALIWORKS CORP BHD	MALAYSIA	1.5	138	118	8.3	-	-	11.4	12.6	14.4	0.0	0.4	0.4
BIO-TREAT TECHNOLOGY LTD	CHINA	0.1	42	120	-	-	-	-	-	-	0.1	-	0.3
MING HING WATERWORKS HOLDING	HONG KONG	0.1	89	86	88.0	-	-	-	-	-	0.0	-	1.0
SALCON BHD	MALAYSIA	0.6	73	88	-	-	4.8	12.5	11.0	9.7	0.0	2.3%	0.3
CHINA WATER INDUSTRY GROUP L	HONG KONG	0.1	32	91	72.7	-	-	-	-	-	0.0	-	0.3
PBA HOLDINGS BHD	MALAYSIA	0.8	67	70	5.1	-	-	16.1	15.8	15.5	0.0	4.9%	0.4
US waste peers	Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	Price/Book
WASTE MANAGEMENT INC	UNITED STATES	33.2	12403	18506	7.7	7.3	6.8	16.8	15.7	13.9	0.0	3.7%	2.6
REPUBLIC SERVICES INC	UNITED STATES	30.7	9083	14282	7.9	7.4	6.9	20.2	18.0	15.3	0.0	2.5%	1.5
Asian waste peers	Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	Price/Book
TRANSAPACIFIC INDUSTRIES GROU	AUSTRALIA	1.0	652	1843	8.6	6.8	6.2	-	16.4	10.6	0.0	0.7%	0.5
European water tech peers	Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	Price/Book
HALMA PLC	BRITAIN	287.6	1293	1283	10.2	9.3	8.9	17.9	14.9	14.0	0.0	3.2%	3.4
BWT AG	AUSTRIA	18.3	327	353	7.4	8.0	7.1	13.2	15.0	13.2	0.0	2.4%	2.1
US water tech peers	Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	Price/Book
ITT CORP	UNITED STATES	47.1	6687	7259	6.0	6.2	5.8	11.1	11.2	10.2	0.0	2.0%	2.2
NALCO HOLDING CO	UNITED STATES	23.4	2502	4625	8.8	8.4	7.8	22.9	16.2	13.5	0.0	0.6%	6.7
PALL CORP	UNITED STATES	37.0	3337	3521	10.0	9.7	9.1	18.1	18.0	16.1	0.0	1.6%	3.5
MUELLER WATER PRODUCTS INC-A	UNITED STATES	3.8	452	888	13.9	10.7	6.0	-	-	17.4	0.0	1.8%	1.4
CALGON CARBON CORP	UNITED STATES	13.2	567	550	9.3	7.8	6.4	17.6	16.8	13.9	0.0	-	2.4
INSITUFORM TECHNOLOGIES-CL A	UNITED STATES	23.3	707	723	9.6	7.8	6.8	21.6	15.6	13.2	0.0	-	1.7
GLV INC-A	CANADA	7.6	248	263	15.3	8.6	6.3	25.5	13.2	13.2	0.0	-	1.2
ENERGY RECOVERY INC	UNITED STATES	3.7	148	112	24.4	16.5	7.7	-	83.2	23.6	0.0	-	1.5
Asian water tech peers	Country	Close Price	Market value (€m)	Enterprise value (€m)	LTM EV/EBITDA	2010 EV/EBITDA	2011 EV/EBITDA	LTM PER	2010 PER	2011 PER	LTM DY	2010 DY	Price/Book
KURITA WATER INDUSTRIES LTD	JAPAN	2508.0	2888	2602	6.9	6.3	5.9	18.2	-	-	0.0	1.6%	1.6
EBARA CORP	JAPAN	350.0	1297	2118	6.8	7.3	6.1	26.8	-	-	0.0	1.6%	1.1
HORIBA LTD	JAPAN	2384.0	872	777	6.0	6.0	4.9	30.8	-	-	0.0	0.9%	1.2
ORGANO CORP	JAPAN	563.0	283	281	9.8	-	-	49.1	-	-	0.0	1.8%	0.8
DUOYUAN GLOBAL WATER INC-ADR	CHINA	18.9	359	267	7.2	7.2	5.1	27.6	14.4	11.4	0.0	-	2.2
UNITED ENVIROTECH LTD	SINGAPORE	0.4	95	86	-	-	4.6	11.0	8.2	6.2	0.0	-	1.5

Source: Bloomberg (Data as at 15/7/10)

Water Europe

Water Europe, comprising around 40% of group EBITDA, is split between the Lyonnaise des Eaux (France, Italy, Germany) and Agbar (largely Spain but also Chile and UK) water activities.

Water Europe 2009 revenue split (€m)

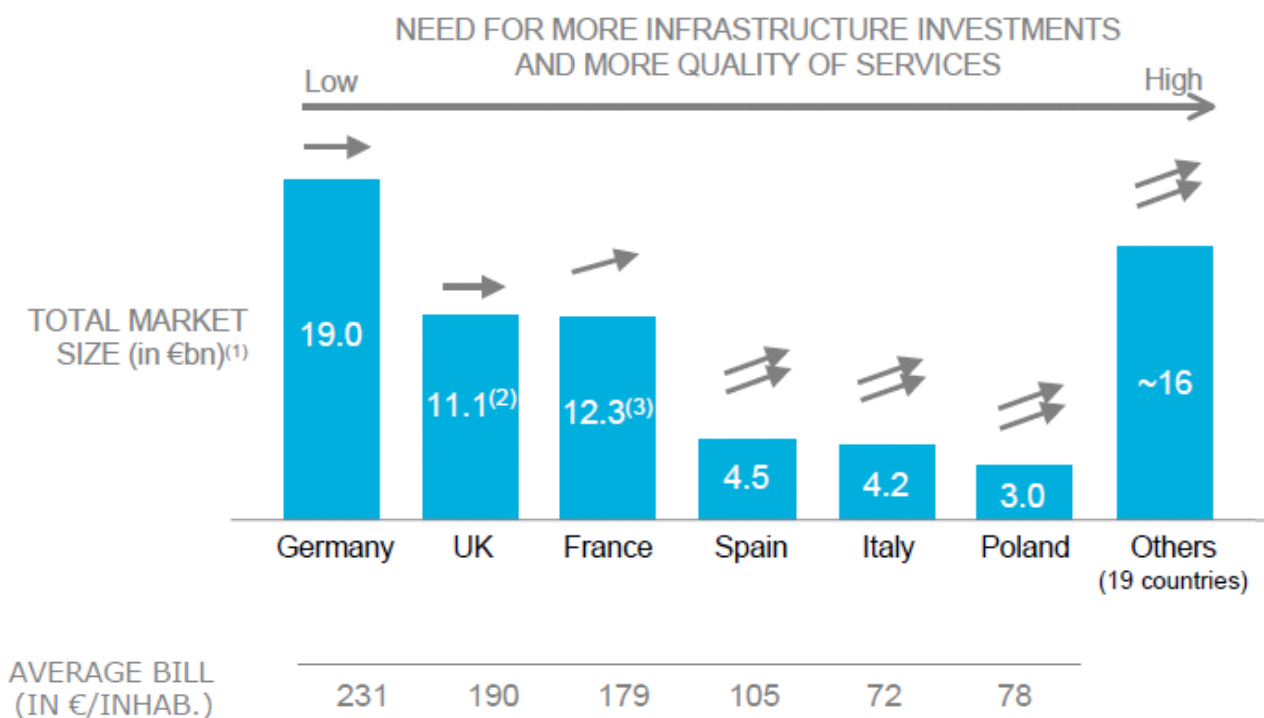


Source: Suez Environnement; compiled by Daiwa CM Europe.

We estimate that following the increased shareholding in and full consolidation of the Agbar water activities, EBITDA for the two divisions is of a similar size (at around €500m), although Criteria retains a 25% minority shareholding in Agbar.

By market size, Germany (€19bn) represents the largest water services market in Europe, however it is highly fragmented and dominated by the municipal utilities. The UK (€12bn) and France (€11bn) represent the next largest markets, with Spain the fourth largest at €5bn. Whilst SEV has a varying market presence in all four of these geographic markets, it has greatest exposure to France and Spain, markets which are expected to produce relatively higher growth as a result of the additional requirement necessary to bring the country's drinking water and wastewater standards up to EU regulated levels.

European water market size (in water and wastewater revenues) and average bill per capita



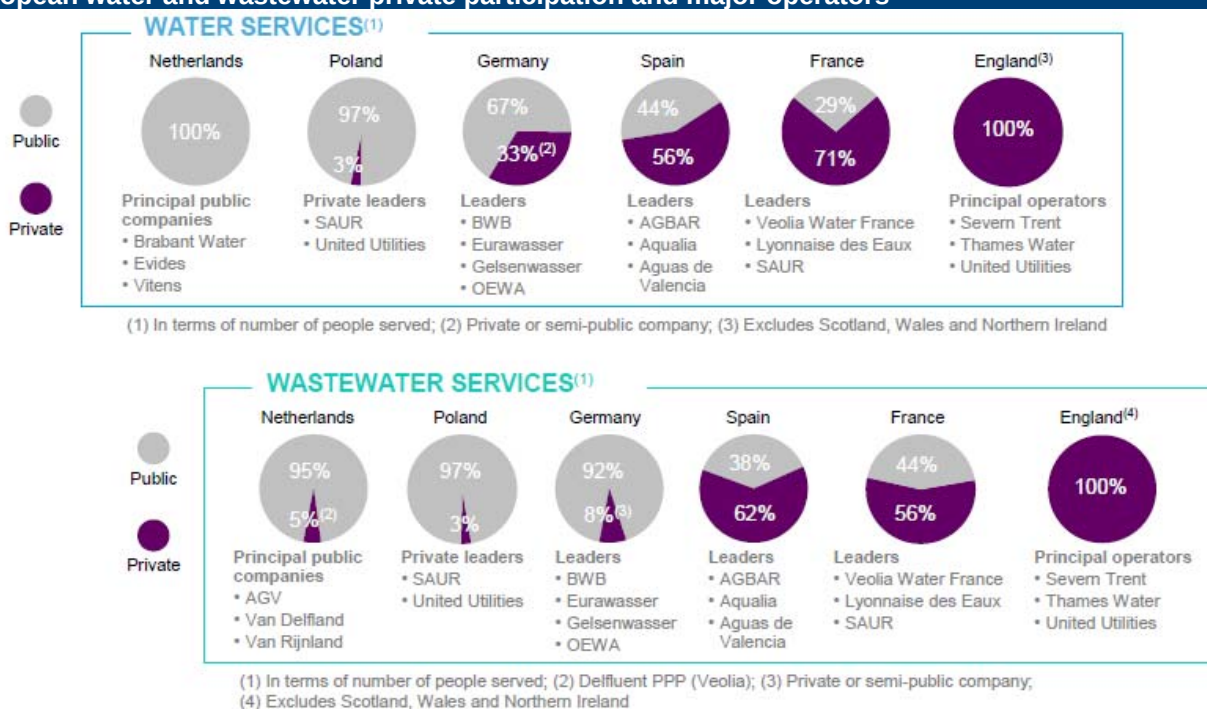
1) Total revenue from customer's billed water and wastewater services. Source: Suez Environnement

2) Source: OFWAT

3) Source: BIPE – FP2E (2008 data)

France and Spain are also markets where the proportion of private sector involvement in the water and wastewater sector is expected to continue to grow (unlike the UK which is already largely in private sector ownership).

European water and wastewater private participation and major operators



Source: BIPE – Club Enviroscope, Suez Environnement; compiled by Daiwa CM Europe.

As can be seen from the table below, the European markets with an established private water management presence are France, Germany, Greece, Italy, Portugal, Spain and the UK. Over the next fifteen years the markets where private sector participation is expected to increase the most are Ireland, Portugal and Spain.

Western Europe Private Sector Participation penetration forecasts						
	2009	2009	2015	2015	2025	2025
	Water	Sewerage	Water	Sewerage	Water	Sewerage
Austria	7%	0%	9%	12%	12%	17%
Belgium	3%	10%	3%	11%	3%	12%
Denmark	1%	0%	2%	2%	2%	2%
Finland	0%	1%	0%	2%	2%	2%
France	74%	55%	75%	71%	76%	76%
Germany	21%	18%	26%	29%	27%	31%
Greece	44%	37%	46%	45%	48%	48%
Ireland	1%	42%	21%	46%	19%	47%
Italy	41%	30%	53%	46%	59%	55%
Netherlands	0%	10%	0%	11%	0%	11%
Norway	6%	5%	5%	10%	8%	12%
Portugal	25%	23%	56%	51%	61%	56%
Spain	43%	50%	63%	57%	64%	62%
Sweden	1%	1%	5%	5%	5%	5%
Switzerland	0%	0%	0%	0%	0%	0%
United Kingdom	88%	90%	94%	96%	94%	97%

Source: Pinsent Masons Water Yearbook 2009-2010; compiled by Daiwa CM Europe.

Regulatory driven growth

The EU Directive 98/83/EC on Drinking Water dictates the quality requirements of drinking water relating to several parameters (turbidity, chlorites, arsenic, volatile organohalogens, nickel) but in particular requires the presence of lead to be below a certain threshold by 2013, which in essence requires the replacement of all existing lead pipes (Suez Environnement is offering its customers to conduct this work for additional fees).

The EU Urban Waste Water Treatment Directive (91/271/EEC) dictates that the original EU15 member countries should have systems in place by December 2000 for collecting and treating wastewater in urban areas with more than 15,000 inhabitants. EU12 members have transitional periods ranging to 2015 (Romania 2019).

These directives are a pre-requisite for meeting the goals in the EU Water Framework Directive (2000/60/EC) which requires that all waters in the EU achieve good ecological status by 2015.

Whilst data within the EU15 is not available for Greece, Ireland, Italy, Spain and the UK, the following table (2005 data) highlights that Belgium, France and Portugal are significantly behind Germany in complying with the EU directive.

EU compliance with Urban Water Waste Treatment Directive (2005)			
2005	Share of generated load collected	Article 4 compliance (secondary treatment)	Article 5 compliance (more stringent treatment)
Austria	99%	100%	100%
Belgium	97%	67%	49%
Denmark	100%	100%	88%
Finland	99%	88%	34%
France	100%	64%	50%
Germany	99%	100%	100%
Luxembourg	98%	95%	95%
Netherlands	100%	100%	100%
Portugal	95%	41%	13%
Sweden	100%	98%	67%

Source: European Commission; compiled by Daiwa CM Europe.

The EC has taken action against countries that are not complying with the directives. In November 2009 the European Commission (EC) initiated court proceedings in the European Court of Justice (ECJ) against France for not complying with this legislation as it deemed 65 large French towns/cities (including Bordeaux and Lyon) did not have treatment facilities up to EU standards. This followed warning letters issued by the EC in 2004 and 2008.

Separately, the EC has also sent a written warning to Belgium, Luxembourg, Portugal, France and Germany for inadequate waste treatment in smaller towns (2,000 to 15,000 inhabitants with deadline for compliance of December 2005).

Within Spain the EU UWWTD directive has had less of an effect as a result of additional phrasing added to the technical definition of the water collection system (Real Decreto-Ley 11/1995) which excluded many municipal sewer and drainage networks from the directive. Even so, the EC has issued a final written warning to Spain in October 2009 for failing to implement a 2007 ECJ ruling on wastewater treatment in the Valencia region.

Should France or Spain (or any other member state) fail to comply with the Court judgement within the time limit laid down, under Article 228 of the EC Treaty financial penalties can be imposed.

France

The French water and wastewater service market is estimated by Suez Environnement to total around €12bn in revenue, split evenly between drinking water production and distribution and wastewater treatment.

Since 1991 domestic water consumption has been decreasing by around 1% per annum, with water bills calculated (since 1994) according to the volume of water used. Suez Environnement has experienced a roughly 1% decline in billed water volumes in France for the last fifteen years (toilets, showerheads, washing machines and dishwashers have all become more water efficient).

The provision of water and wastewater services is a responsibility of the local municipalities, who have ownership of the infrastructure assets but generally contract out the operation of the water and wastewater services under long term contracts (typically 10 to 20 years).

Private sector involvement has been increasing by around 1% per annum since the late 1930s and the private sector now services around 71% of drinking water volumes billed and around 56% of wastewater services (largely in urban areas).

Lyonnais des Eaux France (LDEF) has around 2,600 DSP (Delegation of Public Services) contracts (with an average contract duration of 12 years) servicing 12m people, accounting for around 19% market share for drinking water supply and around 18% for wastewater.

With an average renewal rate (as % of revenues) of 88% and a residual contract life of around 8 years, this suggests that each year SEV has to produce about 1.5% revenue growth from new contracts simply to offset the effect of lost contracts.

In 2008 the city of Paris water company (Eaux de Paris) announced its decision not to renew the delegated management contracts that expired at the end of 2009. We estimate these contracts represented revenues of around €140m for Veolia and around €60m for SEV (€30m drinking water, €30m road water) and EBITDA of

around €20m and €10m respectively (SEV has also stated that no single contract accounts for more than 1% of group EBITDA which would represent a limit of around €20m).

Tariffs are typically adjusted either once or twice a year by an automatic escalation formula which incorporates the movement in the operators' major cost items such as labour and energy. Private sector water pricing has historically increased at a rate of 2.8% per annum between 2004-2007, below the 3.2% reported for the overall French water sector (including municipals) but ahead of the overall CPI inflation rate of 1.7%.

French water tariff pricing

	1994	1996	1998	2000	2002	2004	2007
Average of all French water and wastewater prices (1)	100.0	114.5	124	125.6	131.7	138.1	150.6
Average for private sector contracts (2)	100.0	113.6	118.7	122.2	126.6	129.2	143.6
Overall French CPI	100.0	103.9	105.3	108.4	112.4	117.3	124.0
Water tariffs as % of household income	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%

Source: INSEE, FP2E, Pinsent Masons Water Yearbook 2009-2010; compiled by Daiwa CM Europe.

Drinking water and wastewater services still account for the majority of LDEF revenues (51% and 24% respectively in 2009), with works-related services (e.g. for improvements or connections to distribution facilities and networks) accounting for 11% of 2009 revenues and supplementary services such as meter reading accounting for 14% of 2009 revenues. Supplementary service revenues have been growing at an above average rate of growth as local municipalities outsource labour intensive activities such as meter reading and call centre activities.

Competition

Private sector involvement in the water sector commenced in 1853 with the founding of Compagnie Generale des Eaux (Veolia), followed in 1880 with the founding of Lyonnaise des Eaux (Suez Environnement). By 1933 there were eight major private sector players, falling to five by 1990.

Now over 70% of the French water market is controlled by just three companies – Suez Environnement, Veolia and La Saur.

Saur's ownership structure potentially highlights the "strategic" nature of the French water sector. Historically Saur was owned by construction/concession group Bouygues but in 2005 was sold to private equity PAI Partners for €1bn. PAI subsequently sold Saur in 2007 for an estimated €2.3bn to Seche Environnement and a consortium of French financial institutions, but only after concerns were expressed about an initial approach led by Macquarie.

Six smaller French companies hold less than 5% of the market (Societe des Eaux de Fin d'Oise (SEFO), Saede, Sogedo, Alteau, Ternois Epuration and Groupe Raus) whilst German listed Gelsenwasser has a French subsidiary (Nantaise des Eaux), acquired in 2007.

France – estimated 2009 revenues of major water and solid waste service operators

France - estimated 2009 revenues (€m)	Water services	Waste services
Veolia	4,751	3,294
Suez Environnement	2,276	2,872
Saur	1,100	306

Source: Daiwa CM Europe estimates.

This degree of market concentration has raised concerns and in April 2010 the European Commission and the Autorite de la Concurrence (French Competition

Authority) launched an investigation to review whether there had been any collusion/unfair pricing when tendering for local authority water and sanitation management service contracts.

This is only a preliminary investigation which in itself does not indicate any breach of EU competition laws (and we do not expect any material feedback from the EU during 2010). Unfortunately during the process a SEV employee accidentally moved a seal on a door, which in itself may draw a fine (maximum permitted of 1% of revenues which would suggest around €20m but historically fines have averaged 0.14% which would suggest around €3m).

Historically the French water market appeared to lack strong competitive forces. Until the Nantes sewerage concession was awarded to Veolia in 1997, SEV and Veolia had never gained a contract from each other. However, since 1997 contracts at their expiry must be put out to competitive tender (Sapin Act) and private sector companies now provide the local authorities (and audit offices) with externally audited annual reports and results statements, publish annual reports on water prices (and quality) and have reduced the time period between price renegotiations from 15 years to every 5 years.

As an example of increased competition we would highlight the SEDIF (Great Paris Water Authority) contract currently held by Veolia but expiring end 2010. Although Veolia has held the contract for around 60 years (worth approximately €360m in revenues in 2009), with both Veolia and SEV shortlisted on the tender, Veolia's winning bid for a new 12 year cumulative contract value of ~€3bn suggests a price reduction of up to 20% (press reports 16%).

In addition, market competition also exists between the private and municipal segments of the market in that water services can always be returned to the municipal sector (as they have done for the city of Paris contract).

Finally we estimate EBITDA margins in SEV's French water business are around 20%, below those achieved by Agbar in Spain (28% in 2008 for Water & Environmental services) and similar to the 19% achieved in 2009 by aqualia (and the 18.5% average EBITDA margin of the Italian private operators).

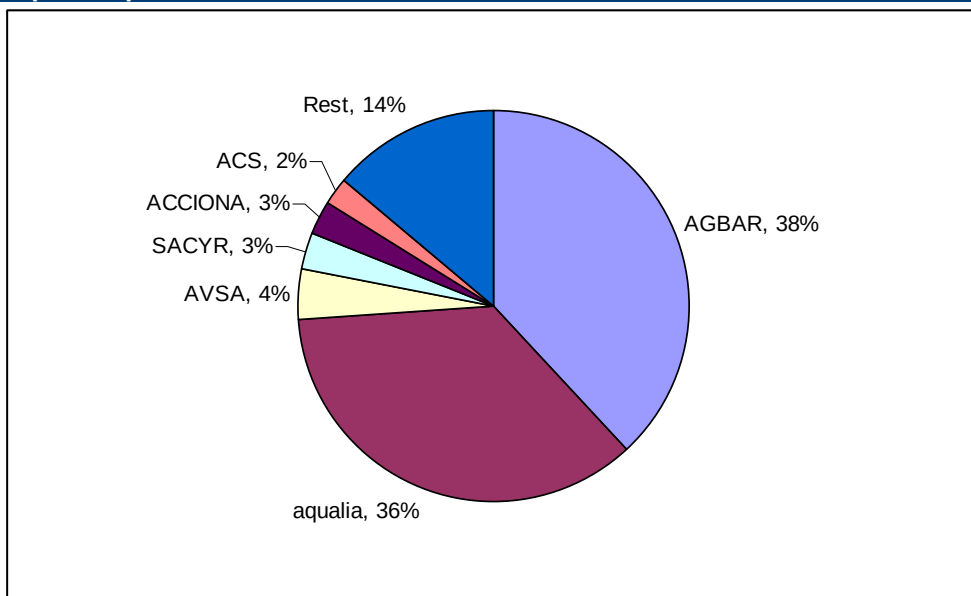
Whilst the 2009 post-tax ROCE of the Water Europe division of 9.0% is above the regulated returns of around 7% in Italy and around 6.5% in the UK (4.5% post-tax real assumed cost of capital), we estimate this largely reflects the lower capital intensity of the French management contract model and the relative absence of acquired goodwill.

Spain

Suez Environnement estimates the water sector in Spain represents some €4.5bn in revenue. Private operators currently represent about 56% of drinking water production and distribution and 62% of wastewater production².

Agbar is the leader in the Spanish water market with around 13m drinking water inhabitants (9m wastewater) and about a 38% share of the private sector (or around 27% of the total market).

Spanish private water sector market shares



Source: FCC; compiled by Daiwa CM Europe.

Of a similar size to Agbar is aqualia (subsidiary of FCC SM) with around 13m customers in Spain (26m globally). The remainder of the private market is relatively fragmented with small shares held by Aguas de Valencia (33% stake acquired by SEV in 2007 and serving 1m people), SACYR (SYV SM – through the service division Valoriza), ACCIONA (ANA SM) and ACS (ACS SM). SEV retains its unlisted 33% shareholding in Aguas de Valencia which it values at around €130m, whilst Agbar has recently launched a tender for the shares in Aigues de Sabadell (AIG/B SM – 0.4m inhabitants) that it does not already own. Veolia exited the Spanish water market when in 2004 it sold its shareholding in the holding company controlling FCC for €916m.

Contract duration is typically longer in Spain with new contracts typically having a contract life of around 30 years. This longer contract duration is also reflected in a longer backlog of around 19 years (suggesting the business should be more stable and potentially more highly rated than Lyonnaise des Eaux). Spanish tariffs are revised on an annual basis and are CPI adjusted so remuneration may not as closely match specific labour or energy cost inflation as the French indexation formula.

² Source: BIPE

Germany

Germany's water sector is the largest in Europe with an estimated market size of €19bn. Municipalities largely manage all of the utility services (power, gas and water) through the Stadtwerke system of local utilities - the Western Lander has over 1,400 water supply companies and some 6,000 water and sewerage entities.

Private sector participation in the water sector in Germany is relatively small at 30% of drinking water production and 10% of wastewater treatment and is dominated by RWE (RWE GY). RWE serves an estimated 12m people (13m globally) through its investments in RWE Aqua, RWW (Rheinisch-Westfaelische Wasserwerksgesellschaft) and its 24.95% stake in Berlin Wasser (50.1% owned by the state of Berlin).

Other large operators include Gelsenwasser (WWG GY – listed but 93% owned by the municipalities of Bochum and Dortmund following the sale by E.ON in 2003) and OEWA (Veolia).

Suez Environnement is present in the market through Eurawasser, servicing around 700k customers with 2009 revenues of €62m.

Germany – major water and sewerage operators

Company	Parent company (country)	Population served - water	Population served - sewerage	Population served - total
AWS	Veolia (France) / VKR (Germany)	620,000	420,000	620,000
Berlin Wasser	State of Berlin (Germany) / Veolia (France) / RWE (Germany)	3,590,000	4,000,000	4,090,000
Energie	Energie (Austria)	15,000	0	15,000
Eurawasser	Suez (France)	272,000	642,000	642,000
Gelsenwasser	Gelsenwasser (Germany)	4,580,000	545,000	5,245,000
Hansewasser	Gelsenwasser (Germany)	0	550,000	550,000
MVV	Mannheim Municipality (Germany)	990,000	400,000	990,000
Oewa	Veolia (France) / VKR (Germany)	620,000	420,000	620,000
RWE Aqua	RWE (Germany)	2,100,000	4,400,000	6,300,000
RWW	RWE (Germany)	1,300,000	1,300,000	1,300,000
Stadtwerke Gottingen	Gelsenwasser (Germany)	50,000	0	50,000
Strewa	Severn Trent (UK)	0	45,000	45,000
Stadtwerke Gorlitz	Veolia (France)	80,000	80,000	80,000
Stadtwerke Gera	Veolia (France)	165,000	165,000	165,000
Bruanschweig	Veolia (France)	250,000	250,000	250,000
WTE	EVN (Austria)	21,000	105,000	105,000
Remondis Aqua	Remondis (Germany)	120,000	540,000	540,000

Source: Pinsent Masons Water Yearbook 2009-2010, DCME estimates; compiled by Daiwa CM Europe.

Significant investment in German water and wastewater infrastructure is required, particularly in the former GDR where around 20% of surface water is considered of a poor quality. Whilst over 90% of the population in Western Germany are connected to a sewerage network that provides treatment to sewage, this proportion is only around 60% in the former GDR. The private sector participation market is therefore more likely to develop in the Eastern Lander, where the investment requirements are greater.

Germany – annual water and wastewater infrastructure investment

Annual investment €bn	2000	2003	2005	2006	2007	2008	2009	2010
Water	2.4	2.6	2.3	2.1	2.1	2.1	2.0	2.0
Wastewater	6.8	6.0	5.5	4.6	4.2	4.5	4.5	4.5
Total	9.2	8.6	7.8	6.7	6.3	6.6	6.5	6.5

Source: Global Water Intelligence (2009); compiled by Daiwa CM Europe.

Italy

Coverage of water distribution in Italy is relatively high at 96% but the average age of the network (30 years) and the relatively high level of water losses (39%) are a cause of concern.

The coverage in wastewater (75%) and sewerage (85%) is lower (and behind peers such as Netherlands and Germany) and the rivers Po, Tiber, Adige and Arno that account for around 40% of Italy's fresh water resources have all been classified by the National Information System on the Environment (SINA) as being poor or bad quality. The water quality in natural and man-made lakes is also generally poor and subject to frequent algal blooms (due to the intensive use of herbicides, fertilizers and the release of untreated sewage).

The investment needed in the water sector in order to comply with the EU Water Framework Directive is estimated³ at around €26bn (of which around €10bn is for drinking water with the remainder for sanitation and wastewater treatment).

Italy – planned investment in wastewater treatment (€m)			
Region	Total	New build	Upgrading
Piemonte	1,280	55%	45%
Lombardia	11,360	38%	62%
Liguria	334	-	-
Veneto	2,270	46%	54%
Emilia Romagna	307	56%	44%
Toscana	827	-	-
Umbria	219	90%	10%
Marche	26	-	-
Lazio	1,850	44%	56%
Abruzzo	20	52%	48%
Molise	18	74%	26%
Campania	1,690	51%	49%
Puglia	1,620	46%	54%
Basilicata	10	26%	74%
Calabria	1,120	40%	60%
Sicilia	3,020	37%	63%
Total (estimated)	25,971	43%	57%

Source: Global Water Intelligence; compiled by Daiwa CM Europe.

The Italian water services market has experienced significant consolidation over the past 15 years as a result of the 1994 Galli Law which reduced the number of managing entities from over 10,000 to around 90 managing areas (Ambiti Territoriali Ottimali or ATO).

The majority of these ATOs (70% by population served) are managed in-house (public enterprise) and as a result water service tariffs have been kept relatively low. The average water tariff in Italy in 2008 was €1.29 per m³ (equivalent to around €20 per family per month) compared to over €2 per m³ in the UK.

Market liberalization will increase from 2013 as new legislation ("Decreto Ronchi") requires in-house concessions to be tendered after they expire by the end 2010 and will only permit in-house utilities to tender for local concessions if they sell at least 40% of their equity to private investors. In addition, contracts issued to publically listed water companies have to be tendered after they expire by the end of 2010 and contracts issued before 2003 can only be retained if local authority ownership in the companies is reduced below 40% by June 2013 and below 30% by December 2015. SEV estimates the additional population that might be served by the private sector as a result of this law is around 35m or twice the size of the existing private sector market.

³ Global Water Intelligence (ACEA estimates €28bn)

Tariffs should also increase as both the 1994 Galli law and the European Water Framework Directive contain the principle of full cost recovery (capex, opex and environmental/resource costs) within the basis for setting tariffs.

For private water companies water tariffs are calculated to produce a post tax return of 7% on capital invested (with most of the diversified operators achieving around a high teens EBITDA margin).

Italian water utility EBITDA margins

	2009 EBITDA margin %
Acea	14.4%
Iride	17.4%
Hera	12.3%
Enia	16.0%
AcegasAps	21.9%
A2A	16.9%
Acque Potabili (2008)	15.5%
Mediterranea delle Acque	33.8%

Note: Iride and Enia have recently merged to form Iren SpA

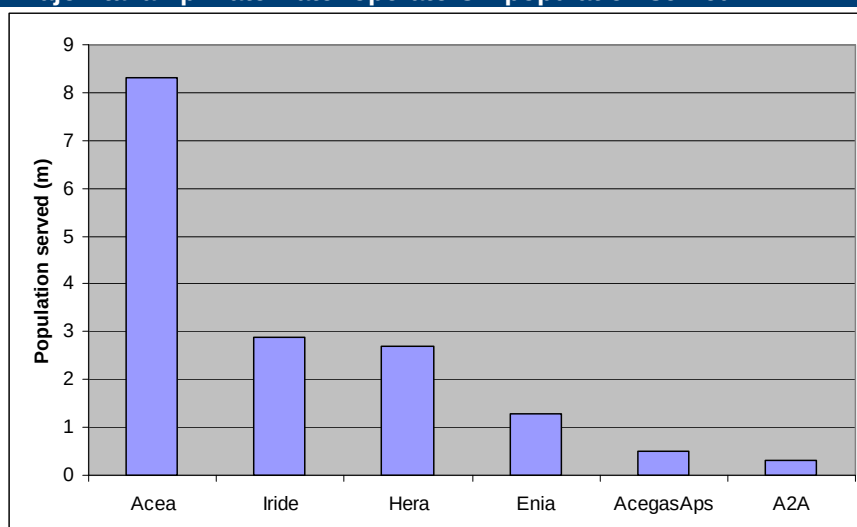
Source: Daiwa CM Europe.

The annual turnover of the Italian water industry is estimated⁴ at about €6.5bn (for around 5.5b m3 of water distributed), split 61% for production and distribution, 28% for wastewater and 11% for sewerage.

The largest private operator is Acea (ACE IM), with water related activities representing around 40% of the group EBITDA and invested capital (remainder largely power). Acea provides water services in Rome (ATO2) and major Tuscan cities (e.g. Florence, Pisa, Siena, Arezzo), all with long term contracts (typically 20 to 25 years).

Suez Environnement has a joint venture with Acea relating to its water services in Florence (Puliaacqua) and Pisa (Acque). In addition SEV independently owns two water and wastewater companies in Tuscany (Acque Toscane and Nuove Acque).

Major Italian private water operators – population served



Note: Iride and Enia have recently merged to form Iren SpA

Source: Daiwa CM Europe.

⁴ Source: ACEA (2008). Suez Environnement estimates market size excluding sewerage at €4.2bn

Combined, GDF Suez and Suez Environnement hold around 10% of Acea, with Suez Environnement with a 5% shareholding. During 2002 Acea and Electrabel (part of GDF Suez) entered into a strategic joint venture (AceaElectrabel) to develop energy activities in Italy. However the joint venture has not developed as planned and the management of Acea are now seeking to resolve the dispute with GDF by way of arbitration proceedings.

Diversified utility Iride has recently teamed with Italy infrastructure fund F2i to buy out the minorities of Mediterranea delle Acque (MEA IM), including those owned by Veolia, and co-finance Iride's water investment plans with the aim to participate in future public tender offerings and to become one of the leading water service operators in Italy.

United Kingdom

The water sector in the UK (and in particular England) has been almost entirely privatised since 1989 and operators also own the infrastructure. The private sector represents about 87% of drinking water production and around 85% of wastewater treatment.

Just four of the large water companies remain listed (NWG, Pennon, Severn Trent and United Utilities – Dee Valley is UK listed but relatively small), with many owned by infrastructure funds.

UK Water Company Ownership

Operating Company	Ownership
AWG	Osprey Acquisitions (Investment Consortium)
Bournemouth W Hampshire	Cascal (listed)
Bristol Water	Agbar/Suez Environnement
Cambridge Water	CKI (listed)
Dee Valley (DVW LN)	UK Listed
East Surrey Water	Deutsche Bank
Kelda Group	Saltaire Water (Investment Consortium)
Mid Kent Water	Westpac
Northumbrian Water (NWG LN)	UK Listed
Pennon (PNN LN)	UK Listed
Portsmouth Water	South Downs Capital
Severn Trent (SVT LN)	UK Listed
South East Water	Westpac
Southern Water	Greensands (Investment Consortium)
South Staffs Water	Alinda Infrastructure Fund
Thames Water	Macquarie
United Utilities (UU/ LN)	UK Listed
Veolia Central	Veolia (listed)
Veolia East	Veolia (listed)
Veolia Southeast	Veolia (listed)
Welsh Water	Not-For-Profit
Wessex Water	YTL Holdings (Malaysia)

Source: Daiwa CM Europe.

Veolia has longstanding ownership of three UK water companies (having sold its stake in Southern Water in 2006).

Suez Environnement's exposure is limited to Bristol Water (acquired in 2006) following the disposal of its shareholding in Northumbrian water in 2004. Bristol Water services 1.1m customers and had reported revenues of €57m in 2009.

Greece

Given the dramatic increase in water consumption since the 1970s (although now declining) Greece suffers from significant water shortages with widespread groundwater depletion and salination. It is estimated 4.1m people (>40% of the population) face regular water shortages.

In 1980 the government established state funded water and sewerage corporations, two of whom have been partially privatised. EYDAP covering the 4m inhabitants of Athens was privatised in 2000 whilst EYATH covering the 0.9m inhabitants of Thessaloniki was privatised in 2001.

To assist with its public finances, Greece has recently announced a wide ranging privatization programme which includes the planned sale of 23% of EYATH and 10% of EYDAP, leaving the government with a 51% controlling stake in both companies.

Given Suez Environnement already has a 5.3% shareholding in EYATH, we would expect the group to participate in the forthcoming sale process (23% stake currently worth around €35m).

Chile / China / Other

The Chilean water sector is a regulated market and as with the energy sector the Chilean government has demonstrated a stable regulatory framework.

SEV is present in Chile through the listed Agbar subsidiary Aguas Andinas (AGUAS/A CI), which provides drinking water to 6m inhabitants and wastewater services to 5m. In July 2008 Aguas Adinas acquired a 53.5% share (largely from Iberdrola) of southern Chilean water utility Essal for €109m (now fully consolidated), representing an EV/EBITDA of around 11x. Essal provides drinking and wastewater services to 650,000 inhabitants.

The Essal acquisition raised Suez Environnement's market share in Chile from around 40% to around 44%, which given the competition law ceiling of 50% effectively rules out further new company acquisitions, although Suez Environnement could participate in government stake sales within its existing water holdings (e.g. SEV's economic interest in Aguas Andinas is only 13%). It has been reported that the Chile government may raise over \$1bn from selling shareholdings in water utilities to finance the earthquake reconstruction.

Agbar also has a presence in Mexico (Saltillo, services provided to around 0.9m inhabitants), Colombia (services provided to around 0.9m inhabitants), Cuba (services provided to around 1.3m inhabitants) and Algeria (services provided to around 1.6m inhabitants).

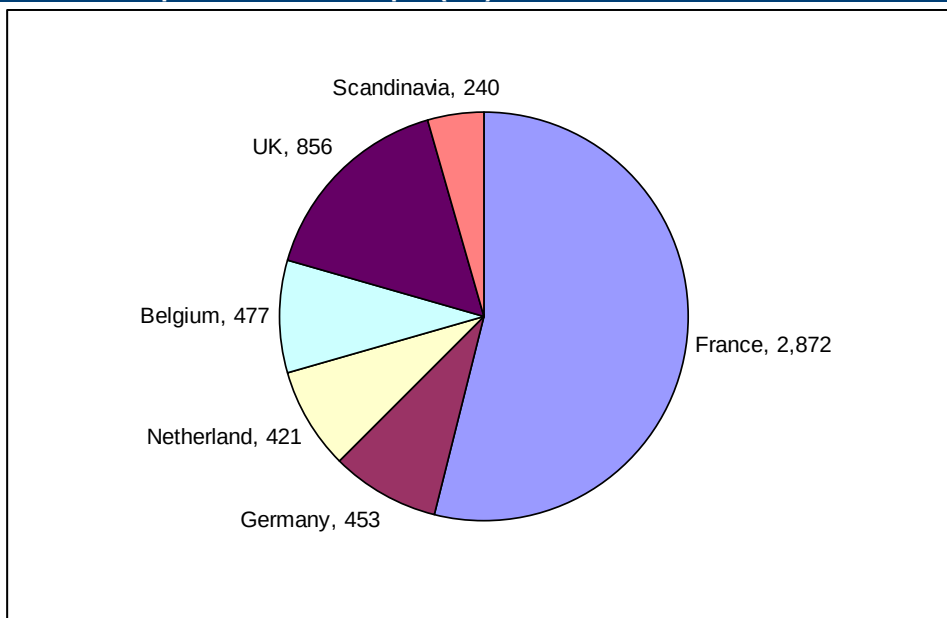
Similarly, in addition to Suez Environnement's Chinese operations reported in the International division, Agbar also has interests in the Chinese water and wastewater sector.

Agbar has a 71.5% shareholding in Jiangsu Water Company (having acquired additional 23% shareholding in 2008 for €50m suggesting a group equity value of €217m) which is a joint venture company with the Golden State Water Group corporation. JWC is responsible for four 30-year concession agreements in the cities of Nanjing (wastewater for 6m inhabitants), Taizhou (water treatment for 5m inhabitants), Taixing (raw water supply and 750km supply network) and Xuyi (drinking water treatment plant).

Waste Europe

Waste Europe comprises around 40% of group EBITDA, and is the business unit for the group's waste collection, sorting and recycling activities in France, Benelux, Germany, Scandinavia and UK.

Waste Europe 2009 revenue split (€m)



Source: Suez Environnement; compiled by Daiwa CM Europe.

SITA (Société Industrielle des Transports Automobiles) was created in 1919 as one of two service providers (along with Veolia's Compagnie Generale d'Enterprises Automobiles or CGEA) selected to collect household waste in Paris. In 1971 Lyonnaise des Eaux acquired a stake in SITA which has been fully owned by the group since 2000.

Waste collection is split between household and municipal solid waste, industrial and commercial waste, building and demolition waste, and hazardous industrial waste. Roughly half of SEV's Waste Europe revenues are derived from municipal clients (the remainder from industrial and commercial as SEV is relatively underexposed to demolition waste),

Whilst governments / local authorities are seeking to reduce public spending, waste collection is perceived by the public as a "frontline" service which should not be cut. An opinion poll published in July 2010 by the Local Government Association in the UK cited waste collection sixth in the list of front line services (after the police, fire service, NHS, schools and elderly care). Only one percent of respondents thought street cleaning, care for the elderly and rubbish collections should be cut to save public money (compared to 14% for defense and 34% for benefit payments).

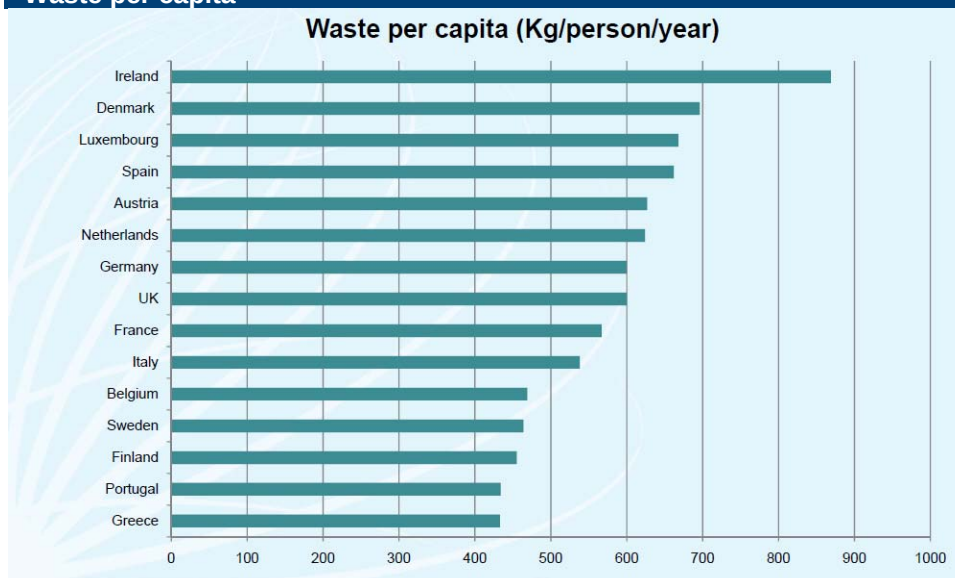
The volumes of household and municipal waste produced in Europe have grown steadily between 1995 and 2007 at an average annual growth of 1%. Whilst a strict comparison of Eurostat historic data is not possible because the data set has been modified, it is clear that volume growth within a number of the "original" member countries has slowed/declined (e.g. Belgium, France, Germany, Netherlands, Italy, UK), whilst strong growth is still being experienced in a number of southern and eastern European countries (e.g. Greece, Portugal, Spain).

Household waste volumes - top 10 European countries

Household waste (m tonnes)	2004	2006
United Kingdom	52.4	47.7
Turkey	29.8	30.1
France	25.1	25.5
Italy	25.0	25.1
Spain	21.8	23.2
Germany	26.1	20.9
Netherlands	7.9	8.0
Portugal	5.1	6.7
Belgium	6.5	5.0
Greece	4.6	4.9

Source: Eurostat; compiled by Daiwa CM Europe.

Suez Environnement estimates that European household and municipal waste volume should increase by an average of 1.5% per annum to 2020 but with a significant divergence between growth in the “new” members of the EU (like Greece and Portugal that still have relatively low per capita waste levels) and the “original” countries.

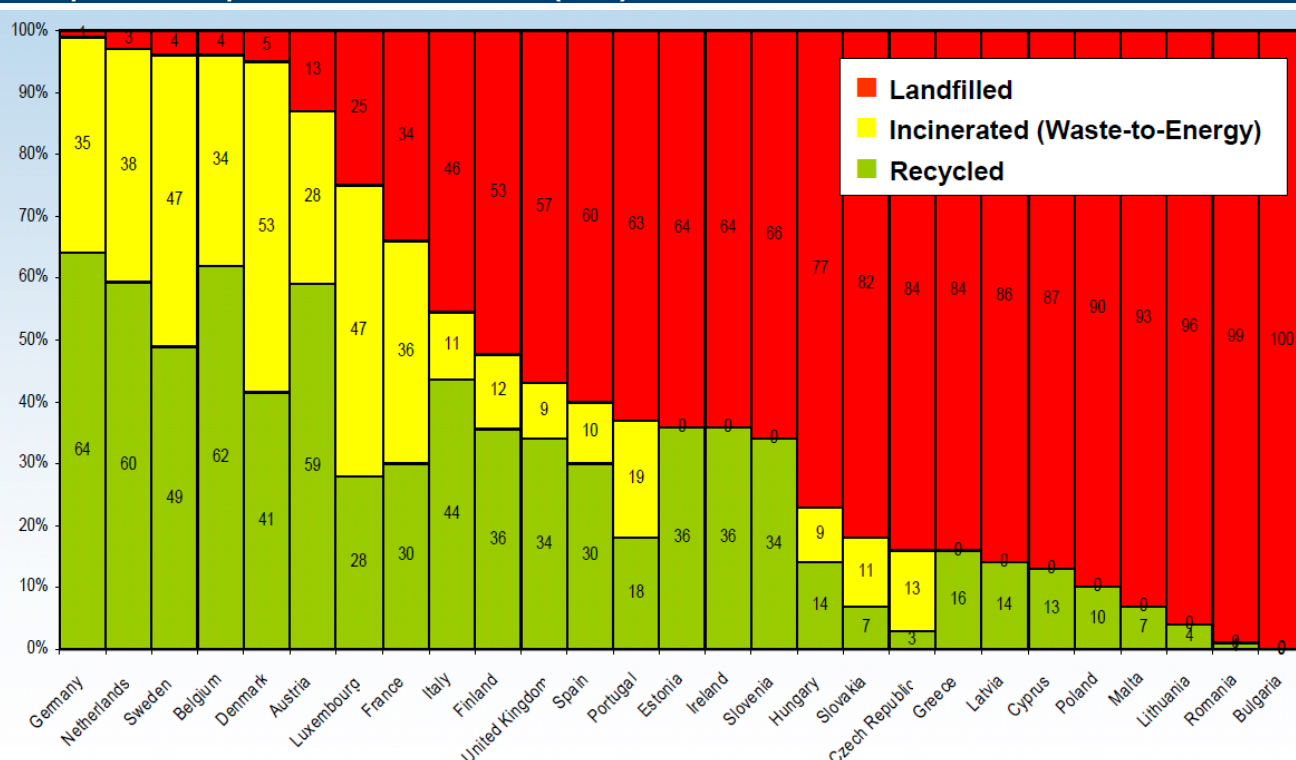
Waste per capita

Source: Caledonian Environment Centre; compiled by Daiwa CM Europe.

The production of industrial and commercial waste totalled around 800m tonnes in 2006, with “original” members accounting for more than 65% of this waste. Suez Environnement estimates that growth in industrial and commercial waste from “original” member states will average 2.5% per annum up to 2020.

The European Waste Framework Directive has set a target of 50% of municipal solid waste to be recycled by 2020. Whilst the European currently recycles around 40% as a whole, there is significant divergence at a national level between countries such as Germany, the Netherlands, and Belgium achieving far higher rates of recycling (around 60%) and countries such as France and Spain (and Eastern Europe in general) achieving far lower rates (30% or below).

European municipal solid waste treatment (2007)



Source: Eurostat; compiled by Daiwa CM Europe.

In addition to volume growth, the level of treatment applied to waste after collection is an important element in determining the value-added of the waste treatment process.

Volumes sent directly to final treatment facilities are reducing sharply as regulatory measures have been introduced to improve the level of waste recovery within the European Community. The reduction in waste sent to landfill is being driven by sortation and waste-to-energy (WTE). Sortation identifies and separates materials suitable for the production of “secondary raw materials” (metals, plastics, glass, paper etc).

Energy recovery through incineration, refuse-derived fuel or biomethanization are high value added techniques typically used in environmentally developed countries such as the Netherlands and Germany (where landfilling of household and municipal solid waste accounts for only 2% and 1% respectively compared to around 60% in the UK and Spain).

Since January 2009, several European countries (Netherlands, UK and France) have increased the level of taxes imposed on volumes sent to landfill, stimulating the respective waste treatment sectors. The gradual adoption of EU Directives on medium and long-term targets for waste and waste recovery rates by all members of the European Union should support longer term market growth.

In the United Kingdom the new Environment Secretary Caroline Spelman has recently announced a review of UK waste policy in an effort to boost recycling rates. She has stated that the UK should have more domestic facilities for processing recyclable rubbish (rather than sending it abroad) and is aiming to make the country a “zero waste economy”. Policy focus will also shift towards commercial waste and aluminium, glass and paper may be banned from landfill.

France

The French waste sector is worth approximately €10.8bn⁵, with private sector operators accounting for around half of household waste collection.

The French waste sector should experience growth as the proportion of waste recycled increases to the targeted 50% level. Currently around 34% of French household waste is sent to landfill, 30% is subjected to thermal treatment (waste to energy) and 36% is recovered.

SITA is the largest operator in the treatment of non-hazardous waste in France (18m tonnes both in landfill and incineration) and the second largest operator (after Veolia) in municipal and industrial & commercial waste collection (to 15m inhabitants). It is also a top two operator in the treatment of hazardous waste.

SITA France market share (% of total volume treated)				
Market share	Municipal solid waste collection	I&C collection	Incineration	Landfill
Non-hazardous waste	15%	26%	32%	34%
Hazardous waste			23%	57%

Source: Suez Environnement (2006 data); compiled by Daiwa CM Europe.

Benelux/Germany

Whilst Suez Environnement revenues within the Benelux/Germany region are relatively evenly spread across the three countries, by market size Germany at approximately €18bn⁶ is around three times the size of the Dutch market and six times the size of the Belgium market.

Whilst reportedly Germany achieves very high levels of recovery/conversion (65%) and incineration (34%) with less than 1% of municipal solid waste “landfilled”, these figures may be flattered by the inclusion of waste storage in salt mines within the recovered/converted statistics.

The German waste management market is dominated by municipal utilities accounting for around 38% of the market. The top four private operators account for a further 46% of the market.

German waste management market share		
Company	Owner	Market share
Municipalities	Public	37.5%
REMONDIS	Private	18.2%
Onyx/Sulo	Veolia	12.6%
Alba	Private	9.0%
Sita	Suez	6.5%
Others	-	16.2%

Source: Landauer, Handelsblatt, PSIRU; compiled by Daiwa CM Europe.

The market leader in the waste market in Germany is family owned REMONDIS AG (25m tonnes and €5.6bn revenues), the third largest waste operator in Europe (operates in 20 European countries as well as China, Japan, Taiwan and Australia). REMONDIS has also diversified into industrial water treatment in Germany, Spain, Poland, India and Turkey. Veolia also has a sizeable presence in Germany following its (arguably ill-timed) €1.5bn acquisition of Sulo, the second largest

⁵ Source: IFEN

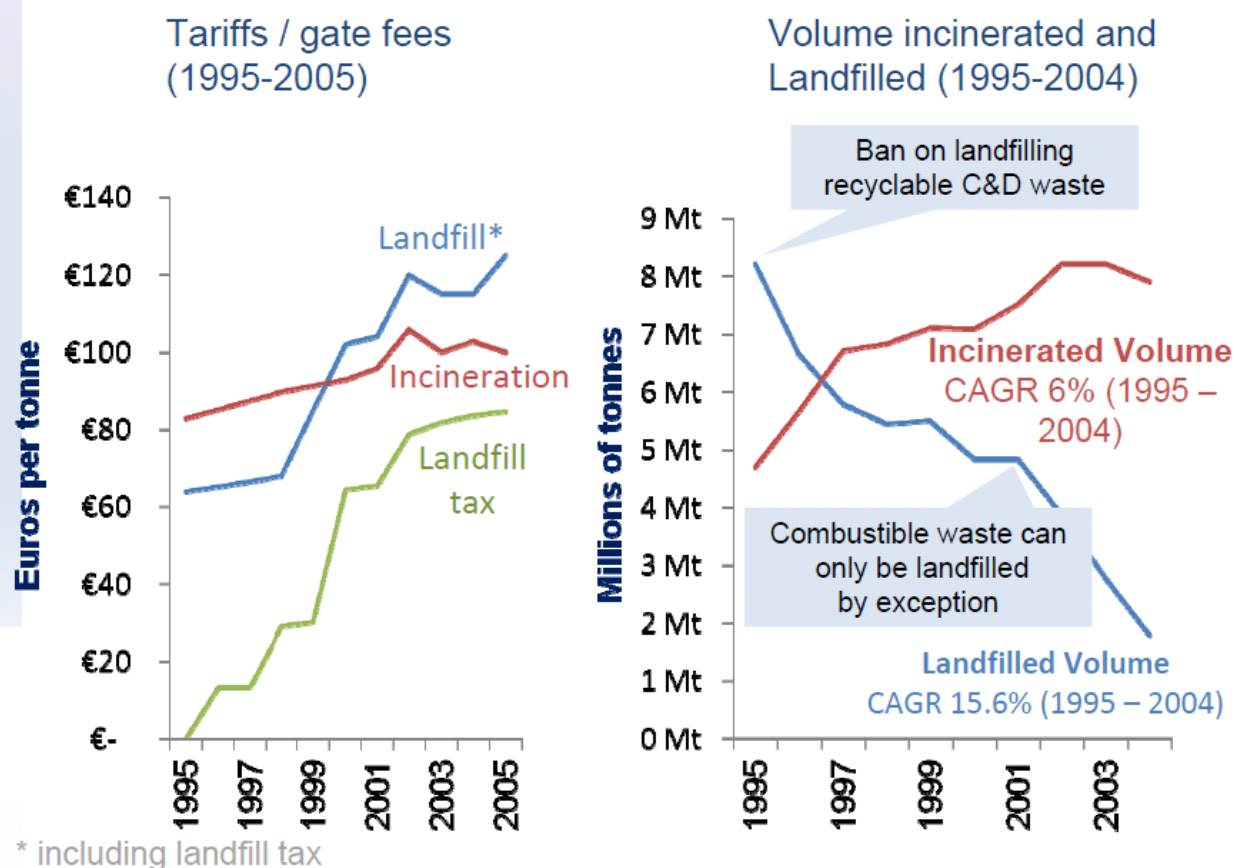
⁶ Source: Ecoprog

waste management group in Germany, in 2007. Alba, the third largest operator in Germany is privately owned and has global group wide revenues of €2.7bn.

SITA Deutschland is the fourth largest operator in Germany (focus on municipal solid waste in Western Germany) and achieved revenues of €453m in 2009 (servicing approximately 8m people and treating 1.4m tonnes of waste).

The Dutch waste market is estimated to be worth €6bn, with just 2% of household waste sent to landfill. The Dutch market is viewed as being among the most advanced in terms of environmental regulations, with landfill taxes having increased from around €3/tonne in the mid 1990s to over €80/tonne.

Dutch waste management tariffs and volumes



Source: SenterNovem, Shanks plc; compiled by Daiwa CM Europe.

SITA Nederland is the second largest private operator in the Dutch waste market after Van Gansewinkel Groep (Dutch revenues of €887m and group revenues of €1.1bn – owned by KKR and CVC) but is of a similar size to Shanks plc (Dutch revenues of €400m and group revenues of €770m). SITA Nederland achieved revenues of €421m in 2009, servicing 1.6m people and treating 1.4m tonnes of waste. 2010 revenue growth should benefit from a contract gain in 2009 vs Van Gansewinkel representing an additional treatment volume of 300,000 to 500,000 tonnes per annum.

The Belgian waste market is worth approximately €3bn and has only 4% of its waste sent to landfill. Currently municipal waste collection and treatment is handled by the public sector but SITA Belgium has a strong position in industrial and commercial waste collection services and achieved revenues of €477m in 2009 (vs Belgium revenues of around €200m for Van Gansewinkel and Shanks).

UK/Scandinavia

The UK still has a relatively high share of waste sent to landfill (57% in 2007), which should shift to recycling/waste to energy given material increases introduced to landfill taxes. UK landfill taxes are currently £48/tonne (in addition to the standard landfill operator waste disposal fee) and will increase by £8 per tonne per annum to at least 2014 (which will then provide a £80/tonne floor level until at least 2020).

Suez Environnement estimates the UK waste market to be worth around €10bn. SITA UK had revenues in 2009 of €856m (servicing 4m inhabitants and treating 10m tonnes of waste), which made the unit the second largest waste management operator in the UK after Waste Recycling Group (WRG). WRG was acquired by FCC in 2006 for €1.4bn and is the largest landfill operator in the UK with about a 40% share of the available capacity (treating over 11.5m tonnes of solid municipal waste per annum with revenues of around €1bn).

In Scandinavia, Suez Environnement is one of the top two waste management operators in Sweden and Finland (€240m of revenues in 2009). Whilst Sweden already achieves a very high level of recycling/incineration with just 4% of household waste landfilled, 53% of household waste in Finland is sent to landfill.

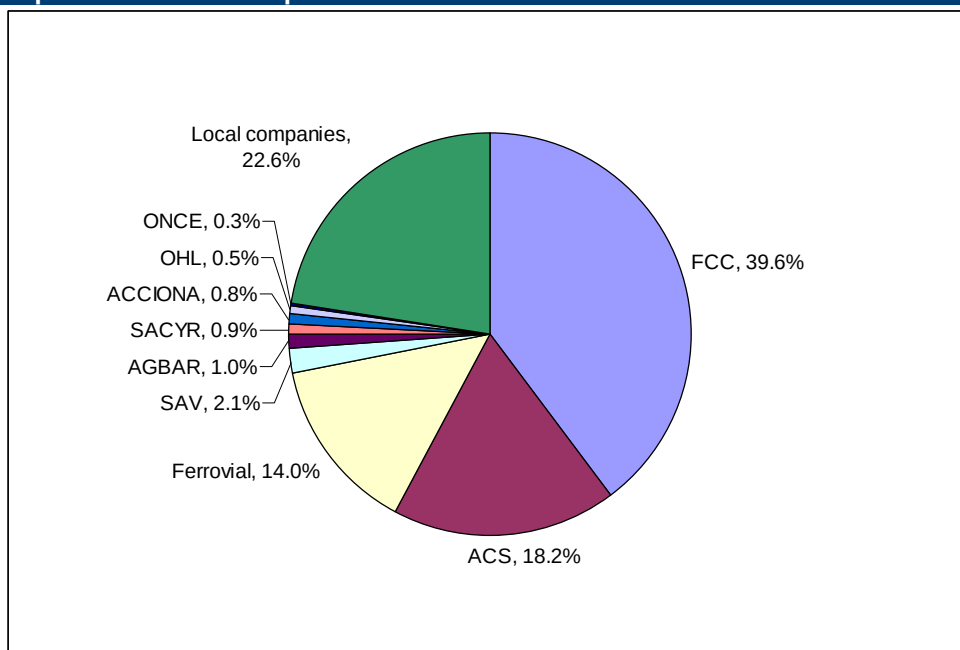
The market leader in Sweden is Ragn-Sells with revenues of around €350m whilst in Finland the market leader is listed Lassila & Tikanoja (LAT1V FH) with approximately €250m of revenues.

Spain

Suez Environnement doesn't have exposure to the Spanish waste management sector (Agbar is focused more on drinking water and wastewater treatment).

The Spanish solid municipal waste collection market has largely been privatised (76%) and is relatively consolidated with three operators (FCC, ACS and Ferrovial) accounting for over 70% of the market. Waste collection contracts are typically structured on a medium to long term basis (8 to 10 years).

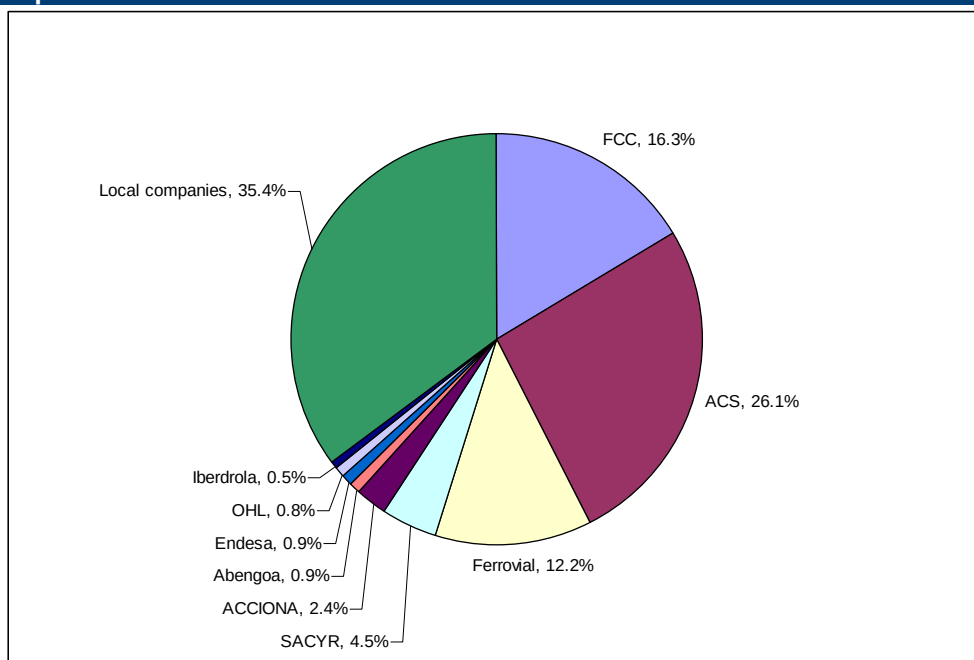
Spanish solid municipal waste collection market share



Source: FCC; compiled by Daiwa CM Europe.

The waste treatment sector is also largely privatised (79%) but is less well consolidated (same top three operators account for 55% of the market), with ACS the market leader. The higher investment requirements relating to urban waste treatment result in longer duration of contracts (10 to 30 years).

Spanish solid urban waste treatment market share



Source: FCC; compiled by Daiwa CM Europe.

FCC is the leading operator in Spain of solid municipal waste collection (17m inhabitants and 7m tonnes) and the second largest in domestic waste treatment (16m inhabitants, 9m tonnes and 43 landfill sites). It is also the leading operator of industrial and hazardous waste treatment plants in Spain (14 treatment plants and 10 landfill sites).

Urbaser (ACS) is the leader in the management of solid urban waste treatment plants in Spain (managing around 7m tonnes of waste per annum) and supplying drinking water to around 0.9m inhabitants. In Europe the group also has waste treatment plants in France.

Cespa (Ferrovial) provides waste collection and treatment services to 6.2m inhabitants in Spain (and street cleaning for 5.3m inhabitants) and revenues of over €1bn.

Italy

As with the water sector, the Italian waste management sector is structured on the basis of regional ATOs (Ambiti Territoriali Ottimali), with many municipal in-house operations. As a result the sector is highly fragmented, with the market leader Hera accounting for just 5m tonnes of waste out of a national total of 160m.

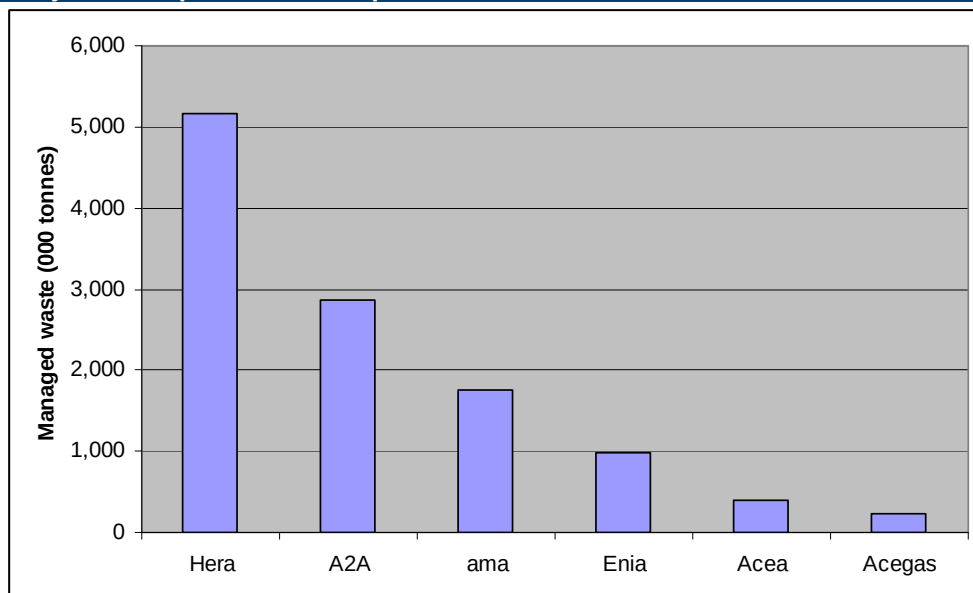
In addition, the country lacks sufficient landfill, recovery and incineration facilities, which has resulted in high profile cases of garbage-lined streets (and claims that not all operators have applied the correct disposal regulations to industrial waste).

In March 2010 the European Court of Justice ruled that Italy had failed to fulfil its obligations to the EU directive on waste disposal by allowing thousands of tonnes

of waste to pile up in Naples and other areas of the Campania region and that the crisis had resulted from a structural deficit of waste disposal facilities.

As with the water sector, the Decreto Ronchi legislation should stimulate market liberalization from 2013, with private operators likely to grow in scale. In July 2009 Hera Group reorganized its waste disposal activities into a single operation (Herambiente) and is seeking a financial partner to expand the operation (will sell a 25% stake in the venture).

Major Italian private waste operators

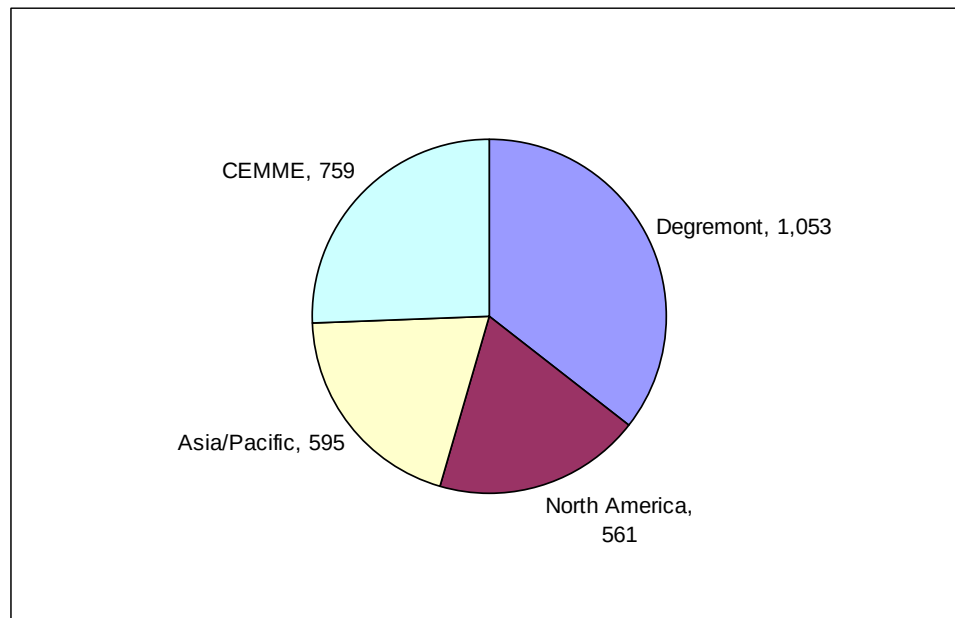


Source: Daiwa CM Europe.

International

The International activities include Degremont, the world leader in design and building of water treatment plants, as well as SE's water and waste activities in the US, Asia-Pacific and Rest of the World.

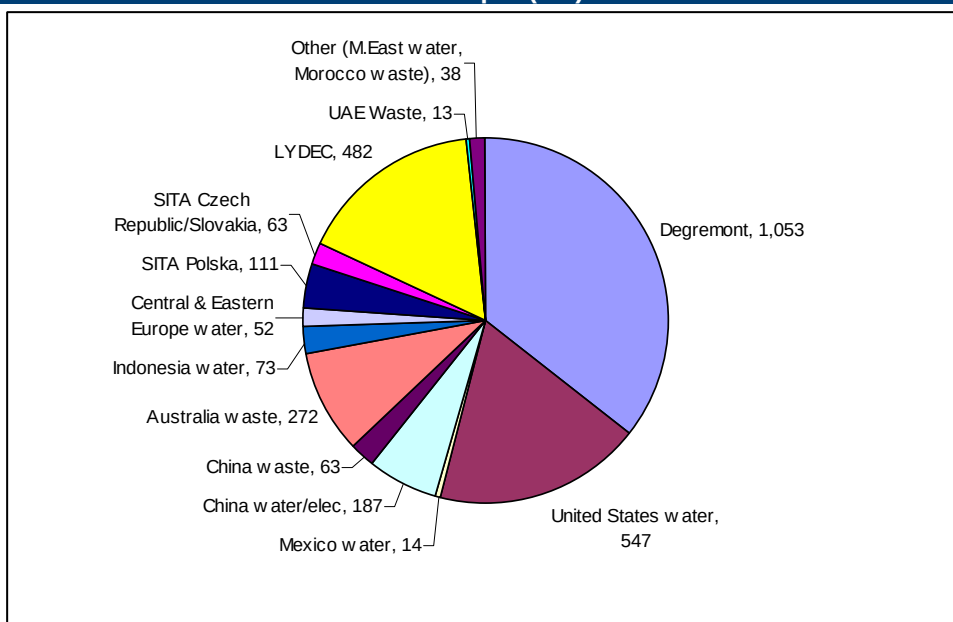
International division 2009 revenue split (€m)



Source: Suez Environnement; compiled by Daiwa CM Europe.

A more detailed breakdown highlights that excluding Degremont (which operates globally), the key markets of the United States (€547m consolidated revenues), Morocco (€482m), Australia (€272m) and China (€250m) account for over 80% of divisional revenues.

International division 2009 revenue split (€m)



Source: Suez Environnement; compiled by Daiwa CM Europe.

Degremont

Degremont is the global market leader in the design, build, operation and maintenance of drinking water, desalination, reuse and sludge treatment plants, having installed facilities that treat water for over 1bn people.

Although more than three quarters of Degremont's revenues are derived internationally (has installations in over 70 countries), the company still has a strong presence in France.

Roughly two thirds of Degremont's revenue related to the design and build function (turnkey contracts) and the unit has good revenue visibility with a 2009 year-end D&B order backlog of €1.8bn (roughly 27 months).

In July 2009 Degremont was awarded (as part of the AquaSure consortium comprising Suez Environnement, Degremont, Thiess and Macquarie) the contract for the design and construction of Australia's largest seawater desalination plant in Melbourne. The total investment for the plant will be €2bn and the contract should generate €650m of design and build revenues for Degremont over the next three years and a further €550m over the 30 year operational contract period. Both the construction and the operation of the plant will be conducted by a joint venture between Thiess (Australian engineering and construction group) and Degremont.

North America

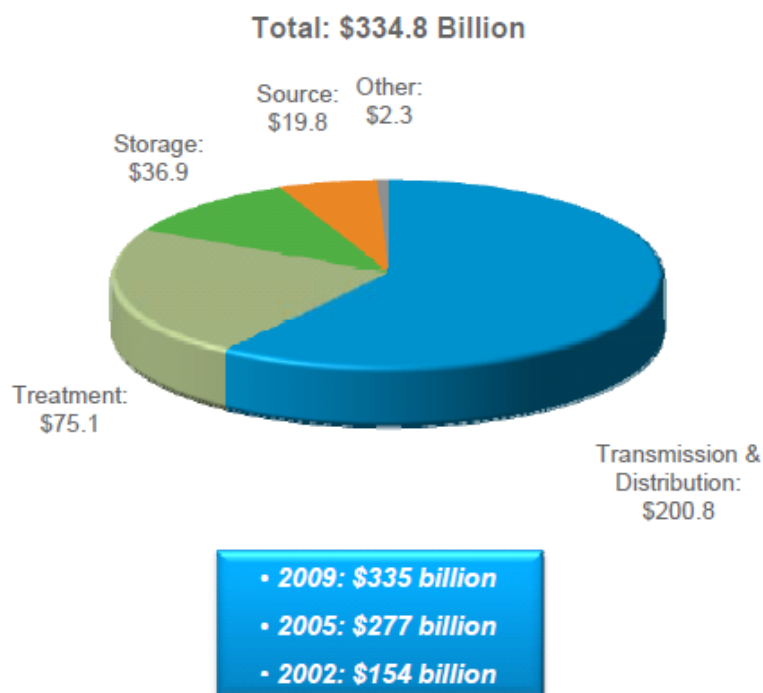
Suez Environment estimates that the market size for water management services is around \$85bn (in line with the OECD estimate of \$88bn), of which \$63bn is for site operation activities (roughly \$20bn of engineering, building and equipment activities).

The US Environmental Protection Agency estimates for drinking water alone \$335bn of spending will be required over the next 20 years (in 2007 US\$, up from \$154bn estimated in 2002).

The American Society of Civil Engineers (ASCE), which grades the state of the US drinking and wastewater infrastructure as "D-", estimates investment of at least \$11bn per annum is required to replace existing infrastructure, with leaking pipes losing around 7bn gallons of clean drinking water a day.

Wastewater infrastructure will also require around \$20bn per annum of investment, within the total twenty year period. The total cumulative 20 year estimate of around \$610bn compares to the OECD estimate for US drinking and wastewater investment of \$500bn required during the 2006-2025 period.

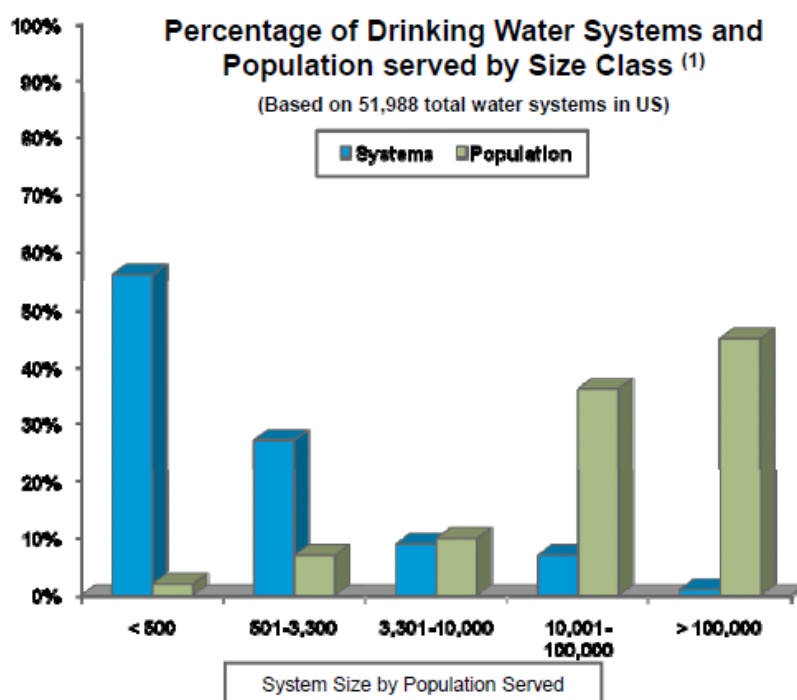
Estimated 20 year total investment in US public water systems



Source: American Water; compiled by Daiwa CM Europe.

Suez Environnement believes the fragmented nature of the US market provides scope for consolidation. This is because there are currently approximately 53,000 community water systems, with the majority serving relatively small catchment areas.

Water industry structure in United States



Source: American Water; compiled by Daiwa CM Europe.

The drink water supply industry is still dominated by public water utilities, serving around 85% of the population with private companies supplying the remainder. Public sector involvement in the wastewater sector is even greater with privately owned utilities only accounting for 2% of the market.

Given the investment requirements of the industry and the capital constraints of the municipalities, private sector involvement in the sector is set to increase.

SEV operates in the water and wastewater sectors in the US through its ownership of United Water and Utility Service Group. Revenues in 2009 totalled €547m, split evenly between regulated activities and service contracts.

United Water is the third largest private water company in the US (12% market share of private water sector) behind American Water (AWK US) and Aqua America (WTR US). Roughly two thirds of United Water's revenues are derived from regulated activities (with asset ownership), with the remainder from asset-light contract services (utility retains ownership but United Water selected as an operator for a period of 3 to 6 years).

The regulated activities of the company relate to 25 utilities across 8 states, servicing 1.6m people with drinking water. United Water also provides contract wastewater services to 5.7m inhabitants in 18 states (Midwest and Northeast).

The regulated US water sector is structured on the basis of an allowed return on equity based on the regulated asset base (used and useful assets) leveraged to an acceptable level of gearing (generally 50%).

Theoretically rates are set to allow recovery of opex, assets (through D&A), debt and taxes and to provide a ROE in the range of 10% (historic returns have differed as some costs have not been allowed to be passed through but new rate cases are being granted 10% ROEs).

Given the regulated return, earnings growth is primarily driven by the rate base growth, which in turn is driven by capex. The United Water regulated asset base (RAB) grew at an average compound rate of 10% per annum between 2005 and 2008 to \$1.6bn.

Utility Service Group was acquired in August 2008 for €113m. The company manages and maintains over 4,000 water storage tanks on behalf of 2,000 municipalities.

The group also has activities in Mexico through Bal-Ondea, a joint venture between SEV and Penoles (part of the mining BAL Group), with service contracts for Mexico City and Cancun. Bal-Ondea is the largest private operator in the water market in Mexico with revenues of around €40m. The total market size of the Mexican water market is estimated⁷ at \$2.2bn, of which private operators accounted for just \$100m (2m out of the 96m inhabitants estimated to have access to drinking water).

⁷ Source: Comision Nacional del Agua (CNA)

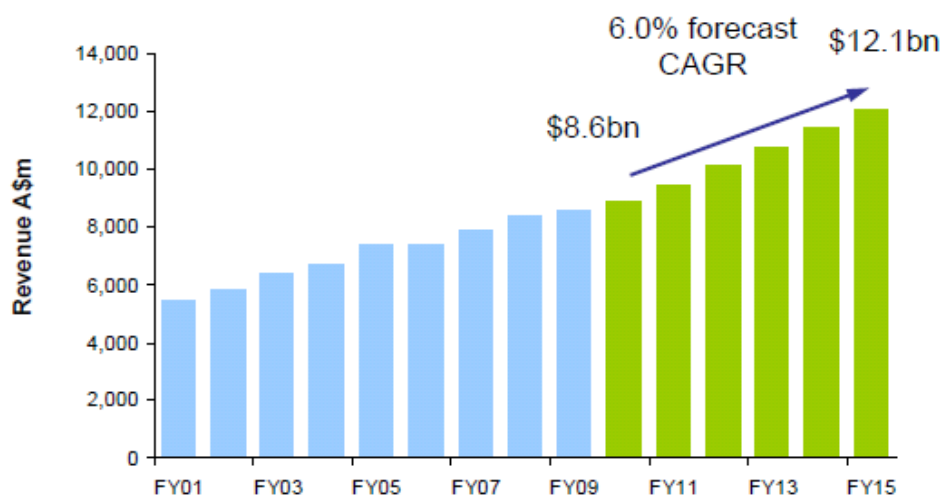
Asia Pacific

Asia Pacific revenues in 2009 were split between Australia (46%), China (42%) and Indonesia (12%).

Within the division, the Australian revenues in 2009 of €272m relate to Suez Environnement's waste operation, SITA Australia. SITA is the third largest waste management company in Australia (after Transpacific Industries and Veolia) and is 60% owned by SEV and 40% by SembCorp (SCI SP) and operates in 5 states offering collection, recycling & sorting, treatment and disposal services.

Suez Environnement estimates that the Australian waste management industry is worth around €1bn. Whilst IBISWorld estimates the market to be worth around €6bn, this figure is inflated by the inclusion of taxes and levies. However both parties consider the market to have major growth potential as a result of population growth, above average GDP growth and the implementation of landfilled waste reduction goals.

Australian waste disposal service market



*Source: IBISWorld Pty Ltd Industry Report, Waste Disposal Services In Australia, 2 February 2010. Revenue on a 'constant price' basis. CAGR = Compound Average Growth Rate

Source: IBISWorld, Transpacific; compiled by Daiwa CM Europe.

The market remains highly fragmented, with six large national operators (Transpacific, Veolia, SITA, JJ Richards, Thiess and REMONDIS) as well as a number of regional competitors (e.g. WSN, Wanless and Tox Free). We expect market consolidation to continue and in particular the relatively high level of debt incurred by Transpacific (despite its recapitalization in August 2009) could result in a disposal to a larger (and better resourced) operator.

In the water sector, Suez Environnement is active in Australia through Degremont. Australia has significant regional water shortages due to recurrent, long-lasting droughts. In addition, the scope for water recycling in the mining sector has significant potential for growth.

China

The need for investment in China's water infrastructure is significant as according to the World Bank, whilst China has 3,507 bcm of water resources, only 20% is currently accessible and reliable and therefore its per capita availability of water resources is only around 2,156 m³/year – one-fourth of the world average of 8,549 m³/year (ranking China at #118 in the country list).

China's problems are made even more severe by the fact its water resources are unevenly distributed, with lower rainfall in the North (757 m³/year – lower than the 1,000 m³/year defined as water scarcity) which contains around 50% of China's population but only 20% of the available water resources.

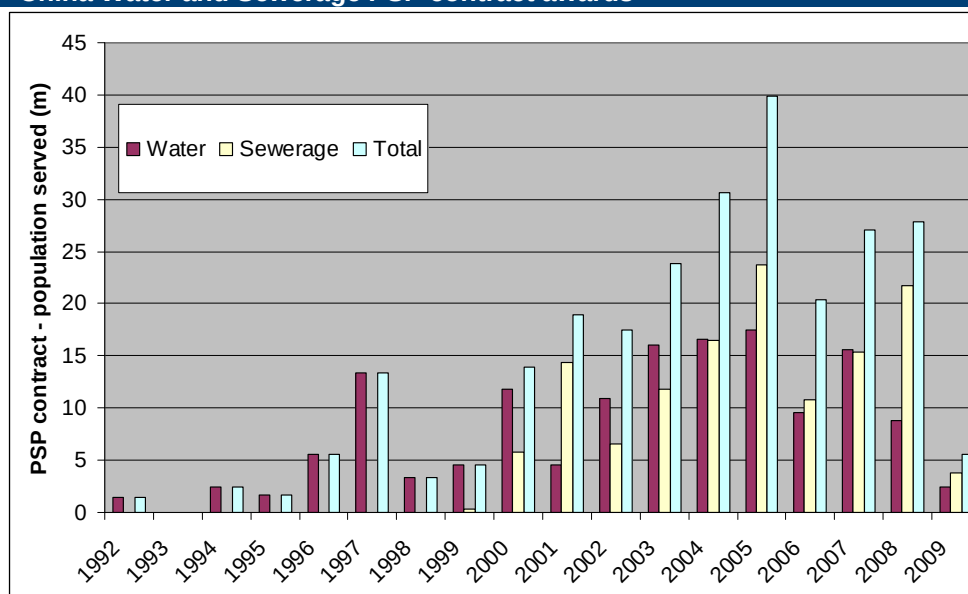
Water scarcity is forecast to increase with China's per capita freshwater resources forecast to decline to 1,875 m³ by 2033 as the population rises to 1.5bn. Sixteen of the twenty most polluted cities in the world are located in China and it is estimated⁸ that half of all wastewater is not treated (only fit for industrial and agricultural use) and over 660 cities have no wastewater treatment systems (the World Bank estimates the tonnage of wastewater will grow by 40% by 2015).

The Water Resource Group forecasts that unabated industrial water demand will grow by 3% per annum from 2005 to 2030, with thermal power cooling forecast to account for nearly a third of industrial water demand (82 bcm) in 2030.

The OECD estimates that to maintain and operate China's existing water and wastewater infrastructure at an adequate level would require around \$45bn pa of expenditure, whilst new investment would require around \$26bn per annum of investment.

Private sector involvement in the Chinese water sector has grown significantly over the past 10 years, as demonstrated by the number of reported private sector partnership (PSP) contract awards. Whilst 2009 was a relatively quiet period for new contracts, Suez Environnement commented with its Q1 results on the recovery of the market in 2010.

China Water and Sewerage PSP contract awards



Source: : Pinsent Masons Water Yearbook 2009-2010; compiled by Daiwa CM Europe.

⁸ Source: OECD

In addition to Degremont's activities in China, SEV operates water services through Sino-French Holdings (SFH) and waste activities through Swire SITA. Agbar also has a presence in China through its 72% shareholding in Jiangsu Water.

Suez Environnement activities in China



Source: Suez Environnement; compiled by Daiwa CM Europe.

Managed revenues from companies in which the group has an interest totalled €866m in 2009, up 14% compared to 2008. Because of the shareholder structure of the water activities, Suez Environnement is generally consolidating a quarter of the managed revenues and consolidated revenues totalled €250m in 2009 (of which water totalled €187m) out of Asia Pacific revenues of €595m.

The Chinese water activities are largely managed through SFH, a 50/50 joint venture between NWS Holdings (659 HK) and Suez Environnement. SFH owns 100% of Sino French Water, a holding company for 22 joint ventures in mainland China serving over 11m inhabitants. In addition Sino French Water owns 85% of Macao Water (concession renewed in 2009 to run to 2029 with cumulative revenues of €500m) and 38% of Companhia de Electricidade de Macau (CEM). Suez Environnement estimates that it is one of the three largest private operators in the Chinese market for drinking water and wastewater treatment services.

In 2008, SFH acquired a 15% shareholding in Chongqing Water Group (601158 CH) for approximately €140m (plus €14m capex), reduced to 13.44% as part of CWG's IPO in March 2010. Whilst the market value of SEV's share of the Chongqing Water stake is currently worth around €350m, we estimate CWG contributed just €10m of EBITDA to Suez Environnement in 2009.

The partnership with CWG was strengthened in 2009 with a 30 year drinking water

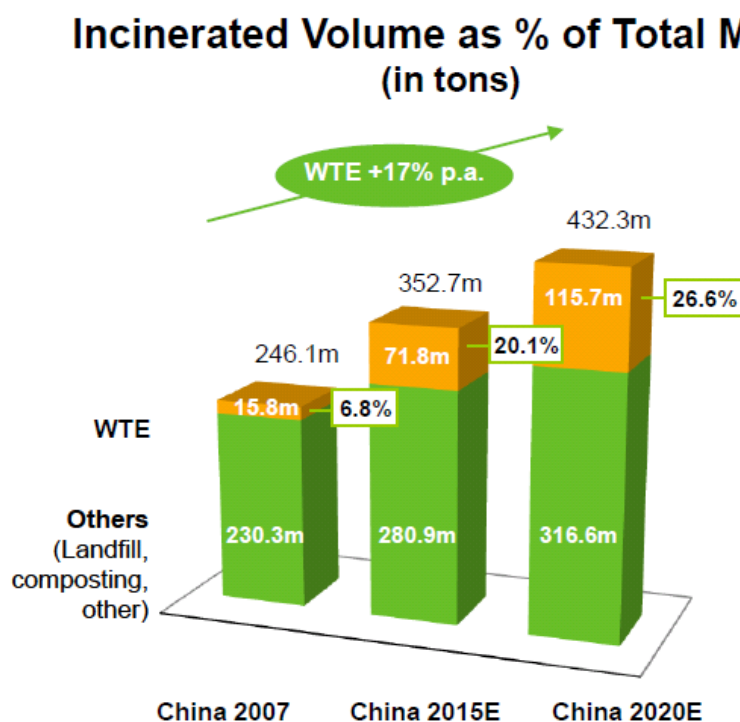
distribution concession contract for the Yuelai district (1.2m residents) and in May 2010 with a joint venture partnership for a 30 year concession for industrial water services in Chongqing Changshou Chemical Industrial Park.

SEV's Chinese waste revenues totalled €63m in 2009 although this should more than double in 2010 as in December 2009 SEV took 100% control of Swire SITA Waste Limited, a waste management company operating in China, by acquiring the remaining 50% stake from Swire Pacific for \$242m (prompting full consolidation).

In solid waste China has surpassed the US as the largest waste generator in the world and is likely to retain this role with municipal solid waste (MSW) volumes forecast to increase by 4.4% pa to 2020. By 2030 the World Bank estimates the tonnage of municipal waste will have more than doubled to 550m tonnes. China also generates large amounts of hazardous waste which is not currently being appropriately treated.

China is the fastest growing waste-to-energy market globally with 77 operating plants and 96 in construction or planning. In addition it is forecast that a further 100-130 WTE plants will be required over the next 10 years.

China – WTE volumes as % of total municipal solid waste volumes



Source: Waste Management Inc; compiled by Daiwa CM Europe.

Indonesia

Suez Environnement is active in the Indonesian water sector through its 51% shareholding in PTT PAM Lyonnaise Jaya (Palyja). The 49% stake owned by local partner PT Astratel Nusantara (30%) and Citigroup (19%) was sold by Suez Environnement in 2006. The unit contributed €73m of revenues in 2009 and provides drinking water to over 3m inhabitants.

Central Europe, Mediterranean and Middle East (CEMME)

The bulk (€482m out of €759m) of the CEMME divisional revenue relates to Suez Environnement's 51% shareholding in Lyonnaise des Eaux de Casablanca (LYDEC), the electricity and water service provider in Casablanca and Mohammedia (in total 3m inhabitants).

LYDEC has provided electricity and water services to the two Moroccan cities since 1997 and operates on an outsourced management contract basis. The company reported 2009 EBITDA of €87m (out of International EBITDA of €468m), with roughly two thirds of revenues derived from electricity distribution.

The next largest segments are the Eastern European waste activities. With €111m of revenues, SITA Polska is the second largest waste management operator in Poland (after REMONDIS), collecting over 0.9m tonnes of waste. SITA is also the third largest private waste operator in the Czech Republic and Slovakia, collecting over 0.5m tonnes of waste (contributing €63m of revenue).

In water sector, SEV is the second largest in the water supply market in the Czech Republic, Hungary and Slovakia. These activities contributed €52m of revenues in 2009. SEV also has a 46% shareholding in Brnenské Vodárny a Kanalizace (BVK), the partly privatised water company for the city of Brno (and neighbouring cities) in the Czech Republic (the city owns 51% of the utility) which is accounted for in associate income (although we estimate only a small share of the €38m 2009 group associate income).

In the Middle East, in addition to Degremont the group is active in the water sector through local partnerships. In the UAE the group has a joint venture (Al Qudra Suez Services) with the Al Qudra Group to develop water, wastewater and waste treatment facilities in the region. In Saudi Arabia the group has a joint venture (Jeddah Water Services) with Aqua Power Development relating to the management of water and wastewater services in Jeddah.

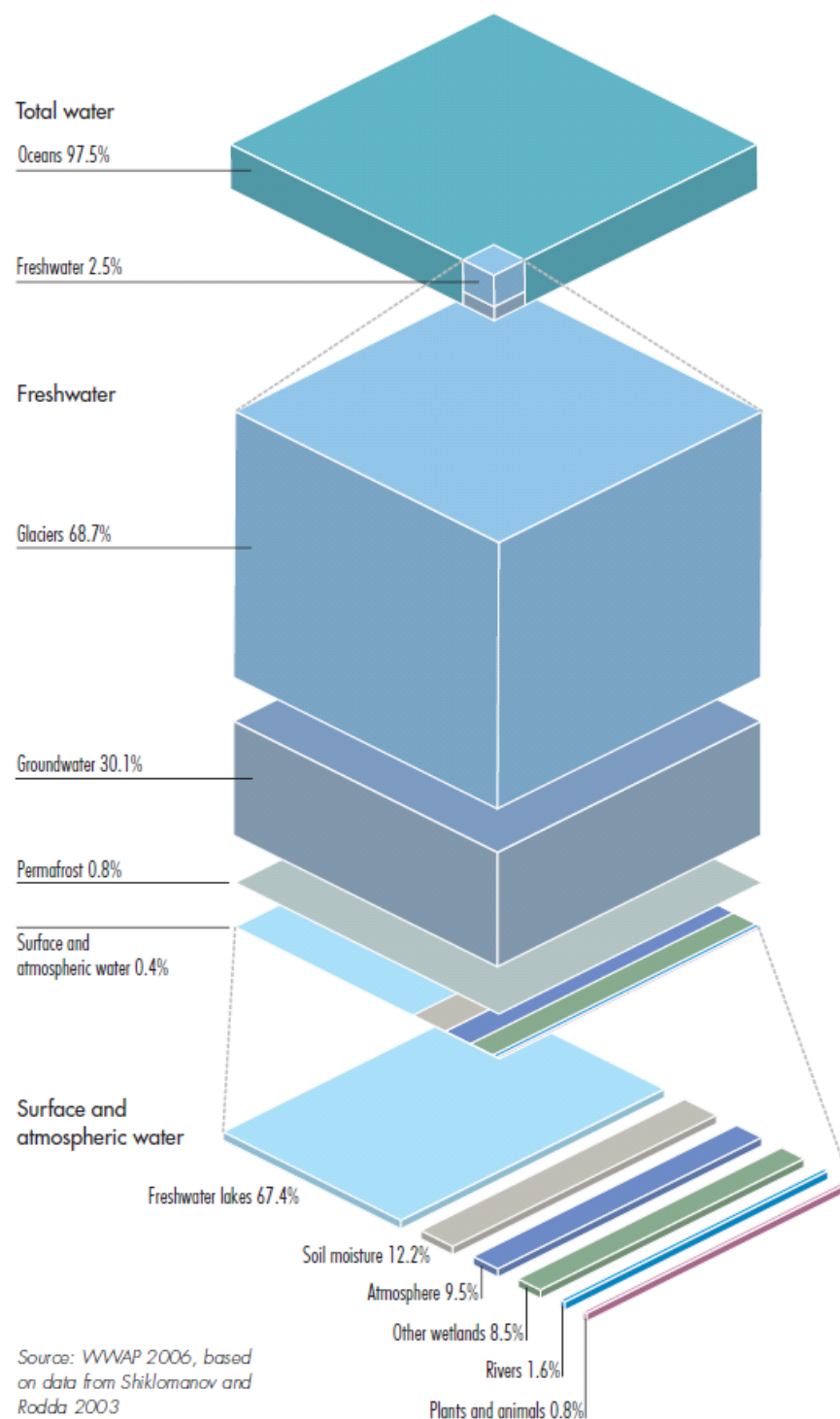
In 2008 SEV acquired Trashco, a waste management collection operation in Abu Dhabi (contributed €13m of revenues in 2009). Whilst fundamental market dynamics in the region remain strong, SEV did incur a €20m impairment charge in 2009 relating to the Jumeirah Golf Estates sewerage treatment plant as a result of the client halving the scope of the project.

Water and wastewater market

Global supply and demand factors

The global quantity of freshwater is only about 2.5% of the total quantity of water on earth and of this around 70% exists in the forms of glaciers or under permanently frozen soil. Readily available freshwater resources therefore account for only about 0.8% of all the water on earth, the vast majority of which is held as groundwater rather than surface water.

Global distribution of the world's water



Source: WWAP 2006; compiled by Daiwa CM Europe.

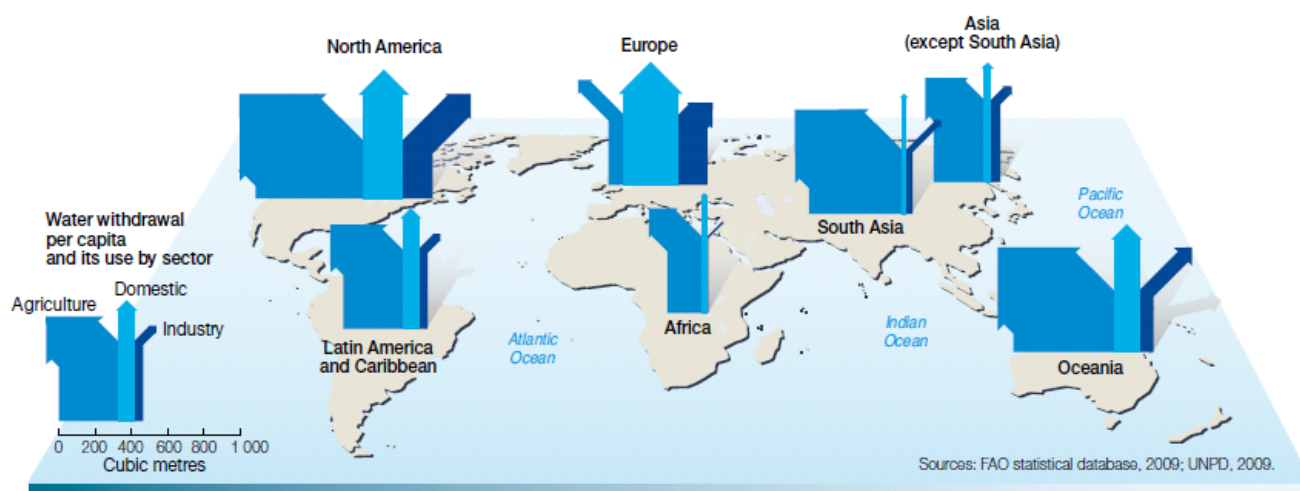
Global water use (both withdrawal and consumption) over the past century has increased by a factor of around 6x. The four main drivers for the increase have been population growth, increased per capita demand, the increase in irrigated agriculture and industrial development.

Global Water Use				
Cubic kilometres	1900	1950	1995	2025
Agriculture - withdrawal	500	1,100	2,500	3,200
Agriculture - consumption	300	700	1,750	2,250
Industry - withdrawal	40	200	750	1,200
Industry - consumption	5	20	80	170
Domestic - withdrawal	20	90	350	600
Domestic - consumption	5	15	50	75
Total - withdrawal	560	1,390	3,600	5,000
Total - consumption	310	735	1,880	2,495

Source: OECD; compiled by Daiwa CM Europe.

Global water withdrawal is still dominated by agricultural use (accounting for around 70% of the withdrawal and around 90% of the consumption of water), although its importance varies by region, contributing to a large share of demand in North America and Oceania but a relatively small share of use in Europe.

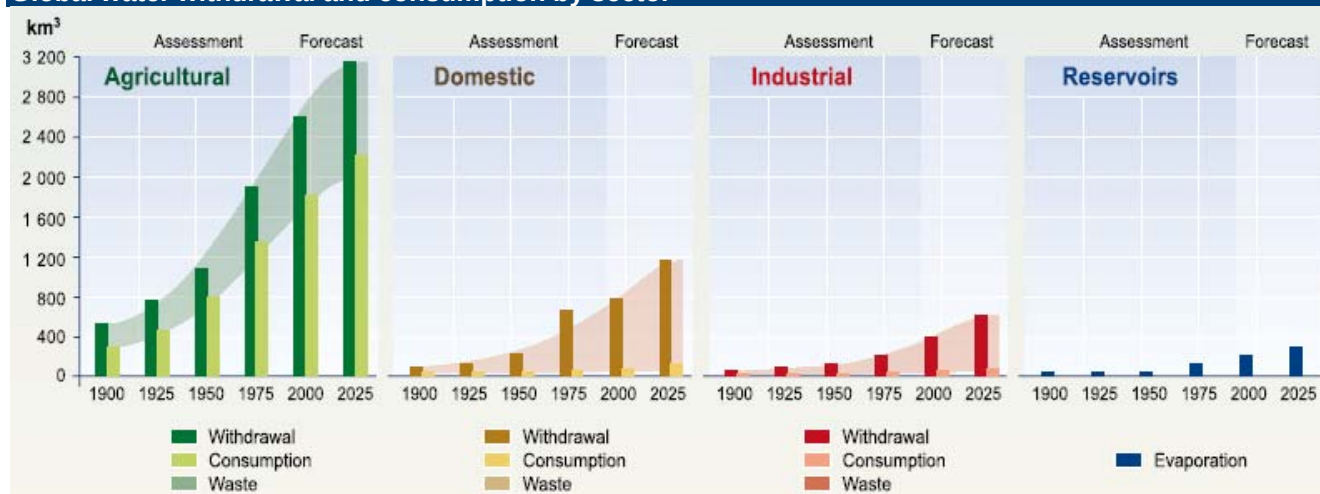
Regional water withdrawal per capita



Source: FAO, UNDP; compiled by Daiwa CM Europe.

However in the future agriculture water use is forecast to grow at a slower rate than overall global water demand. The Water Resources Group estimates that unconstrained global water demand (water withdrawal) will grow at a rate of around 2% per annum to 2030 (GWI forecast 1% actual growth), largely driven by domestic and industrial demand, as improved water efficiency results in agriculture water demand increasing at around 1% per annum.

Global water withdrawal and consumption by sector

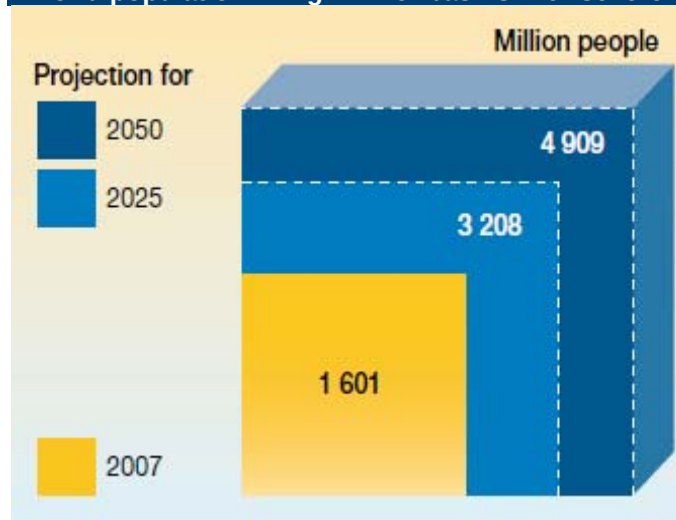


Source: Shiklomanov, SHI and UNESCO; compiled by Daiwa CM Europe.

Fulfilling this increased demand will present a challenge. This will put further pressure on reservoir extraction which is forecast to increase significantly and will reduce river water flow (UNEP already estimates that around half of the 500 great rivers of the world are drying).

By 2025 the UN estimates 1.8bn people will be living in countries or regions with absolute water scarcity (<1,000 m³ per capita per year) and 3.2bn people could be under conditions of water stress (below 1,700 m³ per capita per year).

World population living in river basins with severe water stress



Source: Joseph Alcamo, UNEP; compiled by Daiwa CM Europe.

Regional supply and demand factors

National per capita water withdrawal rates reflect availability / continuity of supply, relative wealth, relative size of the agricultural sector and climatic conditions (e.g. water used for domestic gardening is around 50% of domestic use in Australia). These factors inflate use in countries such as the USA and restrict consumption in countries such as the UK (hosepipe bans).

The following table ranks domestic freshwater withdrawal per capita (for countries with a population >50m). As can be seen, consumption in the USA at 203m³ is significantly ahead of other developed markets such as Japan (136m³) or Italy (131m³). In contrast, domestic consumption in developing markets such as China (27m³) and India (47m³) remains relatively low.

Freshwater withdrawal per capita by country											
Country	Total Freshwater Withdrawal (km ³ /yr)	Per Capita Withdrawal (m ³ /p/yr)	Domestic Use (%)	Industrial Use (%)	Agricultural Use (%)	Domestic Use m ³ /p/yr	Industrial Use m ³ /p/yr	Agricultural Use m ³ /p/yr	2005 Population (millions)	Population with access to improved water (%)	Population with access to improved sanitation (%)
United States of America	477.0	1,600	13	46	41	203	736	660	298	100	100
Japan	88.4	690	20	18	62	136	123	431	128	100	100
Italy	42.0	723	18	37	45	131	265	326	58	100	100
Mexico	78.2	731	17	5	77	127	40	564	107	97	79
Russian Federation	76.7	535	19	63	18	100	340	95	143	97	87
France	33.2	548	16	74	10	86	408	54	61	100	100
Turkey	39.8	544	15	11	74	80	59	404	73	96	88
Iran	72.9	1,048	7	2	91	71	24	953	70	94	84
Egypt	68.3	923	8	6	86	70	55	793	74	98	70
Vietnam	71.4	847	8	24	68	66	205	577	84	85	61
Brazil	59.3	318	20	18	62	65	57	196	186	90	75
Philippines	28.5	343	17	9	74	57	32	254	83	85	72
Germany	38.0	460	12	68	20	57	312	91	83	100	100
India	645.8	585	8	5	86	47	32	506	1,103	86	33
United Kingdom	11.8	197	22	75	3	43	148	6	60	100	100
Thailand	82.8	1,288	2	2	95	32	32	1225	64	99	99
Indonesia	82.8	372	8	1	91	30	3	339	223	77	55
China	549.8	415	7	26	68	27	107	281	1,323	77	44
Pakistan	169.4	1,072	2	2	96	21	22	1030	158	91	59
Bangladesh	79.4	560	3	1	96	18	4	538	142	74	39
Nigeria	8.0	61	21	10	69	13	6	42	132	48	44
Myanmar	33.2	658	1	1	98	8	4	646	51	78	77
Ethiopia	5.6	72	6	0	94	4	0	67	77	22	13
Congo, Democratic Republic	0.4	6	53	17	31	3	1	2	58	46	30

Source: Pacific Institute; compiled by Daiwa CM Europe.

Availability

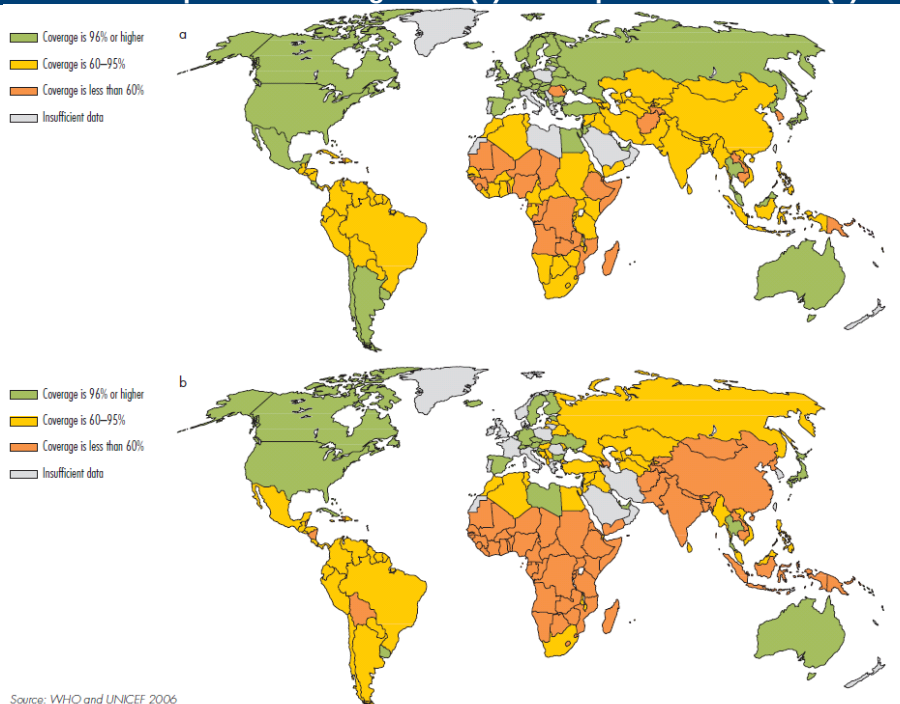
Given Latin America benefits from a relative abundance of water resources (26% of the world's freshwater resource but only 6% of the world's population) and has a similar weighting of agricultural usage, per capita consumption levels in Asia are likely to continue to lag those in Latin America.

Global share of freshwater resource and population by region						
	North and Central America	South America	Europe	Africa	Asia	Australia and Oceania
% World's Water	15	26	8	11	36	5
Population	8	6	13	13	59	1
Ratio (x)	1.9	4.3	0.6	0.8	0.6	5.0

Source: OECD; compiled by Daiwa CM Europe.

Currently total (urban and rural) access to "improved" water services (e.g. standpipes, boreholes, dug wells – likely to provide safe water) is only around 80% in Asia and around 40% in Africa.

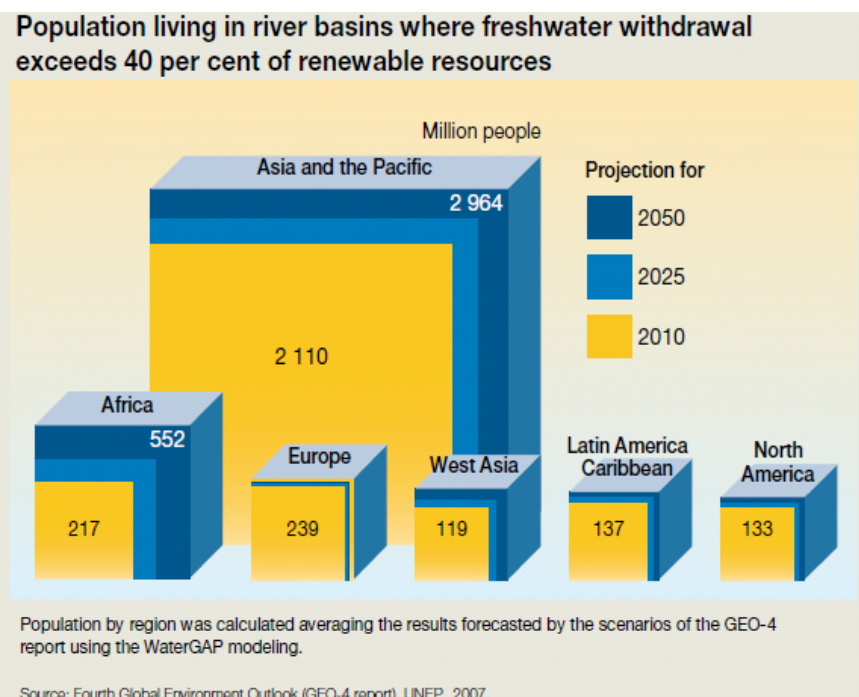
Access to improved drinking water (a) and improved sanitation (b)



Source: WHO and UNICEF; compiled by Daiwa CM Europe.

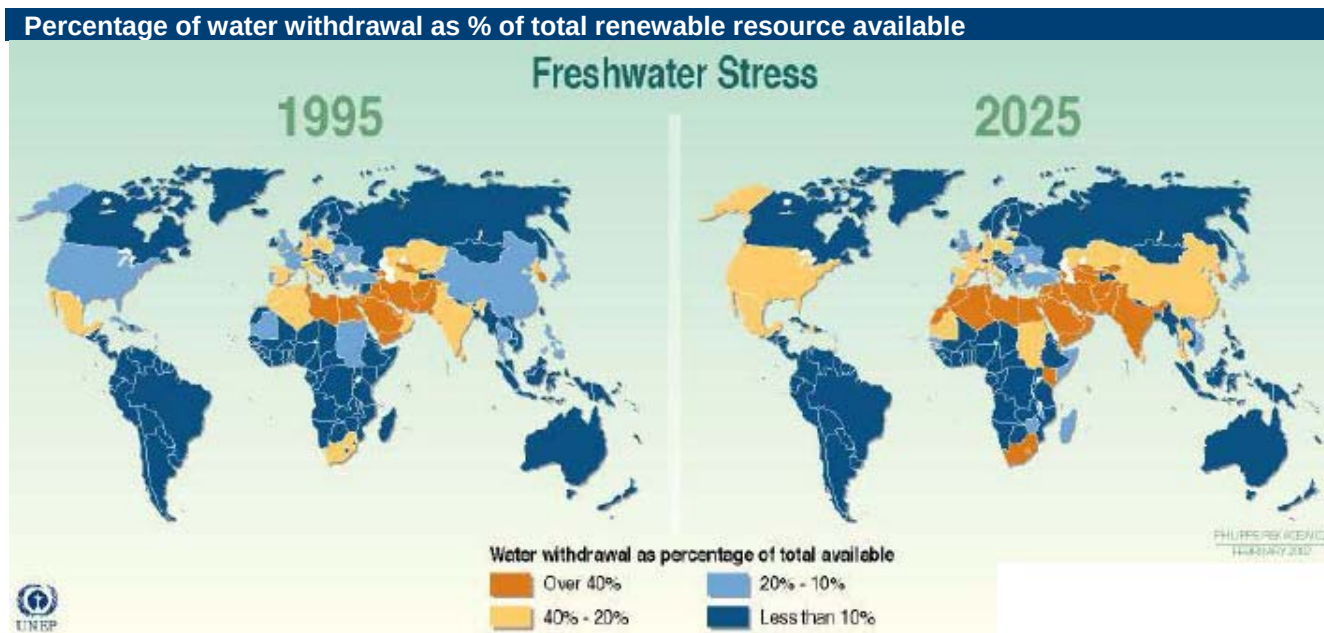
The pressure on Asian water resources is forecast to intensify. By 2050 UNEP forecasts that 3bn people in Asia will live in river basins where freshwater withdrawal exceeds 40% of renewable resources, an increase of nearly 50% from the estimated current level.

Population living in river basins with high freshwater withdrawal



Source: UNEP; compiled by Daiwa CM Europe.

However, regional or even national water availability statistics can prove misleading because of local scarcity issues. Although Australia as a whole is deemed to be comfortably supplied with water resources in 2025 (<10% water withdrawal as % of total renewable resource), the Western and Southern regions face chronic water shortages.



There is an even greater regional disparity with regard to “improved” sanitation (e.g. connection to a public sewer, pit latrine or septic system) between the developed (100%) and developing nations. The proportion of households in major cities in Asia with a sewer connection is estimated at just 45% compared to over 90% in North America and Europe.

Proportion of households in major cities connected to mains water and sewers						
% with this facility	North America	Europe	Oceania	Latin America and Caribbean	Asia	Africa
House or yard connection for water	100	96	73	78	78	43
Sewer connection	96	92	14	34	45	17

Source: OECD; compiled by Daiwa CM Europe.

Affordability / Relative wealth

Whilst absolute water charges in developing markets may be low compared to developed markets (e.g. <10p/m³ in Mexico City vs ~200p/m³ in the UK), the relative affordability of water and sewerage is around 3% in many developing markets, the threshold for “water poverty” in the UK.

In contrast, the United States (with a high per capita consumption) has one of the lowest affordability ratios at 0.5% (spending on water and sewerage as a proportion of household budgets). Western European markets have affordability ratios around 1% (typically above 1% in Northern Europe and below 1% in Southern Europe).

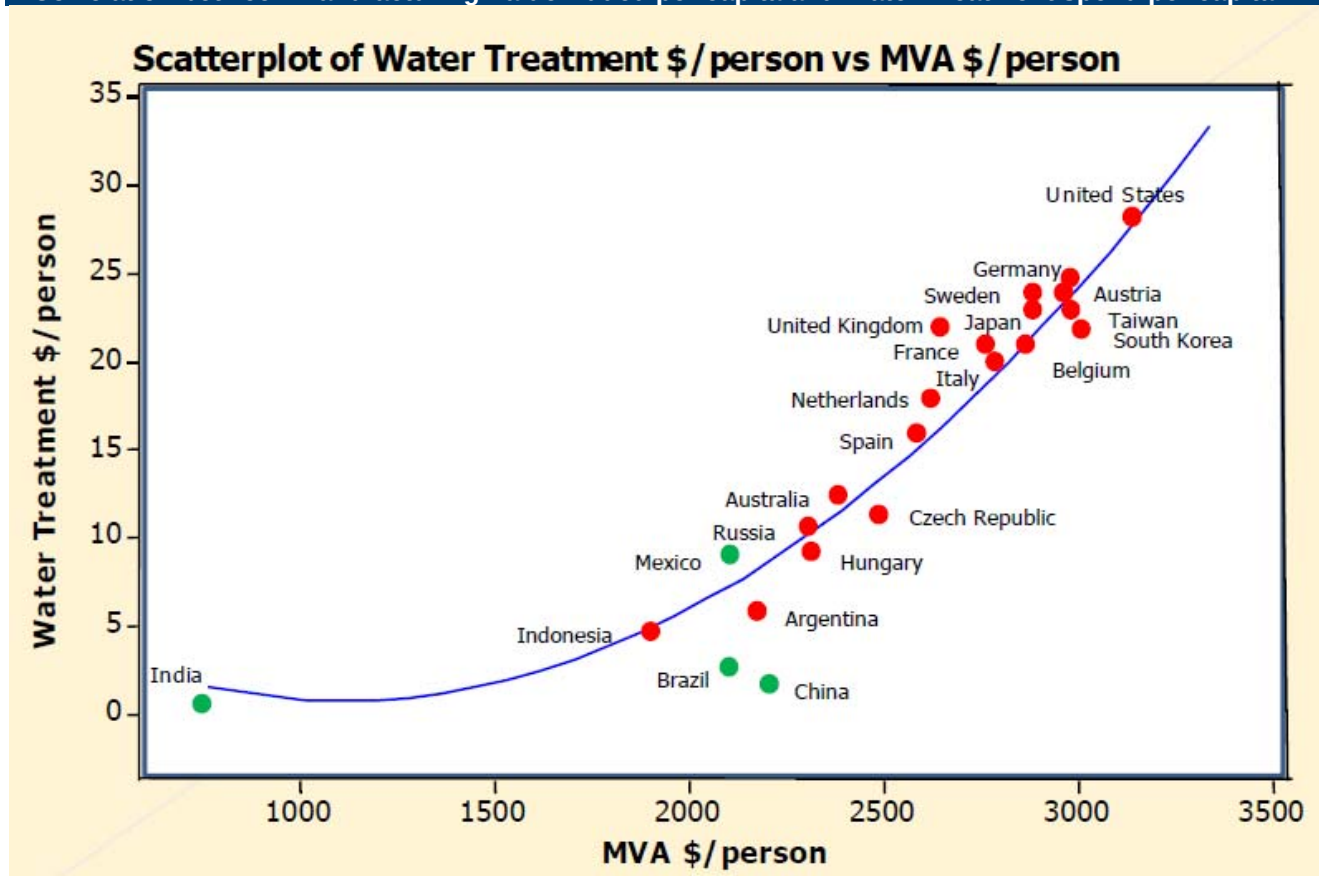
International water and sewerage tariffs 2007 (\$/m3)

As of June 2007		Water \$/m3 for 15m3/month	Wastewater \$/m3 for 15m3/month	Total \$/m3 for 15m3/month
City	Country			
Copenhagen	Denmark	7.71	0.00	7.71
Berlin	Germany	3.13	3.49	6.62
Zurich	Switzerland	2.43	2.78	5.21
Brussels	Belgium	3.76	0.59	4.35
London	UK	2.29	1.48	3.77
Sydney	Australia	1.46	2.00	3.46
Amsterdam	Netherlands	2.31	0.84	3.15
Helsinki	Finland	1.30	1.69	2.99
Prague	Czech Republic	1.30	1.12	2.42
Budapest	Hungary	0.98	1.39	2.37
Kosice	Slovakia	1.47	0.89	2.36
New York City	USA	0.91	1.44	2.35
Tallinn	Estonia	1.25	1.01	2.26
Istanbul	Turkey	1.40	0.70	2.10
Warsaw	Poland	0.93	1.15	2.08
Madrid	Spain	0.97	0.80	1.77
Tokyo	Japan	0.91	0.75	1.66
Vilnius	Lithuania	0.74	0.89	1.63
Stockholm	Sweden	1.54	0.00	1.54
Toronto	Canada	1.50	0.00	1.50
Sao Paulo	Brazil	0.73	0.73	1.46
Muscat	Oman	1.38	0.00	1.38
Athens	Greece	0.81	0.53	1.34
Rome	Italy	0.66	0.61	1.27
Doha	Qatar	1.21	0.00	1.21
Bucharest	Romania	0.99	0.22	1.21
Riga	Latvia	0.58	0.58	1.16
Santiago-de-Chile	Chile	0.54	0.49	1.03
Tel Aviv	Israel	1.00	0.00	1.00
Manila	Philippines	0.66	0.32	0.98
Casablanca	Morocco	0.75	0.12	0.87
Seoul	Korea	0.58	0.17	0.75
Sofia	Bulgaria	0.55	0.20	0.75
Jakarta	Indonesia	0.75	0.00	0.75
Moscow	Russia	0.38	0.31	0.69
Gaborone	Botswana	0.63	0.00	0.63
Kiev	Ukraine	0.40	0.23	0.63
Belgrade	Serbia	0.49	0.12	0.61
Kathmandu	Nepal	0.40	0.20	0.60
Panama-city	Panama	0.53	0.00	0.53
Hong Kong	China	0.40	0.12	0.52
Johannesburg	South Africa	0.29	0.23	0.52
Yerevan	Armenia	0.43	0.08	0.51
Guayaquil	Ecuador	0.28	0.22	0.50
Beijing	China	0.37	0.12	0.49
Bamako	Mali	0.43	0.00	0.43
Lagos	Nigeria	0.40	0.00	0.40
Taipei	Taiwan	0.29	0.11	0.40
Chisinau	Moldova	0.33	0.05	0.38
Nairobi	Kenya	0.21	0.13	0.34
Antananarivo	Madagascar	0.28	0.00	0.28
Buenos Aires	Argentina	0.13	0.13	0.26
Addis Ababa	Ethiopia	0.22	0.00	0.22
Lima	Peru	0.22	0.00	0.22
Caracas	Venezuela	0.21	0.00	0.21
Minsk	Belarus	0.12	0.06	0.18
Tbilisi	Georgia	0.18	0.00	0.18
Almaty	Kazakhstan	0.11	0.07	0.18
Hanoi	Vietnam	0.18	0.00	0.18
Mexico City	Mexico	0.10	0.06	0.16
Baku	Azerbaijan	0.15	0.00	0.15
Algiers	Algeria	0.11	0.00	0.11
New Delhi	India	0.11	0.00	0.11
Damascus	Syria	0.07	0.01	0.08
Manama	Bahrain	0.07	0.00	0.07
Tegucigalpa	Honduras	0.05	0.01	0.06
Cairo	Egypt	0.06	0.00	0.06
Ulan Bator	Mongolia	0.02	0.03	0.05
Karachi	Pakistan	0.04	0.01	0.05
Jeddah	Saudi Arabia	0.05	0.00	0.05
Dubai	UAE	0.02	0.00	0.02
Tashkent	Uzbekistan	0.01	0.01	0.02
Havana	Cuba	0.01	0.00	0.01
Colombo	Sri Lanka	0.01	0.00	0.01

Source: The World's Water 2008-2009; compiled by Daiwa CM Europe.

As industrial profitability/household income increases in developing countries, the absolute level of water spending should increase. The following chart plots annual water treatment spend per capita against Manufacturing Value Added (MVA) per capita, highlighting the correlation between higher MVA/GDP per capita and higher absolute water spend per capita.

Correlation between Manufacturing Value Added per capita and Water Treatment spend per capita



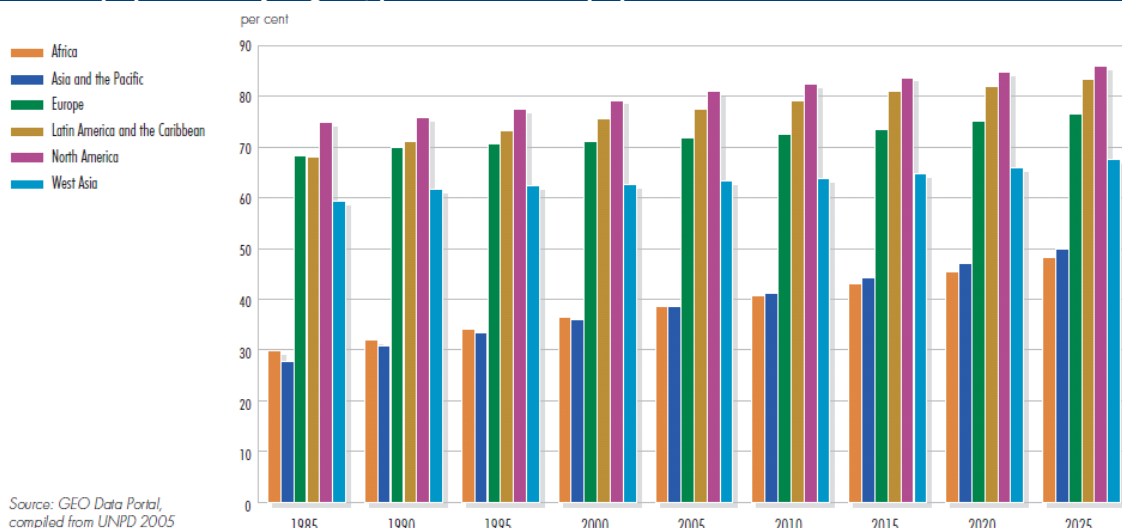
Source: Nalco Inc; compiled by Daiwa CM Europe.

As well as the cost of the delivery/treatment of water increasing as countries experience economic development, the value of the raw water itself may increase in value. Whilst the cost of the raw water will only be transparent where tradable markets exist (e.g. water rights in the US and Latin America), the cost of importing water from Malaysia to Singapore has increased from an initial rate of \$0.002/m³ in 1961 to demands from Malaysia ranging from \$0.24-\$0.51/m³. Whilst the upper range seems high (nearly in line with reverse osmosis costs), the demands highlight that water is increasingly being valued in line with the market price of gas (~\$0.2/m³) which could justify increased trading and transportation investment.

Urbanisation

In developing countries rural migration continues to fuel urban population growth (forecast to grow at almost twice the rate of total population growth to 2025), with roughly half the total population of Asia and Africa expected to live in cities by 2025 (up from <30% in 1985).

Urban population by region, per cent of total population

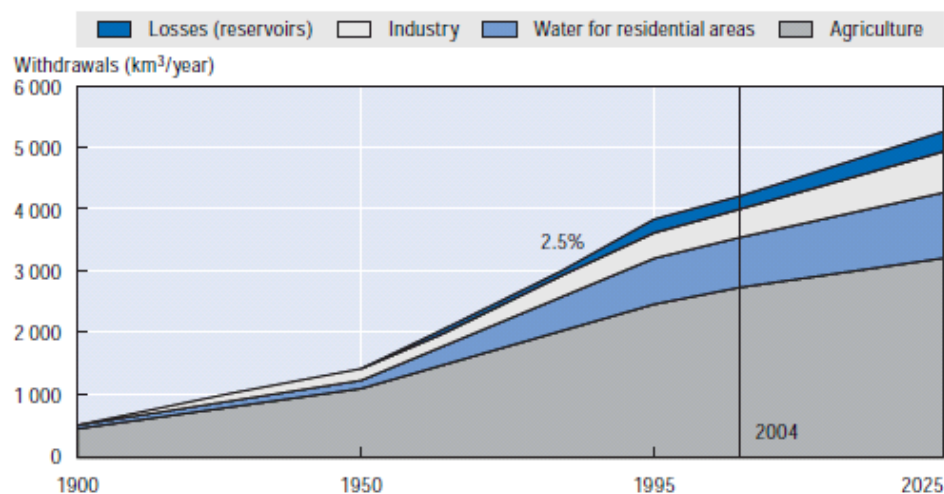


Source: United Nations GEO4 report; compiled by Daiwa CM Europe.

Increased urbanization and improved access to water services will increase per capita domestic consumption and it is estimated⁹ that domestic water consumption will total 21% of global demand in 2025 vs 10% in 1995. Domestic water consumption is forecast to increase by 71% by 2020 vs 1995. More than 90% of this growth will be derived from developing countries.

Global water withdrawal forecasts

Chart 2



Source: Shikomanov; compiled by Daiwa CM Europe.

Industrial water consumption will also grow faster in developing countries (it has generally been falling in Western Europe and is forecast to fall for most developed markets as a result of tightening environmental regulations and the changing nature of industrial use). The majority of the developing market growth will be driven by China and India who are both forecast to double their domestic and industrial water consumption by 2030¹⁰, with agricultural use forecasted to remain stable (irrigation efficiency in Asia is currently around 25% and should improve).

Given the increasing scarcity of water resources in Asia, decisions about agricultural use vs higher value added industrial use could also influence general soft commodity prices (e.g. if China decided to import more wheat to ration agricultural water use).

⁹ Alcamo, Henrichs and Rosch

¹⁰ Indian Planning Commission, Briscoe, OECD

Water sector investment requirements

Although global water demand growth (1% per annum to 2030¹¹) is forecast to grow at a slower pace than global power consumption growth (2.5% per annum to 2030¹²), the level of investment required to fulfil this demand is estimated to be far greater given the limited available water resources.

Global demand for water totalled around 4,250 km³ per annum in 2007 but is forecast to increase to 5,200 km³ per annum by 2025. Whilst conventional water resources could potentially supply around a third of this increase, “new water” supplies such as desalinated water (contracted desalination capacity forecast to double 2012 vs 2008¹¹) and water recycling (20% CAGR growth forecast 2009-2016¹¹) must supply the remainder.

Desalination is already the source of water supply for more than 200m people and with 2.4bn people living near the sea this solution could be applied to many more people. However there is an energy/cost implication for desalination, which differs depending upon the technology applied (membrane or thermal).

With membrane technologies (reverse osmosis), sea water is filtered by applying pressure across a membrane separating permeate (the liquid flowing through the membrane) on one side and brine (concentrated salt solution) on the other. The major energy requirement is for the initial pressurisation of the feedwater.

For thermal technologies sea water is evaporated and condensed to form a salt-free distillate. The process is achieved through either multi-stage flash or multiple effect distillation .

Multi-stage flash (MSF) desalination has been used since the 1950s and is based on passing the source water into a container and heating it to high temperatures. A part of the water flashes to a vapour stage, while the rest of the hot water continues flowing through a series of chambers. Within each chamber/procedure the water loses some of its salt which remains with the residuals. The vapour is condensed as liquid freshwater.

Multiple effect distillation (MED) technology was widely used before the MSF method but experienced operational and maintenance difficulties. Improvements in technology and its better fuel efficiency vs MSF have renewed interest in the process. Water is pumped through a series of heated horizontal tubes to evaporate it, but importantly the heat in the vapour and initial condensate are recaptured and used as a thermal source for subsequent stage evaporation.

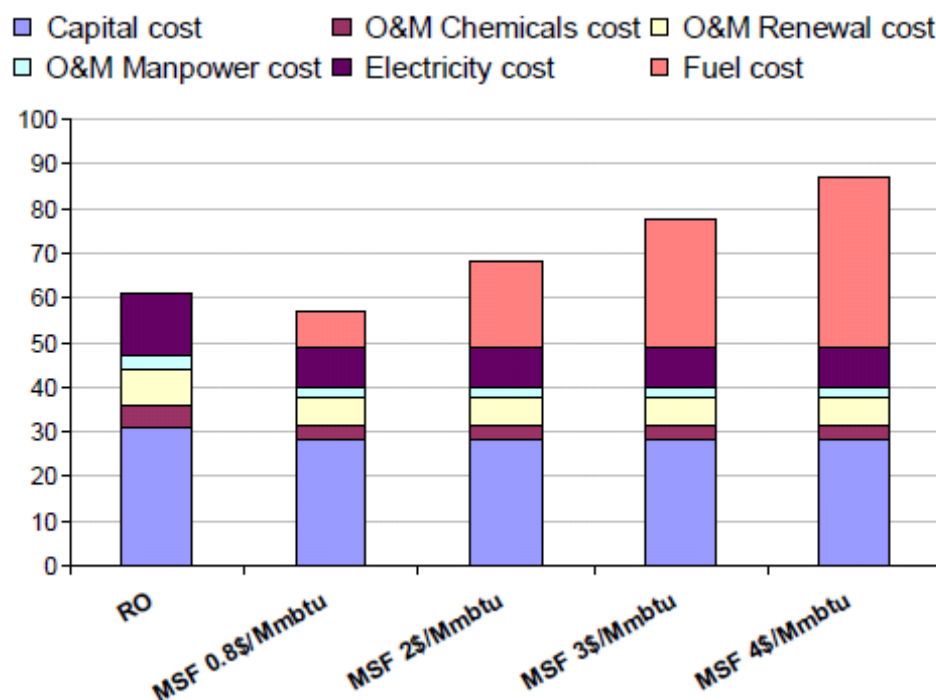
Whilst MSF has traditionally dominated the desalination industry, due to improvements in membrane technologies and fuel/electricity efficiency the technology is losing out to reverse osmosis and MED, particularly as gas prices recover.

With gas prices (e.g. Henry Hub) currently around \$4.4/Mmbtu, reverse osmosis is generally more cost effective. Suez Environnement estimates that RO water costs are around \$0.6/m³ compared to around \$0.9 for MSF. Even when combined with CCGT power generation, RO produces an estimated 12% total energy saving (e.g. 12% less gas for same power and water output) vs 6.5% saving for MSF.

¹¹ Global Water Intelligence

¹² IEA World Energy Outlook 2009

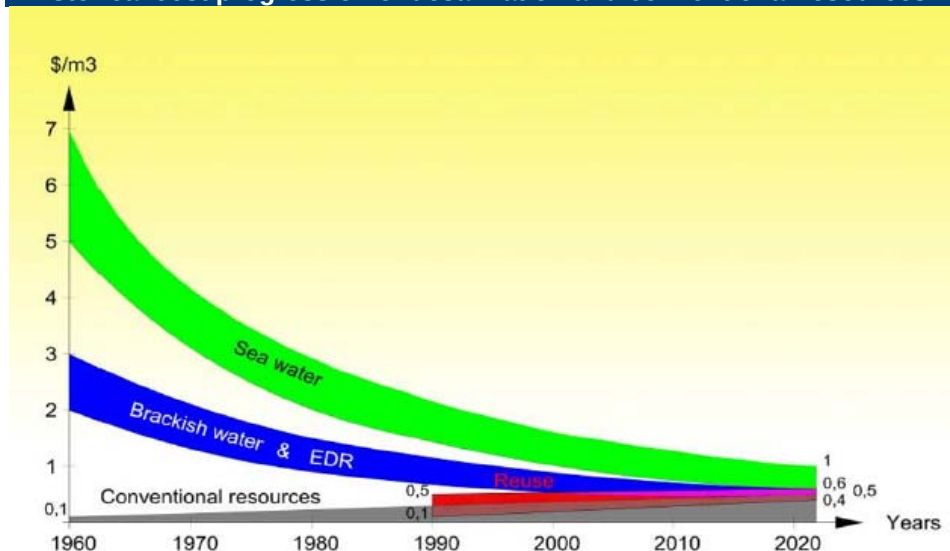
Cost breakdown of water cost (\$/m³) based on technology / fuel prices



Source: Suez Environnement; compiled by Daiwa CM Europe.

However as desalination technology matures the cost of freshwater production is expected to reduce, whilst at the same time the cost of extracting/distributing water from conventional resources is expected to increase. Water companies such as ACCIONA expect a convergence in these costs within the next 20 years.

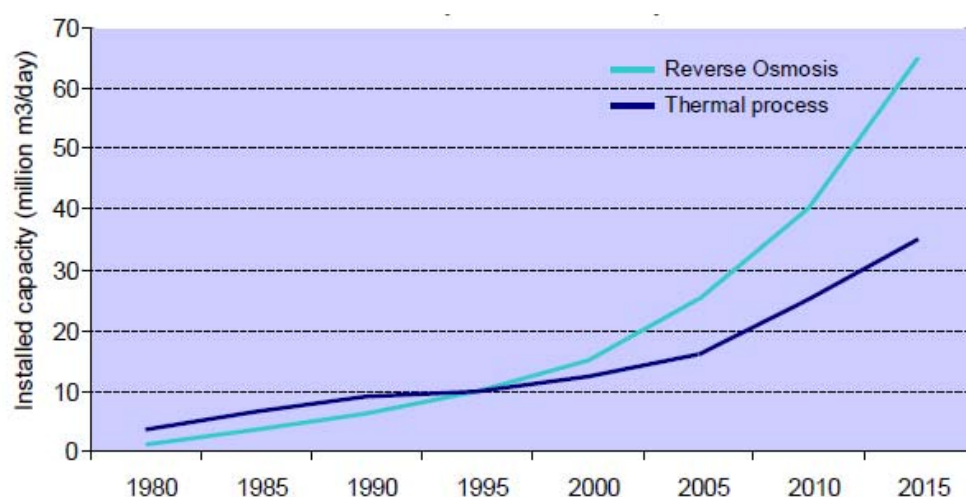
Historical cost progression of desalination and conventional resources



Source: ACCIONA; compiled by Daiwa CM Europe.

Suez Environnement estimates that global reverse osmosis investment will total \$17bn for the period 2005-2015 and has already supplanted thermal solutions as the preferred choice for new capacity.

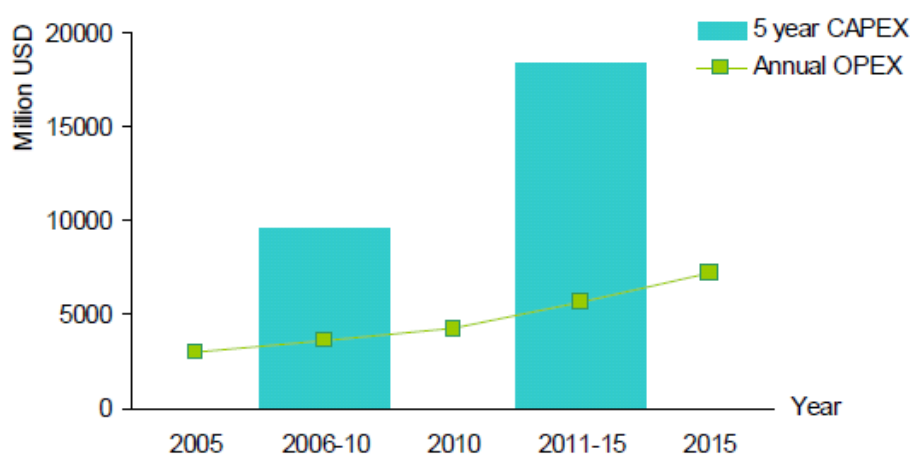
Global desalination capacity by technology



Source: Suez Environnement; compiled by Daiwa CM Europe.

Water recycling can be applied across all three of the major water uses (agriculture, industry, domestic). However at the moment the market is relatively small as, although 368km³/year of wastewater is collected globally, only around half of this volume (160km³/year) is actually treated and less than 5% (7.1km³/year) is recycled. Given most new wastewater treatment plants can be designed for reuse we expect the 10% proportion of wastewater volumes being recycled to increase over time.

Global water reuse investment (5 year) and opex



Source: Suez Environnement; compiled by Daiwa CM Europe.

Global investment trends

Global investment in the water sector during 2005-2030 is forecast¹³ to total \$22.6 trillion, roughly double the amount for the power sector (with estimates ranging from \$9-\$14 trillion). By region, Asia/Oceania will receive the lion's share (40%) of this water investment.

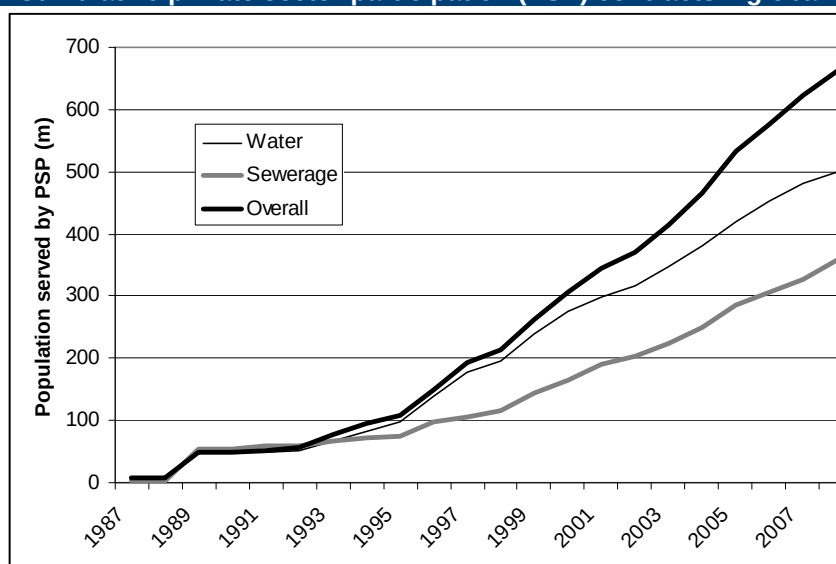
2005-2030 Project Infrastructure Investments (\$ trillions)

\$ trillions	Water	Power	Road & Rail	Air/Seaport	Total
North America	3.62	1.53	0.94	0.43	6.52
Latin/South America	4.97	1.44	1.01	0.06	7.48
Europe	4.52	1.08	3.12	0.43	9.15
Asia/Oceania	9.04	4.23	2.11	0.51	15.89
Other (inc. Middle East/Africa)	0.46	0.72	0.62	0.16	1.96
Total	22.61	9.00	7.80	1.59	41.00
% of infrastructure spending	55%	22%	19%	4%	100%

Source: Cohen & Steers Global Infrastructure Report 2009; compiled by Daiwa CM Europe.

The private sector is facilitating a significant component of the required investment to improve existing water supplies and deliver the "new water" facilities. In 1999 only 5% of the world's population had its water requirements served by the private sector but this proportion has increased to 12% in 2009 (over 700m people) and is forecast¹⁴ to increase to 20% by 2025.

Cumulative private sector participation (PSP) contracts – global total



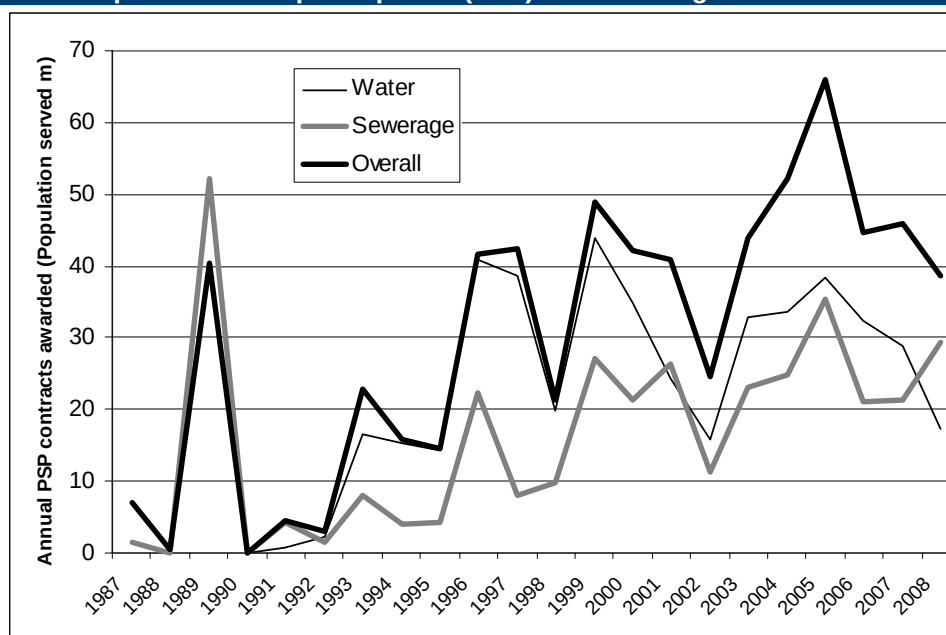
Source: Pinsent Masons Water Yearbook 2009-2010; compiled by Daiwa CM Europe.

The global number of people serviced by private sector participation contracts in the water and sewerage market has shown steady growth over the past twenty years, with the exception of the 1989 UK privatization process and the 2002/2003 decline in emerging market activity.

¹³ Cohen & Steers (multiple forecasts)

¹⁴ Pinsent Masons Water Yearbook 2009-2010

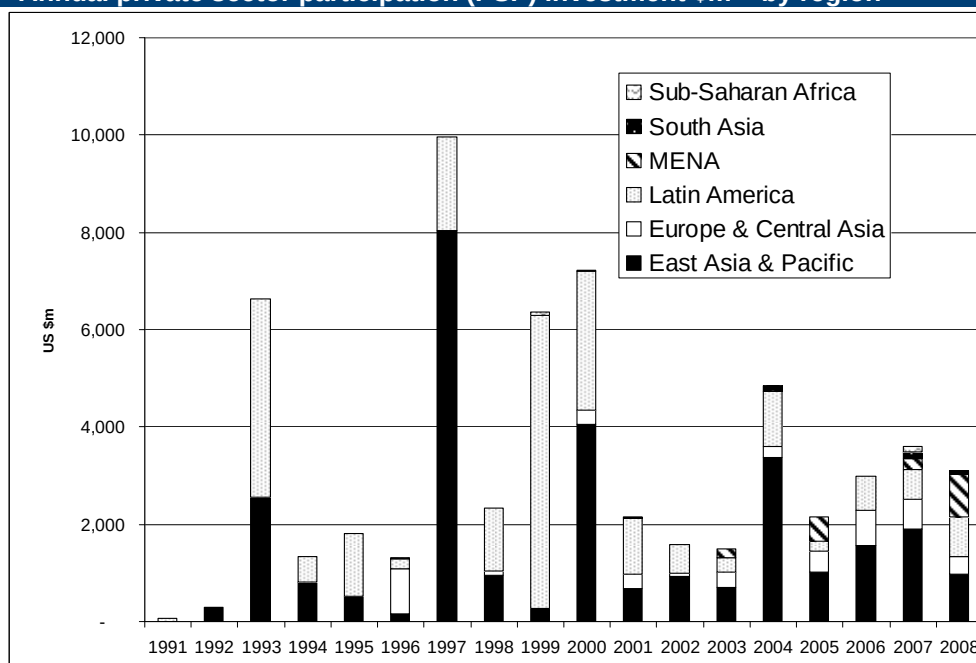
Annual private sector participation (PSP) contracts – global total



Source: Pinsent Masons Yearbook 2009-2010; compiled by Daiwa CM Europe.

However by value of investment, whilst market activity has recovered from its 2002/2003 lows, it is still materially down from its late 1990s peak (countries such as Chile shifted from outright privatizations to concession sales). In addition, geographically there has been a shift in spending away from Latin America (as the market matures) towards Asia.

Annual private sector participation (PSP) investment \$m – by region



Source: Pinsent Masons Yearbook 2009-2010; compiled by Daiwa CM Europe.

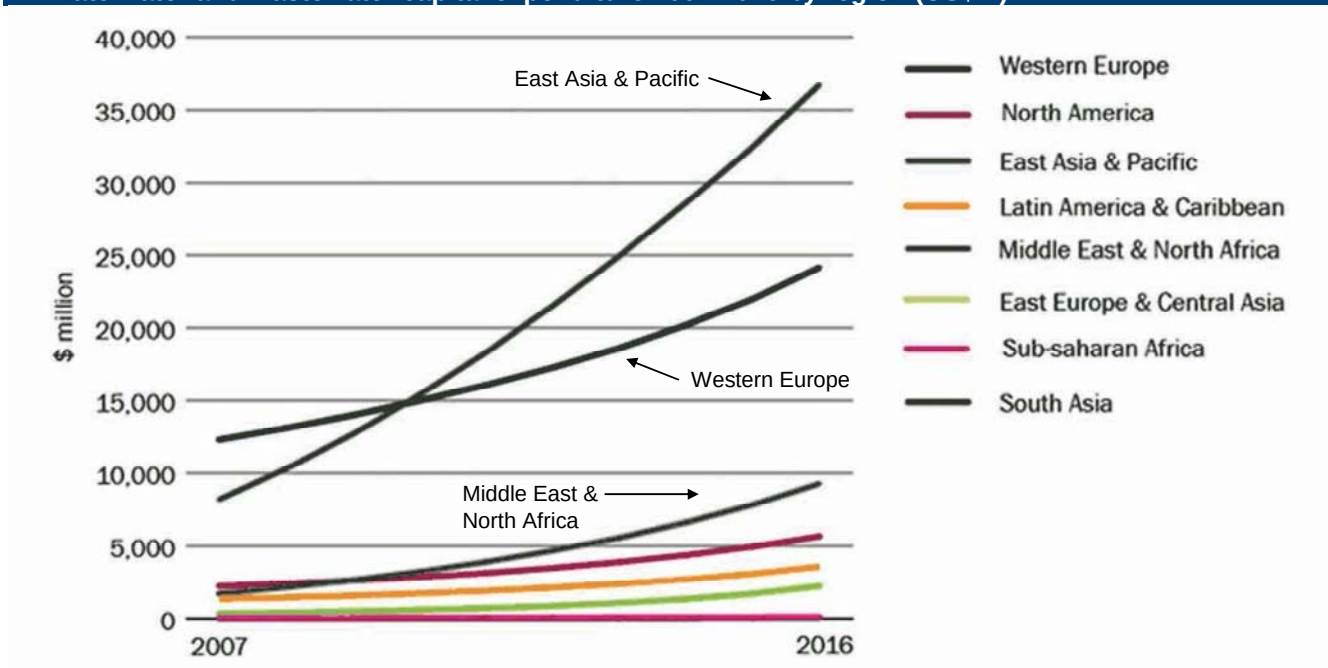
China has represented the majority of this global market growth, accounting for an estimated 50%+ of all PSP awards since 2001 and now accounting for 32% of the world population served by the private sector. However other Asian markets such as Australia and Thailand are also forecast to display a strong PSP growth.

South East and East Asia and Oceania - forecast proportion of private sector participation by country

	2009		2015		2025	
Proportion of private sector participation	Water	Sewerage	Water	Sewerage	Water	Sewerage
Australia	27%	7%	37%	13%	43%	18%
China	12%	10%	14%	12%	18%	19%
Hong Kong	67%	0%	91%	26%	90%	30%
Indonesia	5%	0%	8%	1%	13%	1%
Japan	0%	0%	5%	13%	8%	16%
Macao	100%	0%	100%	0%	100%	100%
Malaysia	61%	0%	80%	33%	80%	44%
New Zealand	1%	10%	3%	11%	3%	10%
Philippines	15%	2%	20%	8%	30%	13%
Singapore	33%	0%	33%	8%	33%	10%
South Korea	0%	5%	0%	16%	10%	24%
Taiwan	13%	1%	30%	2%	35%	6%
Thailand	3%	0%	64%	22%	65%	36%
Vanuatu	15%	0%	20%	0%	33%	0%
Vietnam	0%	0%	8%	0%	12%	5%

Source: Pinstent Masons Water Yearbook 2009-2010; compiled by Daiwa CM Europe.

The growth of private water investment in Asia should result in investment in the region totalling over \$36bn in 2016, 50% greater than the \$24bn forecast for Western Europe in that year.

Private water and wastewater capital expenditure 2007-2016 by region (US\$m)

Source: Global Water Intelligence; compiled by Daiwa CM Europe.

In comparison private sector participation in South Asia (with the exception of the Maldives) is expected to remain relatively low.

South and Central Asia - forecast proportion of private sector participation by country						
	2009	2009	2015	2015	2025	2025
Proportion of private sector participation	Water	Sewerage	Water	Sewerage	Water	Sewerage
Bangladesh	0%	0%	0%	0%	0%	0%
India	1%	0%	3%	0%	5%	1%
Iran	0%	0%	0%	0%	0%	0%
Kazakhstan	2%	0%	3%	0%	6%	3%
Maldives	32%	0%	50%	0%	50%	0%
Mongolia	0%	0%	0%	0%	0%	0%
Nepal	0%	0%	3%	0%	8%	0%
Pakistan	0%	0%	0%	0%	0%	2%
Sri Lanka	0%	0%	1%	0%	5%	0%
Uzbekistan	2%	0%	3%	0%	6%	3%

Source: Pinsent Masons Water Yearbook 2009-2010; compiled by Daiwa CM Europe.

As a result, whilst in South East Asia nearly an additional 300m people are forecast to be provided water or sewerage services by private enterprises by 2025, the increase in South & Central Asia is less than 90m (similar to the roughly 90m increase expected in Western and C&E Europe combined).

Forecast number of people served by private water or sewerage services by region						
	People (m)		People (m)		People (m)	
	2009	% of total	2015	% of total	2025	% of total
People served by private sector participation						
Western Europe	181.4	45%	219.5	54%	226.6	55%
C&E Europe	33.8	10%	64.4	20%	81.1	27%
ME & Africa	68.2	5%	123.1	9%	217.8	13%
South & Central Asia	10.1	1%	43.1	2%	97.4	5%
South East Asia	314.6	15%	443.6	20%	605.2	26%
Oceania	8.4	25%	12.1	32%	14.7	36%
North America	100.4	22%	136.2	28%	209.0	40%
Latin America	85.1	18%	121.5	24%	158.0	29%
World Total	802.0	12%	1163.5	16%	1609.8	20%

Source: Pinsent Masons Water Yearbook 2009-2010; compiled by Daiwa CM Europe.

Whilst both developed and developing nations require a significant increase in investment, in absolute terms China, the United States, India and Japan are forecast by the OECD to dominate future global water investment.

Annual national water infrastructure expenditure					
	GDP	GDP/cap	Current expenditure	Average annual	Average annual
	(\$bn)	(\$)	on water infrastructure (\$bn)	investment by 2015 (\$bn)	investment by 2025 (\$bn)
China	7,334	5,642	110.0	182.1	247.2
United States	11,724	39,496	87.9	101.7	167.6
India	3,291	3,080	23.4	74.8	108.3
Japan	3,817	29,906	28.6	47.0	63.4
Germany	2,391	28,988	17.9	23.4	35.8
Brazil	1,462	8,048	2.9	19.8	32.0
United Kingdom	1,736	28,938	12.5	19.1	28.0
Russia	1,449	10,179	4.6	11.5	26.4
France	1,724	27,738	12.9	16.9	25.8
Italy	1,620	27,984	12.2	16.8	25.2
South Korea	1,030	21,419	7.7	12.8	18.0
Spain	971	23,627	7.3	11.0	16.0
Canada	1,050	32,921	7.9	10.3	15.7
Mexico	1,006	9,887	19.1	16.8	15.4
Australia	602	29,893	4.5	6.9	10.0
Turkey	530	7,503	10.1	9.3	9.7
Netherlands	477	29,332	3.6	5.4	7.9
Poland	475	12,452	9.0	7.9	7.2
Belgium	309	29,707	2.3	2.8	4.4
Austria	254	31,254	1.9	2.6	3.9

Source: OECD; compiled by Daiwa CM Europe.

India

The Water Resource Group estimates India's total water resource base at 2,518bcm, although it is highly variable due to the monsoon season (when typically 50% of the annual precipitation falls in less than one month and 90% of river flows occur in only 4 months of the year).

With only around 200m³ of water storage capacity per capita (vs around 2,200 m³ in china and around 6,000 m³ in the United States), India's accessible, reliable water supply is just 744 bcm or 29% of its total water resource.

The OECD has estimated that the annual requirement for rehabilitating existing infrastructure is around \$4.6bn, whilst operational expenditure (largely personnel, electricity and subsidies) will require a further \$4.4bn per annum.

New infrastructure investment is estimated to require \$4.1bn of capex and recurrent expenditure of \$3.9bn pa. In addition, meeting the MDG target is estimated to cost around \$3.2bn in annual investment (to 2017) with additional recurrent expenditure of around \$3.1bn pa.

Estimated annual investment needs in Indian water and sewerage sector					
US\$m	Rehabilitation of existing infrastructure	New infrastructure investment	MDG urban areas	MDG rural areas	Total
Capital investment	4,600	4,140	1,820	1,370	11,930
Operational expenditure	4,370	3,930	1,750	1,300	11,350
Total	8,970	8,070	3,570	2,670	23,280

Source: OECD – "The impacts of change on the long term future demand for water sector infrastructure"; compiled by Daiwa CM Europe.

Japan

As with many European markets, total water consumption is expected to decline in Japan, with industrial water use having already fallen by around 25% since the 1970s (despite increasing industrial output).

However significant investment in water infrastructure is required as around 38,000 km of water pipes have exceeded their stipulated service life of 40 years.¹⁵

The structure of the Japanese water market is currently dominated by municipal governments but private sector participation is forecast to increase to 5% in water by 2015 and 8% by 2025 (16% in sewerage by 2015). In 2002 a revision to the Water Supply Law made it possible to privatize water utilities, but greater emphasis may be placed on this process as the relatively small role of the private sector in the operation of Japan's water service network has been attributed by METI as a factor in holding back the progress of Japanese corporations in the global water service management sector.

Whilst Suez Environnement does not have activities in Japan, Veolia has a small presence in the Japanese water sector (providing services to industrial and public authority customers) having made four acquisitions during 2007 and 2008.

¹⁵ Japan Water Works Association

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