Change in recommendation
26 August 2014

Arcadis

Acquisition strategy returns to the surface

Buy (previously Hold)

Price (25/08/14)
€23.90

Target price (12-mth)
€28.00 (maintained)

Forecast total return
19.8%

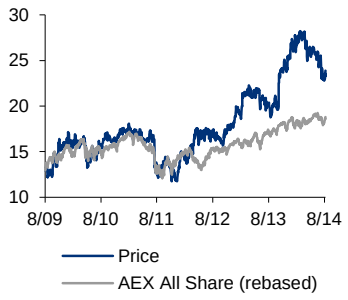
Industrial Goods & Services
Netherlands
Bloomberg: ARCAD NA
Reuters: ARDS.AS

Share data

Avg. daily volume (3-mth)	111,412
Free float (%)	75.0
Market cap (€m)	1,737.8
Net debt (1F, €m)	647
Enterprise value (1F, €m)	2,438
Dividend yield (1F, %)	2.6

Source: Company data, ING estimates

Share price performance



Source: ING

Although the battle might not be over, we foresee Arcadis as taking out Hyder. Together with the acquisition of Callison, net revenue will increase pro forma to €2.3bn. Whereas we believe Callison is priced at an attractive rate, Hyder is acquired at a demanding multiple depending on synergy effects. Not including any equity issue, we have raised our estimates materially. Together with a weak share price performance, Arcadis' multiple has come down, again making the shares attractive. We upgrade Arcadis from Hold to BUY.

On the same day as it acquired architectural firm Callison, Arcadis raised its bid for design & engineering firm Hyder to 730p per share, raising it by 80 pence and exceeding Nippon Koei's bid by 50p. Together with a minority stake of 18% in Hyder we believe Arcadis will acquire Hyder. This will strengthen Arcadis' position in different parts of the world where it wants to be, strengthening its Infra and Building divisions.

We raise our EPS estimates to €1.68 from €1.62 for FY14, reflecting the acquisitions but we are cautious on Arcadis' 2H14 underlying margin development. For FY15 we raise our EPS estimate to €2.00 from €1.80 previously (+19% YoY), while our FY16 EPS estimate is now €2.20 (+10% YoY). Although under the surface differentiating, our EPS numbers are in line with consensus. We have not taken into account any equity raising in our new estimates, albeit the offer documents refer that as a possibility.

We believe that these large acquisitions will deliver their returns but for Hyder Arcadis needs a couple of years to see the value as the multiple paid at >15x EBIT demands considerable synergy effects from cost savings and from cross selling. Callison immediately contributes to EPS at as much as 15cts per share, Hyder from its own activities around 8cts. There are challenges ahead, but these acquisitions also offer Arcadis an opportunity to get an even better portfolio and accelerate growth. Meanwhile, Arcadis' valuation has come down from 8.8x FY15F EV/EBITDA to 7.8x due to marginal organic growth and a modest FY14 guidance of 5-10% earnings growth. These acquisitions are of a larger magnitude than a small 1-2% difference in organic growth. Compared with its engineering peers both in Europe and in the US, Arcadis has a modest 4% premium on FY15F and FY16F EV/EBITDA. In our view, given the business mix, strong earnings growth ahead (12.5% CAGR13-16F), acquisition track record and management's dedicated strategy, we believe we should return to this 20% premium on EV/EBTIDA vs other engineering firms. This leads to an EV/EBITDA of 9.8x and 9.0x for FY15F and FY16F, respectively, or a TP of €28. At the current share price this provides a 20% performance, which results in an upgrade from Hold to BUY.

Forecasts and ratios

Year end Dec (€m)	2012	2013	2014F	2015F	2016F
Revenues	2,546	2,518	2,556	2,985	3,075
Normalised EBITDA	198	202	219	269	286
Normalised net profit	105	111	122	146	160
Normalised EPS (€)	1.49	1.54	1.68	2.00	2.20
Normalised PER (x)	16.0	15.5	14.2	11.9	10.9
EV/normalised EBITDA (x)	10.3	9.7	11.1	8.7	7.8
FCF yield (%)	6.7	6.3	4.1	7.7	8.0
Dividend yield (%)	2.2	2.4	2.6	3.1	3.4
Price/book (x)	3.2	2.9	2.7	2.4	2.1
Normalised ROE (%)	21.2	19.6	19.7	21.0	20.4

Source: Company data, ING estimates

Quirijn Mulder
Amsterdam +31 20 563 8757
quirijn.mulder@ing.com

A tale of two acquisitions

Callison and Hyder, two large acquisitions

The same day Arcadis acquired the architectural firm Callison from Blue Point Capital and management, Arcadis also raised its bid for Hyder from 650p to 730p, above Nippon Koei's offer of 680p.

Good chance to win

With already in possession of 16% of the shares from a number of large shareholders and irrevocables from managers and board members, the total voting rights of Arcadis in Hyder is 18%. The new offer document brings in more information on Hyder's management, which is now fully committed to the new offer. We believe the chances that Nippon Koei makes a renewed offer are still possible, but we have to bear in mind that the current market cap of Nippon Koei is smaller than its offer on Hyder. Arcadis is much bigger: its market cap, revenue and EBITDA are five times those of Nippon Koei.

New estimates

We worked out the new numbers of Arcadis on the back of these two acquisitions, which are among its largest acquisitions ever done. Callison is the fourth largest acquisition and Hyder the largest and most expensive one (Figure 1).

Fig 1 Ranking acquisitions

Year	Name	Net revenues (US$m)	Price (US$m)
Planned Oct-14	**Hyder Consulting (UK)**	**425**	**478**
Jun-09	Malcolm Pirnie (US$)	290	194
Nov-11	EC Harris (UK)	356	156
Aug-14	**Callison (US)**	**147**	**145**
Apr-12	Langdon, Seah (Singapore)	140	125
Jul-07	RTKL (US$)	142	108
Oct-05	BBL (US$)	110	78
Sep-03	PRC (NL)	45	23

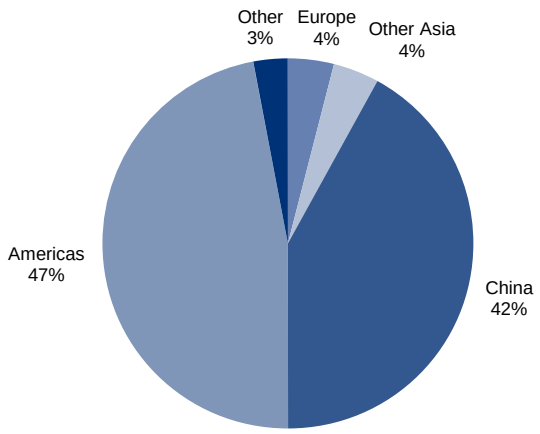
Source: Company data, ING estimates

Callison

Different acquisitions

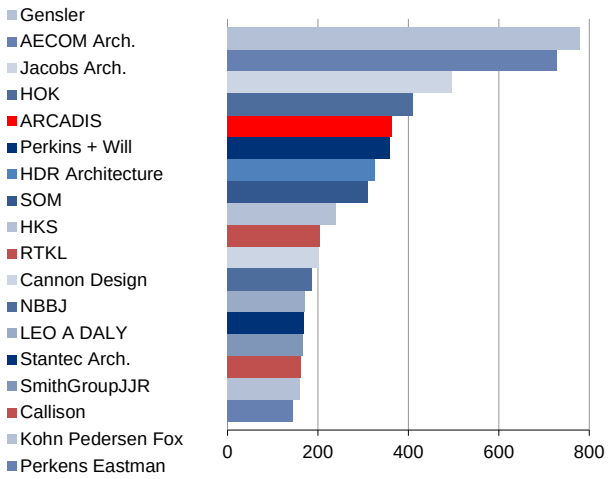
The acquisition of Callison is of another nature than the planned acquisition of Hyder with the main differences related to size, spread of activities and multiples paid.

Fig 2 FY13 Geographical breakdown for Callison



Source: Company data, ING estimates

Fig 3 Largest architectural firms in the world



Source: Company data, ING estimates

Callison, retail architects

For the first time since FY07 when it acquired RTKL, Arcadis did its second acquisition in the architectural arena. Callison is a highly regarded architect and interior design firm, active mainly in US and China (since 2005). The geographical spread of Callison resembles the geographical spread of RTKL, with the US the largest and China second.

Callison comparable to RTKL

Thanks to this step Arcadis becomes, with around US$370m net revenues, the fifth ranked architectural/design firm in the world (Figure 3). What is attractive is that Callison brings in a high number of international clients while it also has a position in Big Cities, both in cities which are already on Arcadis' map as well on Arcadis' future map.

Strong margin

Callison has grown nicely at around 7% in the last couple of years and is a highly profitable firm with margins in our view exceeding every other subsidiary of Arcadis at 15% EBIT margin on gross revenues and 17% on net revenues with an EBITA of US$25m. We estimate EBIT margins of RTKL at around 12-14% on net revenues. The best explanation is RTKL's dependence on government-related designs like hospitals, suffering from lower demand due to US budget cuts for a couple of years now. However, according to Arcadis' management, RTKL is picking up and as a consequence we estimate that RTKL has at this moment a larger backlog than Callison.

6x EBITA price

According to the renewed offer document for Hyder, Arcadis pays €109m for Callison. We estimate that this brings in a multiple of around 6x EBITA and around 5.5x EBITDA. Compared with Arcadis' large acquisitions in the past this multiple is at the bottom of the range. That this acquisition comes in quite cheap is in our view related to the fact that RTKL and Callison know each other quite well and above any other activity, architects are likely sensitive for with whom they can work with. Thanks to this low multiple and a five-year loan with a 2% interest rate, Arcadis was able to state that this acquisition will contribute around €0.15 per share, or around 9% pro forma.

Synergy limited with group

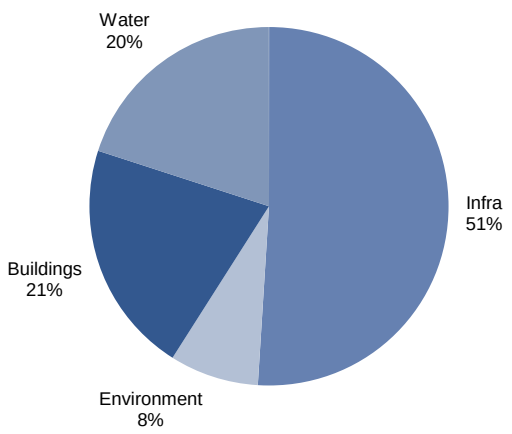
There is limited synergy effect with Arcadis: in fact as we have seen with RTKL, cross selling remains modest with the rest of the group. Between RTKL and Callison we foresee synergy effects in terms of combining offices and also the way Callison applies its way of thinking for local design and the way it prices its services.

Hyder

EBIT margin under pressure

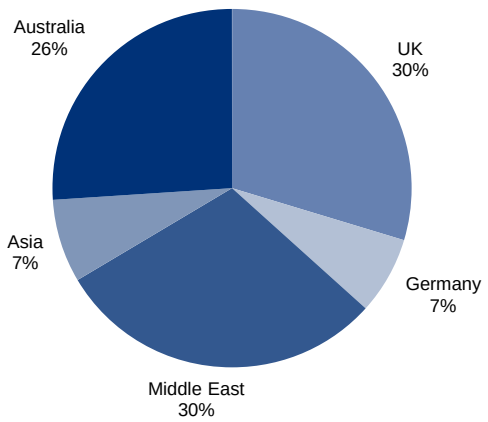
Of another size, price and activity is the pending acquisition of UK listed Hyder. Hyder is a specialized Design & Engineering consultancy firm, specialized in transport, property and utilities. EBIT margins over net revenues are around 7.4% in book year FY14 (1 April 2013 until 31 March 2014), down from around 9% in FY12 and FY13. Revenue growth has been around 3% while the current order book stands at £440m (€550m).

Fig 4 Breakdown by activity Hyder FY13/14 (€304m)



Net revenue FY13
Source: Company data

Fig 5 Geographical breakdown FY13/14



Net revenue FY13
Source: Company data

Aimed to integrate and cross selling

In contrast to the stand alone acquisition of Callison, Hyder will be acquired with the aim to be a fully integrated firm within Arcadis. Hyder strengthens Arcadis' position in different segments and in different areas. Over half of Hyder is Infra-related work, which is

supportive for Arcadis' position in Infra, such as Rail. Also, Hyder's position in Water (utilities) is strong adding to Arcadis' Water capabilities. Geographically, the UK and Middle East positions, both 30% of revenues, can considerably strengthen Arcadis' position in the UK and in the Arab countries. Also, Arcadis now gets with €79m revenues its first footprint in Australia, a country we believe is very interesting for Arcadis' engineering capabilities such as environmental services and water.

A special cost savings trajectory is expected for outsourcing: For the relative easy work, Hyder has set up three outsourcing centres: India (highways, property), Philippines (utility, transport) and Jordan. These outsourcing centres represent around 18% of Hyder's workforce. For Arcadis this is a relative modest activity in Romania with we estimate around 100 people.

Lower earnings due to Australia and Germany

Due to delays in Australia (delays of order intake, new government related) and issues in Germany, Hyder issued a profit warning in March, sending the share price down by 30%. In our view, both Arcadis and Nippon Koei have seen the underlying value for this firm for a longer time, so both were eager to step in. Assuming Arcadis will win this battle, Arcadis becomes around 14% larger with this acquisition, measured by net revenues. Profitability is an issue but Arcadis aims for synergy effects, both based on cross selling and cost savings of £15m (€20m) by FY16. Taking into account some extra revenue thanks to cross selling, Hyder will then see its EBITA margin increase by c.300bp to around 10.5% from 7.4% today.

FY14F EV/EBITDA of 12.6x

Due to the bidding by Nippon Koei, Arcadis has to pay around €35m more for this acquisition, which raised the FY14F EV/EBITDA multiple to 12.6x from 11.2x before and to 7.7x from 6.9x previously. This multiple is the highest ever paid by Arcadis for a large acquisition, but the predicted synergy effects of £15m are so large that the multiple comes down materially. Anyhow, including synergy effects, Arcadis pays more than other acquisitions in the past at 8.5x FY13 EV/EBITA, except for Langdon Sea (8.9x).

Conclusion

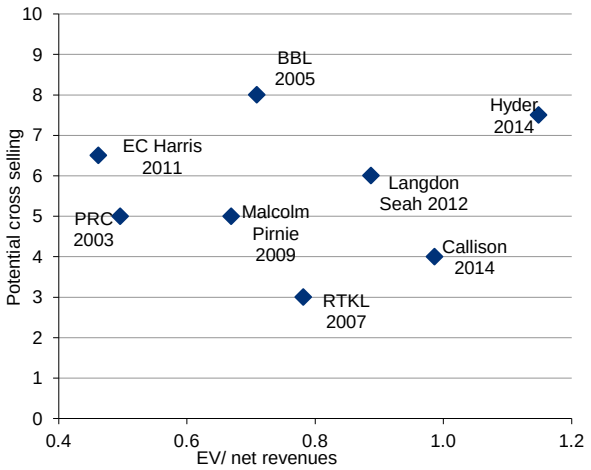
Work to do for Hyder, Callison should do what it is good at

So, while Arcadis has a lot of work to do with Hyder, Callison should continue to make high margins. Even if the Chinese economy weakens further, Callison's management is confident to continue in this immense country. Hyder should benefit from the Arcadis Group with a strong international clients' list and adding its outsourcing centres to Arcadis' portfolio (an answer to war for talent implies that engineers in OECD countries should do more solution-oriented work "sur place" while qualitative high skilled engineering work is done elsewhere).

Context

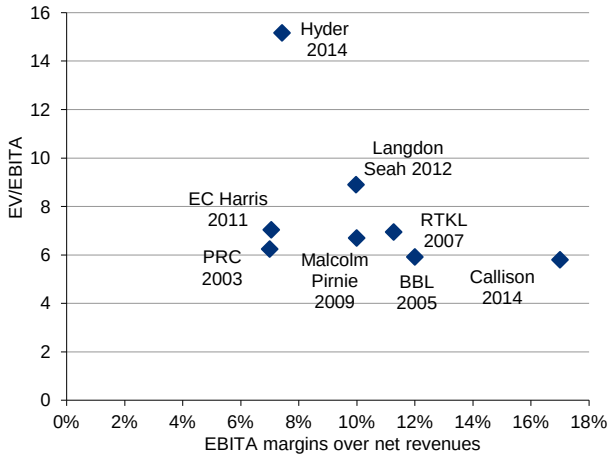
Figure 6 and 7 give an impression on the position of Callison and Hyder within Arcadis' large acquisitions in the last twelve years.

Fig 6 Cross selling and EV/net revenue



Source: Company data, ING estimates

Fig 7 Multiple and margin



Source: Company data, ING estimates

Both highly priced

Figure 6 shows the EV/net revenues paid by Arcadis and the cross selling potential we see. For Callison this is relatively low cross selling due to the activity only related to RTKL. For Hyder the cross selling/synergies are much higher, ranking Hyder in our view between EC Harris (BAC added a lot of value to Arcadis) and BBL (this transformed Arcadis Environmental Services in the US to a top layer with structural higher margins). For Callison and Hyder the price paid is relatively high measured in EV/net revenues: Hyder due to the synergy effects and Callison due to the high EBIT margin over net revenue; on EV//EBITA these numbers are at the bottom as Figure 7 shows.

But Hyder synergy leads, Callison EBIT margin

Figure 7 shows the price paid compared to margins generated. Hyder is the most expensive acquisition ever at 15x EV/EBIT but if successful with the planned cost savings, then Hyder comes out somewhere between Malcolm Pirnie and RTKL. Clearly there is a risk with Hyder, while other acquired firms also realized cross selling synergies after the acquisition, which are not depicted in this graph.

Arcadis group

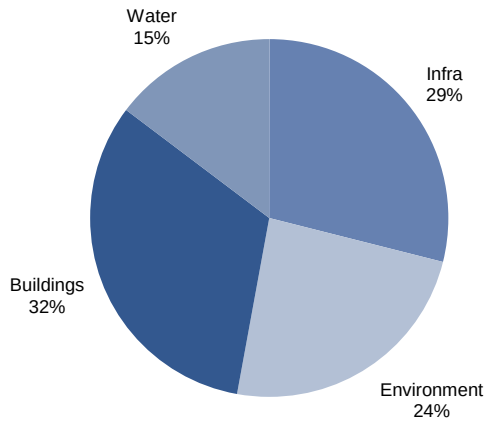
Increase size by a quarter

How does the picture look like for Arcadis after these acquisitions? In total Arcadis will become around 19% larger in size based on gross revenues; 5% by Callison and 14% by Hyder Consulting. The new firms will add more net revenues to its portfolio: 22% (6% and 16%, respectively) as net revenue for both acquisitions is around 87% of gross revenues compared with 75% for Arcadis. EBITA will increase by €41m or 24% on FY13 numbers.

More Infra and Building

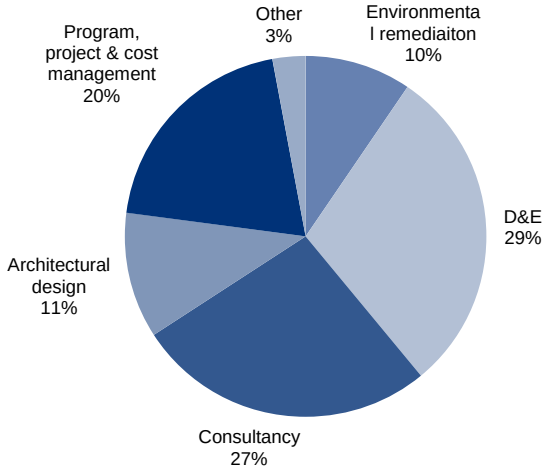
By segments (Figure 8), the revenue breakdown remains more or less the same with a slightly more bias towards Infrastructure and Buildings from 27% to 29%, respectively, to 30% to 32% of Arcadis' net revenues at the cost of Environmental Services at 24% now from 28% previously. By activity (Figure 9), Arcadis becomes more a Design & Engineering firm from 22% to 30% while doubling its Architectural-related income to 11% from 6% previously.

Fig 8 Breakdown segments (net revenue €2.3bn)



Source: Company data, ING estimates

Fig 9 Breakdown activity level (net revenue €2.3bn)



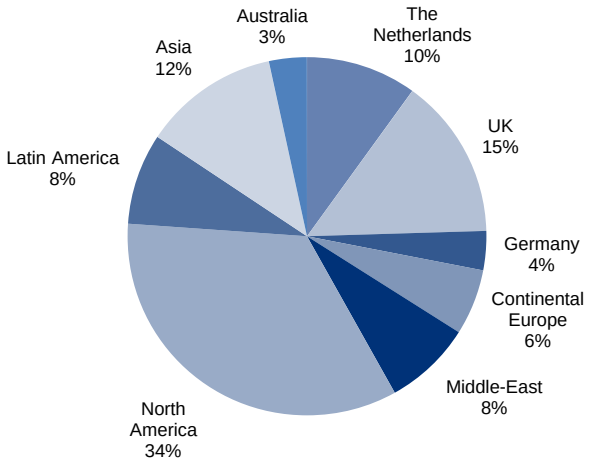
D&E: design & Engineering

Source: Company data, ING estimates

Emerging markets revenue goes from 23% to 28%

Geographically, we have made the following estimates for the new Arcadis based on FY13 numbers for Arcadis and mid FY14 for Callison and Hyder. We estimate net revenues of €2.3bn compared with €1.9bn reported in FY13. Figure 10 shows the breakdown per country based on Arcadis numbers per region, whereas our estimates are on a more detailed level. Roughly, Western Hemisphere represents around 40% of Arcadis, dominated by the US (one-third of total). Far East represents around 15%, Europe, now dominated by UK, 35% of net revenue; 8% is in the Middle East. Emerging markets will represent around 28% of total revenue raised from 23% in FY13. For those who think Arcadis is still a Dutch company, 10% of total revenues in FY15F should be generated in the Netherlands, 90% abroad.

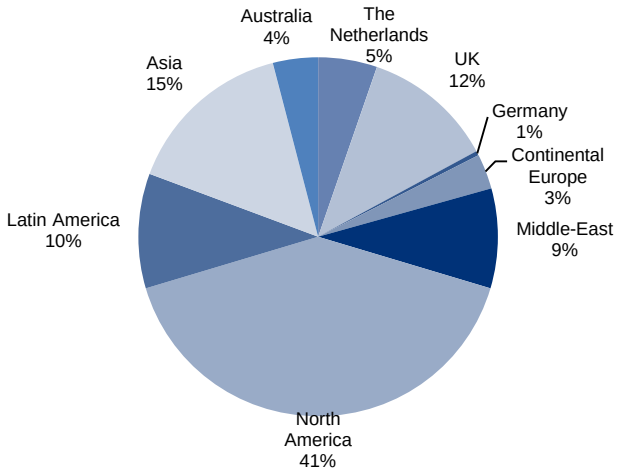
Fig 10 Geographical breakdown net revenue Arcadis after acquisitions (€2.3bn)



FY13 is basis

Source: Company data, ING estimates

Fig 11 Geographical breakdown EBITA after acquisitions (€231m)



FY13 is basis

Source: Company data, ING estimates

Europe still 30% of EBITA

The breakdown of EBITA of €231m in Figure 11 is more than net revenues based on ING estimates. The difference of the breakdown with net revenue remains limited, except for individual countries like Germany due to the issues of Hyder with that country in FY13/14. The Netherlands is in a recovery mode as well, stemming from the restructuring measures taking place in continental Europe. Total Europe represents in our view around 30% of EBITA, and Emerging markets about one-third.

Based on a slight recovery of organic growth, cross selling/synergy with the new acquisitions and a further margin improvement, earnings should be higher with double-digit numbers in the years ahead. Let's first we look at EBITA in 1H14 and our forecast 2H14.

Estimates

1H14

Fig 12 Reconciliation FY14F EBITA

	1Q14	2Q14	3Q14F	4Q14F	FY14F	%YoY chg 1Q14	%YoY chg 2Q14	%YoY chg 3Q14F	%YoY chg 4Q14F	%YoY chg FY14F
EBITA	**41.6**	**41.7**	**46.7**	**54.1**	**184.1**	**5**	**13**	**9**	**21**	**10**
Acquisition costs	0.3	3.6	3.6	0.5	8.0				-55	627
EBITA recurring	41.9	45.3	50.3	54.6	192.1	6	23	8	19	14
Restructuring & integration costs	2.2	3.3	2.0	2.0	9.5	-30	-51	-62	-55	-52
EBITA operational	**44.2**	**48.5**	**52.3**	**56.6**	**201.6**	**3**	**12**	**1**	**12**	**7**
Contribution from acquisitions	(0.5)	(0.3)	0.3	(9.2)	(9.7)	-88	-85	-134	291	0
EBITA operational FX/organically	43.6	48.3	52.6	47.4	191.9	14	16	4	-1	7
FX	2.0	2.1	1.4	0.2	5.7	162	110	-46	-94	-31
EBITA operationally organically	**45.6**	**50.4**	**54.0**	**47.6**	**197.6**	**17**	**18**	**1**	**-8**	**6**
EBITA margins over net revenue										
EBITA (%)	9.0	8.9	10.0	9.7	9.4	6	17	2	1	6
EBITA recurring (%)	9.1	9.6	10.8	9.8	9.8	7	27	10	0	10
EBITA operational (%)	**9.6**	**10.3**	**11.2**	**10.1**	**10.3**	**4**	**15**	**3**	**-6**	**3**
Margin realized from acquisitions (%)	10.0	10.0	-13.9	9.9	9.4	-32	-21	-165	-79	-55
EBITA operational organically/FX (%)	9.6	10.4	11.3	10.2	10.4	9	17	5	-5	6

Source: Company data, ING estimates

Operational EBITA goes up in 2H14 likely

Figure 12 shows the development of EBIT in 1H14 and our estimates for 2H14. Arcadis makes a distinction between EBITA reported and EBITA operational with the main differences mainly acquisition costs for external advisors etc. In 2Q14 this was a high amount and in our view 3Q14 will be high as well due to the Hyder and Callison acquisitions. The second correction is restructuring and integration costs, in fact they return every quarter but the size differs considerably. In FY13 mainly due to the reorganisation in Europe, this figure was €20m. We do not believe these costs will disappear as an organisation of 28,000 employees and active in many countries with different operations always has somewhere something to reorganise.

Organic EBITA could slow down

In addition to Arcadis EBITA operational, we have made the following adjustment to reflect the organic development of EBITA operational: we adjust for acquisitions and for FX effect, as it better gives underlying development. 1H14 in that respect shows a good improvement when taking out FX loss at around €2m per quarter and no contribution from acquisitions. Therefore, underlying results in 1H14 were better than Arcadis reported.

Acquisitions main driver for 4Q14

For 2H14 we foresee a material discrepancy between what Arcadis will report and what underlying business is. EBITA from operations should benefit from lower reorganisation costs but stagnate in 3Q14 while 4Q14 in our view will increase by 12% compared with 21% reported.

Making our adjustments to organic EBITA, taking out acquisitions and FX effect, we foresee a small increase of 1% in 3Q14 but a decline of 8% YoY. After 3Q14 margin slightly up by 30bp we foresee a lower margin in 4Q14 YoY. In our view 4Q13 was quite strong with margins from Continental Europe benefiting from restructuring while 4Q14 will probably show lower EBIT margins from the US. Finally, we expect EBIT margins of acquired firms to modestly pressure margins.

It might be that we are too cautious on margin development with 4Q13 shedding 70bp YoY to 10.2% in 4Q14F. If EBITA margins from operations remain at 4Q13's 10.8%, Arcadis could realize €4m higher EBITA or 4cts per share, which would result in a better net profit from operations at +12% than guided (+5-10% YoY).

Fig 13 Acquisitions Callison & Hyder (€m)

	4Q14F	1Q15F	2Q15F	3Q15F	4Q15F
Contribution to gross revenue	104	119	119	119	16
Contribution to net revenue	90	104	104	104	14
Contribution to EBITA	9	10	10	10	1
EBITA margin (%)	10.2	9.8	9.8	9.8	7.2

Source: Company data, ING estimates

Callison 3Q14, Hyder 4Q14

Knowing what the acquisitions will contribute on a pro forma basis, we have taken these figures as our basis for our calculation in FY14 and FY15. We assume Callison will be taken over per 1 October after the Chinese antitrust authorities have no objections, while for Hyder we take 15 October. This results in the contribution for FY14 as follows:

Fig 14 Acquisition effect 4Q14/FY14F

	4Q14	FY14	YoY 4Q14 (%)	YoY 14 (%)
Contribution to gross revenue	103.7	103.7	16.1	4.1
Contribution to net revenue	90.1	90.1	19.3	4.8
Contribution to EBITA	9.2	9.2	20.6	5.5

EBIT margin deviates marginally to Arcadis'

Source: Company data, ING estimates

For FY15 the numbers are as follows:

Fig 15 Acquisition effect FY15F (€m)

	Callison	Hyder	Total	YoY (%)
Contribution to gross revenue	94.2	279.6	373.8	14.6
Contribution to net revenue	82.9	241.5	324.4	16.6
Contribution to EBITA	14.1	17.5	31.6	17.1
EBITA margin (%)	17.0	7.2	9.7	

Source: ING estimates

These numbers are both based on FY13 or mid FY14 figures and do exclude any revenue growth from the acquired firms, margin recovery or synergy. We exclude costs of £7m/€9m for reorganisations/integrations as well as we do not know when taken; probably part in 4Q14.

Balance sheet

No covenant breach expected, management more conservative

The size of these acquisitions is €469m. We take in our current model this €470m fully financed with short-term debt, blowing up the net debt over EBITDA ratio and not any form of strengthening of the balance sheet with fresh equity. Arcadis will in our view remain below covenants with the banks (net debt over EBITDA covenant is 3x, our estimate is 2.8x). However, management aims to have a net debt below 2x EBITDA. Therefore, management already reported to investigate options to finance acquisition by way of equity or debt instruments.

Figure 16 shows the numbers for net debt and EBITDA released by Arcadis in the renewed offer document for Hyder.

Fig 16 Arcadis: Net debt over EBITDA 12m until 30 June 2014

	Debt	EBITDA	Net debt/EBITDA
Mid FY14 (€m)	269	215	1.3
Acquisition of Callison (€m)	109	20	5.5
After acquisition of Callison (€m)	378		1.6
Acquisition of Hyder (€m)	360	30	12.6
After acquisition of Hyder and Callison (€m)	**738**	**264**	**2.8**

Source: Company data, ING estimates

Net debt at €738m

The starting point slightly deviates from the reported €284m at 1H14, as €269m is used for the bank covenants. Pro forma the number ends at €738m, with covenants at 2.8x. To come below management's wished 2x, this would demand equity raising in the order of around €200m+ but a lower amount could be sufficient: year-end net debt is likely lower than €738m. Whereas 1H14 cash flow was nil partially due to a €41m share buy-back programme and dividend of €19m, cash flow in 2H14 should be material (2H13: €100m). Also, based on the current bid the net acquisition cost of Hyder is €343m thanks Hyder's cash position. All in all, we expect a net debt of €646m at year end, resulting in a net debt year end over FY15 EBITDA of 2.9x and on pro forma EBITDA from Callison and Hyder at 2.5x.

Working capital up

Working capital is part of containing net debt and a high priority of management. Year-end FY14 numbers of NWC on gross revenues will not be better: one of the reasons is mid-year higher working capital than 1H13 and pending acquisitions with a modest 1Q14 contribution to EBITDA but full amount of working capital in the balance sheet. This raises NWC to 17.7% end of FY14 from €16.0% end of FY13. An inflated number but still to take care off we think.

Operating free cash flow

Although the balance sheet is weakened due to these acquisitions, for FY15 and FY16 the balance sheet should recover sharply. On top of the likely return to a normalised working capital ratio to 15-16% of revenues, also low capex against high EBITDA numbers, will bring in cash flow. Thanks to the acquisitions we foresee free cash flow in the range of over €160m in FY15 and FY16.

Fig 17 Net operating free cash flow

	2012	2013	2014F	2015F	2016F
EBITDA	198	202	219	269	286
Change in working capital	(14)	(6)	(37)	2	(6)
Cash inflow	184	196	182	271	280
Capex	(35)	(32)	(34)	(41)	(42)
Gross cash flow	149	164	148	230	238
Tax	(46)	(49)	(55)	(69)	(73)
Net operating free cash flow	103	115	93	162	165

Source: ING estimates

Estimates

All in all, the two acquisitions and no equity raising results in the following adjusted estimates in Figure 18.

Fig 18 New estimates (€m)

	2014F			2015F			2016F	
	Before	After	Consensus	Before	After	Consensus	INGF	Consensus
Gross revenue	2,507	2,555	2,530	2,607	2,984	2,696	3,074	2,807
Net revenue	1,880	1,957	1,923	1,947	2,335	2,048	2,415	2,135
EBITDA	211	219	225	225	269	252	286	276
EBITA	176	184	178	189	234	217	250	240
EBIT	162	169	166	177	214	197	232	222
Result before Tax	153	150	162	172	189	192	212	216
Net profit from operations	119	122	122	132	146	143	160	160
EPS from operations (€)	1.62	1.68	1.65	1.80	2.00	1.92	2.20	2.18
EBITA margin over net revenues (%)	9.4	9.4	9.2	9.7	10.0	10.6	10.3	11.2

Source: Bloomberg, ING estimates

EPS to €2.0 for FY15F from €1.8 previously

We have raised our FY14 EPS estimate to €1.68 from €1.62 previously, reflecting both acquisitions. For FY15 the effect of acquisitions is also visible raising estimates by 11% to €2.00 (+19% YoY). For FY16F we foresee an EPS of €2.20 (+10% YoY). This is in line with the Bloomberg consensus number. For FY15 and FY16 our EPS numbers do not

deviate from consensus either at €2.00 for FY15 while consensus is €1.92 and €2.20 against €2.18.

Consensus flat, underlying different

However, underlying our numbers do clearly deviate from consensus. Our FY15 net revenues are higher than consensus at €2.3bn compared with €2.0bn while our EBIT margin over net revenue is 60bp lower. It is likely that not everyone has adjusted its model as the starting point of pro forma net revenues is €2.3bn released by Arcadis while Hyder has a negative impact on Arcadis' overall margins. For FY16 this difference remains but we believe that in time we will see the numbers change.

Valuation

EV/EBITDA to peers method continued

We look at the valuation on the basis of EV/EBITDA and PER compared with engineering peers. Arcadis trades at a 2015F EV/EBITDA of 8.7x versus the sector at 8.2x or a small average 5% premium. This compares with our February report when Arcadis traded at 8.8x versus the peer group at 7.2x or at a 20% premium to the market. In PER terms, Arcadis is valued at 11.9x for FY15F, at a 27% discount to its peer group compared with a premium of 22% previously. Even without Grontmij's FY15F PER of 22.5x, the discount on FY15F PER is still 21%.

20% was justified, still the case?....

In previous reports we said that a 20% premium on EV/EBITDA for Arcadis was justified given its excellent track record, business mix, clear strategy etc, but we also believed that there was no justification for a higher premium as it is still an engineering firm with the same characteristics as other engineering firms.

Fig 19 Peer group table

			EV/EBITDA (x)			PER (x)		
		Share price* (lc)	2014F	2015F	2016F	2014F	2015F	2016F
Grontmij	Hold; TP €3.6	€3.72	24.2	10.9	7.9		22.5	11.9
WS Atkins	Not Rated	GBp1379	9.0	8.2	7.7	16.4	15.0	13.7
Sweco	Not Rated	SEK102.5	10.2	9.0	8.4	16.8	14.2	12.8
Jaakko Poyry	Not Rated	€3.58	23.7	7.1	5.4		14.6	10.2
Average - Europe			**16.8**	**8.8**	**7.4**	**16.6**	**16.6**	**12.2**
URS	Not Rated	US$60.07	8.1	7.9	7.5	18.5	18.1	15.8
Tetra Tech	Not Rated	US$25.57	7.4	7.1	n/a	15.8	15.1	13.0
AECOM	Not Rated	US$37.22	9.4	6.9	8.4	14.9	13.9	12.0
Average - US			**8.3**	**7.3**	**7.9**	**16.4**	**15.7**	**13.6**
Average - International			**13.2**	**8.2**	**7.5**	**16.5**	**16.2**	**12.8**
Arcadis	Buy; TP €29	**€23.9**	**11.1**	**8.7**	**7.8**	**14.2**	**11.9**	**10.5**
Premium/discount (%)			*-17*	*7*	*3*	*-13*	*-27*	*-17*

*Share price as of close of 22 August 2014

Source: Bloomberg, ING estimates

....Yes, it is!

Today we believe that Arcadis should continue to deserve a premium of around 20% to its peer group. On one hand, there is more uncertainty with regard to the acquisition of Hyder as the Japanese consider their options and also there is no visible benefit yet from such a highly priced acquisition as Hyder is. Additionally, although with no impact on EV, equity raising is not excluded, which will automatically cause dilution. On the other hand, Arcadis' earnings will get a boost both from this acquisition, with FY13 EPS growing from €1.54 to €2.20 in FY16F, delivering a CAGR13-16F of 12.5%. Given the fact that our FY16F EBITDA is only €12m or 5% higher than FY15, there is upside to these numbers (Arcadis guides for £15m). We also believe that these acquisitions offer attractive strengthening of market positions in certain parts of the world where massive spending in infrastructure, building is planned like in the Middle East whereas an engineering firm with experience in natural resources, Australia's market is attractive. Yes, there are challenges ahead, but there is also a good outlook for a company with strong management and dedicated strategy.

Upgrade to Buy

Based on a 20% premium for FY15 but also for FY16 we arrive at a FY15F EV/EBITDA of 9.8x and for FY16F at 9.0x. This leads to a share price of €28, unchanged compared with our previous target when the share price was €27.2. At €28, the current share price offers almost 20% upside for the next twelve months, which translates into a BUY rating from Hold previously.

Risks

Employees leaving

Arcadis depends not only on GDP growth, but also on keeping the right people in the company. Employees leaving is a risk typical for engineering firms, as the employees are the main asset of such companies.

Dilemma of bench sitters?

In a downturn, companies such as Arcadis can face a dilemma about whether or not to keep engineers on the bench awaiting better times or lay off these employees. Correct timing is crucial. In our view, Arcadis has shown that it is able to get rid of employees in a timely manner, also using a flexible shield.

US dependence remains high

Arcadis generates more than 45% of its earnings in the US, and therefore its exposure to the US$ is high, certainly within the Benelux midcap segment. This also reflects the upside if US growth materially deviates from the European, Arcadis can show an outperformance against its European benchmark or European peers

If the acquisition track is broken…

Arcadis has an excellent track record in acquisitions. If Arcadis announces a new acquisition the market might react positively to the news as it in most cases offers higher EPS but also long-term cross selling opportunities. On the other hand investors have rewarded Arcadis for this track record. If a large acquisition fails, the company can be affected in terms of not only its earnings forecast, but also its valuation.

Financials

Year end Dec (€m)	2009	2010	2011	2012	2013	2014F	2015F	2016F
Income statement								
Revenues	1,787	2,003	2,031	2,546	2,518	2,556	2,985	3,075
Cost of goods sold	(568)	(628)	(574)	(673)	(623)	(598)	(648)	(658)
Gross profit	**1,219**	**1,375**	**1,457**	**1,873**	**1,895**	**1,958**	**2,336**	**2,417**
Operating costs	(1,073)	(1,212)	(1,284)	(1,675)	(1,693)	(1,740)	(2,067)	(2,131)
EBITDA	**146**	**163**	**172**	**198**	**202**	**219**	**269**	**286**
Depreciation & amortisation	(32)	(34)	(33)	(47)	(51)	(50)	(56)	(54)
Impairments	0	0	0	0	0	0	0	0
EBIT	**114**	**130**	**139**	**151**	**151**	**169**	**214**	**232**
Net interest	(4)	(18)	(23)	(22)	(18)	(19)	(27)	(21)
Associates	0.0	0.7	0.3	(2)	6	0	1	2
Other pre-tax items	0	0	0	0	0	0	0	0
Pre-tax profit	**111**	**112**	**116**	**126**	**138**	**150**	**189**	**212**
Tax	(37)	(35)	(32)	(36)	(39)	(45)	(55)	(62)
Minorities	(1)	(4)	(4)	(1)	(3)	(3)	(3)	(3)
Other post-tax items	0	0	0	0	0	0	0	0
Net profit	**73**	**74**	**80**	**89**	**97**	**102**	**131**	**147**
Normalised EBITDA	**146**	**163**	**172**	**198**	**202**	**219**	**269**	**286**
Normalised EBIT	**114**	**130**	**139**	**151**	**151**	**169**	**214**	**232**
Normalised net profit	**77**	**78**	**82**	**105**	**111**	**122**	**146**	**160**
Balance sheet								
Tangible fixed assets	111	124	98	111	99	192	198	206
Intangible fixed assets	343	373	501	596	585	945	925	907
Other non-current assets	39	54	53	63	65	65	65	65
Cash & equivalents	225	208	159	228	151	3	6	7
Other current assets	598	641	748	767	780	876	924	947
Total assets	**1,315**	**1,400**	**1,559**	**1,765**	**1,680**	**2,080**	**2,118**	**2,132**
Short-term debt	33	90	44	199	35	35	35	35
Other current liabilities	353	527	608	624	626	682	734	751
Long-term debt	346	329	377	304	324	615	515	415
Other long-term liabilities	45	44	75	101	98	98	95	95
Total liabilities	**777**	**990**	**1,104**	**1,229**	**1,083**	**1,429**	**1,379**	**1,296**
Total equity	369	411	455	537	598	650	739	835
Total liabilities & equity	**1,145**	**1,401**	**1,559**	**1,765**	**1,680**	**2,080**	**2,118**	**2,132**
Capital employed	747	831	876	1,040	957	1,300	1,289	1,285
Net working capital	304	340	416	445	451	495	496	507
Net debt (cash)	153	211	262	276	208	647	544	443
Cash flow								
Cash flow EBITDA	146	164	172	196	208	219	271	288
Change in working capital	(12)	(29)	(33)	1	(11)	(40)	4	(6)
Other non-cash items	8	0	0	0	0	0	0	0
Operating cash flow	**142**	**135**	**140**	**197**	**197**	**179**	**275**	**282**
Cash interest paid	0	(19)	(24)	(20)	(18)	(19)	(27)	(21)
Cash taxes paid	0	(29)	(32)	(27)	(41)	(45)	(55)	(62)
Net cash from operating activities	**142**	**87**	**84**	**150**	**138**	**116**	**194**	**199**
Capex	(25)	(36)	(35)	(35)	(32)	(34)	(41)	(42)
Net acquisitions	0	(40)	(100)	(73)	(27)	(469)	0	0
Other net investing cash flows	0	(1)	(8)	(11)	(4)	0	0	0
Cash from investing activities	**(25)**	**(77)**	**(144)**	**(118)**	**(63)**	**(503)**	**(41)**	**(42)**
Increase (decrease) in equity	0	(14)	(18)	(11)	(0.4)	(33)	0	0
Increase (decrease) in debt	(12)	9	53	40	(81)	291	(103)	(100)
Dividends & minority distribution	(26)	(28)	(32)	(33)	(34)	(21)	(20)	(45)
Other financing cash flow	0	(4)	(5)	(7)	7	0	0	0
Cash from financing activities	**(38)**	**(37)**	**(2)**	**(10)**	**(107)**	**237**	**(123)**	**(145)**
Forex & discontinued operations	0	10	4	(6)	(8)	0	0	0
Net change in cash & equivalents	**79**	**(18)**	**(57)**	**15**	**(40)**	**(150)**	**30**	**12**
FCF	117	72	73	136	125	101	179	178

Normalised earnings (eg, EBITDA, EBIT, net income and other sector-specific line items) are in the opinion of the analyst the best representation of a company's underlying and sustainable earnings derived from its regular operating activities.

Source: Company data, ING estimates

Valuation, ratios and metrics

Year end Dec	2009	2010	2011	2012	2013	2014F	2015F	2016F
Performance & returns								
Revenue growth (%)	2.6	12.1	1.4	25.4	-1.1	1.5	16.8	3.0
Normalised EBITDA growth (%)	-5.9	11.7	5.5	15.0	2.1	8.2	23.2	6.2
Normalised EBIT growth (%)	-4.4	13.3	7.3	8.3	0.28	11.6	26.8	8.5
Normalised EPS growth (%)	5.0	-2.7	3.6	21.6	3.0	9.4	18.9	9.9
Gross margin (%)	68.2	68.6	71.7	73.6	75.2	76.6	78.3	78.6
Normalised EBITDA margin (%)	8.2	8.1	8.5	7.8	8.0	8.6	9.0	9.3
Normalised EBIT margin (%)	6.4	6.5	6.8	5.9	6.0	6.6	7.2	7.5
Reported net margin (%)	4.1	3.7	3.9	3.5	3.8	4.0	4.4	4.8
Reported ROE (%)	26.0	19.9	18.8	18.0	17.1	16.4	18.9	18.8
Normalised ROA (%)	9.6	9.5	9.4	9.1	8.8	9.0	10.2	10.9
ROAIC (%)	13.9	10.9	11.7	11.8	10.0	10.1	11.4	12.3
ROACE (%)	18.1	16.4	16.3	15.7	15.1	14.9	16.5	18.0
ROACE - WACC (%)	10.9	9.2	9.1	8.5	7.9	7.7	9.3	10.8
Leverage & solvency								
Working capital as % of sales	17.0	17.0	20.5	17.5	17.9	19.4	16.6	16.5
Net debt (cash)/EBITDA (x)	1.1	1.3	1.5	1.4	1.0	3.0	2.0	1.5
Net debt (cash)/equity (%)	41.6	51.4	57.5	51.3	34.8	99.5	73.7	53.0
EBITDA net interest coverage (x)	40.2	8.9	7.4	9.1	11.2	11.6	10.1	13.4
Current ratio (x)	2.1	1.4	1.4	1.2	1.4	1.2	1.2	1.2
Dividend cover (cash flow) (x)	5.5	2.9	2.5	4.5	4.2	4.8	8.7	4.5
Valuation								
EV/revenue (x)	1.1	0.98	1.00	0.80	0.78	0.95	0.78	0.73
EV/normalised EBITDA (x)	13.1	12.1	11.7	10.3	9.7	11.1	8.7	7.8
EV/normalised EBIT (x)	16.7	15.2	14.5	13.5	13.1	14.5	10.9	9.6
EV/capital employed (x)	2.6	2.4	2.3	2.0	2.1	1.9	1.8	1.7
EV/invested capital (x)	2.0	2.3	2.1	1.8	1.9	1.7	1.7	1.6
Normalised PER (x)	19.6	20.2	19.5	16.0	15.5	14.2	11.9	10.9
Price/book (x)	n/a	0.07	3.5	3.2	2.9	2.7	2.4	2.1
Dividend yield (%)	1.9	2.0	2.0	2.2	2.4	2.6	3.1	3.4
FCF yield (%)	6.1	3.6	3.6	6.7	6.3	4.1	7.7	8.0
Per share data								
Reported EPS (€)	1.15	1.12	1.20	1.27	1.34	1.40	1.80	2.03
Normalised EPS (€)	1.22	1.19	1.23	1.49	1.54	1.68	2.00	2.20
Dividend per share (€)	0.45	0.47	0.47	0.52	0.57	0.62	0.74	0.81
Equity FCFPS (€)	1.86	0.80	0.74	1.65	1.49	1.13	2.10	2.16
BV/share (€)	n/a	347.8	6.79	7.54	8.18	8.83	10.04	11.36

Source: Company data, ING estimates

Company profile

Arcadis is an engineering consultancy firm with strongholds in the Netherlands (12% of 2012 revenue), Other Europe (22%), the US (45%) and the Emerging Markets (21%). Arcadis' segmental breakdown is consultancy in infrastructure, the environment, building and water. The company's infrastructure activities include road and railway projects. The environmental services division is involved in the maintenance or improvement of air, soil and water quality. Building has been strengthened mainly by the acquisitions of EC Harris in FY11, a company specialised in building, asset consultancy.

Disclosures Appendix

ANALYST CERTIFICATION

The analyst(s) who prepared this report hereby certifies that the views expressed in this report accurately reflect his/her personal views about the subject securities or issuers and no part of his/her compensation was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views in this report.

IMPORTANT DISCLOSURES

For disclosures on companies other than the subject companies of this report visit our disclosures page at http://research.ing.com or write to The Compliance Department, ING Financial Markets LLC, 1325 Avenue of the Americas, New York, USA, 10019.

US regulatory disclosures

- One or more members of ING Group holds 1% or more of the equity shares (as at the end of the month preceding this publication) in the following subject company/ies of this report: Arcadis NV.
- The following subject company/ies of this report are or have been a client of ING Financial Markets LLC or an affiliate within the last 12 months and have received investment banking services: Arcadis NV.

Valuation & risks: For details of the methodologies used to determine our price targets and risks related to the achievement of these targets refer to main body of report and/or the most recent equity company report at http://research.ing.com.

Research analyst(s): The research analyst(s) for this report may not be registered/qualified as a research analyst with the NYSE and/or NASD. The research analyst(s) for this report may not be an associated person of ING Financial Markets LLC and therefore may not be subject to Rule 2711 restrictions on communications with a subject company, public appearances and trading securities held by the research analyst's account.

European regulatory disclosures

- One or more members of ING Group holds 1% or more of the equity shares (as at the end of the month preceding this publication) in the following subject company/ies of this report: Arcadis NV.
- The following subject company/ies of this report are or have been party to an investment banking agreement with one or more members of ING Group over the last 12 months: Arcadis NV.

The *remuneration of research analysts* is not tied to specific investment banking transactions performed by ING Group although it is based in part on overall revenues, to which investment banking contribute.

Financial interests: One of more members of ING Group may hold financial interests in the companies covered in this report other than those disclosed above.

Securities prices: Prices are taken as of the previous day's close on the home market unless otherwise stated.

Job titles. The functional job title of the person/s responsible for the recommendations contained in this report is equity research analyst unless otherwise stated. Corporate titles may differ from functional job titles.

Conflicts of interest policy. ING manages conflicts of interest arising as a result of the preparation and publication of research through its use of internal databases, notifications by the relevant employees and Chinese walls as monitored by ING Compliance. For further details see our research policies page at http://research.ing.com.

Other disclosures

Target prices, where included, are based on reasonable assumptions supported by objective data. Unless otherwise stated, neither historic share price performance data nor ING projections on potential share price performance reflect the impact of commissions, fees and charges. Past performance is not indicative of future results. Forecasts are not a reliable indicator of future performance.

FOREIGN AFFILIATES DISCLOSURES

Each ING legal entity which produces research is a subsidiary, branch or affiliate of ING Bank N.V. See back page for the addresses and primary securities regulator for each of these entities.

RATING DISTRIBUTION (as of end 2Q14)

	Equity coverage	Investment Banking clients*
Buy	45%	60%
Hold	44%	62%
Sell	11%	58%
	100%	

* Percentage of companies in each rating category that are Investment Banking clients of ING Financial Markets LLC or an affiliate.

RATING DEFINITIONS

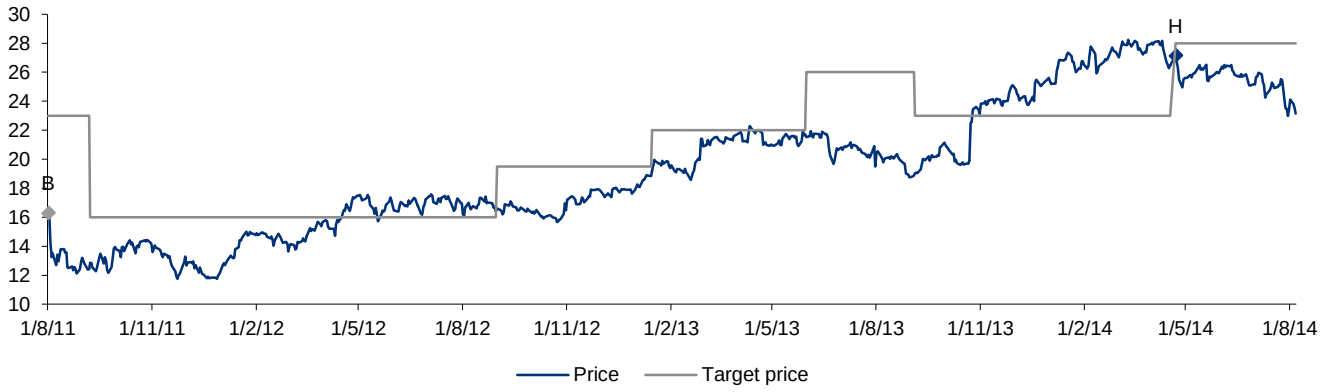
Buy: Forecast 12-mth absolute total return greater than +15%

Hold: Forecast 12-mth absolute total return of +15% to -5%

Sell: Forecast 12-mth absolute total return less than -5%

Total return: forecast share price appreciation to target price plus forecast annual dividend. Price volatility and our preference for not changing recommendations too frequently means forecast returns may fall outside of the above ranges at times.

PRICE & RATINGS HISTORY TO 06/08/14: ARCADIS (ARDS.AS)



B = Buy; H = Hold; S = Sell; NR = Not Rated; R = Restricted

Chart shows ING coverage: current analyst may or may not have covered the stock for the entire period shown

Where ING coverage is longer than three years, chart shows recommendation current at start of the share price history

Source: ING

ING

AMSTERDAM Tel: 31 20 563 8758	**BRUSSELS** Tel: 32 2 547 7534	**LONDON** Tel: 44 20 7767 1000	**NEW YORK** Tel: 1 646 424 6000	**SINGAPORE** Tel: 65 6535 3688
Bratislava Tel: 421 2 5934 6111	**Frankfurt** Tel: 49 69 75936 519	**Madrid** Tel: 34 91 789 8880	**Paris** Tel: 33 1 56 39 32 84	**Sofia** Tel: 359 2 917 6400
Bucharest Tel: 40 21 222 1600	**Geneva** Tel: 41 22 592 3079	**Manila** Tel: 63 2 479 8888	**Prague** Tel: 420 257 474 111	**Taipei** Tel: 886 2 8729 7600
Budapest Tel: 36 1 235 8800	**Hong Kong** Tel: 852 2848 8488	**Mexico City** Tel: 52 55 5258 2000	**Sao Paulo** Tel: 55 11 4504 6000	**Tokyo** Tel: 81 3 3217 0301
Buenos Aires Tel: 54 11 4310 4700	**Istanbul** Tel: 90 212 329 0752	**Milan** Tel: 39 02 89629 3610	**Seoul** Tel: 82 2 317 1800	**Warsaw** Tel: 48 22 820 5018
Dublin Tel: 353 1 638 4000	**Kiev** Tel: 380 44 230 3030	**Moscow** Tel: 7 495 755 5400	**Shanghai** Tel: 86 21 2020 2000	

Research offices: legal entity/address/*primary securities regulator*

Amsterdam	ING Bank N.V., Foppingadreef 7, Amsterdam, Netherlands, 1102BD. *Netherlands Authority for the Financial Markets*
Brussels	ING Belgium S.A./N.V., Avenue Marnix 24, Brussels, Belgium, B-1000. *Financial Services and Market Authority (FSMA)*
Bucharest	ING Bank N.V. Amsterdam - Bucharest Branch, 48 Lancu de Hunedoara Bd., 011745, Bucharest 1, Romania. *Financial Supervisory Authority*
Budapest	ING Bank N.V. Hungary Branch, Dozsa Gyorgy ut 84\B, H - 1068 Budapest, Hungary. *National Bank of Hungary*
Istanbul	ING Bank A.S., ING Bank Headquarters, Resitpasa Mahallesi Eski Buyukdere Cad. No: 8, 34467 Sariyer, Istanbul , Turkey. *Capital Markets Board*
London	ING Bank N.V. London Branch, 60 London Wall, London EC2M 5TQ, United Kingdom. *Authorised by the Dutch Central Bank*
Manila	ING Bank N.V., Manila Branch, 20/F Tower One, Ayala Triangle, Ayala Avenue, 1226 Makati City, Philippines. *Philippine Securities and Exchange Commission*
Milan	ING Bank N.V. Milano, Via Arbe, 49, Milano, Italy, 20125. *Commissione Nazionale per le Società e la Borsa*
Moscow	ING BANK (EURASIA) ZAO, 36, Krasnoproletarskaya ulitsa, 127473 Moscow, Russia. *Federal Financial Markets Service*
Mumbai	ING Vysya Bank Limited, Plot C-12, Block-G, 7th Floor, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051, India. *Securities and Exchange Board of India*
New York	ING Financial Markets LLC, 1325 Avenue of the Americas, New York, United States,10019. *Securities and Exchange Commission*
Prague	ING Bank N.V., Prague Branch, Plzeňská 345/5, 150 00 Prague 5, Czech Republic. *Czech National Bank*
Singapore	ING Bank N.V. Singapore Branch, 19/F Republic Plaza, 9 Raffles Place, #19-02, Singapore, 048619. *Monetary Authority of Singapore*
Warsaw	ING Securities S.A, Ul. Pulawska 2, Warsaw, Poland, 02-566. *Polish Financial Supervision Authority*

Disclaimer

Additional information is available on request