

Iliad

Price EUR223.80

Break up in Orange – Bouygues merger talks

Fair Value EUR212 vs. EUR270 (-5%)

NEUTRAL vs. BUY

Bloomberg	ILD FP
Reuters	ILD.PA
12-month High / Low (EUR)	236.3 / 175.5
Market Cap (EUR)	13,133
Ev (BG Estimates) (EUR)	14,662
Avg. 6m daily volume (000)	100.4
3y EPS CAGR	28.8%

On Friday Bouygues and Orange announced the break-up of their merger negotiations. We think Iliad and the whole telecoms sector in France will react negatively, albeit having already lost 3% last week in anticipation of this news. After cancelling the positive prospective impact of market repair on the company, we have downgraded Iliad's Fair Value to EUR212 from EUR270, and our reco to Neutral. We believe opportunities still exist for Iliad, such as M&A in other markets, or renewed consolidation opportunities in the French market in the medium term, but we have not priced these into our Fair Value at this point.

ANALYSIS

- The reasons for the break-up are twofold.** First, execution risks appeared too great from a regulatory standpoint, with major financial risks in case of a deal break-up following the regulatory process. Second, Bouygues and the French ministry of economy never managed to reach an agreement on the conditions of Bouygues' entry into Orange's capital, in terms of valuation and influence. According to an interview by Martin Bouygues this morning in Le Figaro, Xavier Niel's demands were particularly excessive and put the operation at risk. Nevertheless, it also appears from information in Le Figaro that Iliad made some final moves in the last days of negotiations to make the deal succeed, such as agreeing to take over hundreds of stores from Bouygues Telecom. Bouygues's hard feelings are primarily targeted at Xavier Niel and the French State. Could this lead to some form of reconciliation between Martin Bouygues and Patrick Drahi? Nothing is less certain at this point.
- Now, what's next?** Martin Bouygues stated that "In a market where the possibility of consolidation is now ruled out for the long term, Bouygues Telecom will continue its standalone strategy". Let us remember that Martin Bouygues expressed the same confidence less than a year ago when refusing Patrick Drahi's EUR10bn offer for Bouygues Telecom. And his attempt to merge with Orange shows he might not be so convinced by this strategy. Indeed, we believe Bouygues Telecom will struggle in the CAPEX intensive fight for fiber roll out in particular, and will suffer from NC-SFR's aggressive promotional strategy.
- We do not expect any rebound in French consolidation in the very short term,** but think it remains likely in the medium term. While Iliad and NC-SFR will wait until Bouygues Telecom's valuation drops, the only way for Martin Bouygues to save his telecoms subsidiary is by aggressively recruiting customers. Indeed, Bouygues Telecom's valuation relies more on the number and value of the customer base than on the intrinsic profitability of the business. Thus we expect a bloody price war to return to the market in coming months, to the detriment of all players. Eventually, Martin Bouygues will then agree to sell Bouygues Telecom to Patrick Drahi or Xavier Niel, or dismantle it and sell it in parts to several competitors.
- Could another player, such as Vivendi or a foreign telecoms group, act as a white knight for Bouygues Telecom?** We do not believe so. The problem for Bouygues Telecom is to regain sustainable profitability on the French market. Unless we overestimate crossborder or telecom/media synergies, we do not see how another player could help with this.
- From Iliad's point of view** things are mixed. On the one hand, Iliad will be much impacted by Bouygues aggressivity on the market, and the fixed market in particular. But as Bouygues Telecom's "natural" acquirer on the market, with the least competitive issues, Iliad could end up buying out Bouygues Telecom at a discounted price in a few years from now. In the meantime, Iliad will pursue other opportunities in other markets. In particular, it could be interested in launching an activity in the UK, leveraging on the remedies from the O2 / Three merger. The position of the European competitions authorities on this deal is expected soon. Our Fair Value of EUR212 withdraws positive fixed and mobile market repair effects (EUR58) and prices in strong competition and an ongoing price war in the French market but does not take into account such opportunities as development in the UK and a possible buy-out of the whole or parts of Bouygues Telecom in the end.

	1 M	3 M	6 M	31/12/15
Absolute perf.	-2.5%	1.7%	23.7%	1.7%
Telecom	-3.4%	-7.7%	-1.2%	-7.7%
DJ Stoxx 600	-1.6%	-8.9%	-3.8%	-8.9%

YEnd Dec. (EURm)	2015	2016e	2017e	2018e
Sales	4,414	4,736	5,100	5,458
% change		7.3%	7.7%	7.0%
EBITDA	1,490	1,711	2,005	2,307
EBIT	662	753	1000	1285
% change				
Net income	335.0	385.2	530.4	718.0
% change		15.0%	37.7%	35.4%

	2015	2016e	2017e	2018e
Operating margin	15.1	16.0	19.7	23.6
Net margin	7.6	8.1	10.4	13.2
ROE	12.7	12.8	15.1	17.1
ROCE	9.8	10.1	12.4	15.3
Gearing	45.2	51.0	39.0	21.5

(EUR)	2015	2016e	2017e	2018e
EPS	5.58	6.40	8.81	11.93
% change	-	14.7%	37.7%	35.4%
P/E	40.1x	35.0x	25.4x	18.8x
FCF yield (%)	NM	NM	2.2%	4.3%
Dividends (EUR)	0.38	0.38	0.38	0.38
Div yield (%)	0.2%	0.2%	0.2%	0.2%
EV/Sales	3.2x	3.1x	2.8x	2.6x
EV/EBITDA	9.6x	8.6x	7.2x	6.1x
EV/EBIT	NS	NS	NS	NS



Appendix: Bouygues Telecom's outlook and consolidation scenarios – pros and cons analysis

Bouygues scenario	Buyer	Pros	Cons
Bouygues still decides to sell in the short term	to Iliad	Low execution risk	Relationships between Martin Bouygues and Xavier Niel
		Iliad's interest in accelerating network roll out	Iliad to favour UK deal in the short term Bouygues' valuation, Iliad not ready to pay Cash only deal
	To NC-SFR	Already a network agreement	Relationships between Martin Bouygues and Patrick Drahi Execution risk + social interrogations Social interrogations NC-SFR financing capacity Cash only deal No given less than a year ago
	to several players (dismantling)	Deals already discussed with other parties Value maximisation	Cash only deal Execution risks
	to non French telco players	Opportunity for share-based transactions Limited execution risk	Bouygues' valuation and limited synergies Remaining uncertainty about Bouygues Telecom's ability to regain sustainable profitability on the French market
Bouygues is forced to sell in the medium term	to Iliad	Drop in Bouygues Telecom's valuation	Iliad's less interest in accelerating network roll out
		Low execution risk	Relationships between Martin Bouygues and Xavier Niel Impact of network sharing agreement between NC-SFR and Bouygues Telecom
	To NC-SFR	Drop in Bouygues Telecom's valuation Already a network agreement	Execution risk + social interrogations
	to several players (dismantling)	Value maximisation	Execution risks
to non French telco players	Opportunity for share-based transactions Limited execution risk	Bouygues' valuation and limited synergies	
Bouygues succeeds in its standalone strategy	None		Much uncertainty over Bouygues Telecom's ability to regain sustainable profitability on the market

VALUATION

- Iliad is now trading at 8.3x 2016e EBITDA
- We downgrade our Fair Value to EUR212 with a Neutral recommendation.

[Click here to download](#)



Analyst :
Thomas Coudry
33(0) 1 70 36 57 04
tcoudry@bryangarnier.com

Sector Team :
Richard-Maxime Beaudoux
Gregory Ramirez
Dorian Terral

Bryan Garnier stock rating system

For the purposes of this Report, the Bryan Garnier stock rating system is defined as follows:

Stock rating

BUY	Positive opinion for a stock where we expect a favourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential upside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
NEUTRAL	Opinion recommending not to trade in a stock short-term, neither as a BUYER or a SELLER, due to a specific set of factors. This view is intended to be temporary. It may reflect different situations, but in particular those where a fair value shows no significant potential or where an upcoming binary event constitutes a high-risk that is difficult to quantify. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.
SELL	Negative opinion for a stock where we expect an unfavourable performance in absolute terms over a period of 6 months from the publication of a recommendation. This opinion is based not only on the FV (the potential downside based on valuation), but also takes into account a number of elements that could include a SWOT analysis, momentum, technical aspects or the sector backdrop. Every subsequent published update on the stock will feature an introduction outlining the key reasons behind the opinion.

Distribution of stock ratings

BUY ratings 64%

NEUTRAL ratings 29,4%

SELL ratings 6,6%

Research Disclosure Legend

1	Bryan Garnier shareholding in Issuer	Bryan Garnier & Co Limited or another company in its group (together, the "Bryan Garnier Group") has a shareholding that, individually or combined, exceeds 5% of the paid up and issued share capital of a company that is the subject of this Report (the "Issuer").	No
2	Issuer shareholding in Bryan Garnier	The Issuer has a shareholding that exceeds 5% of the paid up and issued share capital of one or more members of the Bryan Garnier Group.	No
3	Financial interest	A member of the Bryan Garnier Group holds one or more financial interests in relation to the Issuer which are significant in relation to this report	No
4	Market maker or liquidity provider	A member of the Bryan Garnier Group is a market maker or liquidity provider in the securities of the Issuer or in any related derivatives.	No
5	Lead/co-lead manager	In the past twelve months, a member of the Bryan Garnier Group has been lead manager or co-lead manager of one or more publicly disclosed offers of securities of the Issuer or in any related derivatives.	No
6	Investment banking agreement	A member of the Bryan Garnier Group is or has in the past twelve months been party to an agreement with the Issuer relating to the provision of investment banking services, or has in that period received payment or been promised payment in respect of such services.	No
7	Research agreement	A member of the Bryan Garnier Group is party to an agreement with the Issuer relating to the production of this Report.	No
8	Analyst receipt or purchase of shares in Issuer	The investment analyst or another person involved in the preparation of this Report has received or purchased shares of the Issuer prior to a public offering of those shares.	No
9	Remuneration of analyst	The remuneration of the investment analyst or other persons involved in the preparation of this Report is tied to investment banking transactions performed by the Bryan Garnier Group.	No
10	Corporate finance client	In the past twelve months a member of the Bryan Garnier Group has been remunerated for providing corporate finance services to the issuer or may expect to receive or intend to seek remuneration for corporate finance services from the Issuer in the next six months.	No
11	Analyst has short position	The investment analyst or another person involved in the preparation of this Report has a short position in the securities or derivatives of the Issuer.	No
12	Analyst has long position	The investment analyst or another person involved in the preparation of this Report has a long position in the securities or derivatives of the Issuer.	No
13	Bryan Garnier executive is an officer	A partner, director, officer, employee or agent of the Bryan Garnier Group, or a member of such person's household, is a partner, director, officer or an employee of, or adviser to, the Issuer or one of its parents or subsidiaries. The name of such person or persons is disclosed above.	No
14	Analyst disclosure	The analyst hereby certifies that neither the views expressed in the research, nor the timing of the publication of the research has been influenced by any knowledge of clients positions and that the views expressed in the report accurately reflect his/her personal views about the investment and issuer to which the report relates and that no part of his/her remuneration was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in the report.	Yes
15	Other disclosures	Other specific disclosures: Report sent to Issuer to verify factual accuracy (with the recommendation/rating, price target/spread and summary of conclusions removed).	No

A copy of the Bryan Garnier & Co Limited conflicts policy in relation to the production of research is available at www.bryangarnier.com

London	Paris	New York	Geneva	New Delhi
Beaufort House	26 Avenue des Champs Elysées	750 Lexington Avenue	rue de Grenus 7	The Imperial Hotel
15 St. Botolph Street	75008 Paris	New York, NY 10022	CP 2113	Janpath
London EC3A 7BB	Tel: +33 (0) 1 56 68 75 00	Tel: +1 (0) 212 337 7000	Genève 1, CH 1211	New Delhi 110 001
Tel: +44 (0) 207 332 2500	Fax: +33 (0) 1 56 68 75 01	Fax: +1 (0) 212 337 7002	Tel +4122 731 3263	Tel +91 11 4132 6062
Fax: +44 (0) 207 332 2559	Regulated by the	FINRA and SIPC member	Fax+4122731 3243	+91 98 1111 5119
Authorised and regulated by the	Financial Conduct Authority (FCA) and		Regulated by the	Fax +91 11 2621 9062
Financial Conduct Authority	the Autorité de Contrôle prudentiel et de		FINMA	
(FCA)	resolution (ACPR)			

Important information

This document is classified under the FCA Handbook as being investment research (independent research). Bryan Garnier & Co Limited has in place the measures and arrangements required for investment research as set out in the FCA's Conduct of Business Sourcebook.

This report is prepared by Bryan Garnier & Co Limited, registered in England Number 03034095 and its MIFID branch registered in France Number 452 605 512. Bryan Garnier & Co Limited is authorised and regulated by the Financial Conduct Authority (Firm Reference Number 178733) and is a member of the London Stock Exchange. Registered address: Beaufort House 15 St. Botolph Street, London EC3A 7BB, United Kingdom

This Report is provided for information purposes only and does not constitute an offer, or a solicitation of an offer, to buy or sell relevant securities, including securities mentioned in this Report and options, warrants or rights to or interests in any such securities. This Report is for general circulation to clients of the Firm and as such is not, and should not be construed as, investment advice or a personal recommendation. No account is taken of the investment objectives, financial situation or particular needs of any person.

The information and opinions contained in this Report have been compiled from and are based upon generally available information which the Firm believes to be reliable but the accuracy of which cannot be guaranteed. All components and estimates given are statements of the Firm, or an associated company's, opinion only and no express representation or warranty is given or should be implied from such statements. All opinions expressed in this Report are subject to change without notice. To the fullest extent permitted by law neither the Firm nor any associated company accept any liability whatsoever for any direct or consequential loss arising from the use of this Report. Information may be available to the Firm and/or associated companies which are not reflected in this Report. The Firm or an associated company may have a consulting relationship with a company which is the subject of this Report.

This Report may not be reproduced, distributed or published by you for any purpose except with the Firm's prior written permission. The Firm reserves all rights in relation to this Report.

Past performance information contained in this Report is not an indication of future performance. The information in this report has not been audited or verified by an independent party and should not be seen as an indication of returns which might be received by investors. Similarly, where projections, forecasts, targeted or illustrative returns or related statements or expressions of opinion are given ("Forward Looking Information") they should not be regarded as a guarantee, prediction or definitive statement of fact or probability. Actual events and circumstances are difficult or impossible to predict and will differ from assumptions. A number of factors, in addition to the risk factors stated in this Report, could cause actual results to differ materially from those in any Forward Looking Information.

Disclosures specific to clients in the United Kingdom

This Report has not been approved by Bryan Garnier & Co Limited for the purposes of section 21 of the Financial Services and Markets Act 2000 because it is being distributed in the United Kingdom only to persons who have been classified by Bryan Garnier & Co Limited as professional clients or eligible counterparties. Any recipient who is not such a person should return the Report to Bryan Garnier & Co Limited immediately and should not rely on it for any purposes whatsoever.

Notice to US investors

This research report (the "Report") was prepared by Bryan Garnier & Co Limited for information purposes only. The Report is intended for distribution in the United States to "Major US Institutional Investors" as defined in SEC Rule 15a-6 and may not be furnished to any other person in the United States. Each Major US Institutional Investor which receives a copy of this Report by its acceptance hereof represents and agrees that it shall not distribute or provide this Report to any other person. Any US person that desires to effect transactions in any security discussed in this Report should call or write to our US affiliated broker, Bryan Garnier Securities, LLC, 750 Lexington Avenue, New York NY 10022. Telephone: 1-212-337-7000.

This Report is based on information obtained from sources that Bryan Garnier & Co Limited believes to be reliable and, to the best of its knowledge, contains no misleading, untrue or false statements but which it has not independently verified. Neither Bryan Garnier & Co Limited and/or Bryan Garnier Securities LLC make no guarantee, representation or warranty as to its accuracy or completeness. Expressions of opinion herein are subject to change without notice. This Report is not an offer to buy or sell any security.

Bryan Garnier Securities, LLC and/or its affiliate, Bryan Garnier & Co Limited may own more than 1% of the securities of the company(ies) which is (are) the subject matter of this Report, may act as a market maker in the securities of the company(ies) discussed herein, may manage or co-manage a public offering of securities for the subject company(ies), may sell such securities to or buy them from customers on a principal basis and may also perform or seek to perform investment banking services for the company(ies).

Bryan Garnier Securities, LLC and/or Bryan Garnier & Co Limited are unaware of any actual, material conflict of interest of the research analyst who prepared this Report and are also not aware that the research analyst knew or had reason to know of any actual, material conflict of interest at the time this Report is distributed or made available..