

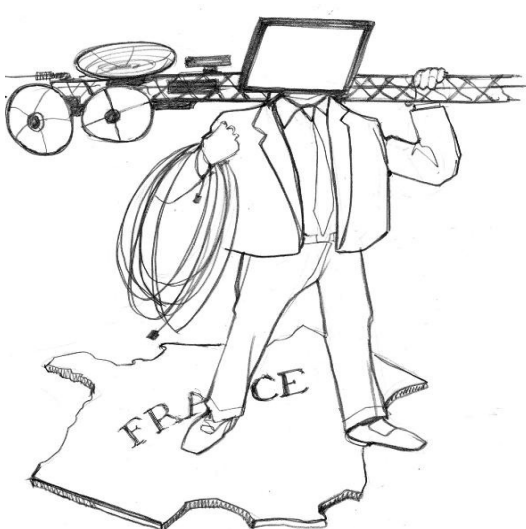
INDEPENDENT RESEARCH

11th April 2016

TMT

Bloomberg	NUM FP
Reuters	NUME.PA
12-month High / Low (EUR)	48.0 / 28.1
Market capitalisation (EURm)	12,856
Enterprise Value (BG estimates EURm)	27,252
Avg. 6m daily volume ('000 shares)	281.8
Free Float	22.0%
3y EPS CAGR	17.4%
Gearing (12/15)	338%
Dividend yields (12/16e)	NM

YE December	12/15	12/16e	12/17e	12/18e
Revenue (EURm)	11,039	10,808	10,886	11,054
EBITA EURm)	937.0	1,613	1,810	2,155
Op.Margin (%)	11.7	14.9	16.6	19.5
Diluted EPS (EUR)	1.45	1.37	1.74	2.35
EV/Sales	2.47x	2.52x	2.44x	2.32x
EV/EBITDA	7.1x	6.8x	6.4x	5.8x
EV/EBITA	29.1x	16.9x	14.7x	11.9x
P/E	20.2x	21.3x	16.8x	12.5x
ROCE	2.8	4.7	5.2	6.2



Numericable SFR


EBITDA or EBITDA rate: that is the question

Fair Value EUR28.4 (price EUR29.34)

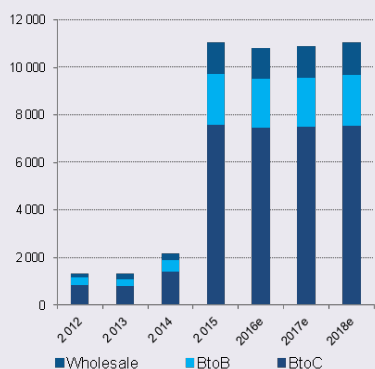
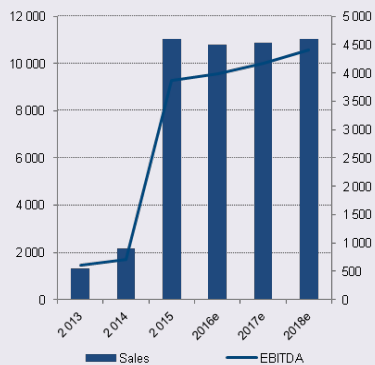
NEUTRAL
Coverage initiated

We are initiating coverage of Numericable-SFR with a Neutral recommendation and Fair Value of EUR28.4. We are forecasting a still difficult year in 2016 for the group, but expect a recovery by 2017 driven by renewed investments and the change in management. But market consolidation will not be there to help.

- NC-SFR had a mixed year in 2015 due to a strong focus on the **EBITDA rate to the detriment of customer volumes** and hence the overall EBITDA generated further out. The impact of this strategy is likely to be felt over **2016, with sales set to drop a further 2.1% vs. -3.5% in 2015, and an increase in adjusted EBITDA of 3% after 20% in 2015.**
- The **relaunch of investments** initiated at the end of 2015, recent **management changes** and the associated **change in strategy and governance**, should help inverse the sales curve as of 2017. We are forecasting a **return to sales growth of 0.7% in 2017**, with a stabilised mobile network especially, and a recovery in the BtoB and wholesale businesses.
- We are forecasting **EBITDA of EUR4.400bn out to 2018**, with a level of **capex stabilised at EUR2bn**, after a catching up in 4G investments.
- Despite the need for refinancing, debt of **3.73x 2015 EBITDA looks sustainable** given the level of cash flow generated by the business, and we also believe that the need to move cash up to the holding company level is a good **dividend opportunity** for shareholders.
- Our DCF valuation yields a **Fair Value of EUR28.4** for NC-SFR, namely a discount of 3.1% relative to the current share price and a multiple of **7.2x our 2016e adjusted EBITDA.**

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Numericable SFR



Company description

Numericable SFR SA Formerly known as Numericable Group SA, is a France-based telecom company, serving three segments: B2C (business to customer), B2B (business to business) and wholesale. The Company's technology relies on an infrastructure which operates as one network serving each of its three segments. In the B2C segment, the group operates under the SFR brand name and offers customers a wide range of products and services including pay TV, high-speed and very-high-speed broadband Internet access, and fixed-line and mobile telephony. The Company has such subsidiaries as Omea Telecom SAS and Virgin Mobile France SA, among others.

Simplified Profit & Loss Account (EURm)	2013	2014	2015	2016e	2017e	2018e
Revenues	1,314	2,170	11,039	10,808	10,886	11,054
Change (%)	0.9%	65.1%	409%	-2.1%	0.7%	1.6%
Adjusted EBITDA	616	706	3,860	3,982	4,171	4,402
EBIT	256	108	937	1,613	1,810	2,155
Change (%)	-14.4%	-57.8%	768%	72.1%	12.2%	19.1%
Financial results	(324)	(600)	(46.0)	(712)	(667)	(620)
Pre-Tax profits	(68.0)	(492)	891	901	1,143	1,535
Tax	133	313	(215)	(258)	(327)	(439)
Minority interests	0.0	0.0	7.0	9.3	9.3	9.3
Net profit	65.0	(175)	682	649	822	1,102
Restated net profit	65.0	(175)	682	649	822	1,102
Change (%)	-23.5%	-369%	-%	-4.8%	26.6%	34.1%
Cash Flow Statement (EURm)						
Operating cash flows	570	1,135	3,554	3,190	3,674	3,675
Change in working capital	21.0	725	(122)	(428)	(72.0)	(206)
Capex, net, and licenses paid	(343)	(13,758)	(1,732)	(2,473)	(2,357)	(2,117)
Dividends	0.0	0.0	(2,516)	0.0	0.0	0.0
Net debt	2,665	13,086	14,401	14,396	13,746	12,808
Free Cash flow	59.0	140	798	5.1	650	938
Balance Sheet (EURm)						
Tangible fixed assets	1,465	5,643	5,627	5,628	5,628	5,487
Intangibles assets	1,791	18,949	18,537	18,514	18,490	18,467
Cash & equivalents	101	620	355	360	1,010	1,948
current assets	561	3,995	3,637	3,631	4,315	5,302
Other assets	143	1,678	2,281	2,114	2,114	2,114
Total assets	3,960	30,265	30,081	30,053	30,715	31,537
L & ST Debt	2,766	12,817	17,285	17,285	17,285	17,285
Others liabilities	860	9,486	8,529	5,528	5,368	5,088
Shareholders' funds	254	7,962	4,267	4,917	5,739	6,841
Total Liabilities	3,960	30,265	30,081	30,053	30,715	31,537
Capital employed	3,045	23,991	24,290	24,695	24,744	24,786
Ratios						
Operating margin	19.48	4.98	11.69	14.92	16.63	19.49
Tax rate	(196)	(63.62)	(24.13)	(28.60)	(28.60)	(28.60)
Net margin	4.95	(8.06)	6.18	6.01	7.55	9.97
ROE (after tax)	25.59	(2.20)	15.86	13.05	14.19	16.00
ROCE (after tax)	6.00	0.32	2.75	4.66	5.22	6.21
Gearing	1,049	164	338	293	240	187
Pay out ratio	0.0	0.0	(369)	0.0	0.0	0.0
Number of shares, diluted	115,271	181,038	465,683	465,683	465,683	465,683
Data per Share (EUR)						
EPS	0.56	(0.97)	1.45	1.37	1.74	2.35
Restated EPS	0.56	(0.97)	1.45	1.37	1.74	2.35
% change	-24.5%	-271%	-%	-5.2%	26.9%	34.5%
BVPS	2.20	43.92	9.14	10.53	12.30	14.66
Operating cash flows	4.94	6.27	7.63	6.85	7.89	7.89
FCF	0.51	0.77	1.71	0.01	1.40	2.01
Net dividend	0.0	0.0	5.40	0.0	0.0	0.0

Source: Company Data; Bryan, Garnier & Co ests.

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1. Investment Case

Why the interest now ?



The reason for writing now :

NC-SFR is at a turning point in its history. After a **year of transition** due to the new group's integration, with a **spectacular recovery in EBITDA** but an **unprecedented deterioration in sales performances**, the new group now needs to **review the situation and refocus its strategy**. This is likely to involve an abandoning of the strategy to **maximise EBITDA** to the benefit of customers in the short term, and **overall EBITDA** over the medium term.

Cheap or expensive ?



Valuation

The share price has plummeted since early 2015 such that it now looks fully valued, including more reasonable sales and EBITDA growth prospects, having abandoned hopes of market consolidation. Our **EUR28.4 Fair Value** points to downside of 3.1% relative to the current price.

When will I start making money ?



Catalysts

1/ New management and governance, 2/ adapting marketing and price strategies, 3/ investments in network and quality of service, 4/ further control of saving plans.

What's the value added ?



Difference from consensus

We are far **more cautious on the 2016e EBITDA** (EUR3982m vs consensus EUR4053m) and on the **EBITDA margin that looks feasible for 2018** (39.8% vs. the consensus at 43.4%). Indeed, restoring sales seems incompatible with further aggressive implementation of savings plans.

Could I loose money ?



Risks to our investment case

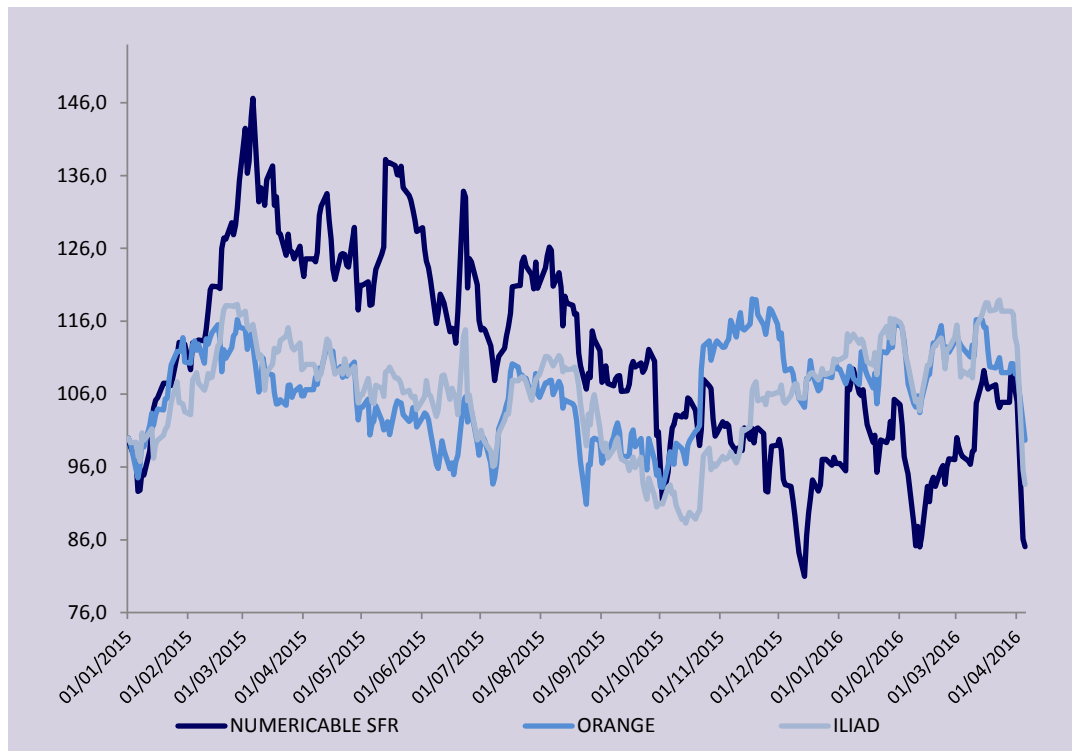
1/ Maintaining a strategy focused on the EBITDA rate to the detriment of sales performance, 2/ Pricing strategy and reaction of Bouygues Telecom, 3/ Rates on the high yield market.

2. NC-SFR valuation

2.1. Change in share price

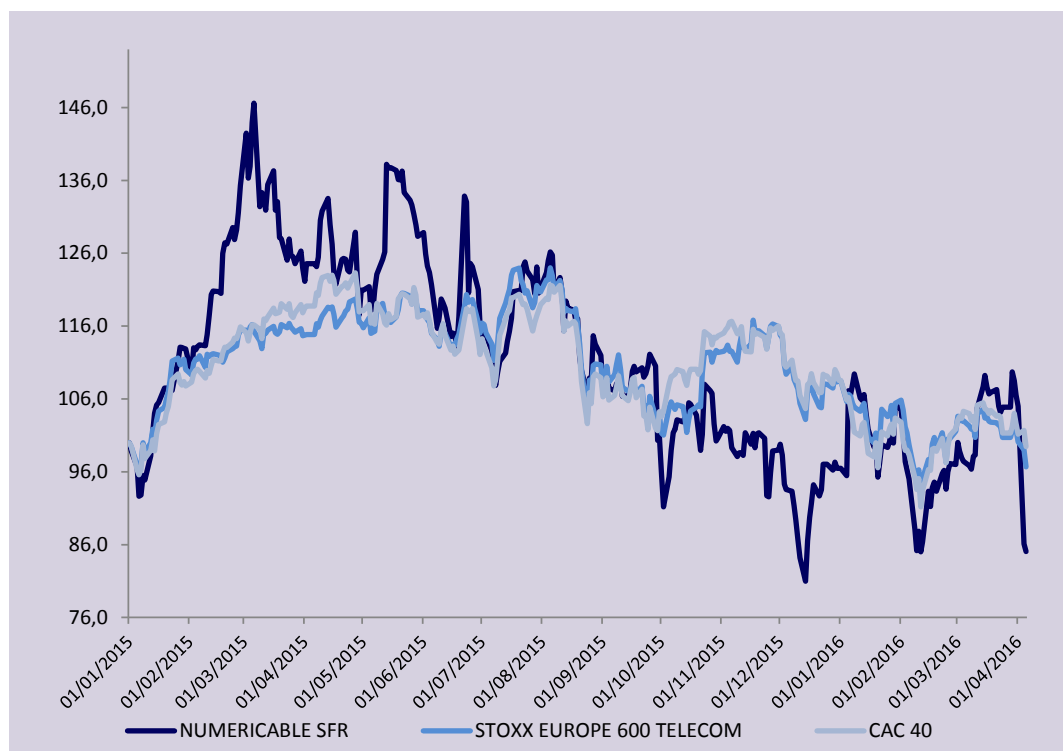
After the enthusiasm seen in H1 2015 following the first set of excellent financial results published by the new group and some wide fluctuations in the share price prompted by discussions over an eventual takeover of Bouygues Telecom, **the share price returned to more reasonable levels in H2 2015 and early 2016**, in view of poor sales performances, and fears over debt levels. NC-SFR's share, backed by hopes of market repair in France since December 2015, had reached the same performance as the STOXX Europe 600 Telecom and CAC40 by the end of March 2016, but **brutally fell after the breakdown of the discussions between Orange and Bouygues**. We think the stock has now reached the right level, having abandoned the market repair hopes and pricing in the full operational risks at NC-SFR.

Fig. 1: Change in NC-SFR share price since 2015 and comparison with competition in France



Source: Thomson Reuters.

Fig. 2: Change in NC-SFR share price since 2015 and comparison with the CAC40 and Telecom indices (base 100)



Source: Thomson Reuters.

2.2. DCF

Our **DCF** valuation puts **Fair Value at EUR28.38**, corresponding to a discount of -3.1% relative to the current share price.

Our model is based on the following assumptions:

- **Sales:** we expect sales to fall by a further **-2.1% in 2016** after dropping 3.5% in 2015, before a return to modest growth in 2017 (**+0.7% in 2017 and +1.6% in 2018**). In particular, BtoC sales are set to fall a further 1.8% in 2016 after dropping 3.7% in 2015 before recovering by 0.3% in 2017 and 0.8% in 2018. Sales from the BtoB and Wholesale businesses are set to fall 3.3% and 2.1% respectively in 2016 vs. -4.8% and +0.2% in 2015, before restoring growth of 2.7% and 1.3% in 2018.
- **EBITDA margin:** improvement in adjusted EBITDA margin on the back of further savings plans and synergies, but at a less buoyant pace than in 2015 given pressure on sales and a less advantageous comparison basis, **rising from 35% at end-2015 to 39.8% in 2018**.
- **Investments (excluding licences):** We have increased our **2016 capex estimate to EUR2.24bn**, namely 20.7% of estimated sales vs. EUR1.85bn in sales in 2015. We have maintained this level of capex in 2017 and 2018, for the time it takes to make up lost ground in the 4G mobile network, before landing at **EUR2bn in 2018**.

- **WCR:** We see no improvement in WCR for the years after 2015, assuming that supplier payment times have already been extended as far as possible since the takeover of SFR by Numericable. We have also integrated into cash flow, payment for the 4G 700MHz licence, booked for EUR466m in 2015, but paid in four instalments of EUR116.5m over 2016-18 (including two in 2016).
- We have assumed a **tax rate of 28.6% out to 2020, normalised to 36.6% thereafter**. Indeed, we estimate that the current price factors in the impact of a tax-loss carry forward from Numericable, that should end after five years.
- We have used a **cost of net debt before tax of 4.9%**.
- We have adopted a **discount rate of 6.14%** with a **beta of 1.07**, corresponding to the two-year historical beta of NC-SFR vs. the CAC40, adding an extra +0.05 to take account of a **refinancing risk** (this increase in beta is equivalent in the DCF valuation to a 100bp increase on EUR9bn in debt). We have also assumed a risk premium of 7.0% and a risk-free rate of 1.6%.
- We have assumed a **growth rate to infinity of 1%**.

Fig. 3: Calculation of discount rate

Inputs	
Risk Free rate	1,6%
Market risk premium	7,0%
B	1,07
Cost of Equity	9,09%
Cost of Debt after taxes	3,5%
Gearing (based on market cap)	112%
WACC	6,14%

Source: Bryan, Garnier & Co ests.

Fig. 4: Discounted cash flow model

EURm	2015e	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e
Sale	11 039	10 808	10 886	11 054	11 220	11 332	11 446	11 560	11 676	11 793	11 910	12 030
Change in sales		-2,1%	0,7%	1,6%	1,5%	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%	1,0%
EBIT	937	1 613	1 810	2 155	2 253	2 323	2 388	2 450	2 509	2 565	2 620	2 701
As % of sales	8,5%	14,9%	16,6%	19,5%	20,1%	20,5%	20,9%	21,2%	21,5%	21,8%	22,0%	22,5%
Tax rate	28,6%	28,6%	28,6%	28,6%	28,6%	28,6%	36,6%	36,6%	36,6%	36,6%	36,6%	36,6%
Net Op. Profit after Tax	669	1 152	1 292	1 539	1 608	1 659	1 514	1 553	1 590	1 626	1 660	1 712
+ D&A and prov.	2554	2262	2263	2165	2132	2105	2084	2068	2054	2043	2035	2000
Cash flow from op.	3 223	3 414	3 555	3 704	3 740	3 764	3 598	3 620	3 644	3 669	3 695	3 712
- Net investments (incl. Frequencies)	-1 864	-2 473	-2 357	-2 117	-2 000	-2 000	-2 000	-2 000	-2 000	-2 000	-2 000	-2 000
- change in WCR	-124	-428	-72	-206	-22	-15	-15	-15	-15	-15	-15	-16
Free cash Flow	1 235	513	1 127	1 381	1 719	1 749	1 583	1 605	1 629	1 653	1 679	1 696
Discounted FCF		488	1 010	1 167	1 368	1 312	1 119	1 069	1 022	977	935	890
Sum of disc. FCF		11 356										
+ disc. terminal value		17 327										
- net debt, 2015		14 401										
- minority interests		12										
Valuation		14 269										
Nbre of shares (fully diluted)		466										
Value per share		28.4										

Source: Company Data; Bryan, Garnier & Co ests.

2.3. Peer comparison

In an approach focused on the resale value of the business, the number of customers is what makes most sense, hence sales and sales multiples (as shown by Bouygues Telecom, which is valued at 13.33x 2015 EBITDA, but "just" 2.3x sales). In this approach **NC-SFR appears to be valued at 2.7x sales, corresponding to a premium of 20% relative to the average valuation of its peers.**

Given that a resale of NC-SFR's customer bases to a player in the French market looks fairly unlikely, **an approach based on EBITDA multiples nevertheless looks smarter.**

We value NC-SFR at 7.2x 2016 EBITDA, which is 7% higher than the valuation of a panel of peer companies in the European market (major telecoms operators, leaders or no. 2 in the market). In view of the leverage effect, this corresponds to a 15% premium to the current price.

This premium nevertheless seems justifiable given the group's EBITDA growth profile: note indeed that the EBITDA multiple is **in line with the panel as of 2018**, and the **2016 P/E is in line with market peers as of 2017.**

Fig. 5: Sales multiples

EV/Revenue Multiples	2015	2016e	2017e	2018e
NC-SFR (DCF BG)	2,6	2,7	2,6	2,5
Upside vs panel average	10%	20%	19%	15%
Orange	1,6	1,5	1,5	1,4
Deutsch Telekom	1,7	1,7	1,6	1,5
Telefonica Deutschland	1,9	2,0	1,9	1,9
Telefonica	2,1	1,8	1,8	1,8
SWISSCOM	3,0	2,9	2,9	2,9
KPN	3,3	3,1	3,1	3,1
TELECOM ITALIA	2,0	2,0	2,0	2,0
PROXIMUS	2,0	2,0	1,9	1,9
TELENET GROUP HOLDING	4,8	3,9	3,7	3,6
MOBISTAR	1,3	1,2	1,2	1,1

Source: Thomson Reuters, Company Data; Bryan, Garnier & Co ests.

Fig. 6: EBITDA multiples

EV/EBITDA Multiples	2015	2016e	2017e	2018e
NC-SFR (DCF BG, adjusted EBITDA)	7,4	7,2	6,7	6,2
Upside vs panel average	2%	7%	5%	0%
Orange	5,3	4,8	4,7	4,5
Deutsch Telekom	5,9	5,8	5,3	4,9
Telefonica Deutschland	8,2	8,3	7,6	7,1
Telefonica	8,7	5,7	5,5	5,4
SWISSCOM	8,5	8,0	8,0	7,8
KPN	10,1	9,0	8,8	8,5
TELECOM ITALIA	4,8	4,8	4,7	4,4
PROXIMUS	7,3	6,8	6,6	6,4
TELENET GROUP HOLDING	9,3	8,7	7,9	7,3
MOBISTAR	4,9	5,4	5,1	5,0

Source: Thomson Reuters, Company Data; Bryan, Garnier & Co ests.

Fig. 7: Price / earnings ratio

P/E	2015	2016e	2017e	2018e
NC-SFR (BG)	19,6	20,6	16,3	12,1
Upside vs panel average	2%	17%	3%	-17%
Orange	16,1	13,9	13,0	12,0
Deutsch Telekom	16,7	17,0	14,9	13,4
Telefonica	16,8	14,0	12,1	10,9
SWISSCOM	19,6	16,9	16,8	16,5
TELECOM ITALIA	21,5	17,2	15,3	15,1
PROXIMUS	19,7	16,9	16,6	15,8
TELENET GROUP HOLDING	28,3	24,0	19,4	15,6
MOBISTAR	15,3	21,3	18,1	17,4

Source: Thomson Reuters, Company Data; Bryan, Garnier & Co ests.

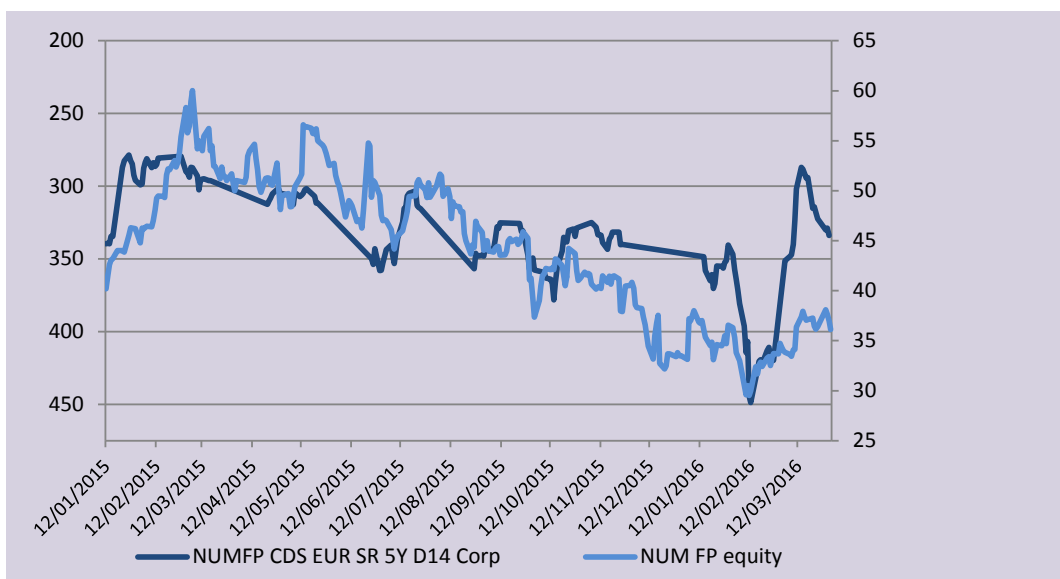
2.4. Impact of debt

NC-SFR's net debt stood at EUR14.4bn at end-2015 and is made up of guaranteed senior bonds as well as debts denominated in euros and dollars. Numericable-SFR has a "B+, negative outlook" rating from Standard & Poor's, and a "B1, stable outlook" at Moody's, corresponding in both cases to the speculative category.

However, for a while now spreads have been widening on the credit market and this has worried the market. The question of NC-SFR's debt is indeed at the centre of investor concerns. As such, we could presume that increasing tension in the credit market prompted by fears of a deterioration in the outlook, could take a toll on NC-SFR.

The chart below shows the correlation between the NC-SFR share price and the group's CDS.

Fig. 8: Correlation between the NC-SFR share price and CDS



Source: Bloomberg.

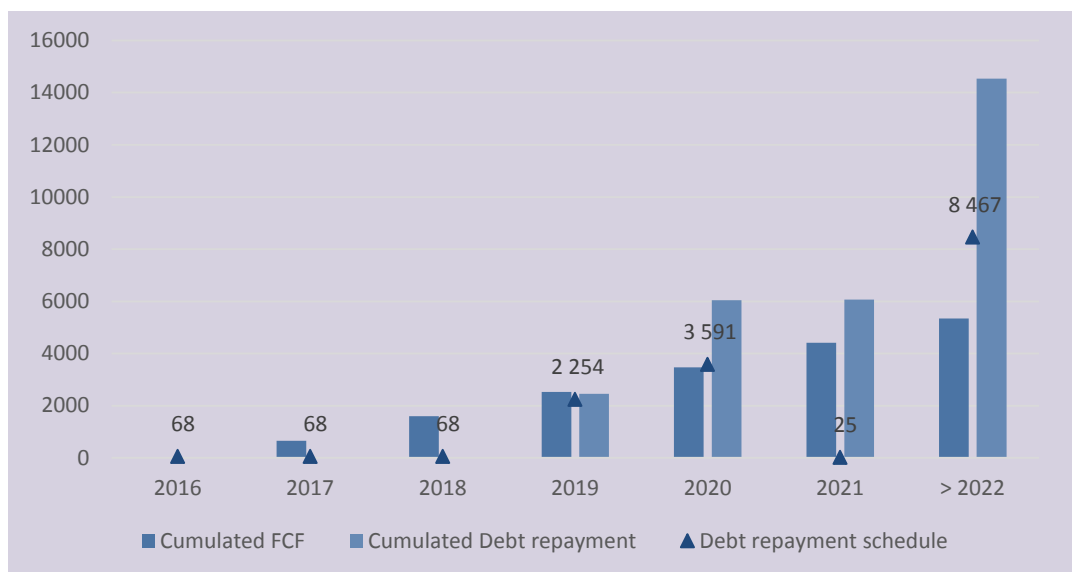
Given the prevailing backdrop of macroeconomic fears (weakness in emerging markets, plunge in oil prices, slowdown in global growth, risk of deflation in the Eurozone), we believe that the credit risk factor could take a toll on the NC share price, independently of the actual risk borne by NC-SFR itself.

NC-SFR had net debt of EUR14.4bn at end-2015, namely **3.73x adjusted 2015 EBITDA**.

However, in a highly capital intensive business where investment spending is key in terms of competitiveness, analysis of the net debt/EBITDA ratio alone does not seem to be sufficient. Net debt/EBITDA-capex looks more significant. **Net debt at end-2015 therefore stood at 8.26x 2016e EBITDA-capex** (excluding licence payment). The difference between the two rates is all the more significant in that NC-SFR' capex represents a significant share of its sales (>20%), as shown previously.

The financial debt repayment schedule is set out in the chart below. As shown, **free cash flow generation does not allow all of the debt to be repaid at maturity**.

Fig. 9: NC-SFR financial debt repayment schedule and analysis of refinancing needs



Source: Company Data; Bryan, Garnier & Co ests.

Refinancing looks all the more necessary in that the calculation above includes neither the probable payment prompted by the acquisition of a 5G licence out to 2020, nor the payment of dividends which seem necessary in order to move cash back up to Altice (as shown by the one-off payment of EUR2.5bn at end-2015). Indeed, as shown in our Altice report published today, the high level of debt on businesses outside France and in the US could require significant cash flow returns by NC-SFR, which is the entity that generates the most cash flow.

The amount of financial expenses estimated for 2018 stands at EUR620m. Assuming refinancing of EUR9bn in 2019, with an average cost of debt increased by 100bp to 6%, the impact on financial expenses would total EUR90m/year, i.e. around 10% of the amount of normalised free cash flow

generation (EUR938m in 2018). **This amount does not seem to be a threat to the structure.** Even assuming a 200bp increase in the rate, the impact should be OK to absorb.

Some operations exist that would help lighten the balance sheet

Note here, that operations exist that would help lighten the balance sheet if necessary:

- Disposal of network infrastructure and/or land to investors (see recent initiatives by Bouygues Telecom with FPS Towers, and Telecom Italia with Inwit). Several billion euros can be found this way. Inwit, the antenna subsidiary of Telecom Italia is today valued around EUR2.6bn.
- Securitisation or disposal of receivables

We are not ruling out the possibility of NC-SFR using this type of solution. In contrast, we believe that optimisation of WCR is already pushed to its maximum and is no longer a source of optimisation that can be activated by the group in the future. By applying a normal average VAT rate of 20%, the amount of trade payables at end-2015 totalled 45% of total group purchases over the year (approximate calculation based on reported EBITDA-sales+capex), corresponding to an average payment time-frame of 5.42 months on our estimates.

As explained in our DCF assumptions, we have factored in this refinancing risk by way of a premium of 0.05 to our beta.

2.5. Other considerations

Other elements can help underpin the NC-SFR share price

We believe that two specific and mutually exclusive factors, could underpin the NC-SFR share price:

- **Minorities buyout.** Altice now owns 78.5% of NC-SFR's capital, thereby valuing minority interests at EUR3.04bn, based on the current share price plus a 10% premium. A minorities buyout would have the advantage of returning 100% of NC-SFR's cash to Altice, and also simplifying the group's management by withdrawing a listed vehicle. We nevertheless consider this scenario fairly unlikely given the high amount at stake, and Altice's priorities, which are more focused on unlocking synergies, paying down debt or refinancing it.
- **Dividend payments.** At end-2015, NC-SFR paid a one-off dividend of EUR2.5bn, pointing to a 18% yield relative to the current share price. NC-SFR needs to return cash to its key shareholder Altice in order for it to reimburse its debt. Even though this type of payment is not the fruit of an actual dividend policy, we expect it could be repeated in the future, thereby benefiting minority shareholders.

The question of minority interests is two-fold since these interests are not only exposed to the opportunity of significant dividend returns, but also to management decisions that could favour Altice shareholders rather than NC-SFR's own interests, like for example: accelerated debt reduction at the holding company to the detriment of the subsidiary, transfer of assets from the Altice group to NC-SFR in order to improve the group's multiples to the detriment of NC-SFR.

3. The French market: the storm goes on

3.1. Price war and customer war

Price war is not over...

Recent months have seen a reorganisation of the market driven by two main factors:

- **Bouygues Telecom, under pressure to ensure its survival, has chosen to favour volumes and market share gains.** Firstly, it has reduced the entry point for its landline range to EUR19.99 including VAT, namely a discount of around EUR10 incl. VAT relative to the market. Secondly, it has moved its low cost B&You mobile range towards its historical premium range, Sensation, offering premium services at low-cost prices: stores and telephone customer service.
- **SFR, bought by Altice/Numéricable, boasts very high speed broadband assets that are unique in the market, and has chosen to favour value,** unlike Bouygues Telecom. With an approach very focused on fibre and contents, during 2015, Numéricable-SFR increase its landline prices and then its mobile prices (Red) and has done the same in early 2016.

These various strategies and positionings have resulted in a divergence of trajectories and sales performances in recent quarters.

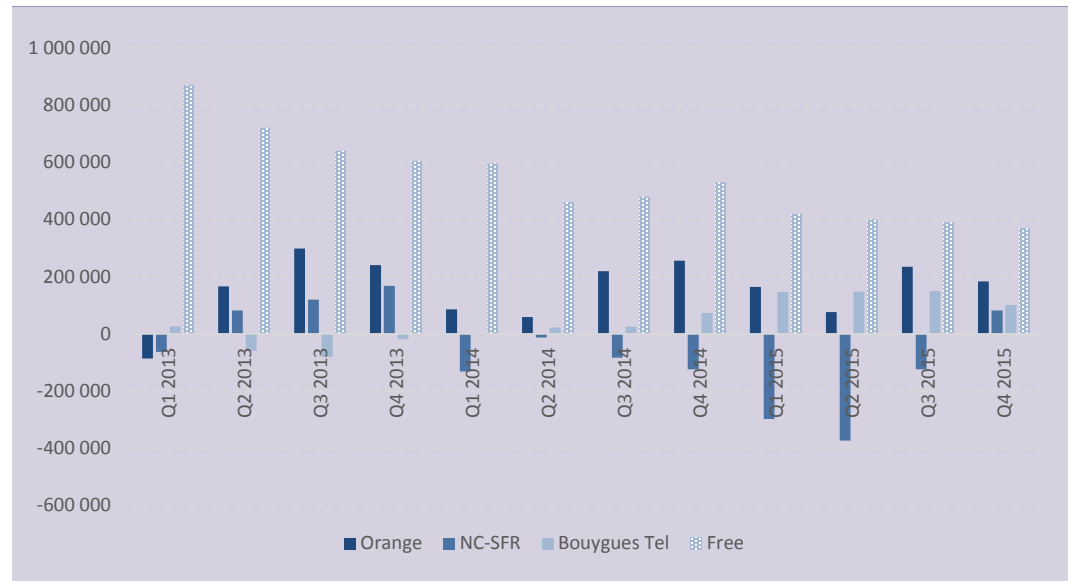
... in particular on the mobile side

In the mobile segment, Free still boasts very high recruitment levels with 1.58m new customers in 2015, vs. 2m in 2014 and 2.8m in 2013. After continuing to suffer considerably from the arrival of Free with a loss of 130k subscribers in 2013, Bouygues Telecom picked up in 2014 after repositioning its prices in Q4 and attracting 116k new subscribers over the year and adding a further 543k during 2015. SFR had a good year in 2013 following its re-pricing and added 350k new subscribers, but began to suffer in 2014 from network quality problems, losing 350k customers over the year, before shedding a further 713k subscribers during 2015, notably due to a lack of competitiveness in 4G, an increase in Red prices and other handset pricing decisions at the beginning of the year. Meanwhile Orange maintained a high level of net sales, adding 660k new subscribers in 2015.

Q4 2015, in particular, saw an unprecedented promotional battle, with a particularly aggressive stance by NC-SFR, especially in its Red low cost offers, with for example:

- Unlimited calls and SMS +20 Go of data for EUR3.99 for 12 months.
- Unlimited calls and SMS + 1 Go (or 5Go) of data for EUR4.99 (or EUR9.99), for life

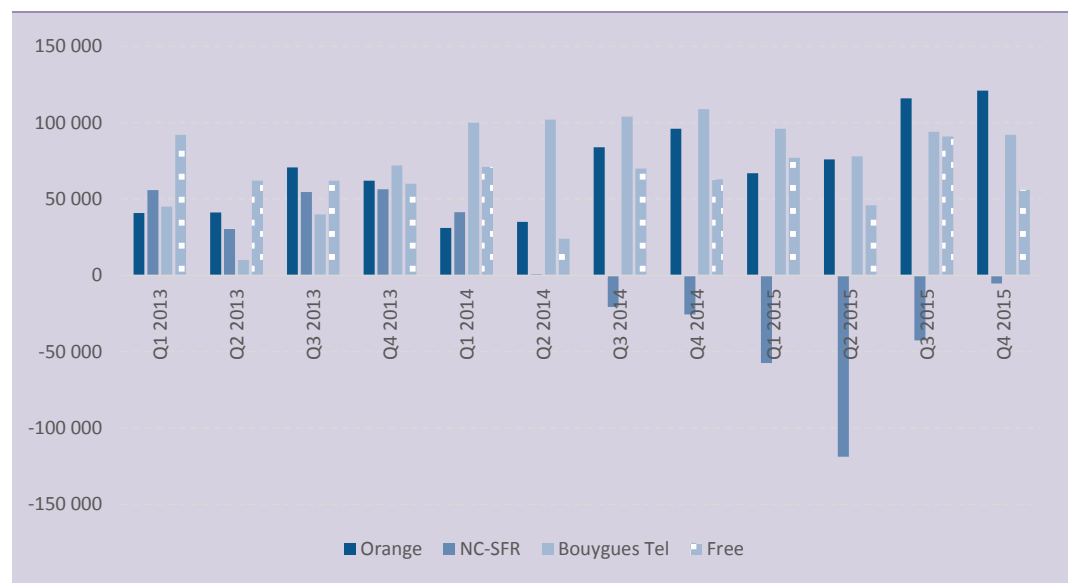
Fig. 10: History of mobile net subscriber sales (excluding M2M)



Source: Company Data; Bryan, Garnier & Co ests.

In the landline segment, Numericable-SFR has been losing customers since Bouygues Telecom's price repositioning in 2014. After losing 46,000 customers in H2 2014, NC-SFR lost a further 224k during 2015, notably due to price hikes and despite significant promotional campaigns. Bouygues Telecom succeeded its bet on volumes, increasing net adds from 167k in 2013 to 415k in 2014, and 360k in 2015. Iliad, which suffered slightly in 2014 with net additions of 230k, restored a performance similar to 2015 with 270k net adds, an outstanding performance in a market that is narrowing, but admittedly achieved by multiplying the number of promotional periods. Orange was less affected, increasing net additions from 214k in 2013 to 264k in 2014 and adding 380k net subscribers in 2015, benefiting fully from NC-SFR's underperformance and driven especially by healthy performances in fibre.

Fig. 11: History of broadband and very high speed landline net sales



Source: Company Data; Bryan, Garnier & Co ests.

As we can see, the market situation is far from stabilised and is not viable for all players in current conditions. The recent breakdown of the merger talks between Orange and Bouygues might worsen the situation. Indeed, we do not expect any consolidation soon as we see no buyer / seller couple, thus we put ourselves in the situation where Bouygues Telecom succeeds in its recovery plan.

4. The new SFR: hesitations concerning the business model

4.1. A strategy still to define

With the vital aim of rapidly increasing the profitability of its customers, NC-SFR's positioning relative to its rivals in the market is specific:

- In terms of marketing and communication strategy, NC-SFR has adopted an **approach focused on landline services** in general, **and fibre and contents** in particular.
- In the landline segment, faced with a still aggressive price war, NC-SFR has chosen to **implement numerous and successive price hikes**, to conquer customers, but also in the subscriber base, by betting on a double asset:
 - **The appeal of its TV contents**, combined with a box that has a good reputation, is powerful, stable and ergonomic.
 - A **unique very high-speed footprint** in the market. It is nevertheless important to note that the price increases have not only concerned fibre customers, or even exclusively 3P clients.
- In the mobile segment, here again NC-SFR has practiced a policy of **price increases**, especially for Red. NC-SFR has also **strengthened rules on downgrading moves**, extending downgrade timeframes or limiting operations to the customer services channel alone.

In 2015, at the same time as a **spectacular recovery in EBITDA**, this strategy resulted in a **significant loss of landline and mobile customers** and a recovery in fixed ARPU.

Indeed, in landline BtoC, NC-SFR lost 3.0% of its overall customer base in 2015 (average network), but in contrast, increased ARPU by 3.0%, enabling it to limit the impact on sales. The change in the mix in favour of fibre nevertheless generated savings in DSL operating expenses, estimated at EUR25.266m, thereby ultimately making the equation positive for the landline margin, despite the loss of customers.

Fig. 12: Illustration of landline customer volume/value effect on 2015

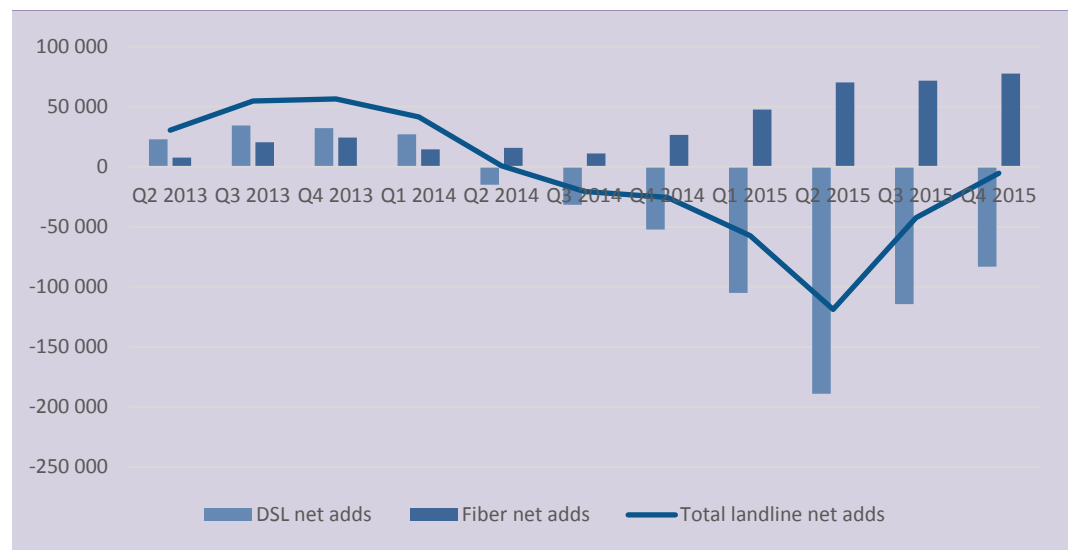
BtoC	2014	2015	Delta
Average landline cust. Base	6 606 673	6 407 980	-3,0%
ow fiber mix	23,0%	26,6%	+360 bps
Average landline ARPU	34,1 €	35,1 €	3,0%
Landline Revenue impact			- 2 979 947 €
ow volume effect			- 82 418 236 €
ow ARPU effect			79 438 289 €
Fiber mix effect on DSL cost savings			25 266 071 €

Source: Company Data; Bryan, Garnier & Co ests.

We nevertheless believe that this strategy cannot last over the long term:

- **Multiple price hikes are not sustainable over time** or need to be offset by equivalent operating expenses in terms of services and contents in order to justify price increases.
- Admittedly, fibre customers generate vastly higher value than DSL customers, with a margin on variable costs at around 60% on our estimates. However, while NC-SFR's footprint is significant with 7.5m fibre customers, it still only covers a minority of customer potential (around 30%). Although **DSL contributes less to margins, it therefore remains key for generating volumes and helping to cover the operator's fixed costs.** To offset the loss of a DSL customer, more is needed than a migration from DSL to fibre, and this is no simple matter given the share of customers eligible for very high speed.
- These effects shown at the limits of the landline business do not capture the effects caused in the mobile segment, in terms of convergence. With a convergence rate of around 50%, we could imagine that **the loss of a landline customer leads to the loss of 0.5 mobile customers over the medium term.**
- NC-SFR is obliged to accompany its premium price policy with **aggressive promotional campaigns.** However, while the promotional policy helps underpin commercial performances in winning customers, it prompts a different treatment between customers in the network and prospective customers. This notably causes an increased churn rate in the base and encourages "premium hunting" behaviour.

Fig. 13: NC-SFR performance in DSL and fibre

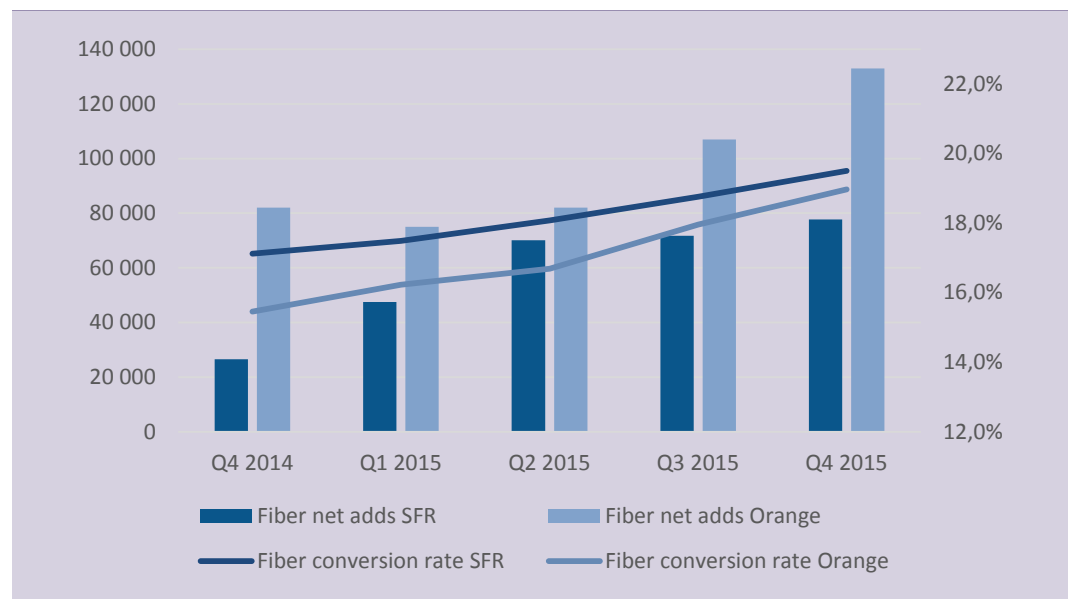


Source: Company Data.

In addition, the performance in fibre should especially be seen in perspective. While **net growth in the fibre customer base in 2015 was far higher than the level in 2014** (267k vs 67k), and has risen attractively in recent quarters, it nevertheless remains **lower than the level at Orange** (397k).

Above all, however, when fibre performances are compared with the number of available sockets, **Orange's efficiency looks far superior:** new fibre clients at NC-SFR accounted for **3.7%** of the average number of NC-SFR sockets available over the year, whereas new Orange fibre customers represented **8.9%** of the average number of Orange sockets available over the year, testifying to a better ability to convert and/or recruit clients in fibre. All of this in a backdrop whereby NC-SFR has made fibre (very high speed) the heart of its strategy, and from one day to the next inherited a base of fibre sockets also offering a migration opportunity for a very large number of DSL customers. Orange is currently overtaking NC-SFR in terms of the load rate for its very high-speed network.

Fig. 14: Comparison of NC-SFR / Orange fibre performances.



Source: Company Data; Bryan, Garnier & Co ests.

In mobile, NC-SFR lost 7.2% of its overall customer base in 2015 (average base), with a decline in mobile ARPU of just 0.2%, vs -5.8% in 2014, due to the pro-active price-increase policy and the limitation of customer downgrades as mentioned above.

This mobile price policy has the following disadvantages:

- It is **limited to premium offers** with commitment. Indeed, all price increases in this type of offer free the customer from their commitment.
- It is **risky for low-cost customers**, who are by nature very wary over prices.
- It is only **sustainable if the quality of service is spot-on**, which is not the case so far for NC-SFR, especially in 4G.
- Symmetrically to landline, **a loss of customers in mobile can affect performances in landline.**
- As in the landline segment, NC-SFR is obliged to accompany its premium price policy with aggressive advertising campaigns. However, while the advertising policy helps underpin sales

Please see the section headed "Important information" on the back page of this report.

performances for winning customers, it prompts a **different treatment of existing and prospective customers**. This leads to a **higher churn rate in the base**, or moves such as **termination/re-opening of a line** that are costly and encouraged by retailers, and which encourage "**premium hunting**" behaviour.

Fig. 15: Illustration of volume/value effect for mobile customers over 2015

BtoC	2014	2015	Delta
Average mobile cust. Base	16 514 583	15 319 306	-7,2%
Average mobile ARPU	22,5 €	22,5 €	-0,2%
Revenue impact			- 332 907 766 €
<i>ow volume effect</i>			- 322 715 896 €
<i>ow ARPU effect</i>			- 10 191 870 €

Source: Company Data; Bryan, Garnier & Co ests.

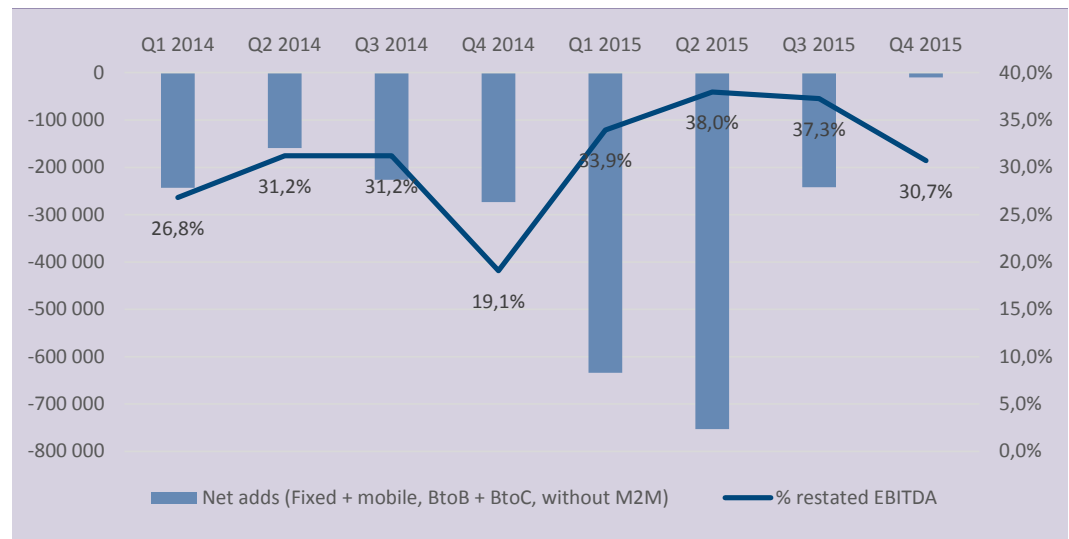
4.2. A mixed situation so far: what next?

We believe the loss of customers noted in 2015 was due to several factors:

- A deliberate strategy to **focus efforts on value customers**.
- **Price hikes** imposed on existing landline and mobile customers.
- A **restriction in the means** used for recruitment and loyalty of premium mobile customers.
- A **change in approach** imposed on distribution, with a refocusing on landline and contents.
- A **destabilisation of teams** due to reorganisations and management changes.
- An **adaptation of go to market** processes and landline connections.
- **Changes in suppliers** that could have damaged the quality of service provided.
- The **strong presence of Altice teams** on the ground with maximum pressure on cost savings and possibly less focus by NC-SFR's management on commercial stakes.
- A **lack of quality and 4G coverage** in the mobile network (already seen in 2014).

The majority of these factors nevertheless helped improve the EBITDA rate over the year. The following chart compares change in EBITDA margin over the year and the volume of customers lost (excluding M2M).

Fig. 16: Change in EBITDA margin and customer volumes over 2014/2015



Source: Company Data; Bryan, Garnier & Co ests.

We nevertheless consider that **the approach seen in 2015 is not sustainable**, and that a premium strategy, requiring high investments and sales costs, is not very compatible with a short-term approach to maximise EBITDA margin.

New management should help change things

In other words, **we are likely to see a reversal of the logic in place in 2015**: indeed, investments in networks and the quality of service should precede the application of a premium strategy. **In the meantime, promotional intensity is likely to continue.**

In Q4 2015, we already noted the effects of this refocusing. In this respect, **we view the arrival of a new management team as highly positive** with Michel Combes in place since Q3 2015 and Michel Paulin due to arrive before the end of H1 2016, as well as the arrival of a new consumer activities directors. In our view, these changes testify to the fact that the key shareholder recognised that a reorganisation of the company's management was necessary. With Michel Combes and Michel Paulin, NC-SFR will boast two managers with experience of large groups and expertise in the entire range of landline and mobile telecoms activities.

These management changes are nevertheless an implied recognition of the fact that **the problems encountered by the new group in 2015 were more imposed rather than chosen**, and that control of the collateral impact of all of the reorganisations implemented last year proved insufficient. **Restoring a brand image that has probably been affected in recent quarters, is now urgent.**

After a restructuring phase, we now expect NC-SFR to enter a consolidation phase, addressing the following problems:

- **An upgrade to investments** in the mobile network, and more generally investments in the quality of services provided, in order to justify a premium price policy and avoid a deterioration in its brand image that could be irreversible.
- **A further aggressive advertising campaign** to underpin sales at least in 2016.

- Further controlled opex savings plans compatible with the commercial recovery in business.
- Transformation of distribution: streamlining of geographical presence, adapting sales techniques with a focus on landline.
- Streamlining the Red and Virgin brand portfolio.

4.3. Finding the right balance between "overall" EBITDA and EBITDA margin

Our previous comments underscore the opposition between an approach focused on maximising the EBITDA rate to the detriment of sales performances, and an approach focused on maximising the customer base. **We believe that NC-SFR has not yet found the right balance between "mass" EBITDA and EBITDA margin.**

To start with, we think it is interesting to draw an **analogy with the retailing sector**, the price policy practiced and its impact on store footfall levels.

The chart below shows changes in prices practiced in Tesco stores at the same time as change in market share. Tesco had major stockmarket and financial difficulties following its margin restatement. Despite increasing prices and hence the unit margin, the decline in footfall led to a deterioration in the sales margin, with customer volumes not covering the fixed cost structure sufficiently.

Fig. 17: Retailing – Tesco approach to prices and impact on market share



Source: Company Data; Bryan, Garnier & Co ests.

The comparison with Tesco is of course limited at this stage, in that NC-SFR is still in a transition phase following the merger with Numericable. An analogy with the retailing sector nevertheless seems relevant given that the telecoms model is increasingly approaching that of commodities in view of three structuring trends:

- A multiplication in the amount of **promotional operations**, which are becoming key in the sales approach for players in the sector.
- Growth in **no-commitment offers**, with the parallel development of SIM-only offers (i.e. with no subsidiaries: recycled handsets, financing offers, alternative distribution platforms to operators etc.).
- An easier process for mobile and landline **number portability**.

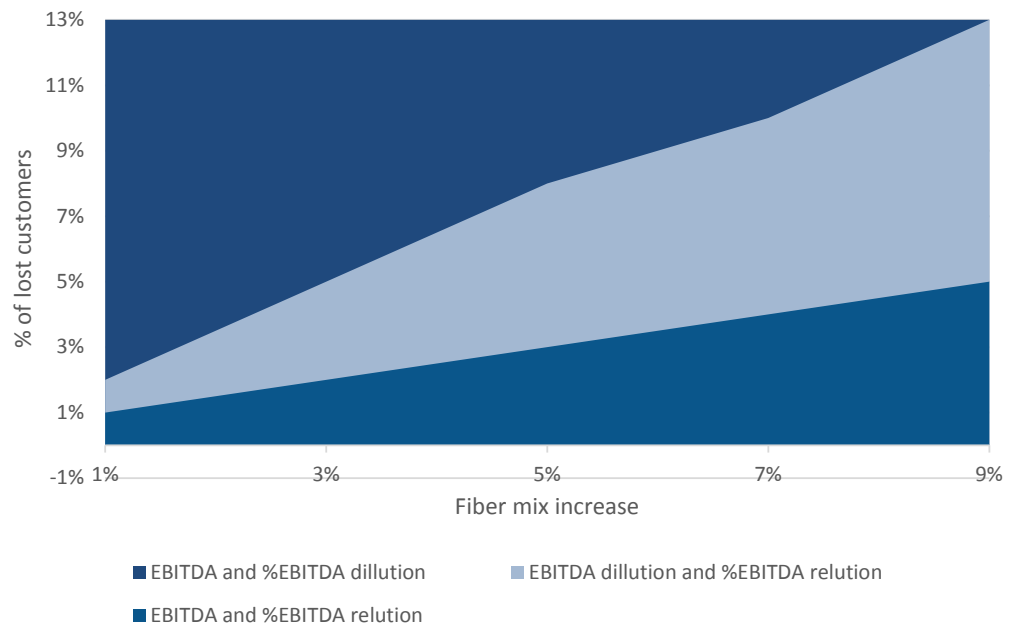
In all, these factors enable a more fluid transfer of customers between operators, therefore prompting fewer recurring revenues, and generally lower inertia in the impact of consumer behaviour on the financial results of operators. However, as we discuss further on, content offers could help slow this trend.

More specifically, in terms of NC-SFR's business model, we have gone into greater depth on three structuring points in the arbitrage between "overall" EBITDA and thr EBITDA rate:

- The compromise between the DSL/fibre mix and the total volume of landline customers.
- The compromise between ARPU vs the total volume of mobile customers.
- The compromise between the premium/low cost mix and the total volume of mobile customers

The following table illustrates the trade off between the increase in the fibre mix vs the loss of customers, i.e. the impact of a strategy highly focused on customers producing a higher EBITDA rate to the detriment of a more generalist approach.

Fig. 18: Impact of fibre mix increase and loss of customers on landline profitability



Source: Bryan, Garnier & Co ests.

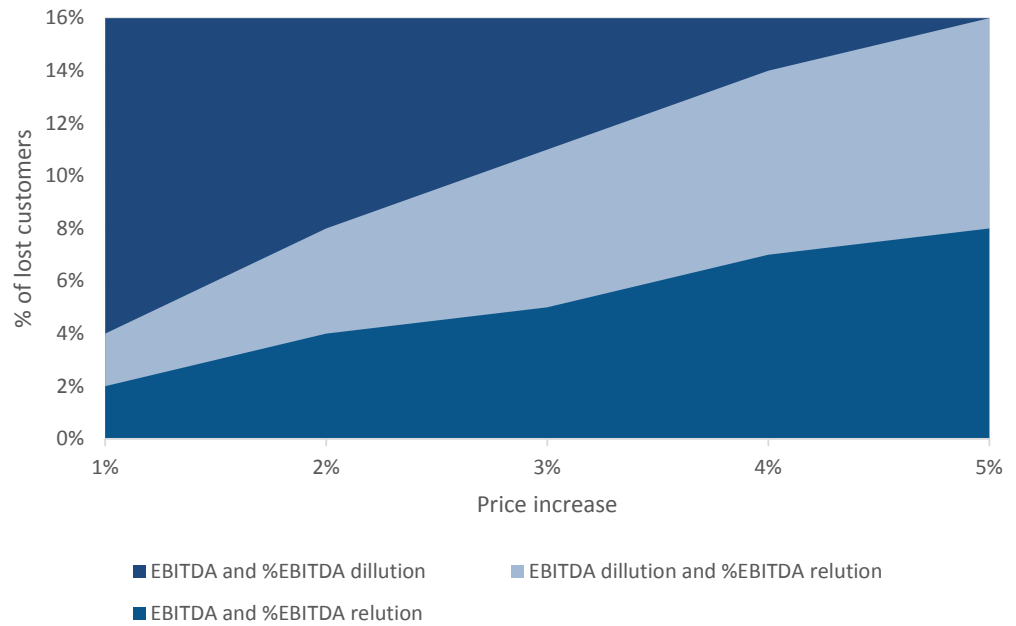
Depending on changes in the fibre customer mix and the overall loss of landline customers, we have identified three zones:

- **An accretive zone**, whereby the EBITDA margin and EBITDA in absolute terms are enhanced: EBITDA margin gains in fibre offset customer losses and the whole contributes more to covering fixed operating expenses in the business.
- **A mixed zone**, where the EBITDA margin rate is improved but overall EBITDA deteriorates: the margin rate is improved by the better fibre mix, but the sales base is too low and the whole contributes less to covering fixed operating expenses. This zone is the most delicate. It shows a better profitability rate, but lower overall profitability in the business (unless simultaneous efforts are made on the fixed operating expense structure).
- **A dilutive zone** in which the EBITDA rate and overall EBITDA deteriorate. Customer losses are such that gains in the fibre mix are fully wiped out.

The main assumptions used for this model are a margin on variable costs of 35% for ADSL customers and 55% for fibre and fixed operating expenses of 13% of sales (kept stable in absolute value terms in the model).

The following table illustrates the trade off between price increases and customer losses in mobile, namely the impact of a strategy focused more on value (ARPU and EBITDA margin) to the detriment of a more volume-based approach.

Fig. 19: Impact of price increases and customer losses on mobile profitability



Source: Bryan, Garnier & Co ests.

As with landline, depending on changes in price and the total loss of customers, three zones can be identified:

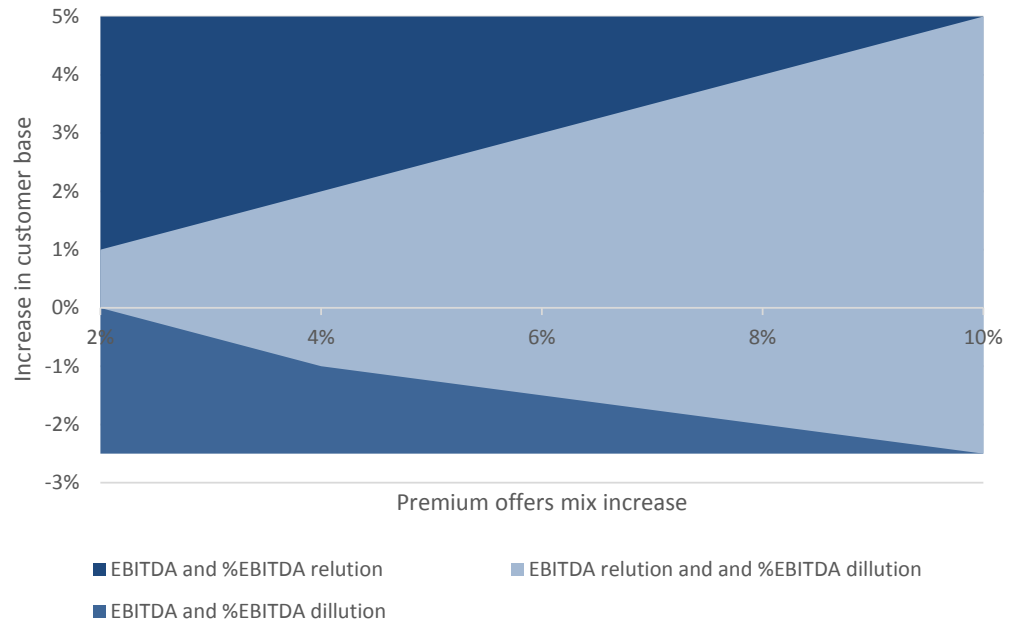
- **An accretive zone**, whereby the EBITDA margin and EBITDA in absolute terms are enhanced: EBITDA margin gains prompted by the increase in prices offset customer losses and the whole contributes more to covering fixed operating expenses.
- **A mixed zone**, where the EBITDA margin rate is improved but overall EBITDA deteriorates: the margin rate is improved by ARPU, but the sales base is too low and the whole contributes less to covering fixed operating expenses. As in landline, this zone is the most delicate. It shows a better profitability rate, but a lower overall profitability of the business (unless simultaneous efforts are made on the fixed operating expense structure).
- **A dilutive zone**, where both EBITDA margin and EBITDA in absolute terms deteriorate. Customer losses are such that ARPU gains are totalled wiped out.

The main assumptions used for this model are a margin on variable costs for mobile clients of 53%, and fixed operating expenses of 13% of sales (kept stable in absolute value terms in the model).

If we take a closer look, the mobile EBITDA rate is not only influenced by prices and the volume of mobile customers, but also by the mix between premium clients (Starter and Power) and the low-cost offers (Red). The premium offers have a lower margin rate on variable costs than low-cost offers (around 50% vs. 66%) primarily due to higher acquisition and loyalty costs. In contrast, their ARPU is virtually double, hence a higher absolute value for the margin on variable costs for premium offers, despite a lower margin rate.

As shown in the chart below, a good performance in the premium mix can offset the loss of a certain number of customers at the EBITDA level. In the case of customer gains, the effect can even be negative for EBITDA margin.

Fig. 20: Impact of premium/low cost mix on mobile customers



Source: Company Data; Bryan, Garnier & Co ests.

The above analysis is valid at cruising speed. However, short-term impacts of sales performances relative to the premium and Red offers are different. Given high acquisition costs (mobile handset subsidy and payments to distributors), we estimate that payback on variable costs for premium offers takes around six/eight months. As of Q2/Q3, **a poor sales performance in premium offers is therefore positive for the rate and the absolute value of EBITDA over the current year.**

As such, we estimate the positive effects on the costs potentially caused by the deterioration in sales performances over 2015 at several dozens EURm.

A strategic choice therefore needs to be made between a policy of maximising EBITDA in the short term and the EBITDA rate, to the detriment of premium customers, and a strategy to maximise EBITDA in absolute value terms implying hefty investments necessary for acquiring premium customers and making them loyal.

Finally, note that, while a valuation based on EBITDA multiples makes sense in a stand-alone approach, **in a business resale value approach, the number of clients makes more sense, hence sales and sales multiples** (as shown in an extreme case by the valuation of Bouygues Telecom's business).

In this context, and in view of the above analysis, we consider it important to **avoid overly focusing on the business's EBITDA rate, in favour of the overall EBITDA generated**, with a more medium term vision.

4.4. Sales set to remain under pressure

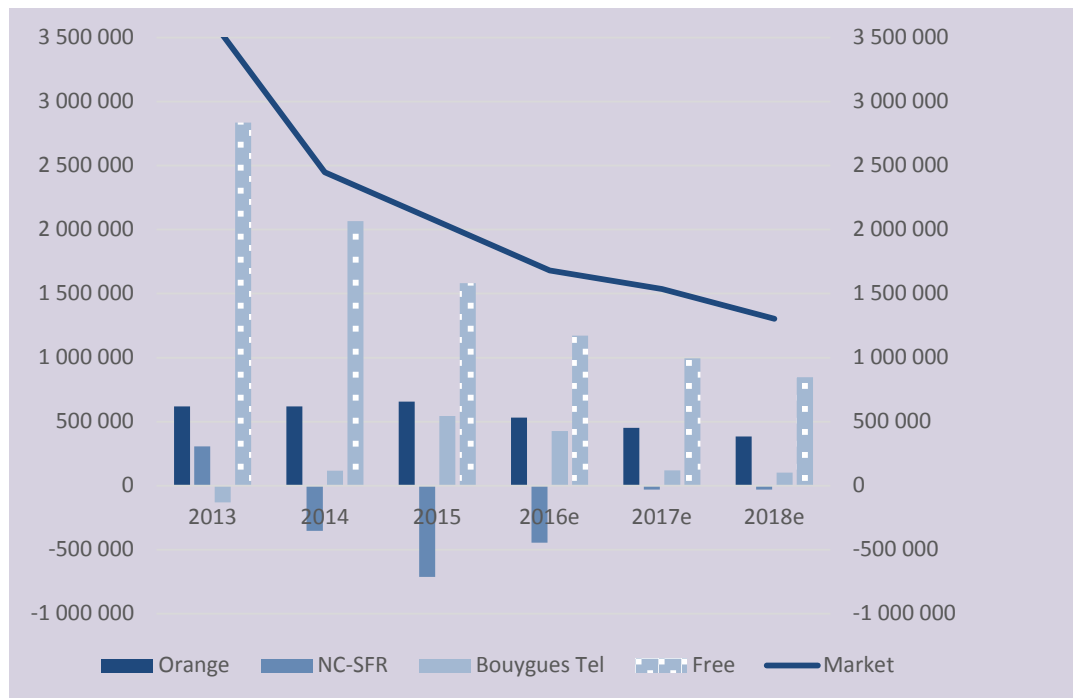
Given the situation described above, the time necessary **1/** to strengthen the quality of the mobile network and **2/** for the new management team to restore control of the strategy, **3/** to continue adaptation, synergy/cost savings and reorganisation plans, we believe that NC-SFR's landline and mobile sales are likely to remain under pressure in 2016, before returning to growth as of 2017.

We believe that the state of play in 2016 should remain fairly similar to 2015, in particular with high promotional activity, for two main reasons:

- In the mobile segment especially NC-SFR will still not have a level of quality comparable to Orange/Bouygues Telecom requiring a price compensation.
- Bouygues Telecom's pricing will remain very aggressive in order to recruit and retain a large number of customers, which is a key point of its recovery strategy.

In the mobile segment, Bouygues Telecom and Orange, benefiting from customer losses at NC-SFR and their network leadership, should continue to post high performances in 2016, before the catching up of NC-SFR. We see NC-SFR falling 3.0% in 2016, and breaking even in 2017 and 2018, after losing 4.6% of its mobile subscriber base in 2015. Bouygues Telecom is set to post a further 3.9% increase in its subscriber base in 2016 after +8% in 2015, while Orange should still benefit from reasonable growth of 2.6%, 2.4% and 2.0% in 2016, 2017 and 2018, respectively after levels of 3.4% in 2015 and 2014. Finally, Free should continue on a healthy trends, with growth in mobile volumes of 10% in 2016, 8% in 2017 and 6.2% in 2018, vs. 26% in 2014 and 16% in 2015.

Fig. 21: Change in mobile net subscriber sales (excluding M2M)

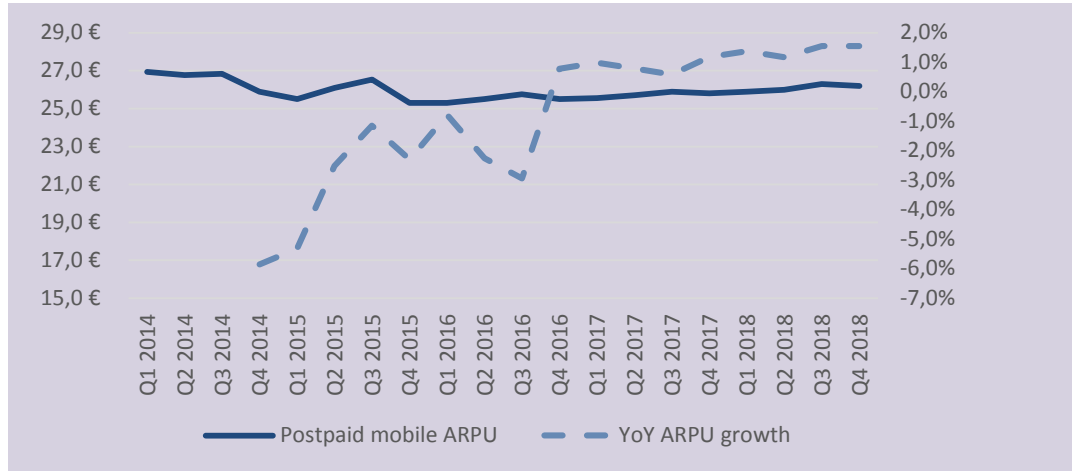


Source: Company Data; Bryan, Garnier & Co ests.

In terms of mobile ARPU, we believe that sales performances should remain affected by sharp promotional intensity, partly offset by price increases applied for winning subscribers and existing customers. New European restrictions on roaming prices are also set to take a toll on 2016. As such, for 2016, we are forecasting a modest decrease in mobile subscriber ARPU, limited to -1.3% vs. -2.8% in 2015. For 2017 and 2018, when the promotional intensity levels off, the improvement in quality of service and the development of data usages should help reach mobile subscriber ARPU growth rates of around 0.9% in 2017 and 1.4% in 2018.

Whatever the case, **we do not believe in a scenario that would see a simultaneous significant recovery in ARPU and sales performances in the mobile segment.**

Fig. 22: Change in NC-SFR postpaid mobile ARPU

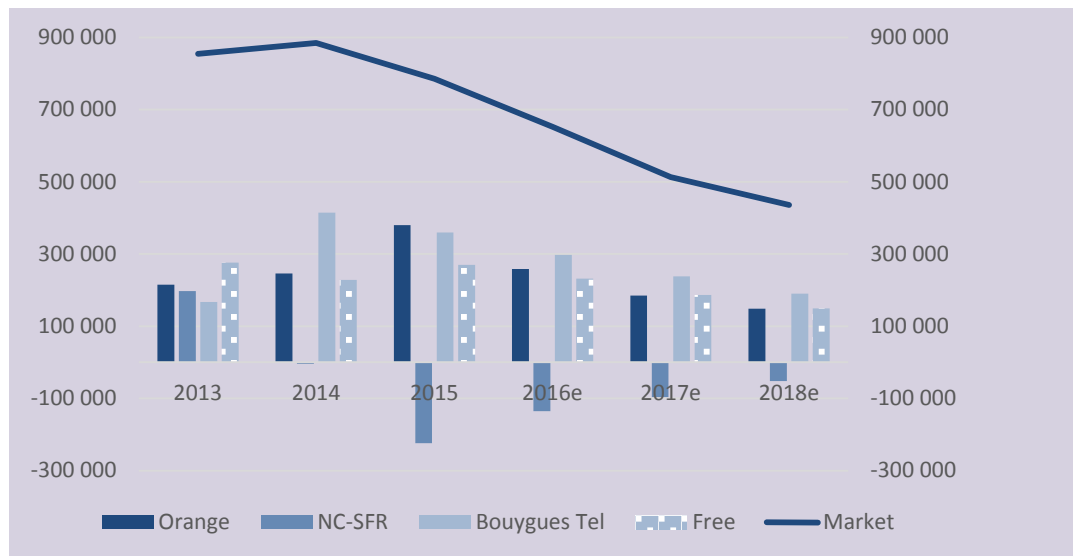


Source: Company Data; Bryan, Garnier & Co ests.

Concerning landlines, growth in the market should slow, falling from a **CAGR of 4.2% over 2012-2015 to 2.4% estimated for 2015-2018**, with the penetration rate gradually tending towards an asymptote.

In a market growing more slowly over 2016-2018, we see the trends noted in 2015 **picking up slightly**. NC-SFT should reduce its customer losses gradually, but remain in **negative net sales territory due to its reaffirmed premium positioning and a focus on fibre**, as shown by the EUR3 price increase in early 2016 for Fibre Power boxes, as well as investments in Altice contents (see below). **Bouygues Telecom should maintain a high recruitment level, benefiting from an attractive price positioning. Orange could suffer somewhat from the gradual recovery of NC-SFR, with Iliad's net sales falling as the market narrows.**

Fig. 23: Change in DSL and fibre net subscriber sales

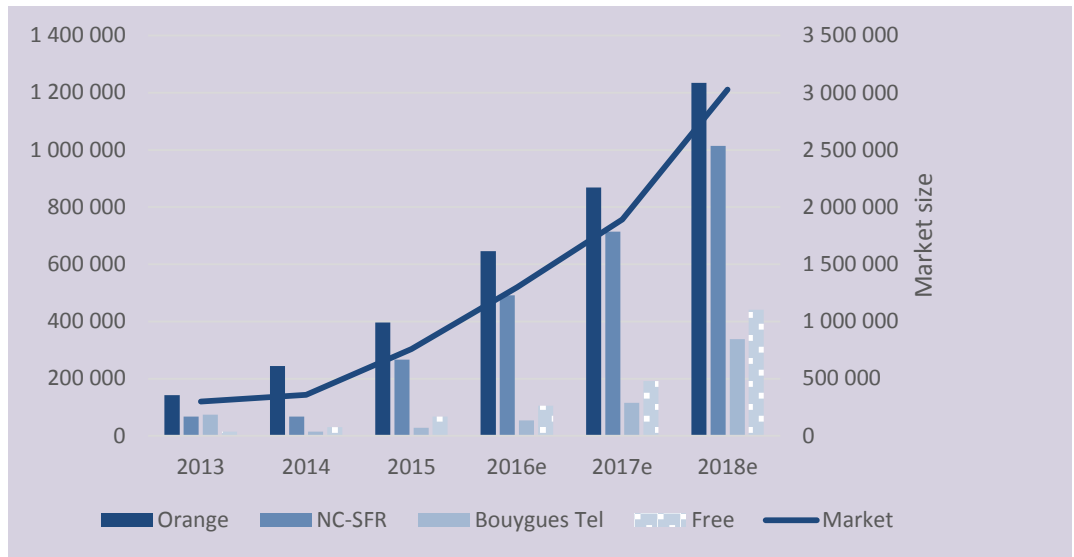


Source: Company Data; Bryan, Garnier & Co ests.

Behind these figures lies a gradual switch from DSL to fibre. This switchover primarily concerns migrations within the customer base at present rather than new customer recruitment. In particular, in 2015, NC-SFR undertook wide-scale migration operations (not obligatory) for DSL customers inherited from SFR to Numericable's very high speed infrastructure.

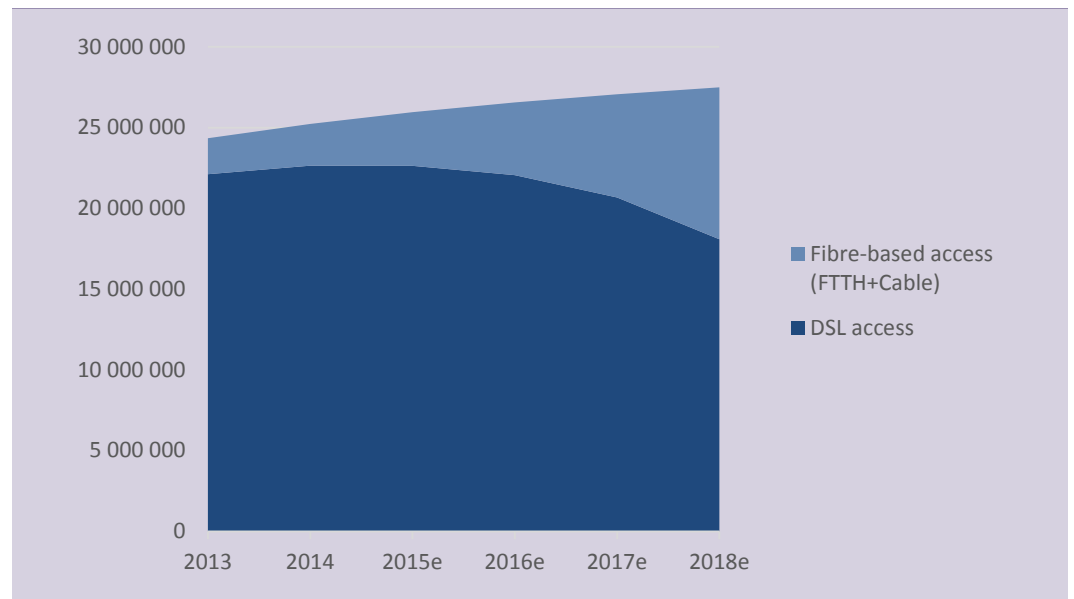
We believe this **trend should continue and amplify** in coming years, encouraged by **1/** the development of usages consuming extensive amounts of bandwidth (multiplication of 4k audio-visual contents, development of multi-screen and simultaneous uses in the household, increase in streaming usages) and **2/** the strategy of players who are gradually stopping the sale of ADSL in areas where they have installed fibre optics in order to make their investments profitable. As such, we are targeting a **near-tripling in the volume of fibre subscribers in the market** between end-2015 and end-2018.

Fig. 24: Change in net fibre sales



Source: Company Data; Bryan, Garnier & Co ests.

Fig. 25: Change in overall DSL and fibre subscriber bases (all four operators)



Source: Company Data; Bryan, Garnier & Co ests.

In terms of landline ARPU, we believe the strategy to increase prices underpinned by premium contents should continue. We are forecasting growth in landline APRU of 3.5% in 2016 vs. 3.0% in 2015, corresponding to the full-year effect of increases in 2015, as well as the latest price increases applied to the base in early 2016. We expect price increases to be more limited in 2017 and beyond, and we are forecasting ARPU growth at 3.0% and 1.8% in 2017 and 2018.

Fig. 26: Evolution of landline ARPU



Source: Company Data; Bryan, Garnier & Co ests.

Concerning BtoB, we expect business to **suffer for a few more quarters** for the same reasons as BtoC, but also due to sustained **aggressive pricing from Bouygues Telecom** on this segment and to the merger still underway of SFR's historical businesses with Telindus on the one hand, and Compléto on the other. We are forecasting a **modest return to growth as of Q3 2016**.

Concerning the wholesale businesses, we believe that performances could suffer especially from the **loss of the Bouygues Telecom DSL contract** in favour of Orange. Price cuts on MVNO contracts should be offset by an increase in traffic. We are forecasting a **return to growth as of Q1 2017**.

The chart below shows prospective sales growth at NC-SFR's three businesses out to 2018.

Fig. 27: Pro forma change in NC-SFR sales

	FY 2013	FY 2014	FY 2015	FY 2016e	FY 2017e	FY 2018e
Proforma Revenues (M€)	12 039	11 436	11 039	10 808	10 886	11 054
		-5,0%	-3,5%	-2,1%	0,7%	1,6%
BtoC	8 256	7 888	7 595	7 462	7 481	7 540
		-4,5%	-3,7%	-1,8%	0,3%	0,8%
BtoB	2 365	2 223	2 116	2 046	2 089	2 145
		-6,0%	-4,8%	-3,3%	2,1%	2,7%
Wholesale	1 418	1 325	1 328	1 300	1 316	1 369
		-6,6%	0,2%	-2,1%	1,3%	4,1%

Source: Company Data; Bryan, Garnier & Co ests.

Pressure on sales exposes NC-SFR to a risky temptation, namely a headlong rush to offset customer losses by price increases in the subscriber base, thereby making customer losses worse and maintaining a vicious circle of value destruction. We believe that NC-SFR will have to be careful not to embark on this type of strategy.

Beware OPEX
management

4.5. Savings need to continue

In 2016, NC-SFR started a very ambitious cost-cutting programme, based on the following action plans:

- **Unlocking** the synergies between NC and SFR: migrating DCS customers to fibre, distribution (start of streamlining in store network), brand (halt to Numericable brand, except for TV bouquets).
- **Review** of sourcing policies (in-house/outsourcing), in particular with lower use of outsourcing.
- **Renegotiating** all supplier contracts.
- **Elimination** of a number of expenses considered useless or excessive.

Including variable sales factors, this policy helped save **EUR665m** in 2015 vs 2014 pro forma.

In the same fashion as sales, aggressive management of opex exposes **NC-SFR to the risk of pushing savings even further in order to offset sales under pressure and safeguard EBITDA. In so doing, NC-SFR would take the risk of stepping up customer losses and ultimately worsening the situation over the medium term.** We believe that NC-SFR should take care not to implement a strategy like this, by making sure that opex savings do not affect sales performances and the quality of services provided.

We nevertheless expect opex savings to continue in view of the following items:

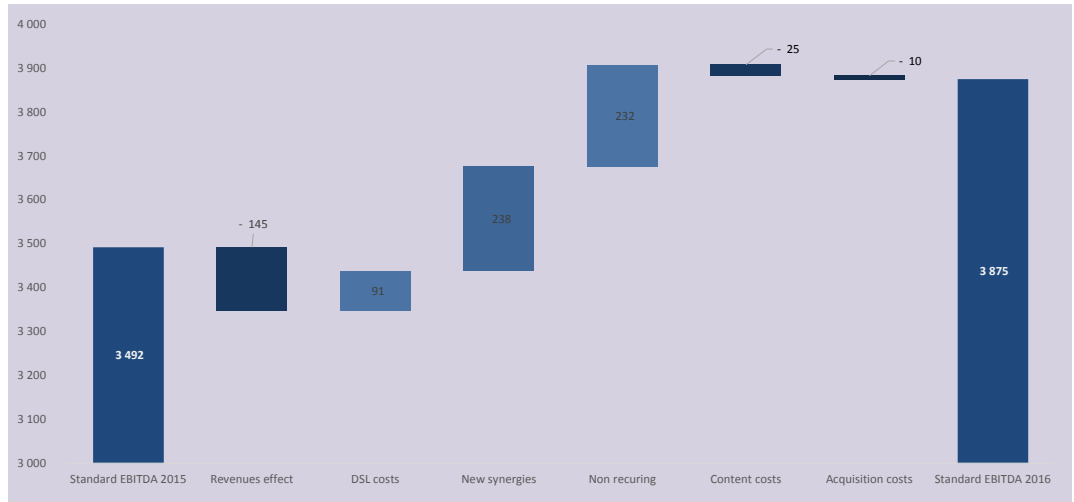
- **Full-year effect of opex savings started in 2015**, estimated at EUR160m.
- **Further migration of DSL to fibre**, savings estimated at EUR98m vs. 2015.
- **Fresh savings and full-year effect of opex savings started in 2015**, for an amount estimated at EUR238m, including the following items: distribution (further streamlining of store network), customer services (sourcing and supplier renegotiations, further digitalisation), brand (Red and Virgin), other operating expenses.

Opposite these savings, certain cost items could nevertheless increase:

- **Subscriber acquisition and loyalty costs:** despite the positive effects prompted especially by the rising momentum of SIM-Only offers, we believe that the recovery in sales performances as of 2016 should go hand in hand with an increase in commercial means, which we estimate at EUR10m.
- **Contents:** as explained further on, we have neutralised the impact of Zive costs provided by Altice, but have assumed a EUR25me impact on the P&L account for a quarter of rights for the UK Premier League football tournament.

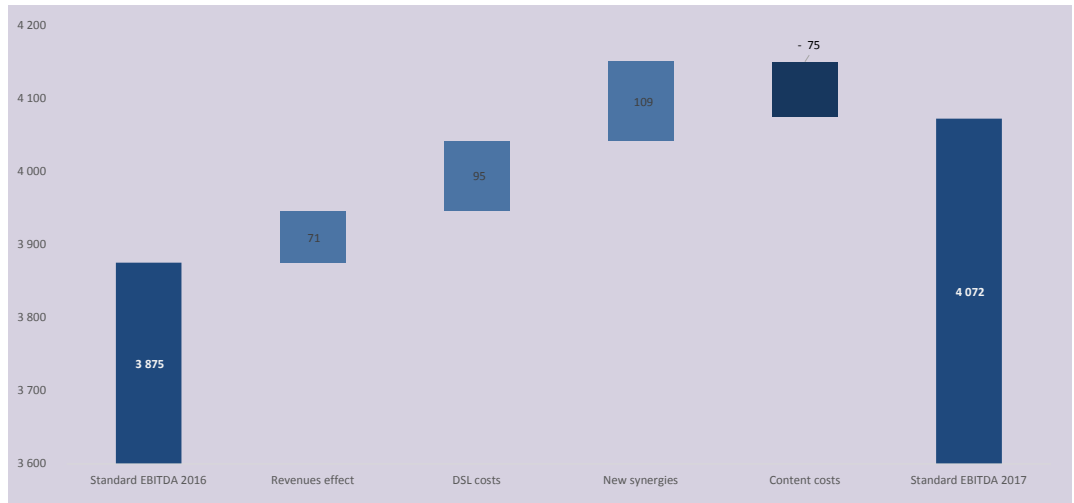
The table below presents a valuation of all of the above-mentioned factors and a switch from 2015 EBITDA to 2016 and 2017 estimated EBITDA (with “standard” EBITDA = EBIT before amortization and depreciation).

Fig. 28: Switch to EBITDA 2015 – 2016



Source: Company Data; Bryan, Garnier & Co ests.

Fig. 29: Switch to EBITDA 2016 – 2017



Source: Company Data; Bryan, Garnier & Co ests.

Under these assumptions, total fixed OPEX savings will reach **EUR800m** in 2017 (net of additional content costs and others), ie 20% of estimated 2014 pro forma fixed cost base. Savings on DSL costs will amount to **EUR261m**.

4.6. A new approach in contents

4.6.1. Diverse strategies

In terms of contents and the telecoms/media convergence, operators fall into two categories:

- Those in favour of a partnership approach.
- Those in favour of a vertical integration of "containers and contents".

The first are attached to the **diverse nature of the catalogue offered, an essentially variable economic model** (revenue share, distribution commissions, possible minimum guaranteed level), that is therefore **not very risky**, and to **the offer's flexibility**. The working in partnership model also helps entrust contents to companies benefiting from economies of scale and know-how in terms of **management of content owners relations**, helping to guarantee optimal price conditions. Note that this stance focused on partners in no way prevents the signing of exclusive deals over durations that are generally limited.

The second group takes more **financial risk** (investments in contents, fixed cost structures and break-even issues) but favour **editorial control**, play more on **exclusivities** and optimise the **integration of contents** in their environments and own platforms.

Fig. 30: Examples of partnerships in contents in the French market

Content Type	Content Partnerships
Music	Deezer (Orange), Spotify (Bouygues Telecom), Napster (NC-SFR)
Press	LeKiosk (NC-SFR)
TV channels	Canal+, Canal Sat, Beln, TF1, Groupe M6, AB, Disney, Lagardère, Turner (almost all operators)
VoD	Canal Play (Orange, Free, Bouygues Telecom), Netflix (Orange, NC-SFR, Bouygues Telecom)

Source: Company Data; Bryan, Garnier & Co.

Fig. 31: Examples of own content initiatives in the French market

Content Type	Owned contents
Press	Libération, Groupe L'express, Stratégies (Altice)
TV channels	OCS (Orange), MCS, Kombat Sport, NextRadio TV (Altice)
VoD	Zive (Altice)
Sport rights	Mobile Ligue 1 (Orange), Premier League, Porto Football club, French Basketball (Altice)

Source: Company Data; Bryan, Garnier & Co.

In the French market, all operators historically belong to the first category except Numéricable-SFR.

In the Vivendi era, no synergies existed between SFR and Canal+. Negotiations were particularly difficult between the two groups (as shown by the failure to sell on SFR's Pay TV business to Canal+ in 2013). Vivendi's principle was to maximise the two groups' interests, each in their own domain,

thereby maximising the overall interest. The same philosophy goes for Bouygues, where there are no contents/container synergies between TF1 and Bouygues Télécoms. Orange, apart from a few initiatives with mixed outcomes (Orange Sport, OCS, Orange Ligue 1 in portability, Dailymotion), remains focused on a primarily partner-based approach to contents.

Numericable, and then Numericable-SFR under the impetus of Altice, has taken a different route. Altice was built on the consolidation in cable, which was historically a Pay-TV offer before being an internet access offer. As such, in the group's genes and its marketing strategy, it has a high presence in contents.

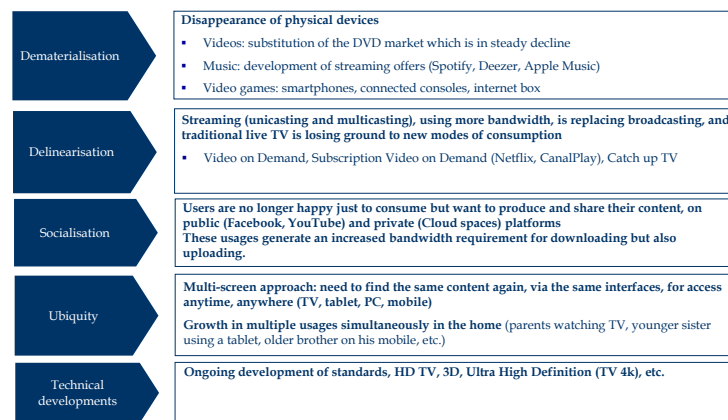
This strategy has been seen in recent months in the following events:

- **A landline range built on moves upscale via TV contents** (and speeds), positioning NC-SFR's know-how in terms of publishing pay TV bouquets at the heart of the new pairing's value strategy.
- **Significant investments in sporting rights:** especially the UK football Premier League for EUR300m for the next three seasons (exclusive rights in France and Monaco), a broadcasting and sponsoring agreement for FC Porto for EUR475.5m over 10 years, an exclusive EUR50m partnership with the French basket ball authorities for the broadcasting of all competitions over five seasons.
- **The launch of a directly operated SVoD offer** (Subscription Video on Demand): Zive, boasting a catalogue of 10,000 programmes out to end H1 2016, including some in 4k. The offer is available in subscriptions based on Power offers, or otherwise available for EUR9.99 a month.
- **Communication focused on contents:** the partnership with Cristiano Ronaldo, personifying the group's sport contents, a TV clip and the SFR website homepage focused on contents.
- **Acquisitions or partnerships with new groups and media** at Altice: partnership with NextRadioTV (radio, free TV), acquisition of Libération, l'Express – L'Expansion group and Stratégies in particular.

4.6.2. A new paradigm

Encouraged especially by NC-SFR and Altice's initiatives in contents, we have witnessed position changes by a certain number of players in recent months, with the **telecoms/media convergence paradigm returning to the limelight**. Several reasons underpin this change, concerning both the nature of the new digital contents offered, as well as changes in modes of consumption, as shown in the table below.

Fig. 32: Change in contents and digital uses



Source: Bryan, Garnier & Co.

As such, Orange has announced a future seminar for its executive committee focused on the question of contents, while Vivendi has placed four representatives on the Board of Directors of Telecom Italia. Numerous other examples illustrate this rebirth in the paradigm as shown in the table below.

Fig. 33: Recent initiatives in telecoms/media convergence in Europe

Telecom Company	Illustration of latest media convergence initiatives
Proximus	Acquisition of Belgium football rights
Telefonica	Acquisition of Canal+ Spain, acquisition of Liga football rights
Orange Spain	Acquisition of Liga football rights
Vodafone	Acquisition of Liga football rights
BT	Acquisition of Champions' League football rights
Liberty Global	Acquisition of production firm All3media (JV with Discovery), investment in ITV
Altice	Launch of Zive, acquisition of Portuguese and English football rights
Telecom Italia	Vivendi acquires a 21,8% stake in the company, four board members
Comcast	Acquisition of NBCUniversal
AT&T	Acquisition of Direct TV

Source: Bryan, Garnier & Co.

In the case of NC-SFR, and more generally in the French market, **contents are vital for selling fibre**, which generates higher EBITDA. It is difficult to sell the interest of access at more than 100mbps without highlighting high-definition content, multi-screen and video streamlining possibilities. In contrast, it is easier to sell video contents with value added with a very high speed access offer. Hence the coherence in NC-SFR's strategy and its unique selling proposition (USP), playing on its clout in both very high speed infrastructure and contents.

We are no longer in the context prevailing in the early 2000s when the ability to monetise digital contents was virtually zero. However, it would still be unreasonable to see massive synergy opportunities in this new environment.

Value creation is not easy on the French market

4.6.3. Limited value creation

We are cautious on the synergies and financial impact of the content/container convergence strategy implemented by NC-SFR in France. Indeed, we believe that the effects could be limited over the medium term, for the following reasons:

- **The French market has a number of specific features:**
 - **France already has an abundant free and diversified TV offer**, with 26 channels available on TNT and more than 150 channels including in the basic TV bouquets of the operators' 3P offers. **The market addressable by pay TV is therefore naturally reduced** and additional pay TV contents should therefore provide exclusive content that is particularly differentiating and qualitative in order to attract customers.
 - **The French pay TV sector is struggling.** The Canal+ channels in France incurred losses of EUR264m of EBITA in 2015, with a loss of 405k customers, while BeIN Sports is thought to lose money also. This has prompted the necessary market consolidation around the exclusivity agreement between Canal+ and BeIN Sports. In this context, it is difficult for NC-SFR to fight efficiently and ensure the profitability of its investments in premium pay content.
- **The regulatory backdrop in France is restrictive**
 - French television services providers are **obliged to take part in the financing and production of cinema works**. These obligations weigh on the profitability of initiatives and damage flexibility in the offer. If the halt to a service implies a decline in audio-visual financing, the subject becomes political. Indeed, it seems politically difficult for Orange (especially since the French state is also a shareholder), to consider stopping OCS if it wanted to. In contrast, the new Zive service is not concerned by these restrictions. The service is provided by Altice, which is a Luxembourg company and NC-SFR is simply the distributor.
 - **Exclusivity agreements are closely monitored by competitions authorities.** This is shown by the exchanges between Orange and the competitions authorities in terms of OCS and Orange Sport in the 2010s, or the exclusivity agreement between Canal+ and BeIN Sports currently being examined by the authorities. The competitions authority notably reserves the right to note "cross" dominant positions between contents services and access services.
- With or without exclusivity agreements, **the business model is not clear.** Orange's experience in Orange Sport (halted in 2012) and in OCS (halt to exclusivity for Orange customers in 2012) show the difficulty in finding a profitable business model. This type of investment is by nature primarily made up of fixed costs and increases the **company's risk level** and break-even point. We have set out below the business case corresponding to the Altice/NC-SFR investment in UK football broadcasting rights.
- Marketing of these services requires a **change in approach**. Operators expanding in contents need to agree to provide the services **significant space in the various distribution channels**. Highlighting these services is bound to come at a cost for the operator's historical approach

focused on the sale of landline and mobile access. This also implies a **change in stance for store sales staff**: the use of contents such as USP, rather than proceeding via rebounds and option sales. While Numericable is historically experienced in this stance, this is not true of the thousands of historical SFR sellers for whom an accompaniment in implementing the change is necessary.

Business case: making investments in Premier League rights profitable

Altice has invested around EUR300m over three years for exclusive rights to the UK Premier League football tournament for France and Monaco. Two macro-scenarios for marketing are open to NC-SFR: **1/** high prices and a small base, or **2/** low prices and a wide base.

Fig. 34: Price strategies for making Premier League contents profitable



Source: Bryan, Garnier & Co.

The first scenario corresponds to a price of EUR9.99 including VAT offered as an option to the operator's 3P **broadband/landline** customers. In this case, we estimate the **take-up rate in the eligible customer base at 20%** in order to make the investments profitable, namely around 1m customers. This rate is particularly high and is unlikely to be achieved in addition to the optional pay TV services already subscribed to.

The second scenario corresponds more to the price approach noted at the group recently. In particular, Zive was included automatically in all of the NC-SFR upscale broadband offers, compared with a generalised price increase of EUR3 including VAT. **EUR2 including VAT would be necessary here for the whole estimated 3P subscriber base** in order to make the investment profitable. This seems difficult, in addition to the recent price increases implemented in the base, due to Zive in particular, and for a service reaching a smaller audience by nature. This approach also implies a **higher churn rate risk** for customers fed up with price increases and not interested in the new contents on offer.

The investment could also aim to be justified by a **better customer retention/acquisition rate**. Assuming a recurring margin on variable costs generated by a broadband customer of EUR16

Please see the section headed "Important information" on the back page of this report.

(including 50% in fibre), around 10% of the base would need to be retained in order to justify the investment. Again, this does not seem feasible.

In these conditions, and even if the various price approaches can combine, we consider it very likely that NC-SFR would have to **distribute more widely its sports offer in order to make its investment profitable**. We have adopted this scenario in our model and are forecasting a **neutral impact from investments in UK football on the group's EBITDA**.

While telecoms/media synergies do not seem obvious for all of the reasons mentioned above, the merger of telecoms and media activities is still interesting. Indeed, if the development of own contents by operators in the form of highly value-creating **vertical integration** may not seem possible, we could see a very attractive **diversification opportunity**. In a backdrop where the **risk of disintermediation** (cord cutting) by web players (GAFA in particular) is a real threat over the medium term, investing in contents could be a way for operators to maintain the link with customers and their usages, and thereby eliminate the **spectre of commoditisation** that is threatening the sector.

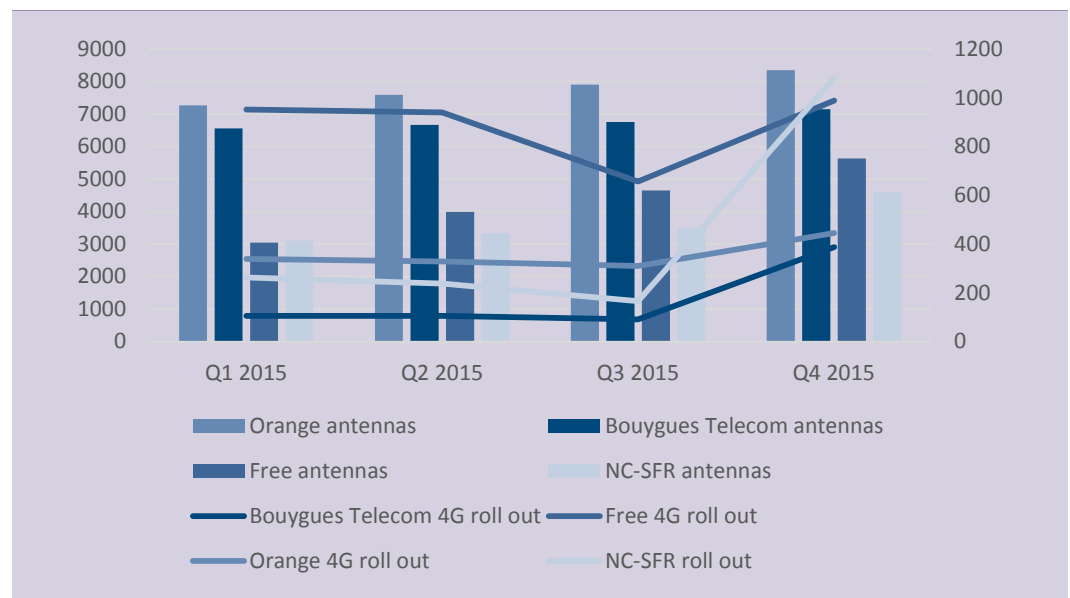
4.7. Strengthened investments

Beyond contents, we believe that fundamentals in the telecoms operator business remain key: network coverage, quality of services provided (availability, rapidity), innovation (very high speed).

Despite further capex savings plans (simplification of information systems, renegotiations and sourcing models etc.) a range of factors prompt the need to step up capex spending at NC-SFR in coming years:

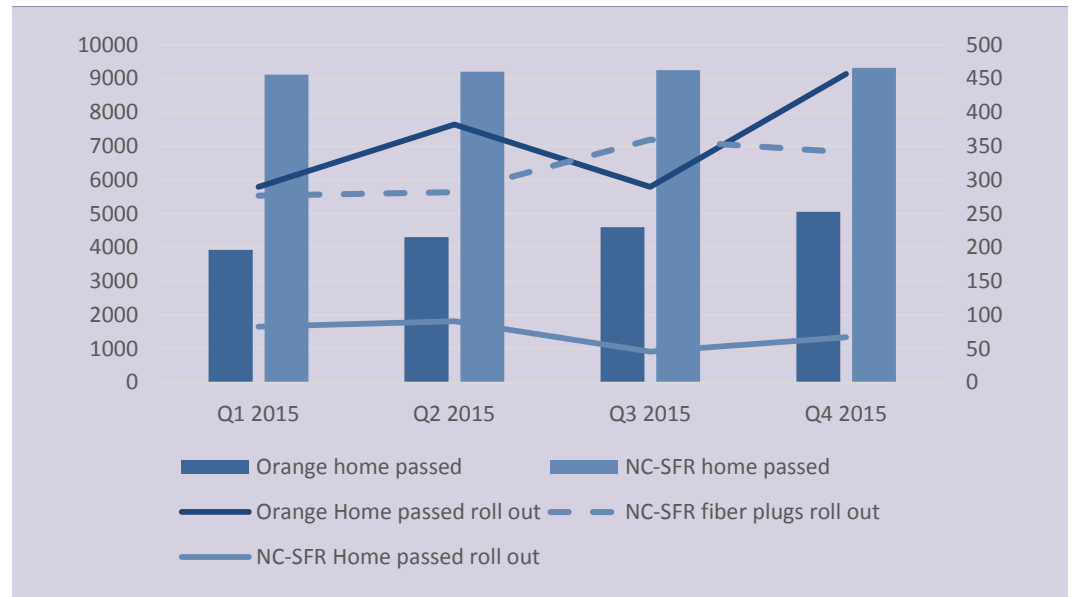
- The **regulatory backdrop**: vigilance of ARCEP concerning network sharing agreements and coverage of less dense 4G zones in particular.
- **4G**: NC-SFR needs to make up its delays in mobile, clocked up since 2014 in 4G coverage with a coverage rate of 65% of the population at end-2015, lower than Bouygues (75%) and Orange (80%). As shown in the chart below, NC-SFR had rolled out fewer 4G sites than the three other operators at end-2015, but its pace of roll-out increased massively in the last quarter. This intensification should continue in 2016 and 2017.
- **Fibre**: NC-SFR needs to continue the race for leadership in fibre and maintain this key competitive edge for as long as possible relative to Orange, which has stepped up its roll out in recent quarters, exceeding NC-SFR in terms of the pace of openings of new fibre plugs as shown in the table below. NC-SFR has also announced it would like to extend its very high speed footprint over 12M by 2017, and 18M by 2020.

Fig. 35: Comparison of 4G roll-out (sites in service and roll-out pace)



Source: Agence Nationale des Fréquences (ANFR)

Fig. 36: Comparison of very high speed roll-out at Fixe NC-SFR and Orange



Source: Company Data; Bryan, Garnier & Co ests.

The following table sets out our estimates for change in capex over 2016-2018

Fig. 37: Evolution of pro forma NC-SFR CAPEX

	2014	2015	2016e	2017e	2018e
CAPEX (without licenses)	1894	1856	2240	2240	2000
% of rev.	16,6%	16,8%	20,7%	20,6%	18,1%

Source: Company Data; Bryan, Garnier & Co ests.

5. Appendices

Fig. 38: P&L NC-SFR 2015 – 2018

	FY 2013	FY 2014	FY 2015	FY 2016e	FY 2017e	FY 2018e
Revenues	1 314	2 170	11 039	10 808	10 886	11 054
COGS and operating expenses	(645)	(1 390)	(6 357)	(6 019)	(5 918)	(5 839)
Labour costs	(155)	(261)	(877)	(832)	(813)	(813)
other non recurrent operating income & expenses & provisions	46	50	(314)	(82)	(82)	(82)
restructuring costs and restatements	56	137	368	107	98	82
Adjusted EBITDA	616	706	3 860	3 982	4 171	4 402
Adj EBITDA %	46,9%	32,5%	35,0%	36,8%	38,3%	39,8%
Standard EBITDA			3 492	3 875	4 073	4 320
Depreciation and amortization	(304)	(461)	(2 554)	(2 262)	(2 263)	(2 165)
EBIT	256	108	937	1 613	1 810	2 155
financial result	(324)	(600)	(46)	(712)	(667)	(620)
Revenues	10	15	782	0	0	0
Gross Debt costs	(185)	(439)	(781)	(712)	(667)	(620)
Other financial costs	(149)	(176)	(47)	0	0	0
income tax	133	313	(215)	(258)	(327)	(439)
Mise en équivalence	0	4	4	6	6	6
consolidated net income after tax	65	(175)	682	649	822	1 102
non controlling interests	0	0	7	9	9	9
consolidated net income (group share)	65	(175)	675	640	812	1 092

Source: Company Data; Bryan, Garnier & Co ests.

Fig. 39: Cash Flow and net debt NC-SFR 2015-2018

	FY 2015	FY 2016e	FY 2017e	FY 2018e
Standard EBITDA	3 563	3 875	4 073	4 320
Cash taxes	- 240	- 258	- 327	- 439
Delta Working Capital from OPEX	- 322	- 428	- 72	- 206
Others	134	-	-	-
Cash flow from operations	3 135	3 190	3 674	3 675
CAPEX (incl licenses)	- 2 370	- 2 473	- 2 357	- 2 117
Delta Working Capital from CAPEX	446	-	-	-
Others	192	-	-	-
Cash flow from investing activities	- 1 732	- 2 473	- 2 357	- 2 117
Dividends	- 2 516	-	-	-
Interests paid	- 605	- 712	- 667	- 620
Capital increases, loans, debt repayments and others	1 363	-	-	-
Cash flow from financing activities	- 1 758	- 712	- 667	- 620
Cash Flow	- 355	5	650	938
Net debt	14401	14396	13746	12808
% Adj EBITDA	3,73	3,62	3,30	2,91

Source: Company Data; Bryan, Garnier & Co ests.

Fig. 40: Net adds and ARPU assumptions

	2013	2014	2015	2016e	2017e	2018e
Mobile BtoC postpaid Net adds	- 252 727	- 399 544	- 243 205	- 9 585	- 9 585	- 9 585
Mobile BtoC postpaid ARPU	29,0	26,6	25,9	25,5	25,7	26,1
YoY Growth		-8,2%	-2,8%	-1,3%	0,9%	1,4%
Landline BtoC net adds	- 4 218	- 224 421	- 135 000	- 96 110	- 52 001	- 52 001
of which DSL	- 71 790	- 491 483	- 627 045	- 810 740	- 1 066 623	- 1 066 623
of which Fibre		67 572	267 062	492 045	714 630	1 014 623
Landline BtoC ARPU	34,3	34,1	35,1	36,3	37,4	38,0
YoY Growth		-0,7%	3,0%	3,5%	3,0%	1,8%

Source: Company Data; Bryan, Garnier & Co ests.

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