BRYAN, GARNIER & CO

INDEPENDENT RESEARCH

12th October 2016

TMT

Bouygues

Do not forget construction!

Fair Value EUR35 (price EUR29.52)

BUY
Coverage initiated

Bloomberg	EN FP
Reuters	BOUY.PA
12-month High / Low (EUR)	37.3 / 25.0
Market capitalisation (EURm)	10,246
Enterprise Value (BG estimates EURm)	12,491
Avg. 6m daily volume ('000 shares)	872.8
Free Float	37.8%
3y EPS CAGR	27.1%
Gearing (12/15)	81%
Dividend yields (12/16e)	5.42%

YE December	12/15	12/16e	12/17e	12/18e
Revenue (EURm)	32,428	31,906	32,822	34,018
EBITA EURm)	668.0	748.0	1,145	1,387
Op.Margin (%)	2.1	2.3	3.5	4.1
Diluted EPS (EUR)	1.18	1.04	1.93	2.42
EV/Sales	0.39x	0.39x	0.38x	0.37x
EV/EBITDA	5.2x	4.7x	4.3x	4.0x
EV/EBITA	18.7x	16.7x	11.0x	9.0x
P/E	25.0x	28.3x	15.3x	12.2x
ROCE	3.1	2.9	5.3	6.5

We are initiating coverage of Bouygues with a BUY recommendation and a fair value of EUR35. In our view the current share price factors in the reassuring outlook for Bouygues Telecom but under-estimates the positive trends linked to the construction activities. Supported by these two activities, Bouygues should return to FCF generation of around €900m by 2019. Without taking into account a possible consolidation move for the telecoms market in France.

- In construction, the Bouygues Group should benefit from the combination of several favourable factors: a gradual improvement in road works in France, whose cycle seems to have bottomed out (market down by -1% YTD, August up by 15%), together with the positive effect of FAST in the United States; the ramp-up of Grand Paris infrastructure project (EUR30bn of works by 2030) for the Construction division; and the prevailing very strong trends for property development (Bouygues H1 2016 reservations +22% in France), for which the Group is the co-leader in France. Almost all the entities should report higher operating margins as of 2016.

- In telecoms, Bouygues Telecom could prove capable of exceeding its EBITDA margin target of 25% by 2017 in our view, driven by a positive trading backdrop and strong sales growth, enabling FCF generation of around EUR300m by 2019. However, constrained by a net annual capex budget limited to €800m, Bouygues Telecom will continue to suffer from a long-term structural deficit in the optical fibre market, and thus profitability under pressure, limiting the EBITDA margin below 30% by 2020.

- Furthermore, in our view the stock is no longer pricing in the real **opportunity for telecoms consolidation** in France despite the fact that this still remains **possible over the medium term.**

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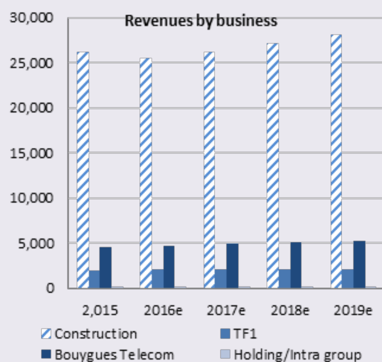

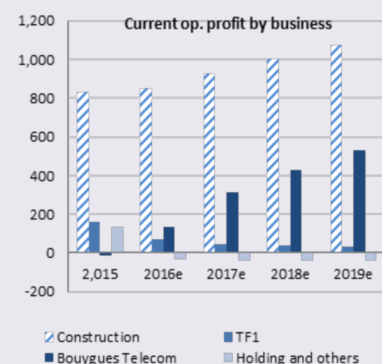

Company description

With more than 120,000 employees, Bouygues is a leading French construction company with operations in more than 100 countries via Bouygues Construction, Bouygues Immobilier and Colas. It is also present in the telecoms (Bouygues Telecom) and media (TF1) sectors, and holds a 29% stake in Alstom. The percentage of employee shareholders is particularly high with 28.6% of the voting rights at 31/12/15, alongside the family holding company controlled by Martin and Olivier Bouygues (27.9%).

Simplified Profit & Loss Account (EURm)	**2014**	**2015**	**2016e**	**2017e**	**2018e**	**2019e**
Revenues	33,138	32,428	31,906	32,822	34,018	35,058
Change (%)	*-%*	*-2.1%*	*-1.6%*	*2.9%*	*3.6%*	*3.1%*
Adjusted EBITDA	2,418	2,411	2,637	2,888	3,136	3,355
EBIT	1,133	668	748	1,145	1,387	1,550
Change (%)	*-%*	*-41.0%*	*12.0%*	*53.0%*	*21.2%*	*11.7%*
Financial results	(301)	(269)	(246)	(226)	(230)	(230)
Pre-Tax profits	1,252	598	592	1,057	1,310	1,477
Tax	(188)	(118)	(191)	(315)	(397)	(453)
Minority interests	257	77.0	40.6	77.0	77.0	77.0
Net profit	1,064	480	401	742	913	1,024
Restated net profit	1,064	480	401	742	913	401
Change (%)	*-%*	*-54.9%*	*-16.5%*	*85.2%*	*23.1%*	*-56.1%*
Cash Flow Statement (EURm)						
Operating cash flows	2,266	2,270	2,576	2,885	3,139	3,024
Change in working capital	8.0	203	145	9.6	(3.2)	(297)
Capex, net	(1,362)	(1,890)	(1,678)	(1,656)	(1,716)	(1,737)
Dividends	(198)	(737)	(639)	(642)	(642)	(642)
Net debt	3,216	2,561	2,563	2,633	2,595	2,634
Free Cash flow	405	(13.0)	459	688	796	603
Balance Sheet (EURm)						
Tangible fixed assets	11,470	10,818	10,064	10,127	10,241	10,365
Intangibles assets	7,034	7,392	7,392	7,392	7,392	7,392
Cash & equivalents	4,144	3,785	4,181	4,111	4,149	4,110
current assets	16,364	15,590	16,570	16,917	17,520	18,238
Other assets	12,220	11,840	12,389	12,806	13,371	14,128
Total assets	34,868	33,835	34,027	34,436	35,153	35,995
L & ST Debt	8,308	7,562	7,755	7,755	7,755	7,755
Others liabilities	17,105	16,980	17,430	17,740	18,187	18,646
Shareholders' funds	9,455	9,293	8,842	8,941	9,212	9,594
Total Liabilities	34,868	33,835	34,027	34,436	35,153	35,995
Capital employed	13,619	13,035	12,416	12,585	12,818	13,239
Ratios						
Operating margin	3.42	2.06	2.34	3.49	4.08	2.34
Tax rate	(15.02)	(19.73)	(32.34)	(29.82)	(30.30)	(30.64)
Net margin	3.21	1.48	1.26	2.26	2.68	1.26
ROE (after tax)	10.28	5.12	4.77	8.78	10.76	11.74
ROCE (after tax)	5.93	3.09	2.90	5.28	6.52	7.16
Gearing	87.87	81.37	87.71	86.74	84.19	80.84
Pay out ratio	NM	NM	NM	NM	NM	NM
Number of shares, diluted	337,657	341,525	345,500	345,282	345,282	345,282
Data per Share (EUR)						
EPS	2.39	1.18	1.04	1.93	2.42	2.74
Restated EPS	2.39	1.18	1.04	1.93	2.42	1.04
% change	*-%*	*-50.6%*	*-11.7%*	*84.8%*	*25.8%*	*-57.0%*
BVPS	23.26	23.03	21.86	21.93	22.49	23.38
Operating cash flows	6.71	6.65	7.46	8.36	9.09	7.46
FCF	1.20	(0.04)	1.33	1.99	2.31	1.75
Net dividend	1.60	1.60	1.60	1.60	1.60	1.60

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

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1. Investment Case

Why the interest now?

Why the interest now?

In our view Bouygues Telecom has now proven its **ability to go it alone over the medium term** thereby **quashing short-term consolidation hopes**. On the other hand, we believe that the construction activities offer promising **prospects and opportunities** which merit greater appreciation: upturn in the road cycle in France, ramp-up of the Grand Paris infrastructure project, continued positive trends in property development…

Cheap or Expensive?

Valuation

We have a Fair Value of **EUR35** of which **66% underpinned by the construction activities,** and corresponding to a **18%** premium to the current share price. We believe that the stock is pricing in a realistic valuation level for **Bouygues Telecom**, **without factoring in any consolidation opportunity**, but is under-estimating the value of the construction activities and the **good prospects linked to the sector.**

When will I start making money?

Catalysts

The direction in the share price will be linked to: **1/**the continued **strong order book** in the construction activities **(+1% on a constant currency basis to end June 2016** to EUR29.5bn), not including the Monaco extension for EUR842m, **2/**a likely improvement in construction business margins **(+15/20bps** a year through to 2019), **3/** an **improvement in the competitive backdrop** for telecoms in France, **4/** the ability to monetise uses and content more effectively, **5/ consolidation** in the telecoms market in France

What's the value added?

Difference from the consensus

The consensus seems to have its **eyes riveted on the telecoms activities** and the **uncertainties** still prevailing in the sector, and has yet to fully capture the **attractive prospects for the construction sector.**

Could I lose money?

Risks to our investment case

The main risks to our scenario are as follows: **1**/potential losses on construction projects which are always possible even if it is the Group's business to manage this type of risk, **2**/a macro downturn, particularly in France, which would hit confidence and thus volumes in the different construction businesses, **3/** a further deterioration in the telecoms market in France, **4/** the worsening Bouygues Telecom's competitive disadvantage in optical fibre.

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2. Summary of the investment case

We have a Fair Value of **EUR35,** corresponding to a **18%** premium to the current share price. In particular, in our view the share price is not adequately pricing in the **good prospects linked to the construction activities.**

In the construction activities, the Bouygues Group should effectively benefit from a number of positive catalysts: **Bouygues Construction** (37% of current operating profit) should continue to benefit from the dynamic linked to the Grand Paris infrastructure project (EUR30bn of works through to 2030, including Eole), with (probably) a slightly lower level of competitive intensity thanks to the complexity of the works; **Colas** (37% of current operating profit) is well positioned to benefit from the ramp-up of the FAST infrastructure plan in the United States (22% of sales in North America) and especially the improvement in the road works cycle in France (51% of sales), which has bottomed out; **Bouygues Immobilier** (15% of current operating profit), number two with 11% of the new residential market will naturally benefit from an exceptional environment with the combination of historically low interest rates, a positive reception for the Pinel scheme and the reconfiguration of the Zero Interest Mortgage scheme; **Bouygues Energies & Services** is also likely to emerge from its relative anonymity through more acquisitions, mostly in international markets. The earnings growth is not necessarily impressive (**c.6.7% annual growth in current operating profit for 2015-19** and 9.5% in net income – for the three divisions combined), but it is regular (stable Bouygues Construction order book, predominance of maintenance at Colas, relative stability of the Bouygues Immobilier margin). The construction division should thus continue to play its role of FCF generator with more than EUR700m expected in 2019E.

Turning to Bouygues Telecom, the new **commercial relaunch strategy** combined with **on-going cost saving** plans is paying off with a return to revenue and EBITDA growth in the past year. In our view Bouygues Telecom looks to have **secured its near-term future** and demonstrated its ability to go it alone. We see the positive commercial trend of the past few months continuing, enabling the division to **exceed the official EBITDA margin target of 25% as of 2017**. Longer term, we nonetheless see the **operator's profitability remaining under pressure** in view of its size and the **lag** it will be difficult to make up for in **fixed line and optical fibre in particular**, penalising the operator when it comes to the achievement of its EBITDA margin target of 35%.

Furthermore, in our view the Bouygues share price is not pricing in **any hopes of a telecoms market consolidation in France.** While we don't include this eventuality in our Fair Value, we do believe that it continues to represent a **real medium-term opportunity** which is likely to support the price of Bouygues Telecom in the wake of any commercial shortcomings. Neither the **rationale for such a consolidation nor the merger scenarios** have gone away, whether it involves dusting off the deal already envisaged with **Orange** earlier this year, or a merger with **SFR**.

We thus deem our "stand-alone" valuation for Bouygues Telecom to constitute a **floor**. Were Bouygues Telecom to see a significant deterioration in its outlook, the eventuality of a consolidation move would then gain traction, meaning that a **materially higher transactional valuation** could then replace one based on the intrinsic value of the business.

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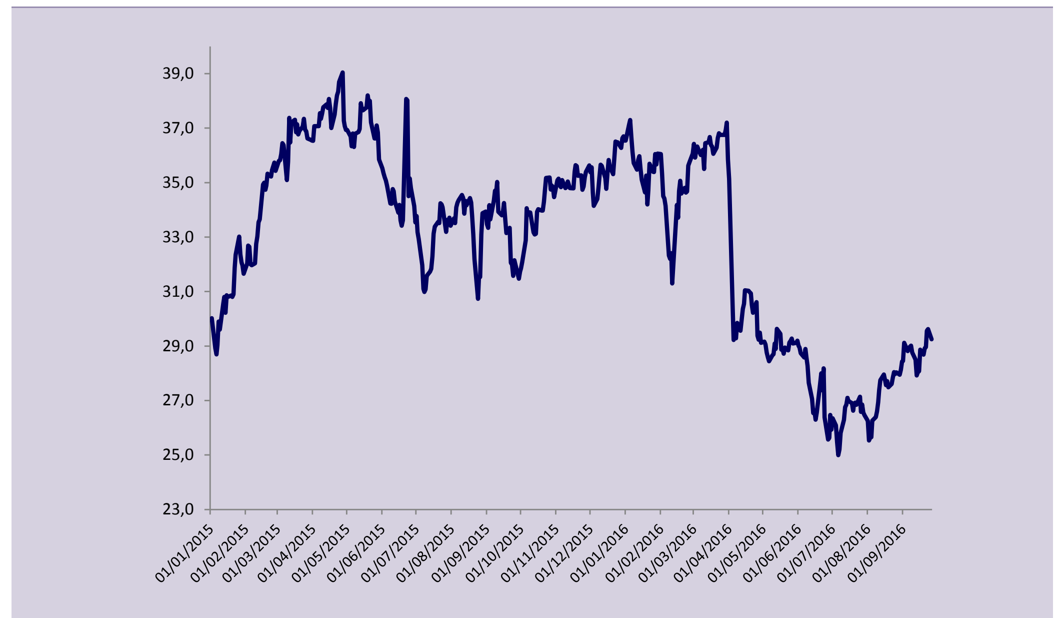
3. Valuation

3.1. Share price performance

The following chart shows the Bouygues share price since the beginning of 2015 and its fluctuation as a function of the negotiation periods regarding a consolidation move for the telecoms market in France.

Fig. 1: Trend in the Bouygues share price since early 2015



Source: Thomson Reuters.

The Bouygues share price has recently returned to **levels close to those of early 2015**. The **commercial relaunch of Bouygues Telecom** in mobile, a possible merger with **SFR** (mid 2015) and **Orange** (early 2016) contributed to supporting the price in 2015 and early 2016 prior to the **breakdown of negotiations** in early April.

The following chart also shows the trend in the Bouygues share price since the beginning of 2016, together with that of the CAC40, Stoxx Europe 600 Telecom and Stoxx Europe 600 Construction & Materials indices.

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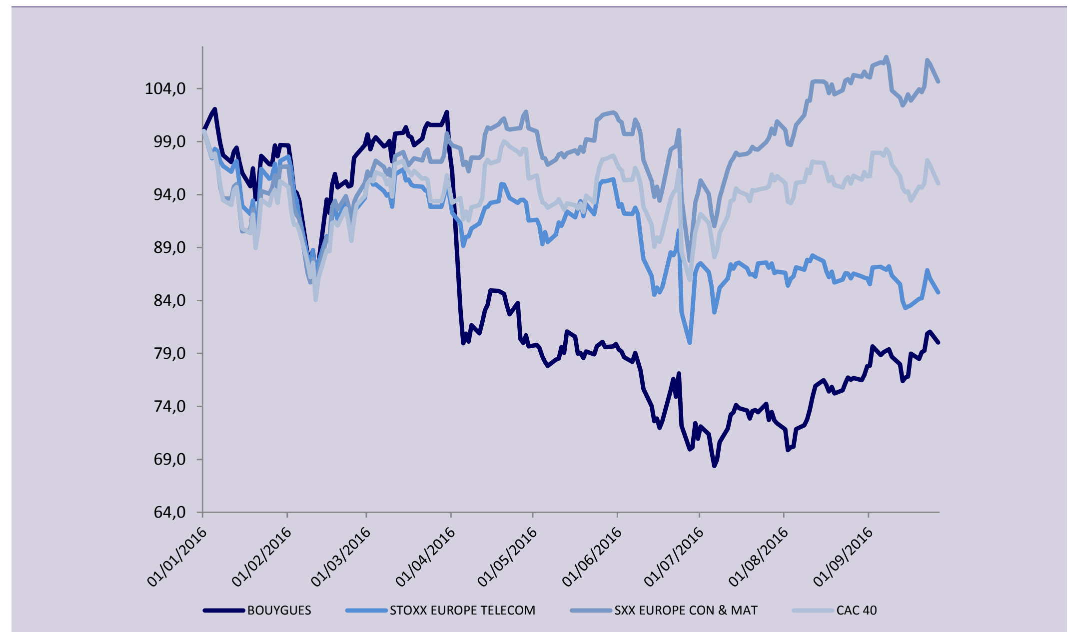
Fig. 2: Trend in the Bouygues share price relative to the main benchmarks (base 100)



Source: Thomson Reuters.

Bouygues **outperformed the indices in early 2016**, under the effect of **telecom consolidation hopes**, before collapsing in early April. In the past few weeks the shares have played catch up with the **CAC40 and Stoxx Europe 600 Telecom indices**, driven by the **good results from Bouygues Telecom**, and have **performed in line with the Stoxx Europe 600 Construction & Materials index**, **capturing the improved outlook** for the construction businesses.

3.2. Summary

Our Bouygues valuation is derived from **a sum of the parts** which applies the following methodologies:

- Bouygues Construction, Bouygues Immobilier and Colas: **multiples**.
- TF1: **stock market valuation.** Our valuation is based on the current market capitalisation of the TF1 Group, to which we add the net cash and financial assets to estimate the total enterprise value**.**
- Bouygues Telecom: **DCF**
- Alstom and other financial shareholdings: valued at current market values.

The valuation summary is presented in the following table.

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Fig. 3: Summary of the Bouygues Group valuation.

	Total Group	Bouygues Constr.	Bouygues Immo.	Colas	TF1	Bouygues Telecom	Holding
EV	**14315**	**2327**	**1257**	**3057**	**1574**	**6331**	**-231**
- net debt	-2563	3187	1	587	133	-1131	-5339
+ Financial assets	2572	287	15	710	120	10	1430
-minority interests	-1760	-36	-3	-36	0	0	0
- Provisions	-494	-135	-75	-284	0	0	0
Equity (M€) - 100%		**5629**	**1195**	**4035**	**1827**	**5210**	**-4140**
% detention	100,0%	100,0%	100,0%	96,0%	43,6%	90,5%	100%
Equity (M€) - Group share	**12070**	**5629**	**1195**	**3873**	**797**	**4716**	**-4140**
Nbre of shares (m)	346	346	346	346	346	346	346
Fair Value (EUR)	**35**	**16,3**	**3,5**	**11,2**	**2,3**	**13,6**	**-12,0**
Current stock price	29,7						
Up/downside	**18%**						

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

The financial assets include, notably, the 28.3% stake in Alstom for EUR1.43bn, and the 32% stake in Tipco Asphalt for €283m. We value the costs of the holding company at 7x the 2016 current operating profit (average multiple for construction activities), but without adding a holding company discount.

Indeed, we view Bouygues as an **industrial group**, which started in construction and then diversified into Media and Telecom, **not as a financial holding**. We view the group's diversification as an asset, allowing to **smooth its risk profile**, making each activity stronger than it would be standing alone.

Our Fair Value thus points to a 18% premium relative to the current share price. At this stage it is important to note that **our Fair Value does not include any premium linked to a potential consolidation move in the telecoms market.**

To establish whether this premium is linked to the construction activities or to Bouygues Telecom, we then attempt to **break down the current Bouygues market capitalisation between its different activities** as follows:

1/ Firstly, we position ourselves on the few weeks having preceded the breakdown of the merger discussions between Bouygues Telecom and Orange, the period during which we deem the market to have been largely pricing in the anticipated transactional value for Bouygues Telecom. Here we use an implied equity value of EUR7.2bn for Bouygues Telecom (group share). Taking the TF1 share price at the time and using our current assumptions on the holding company, we derive an implied market capitalisation for the construction activities of around EUR8.5bn at the end of March.

2/ Secondly, over the three first weeks in April following the failure of the Telecom market consolidation, we assign 100% of the share price decline to the Telecom activities.

3/ Thirdly, to transition from end April to the present, we update the value of the construction activities based on the comparatives over the period (evolution of STOXX EUR 600 Cons & Mat), i.e. an increase of 4%, and update the value of TF1 based on the current share price. We then derive an implied valuation of Bouygues Telecom within the current Bouygues share price of around EUR4.8bn (equity value, group share).

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The following table shows the results obtained.

Fig. 4: Breakdown of the Bouygues market capitalisation by activity

Bouygues MKT cap. Breakdown	Share price (EUR)	Total MKT Cap (EURm)	Constr.	Telecom	TF1	Holding
1/ Including consolidation hopes (last 3 weeks of March 2016)	36	12624	8472	7254	1038	-4140
2/ Post breakdown of merger talks with Orange (3 first weeks of April 2016)	30	10465	8472	5095	1038	-4140
3/ Current	29.7	10291	8811	4824	797	-4140
BG Fair Value	**35**	**12070**	**10697**	**4716**	**797**	**-4140**
FV vs Current	**18%**	**18%**	**21%**	**-2%**		

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

To conclude this analysis, it would appear that the current Bouygues share price **1/ no longer captures any significant hopes of consolidation in the telecoms sector** and thus no corresponding premium on Bouygues Telecom, **2/** values Bouygues Telecom on a basis **close to our estimates, 3/ undervalues the construction activities**. In our view, this state of affairs may be the result of **too much attention being focused on the telecoms business**, to the **detriment of the construction activities**, leading to an under-estimation of their quality and hence of their value.

3.3. Valuation of the construction activities

3.3.1. Introduction

As for Vinci and Eiffage, we apply EBIT multiples to the construction and property businesses. These are either transaction (bottom of the range usually) or sector peer group multiples.

Fig. 5: Valuation of the construction activities – summary

EURm	Bouygues Constr.	Bouygues Immo.	Colas	Total activités de construction
EV	**2,327**	**1,257**	**3,057**	**6,641**
- net debt / + net cash	3,187	1	587	3,775
+ Financial assets	287	15	710	1,012
-minority interests	-36	-3	-36	-75
- Provisions	-135	-75	-284	-494
+/- other adj.	0	0	0	0
Equity	**5,629**	**1,195**	**4,035**	**10,859**
EBIT	362	180	382	924
EV/EBIT	6.4	7.0	8.0	7.2

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

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The following table shows the valuation multiples for the main construction stocks in Europe. Since the strategies pursued, and thus the businesses, are so different, this is for illustrative purposes only. It is impossible to compare the PEs of a Vinci, the world leader in concessions, an Asltadi, which is essentially a building company and a Bouygues, the only player in this sample (to our knowledge) to have ventured into the telecoms arena.

Fig. 6: Multiples for construction stocks in Europe

Contractors		EV/Sales			EV/EBIT			P/E	
x	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
BOUYGUES	0.5	0.4	0.4	17.6	14.5	9.9	20.6	19.2	14.3
VINCI	1.2	1.3	1.3	12.1	11.8	11.6	18.1	16.0	14.8
BILFINGER	0.5	0.2	0.3	19.5	-14.5	20.2	12.8	NM	34.9
BOSKALIS	1.5	1.3	1.3	8.7	11.3	13.5	9.2	15.3	18.1
NCC 'B'	0.5	0.4	0.4	10.8	12.4	10.6	11.3	17.0	15.1
FCC	1.1	1.2	1.1	20.7	19.2	16.3	45.2	30.9	25.0
YIT	0.7	0.8	0.7	12.9	19.3	12.3	16.4	24.9	14.3
CIMIC GROUP	0.6	0.7	0.6	9.2	10.9	10.3	17.8	17.9	16.6
ACS	0.3	0.4	0.3	7.1	7.3	6.8	11.7	11.7	10.8
Eiffage	1.3	1.4	1.3	12.5	12.6	11.7	20.1	16.1	14.0
Ferrovial	2.1	1.5	1.4	23.0	20.1	21.3	18.2	31.3	28.2
Sacyr	1.7	2.0	1.8	34.6	24.8	21.6	2.7	10.6	7.1
HOCHTIEF	0.3	0.4	0.4	10.7	11.3	10.3	39.3	24.4	22.0
Obrascon	1.7	1.3	1.3	10.7	7.5	7.4	9.2	7.1	7.1
Mota-Engil	0.8	0.6	0.6	11.4	9.7	7.1	18.7	6.5	6.9
Skanska	0.4	0.5	0.5	10.6	11.3	10.9	17.1	15.9	16.2
Balfour Beatty	0.1	0.2	0.2	-6.9	21.2	9.7	NM	24.4	16.5
Carillion	0.3	0.4	0.3	6.4	7.0	6.7	7.2	7.3	7.0
Strabag	0.1	0.2	0.2	4.7	6.9	7.0	20.1	12.9	12.7
Astaldi	0.5	0.4	0.4	5.6	4.5	4.1	4.0	4.2	3.1
Salini Impregilo	0.5	0.3	0.2	7.9	6.0	4.6	15.7	13.4	8.7
Median	**0.5**	**0.5**	**0.5**	**10.7**	**11.3**	**10.3**	**16.7**	**16.0**	**14.3**

Share prices on 9/10/16
Source: IBES, Bryan, Garnier & co

3.3.2. Valuation of Bouygues Construction

We value the construction activities and Bouygues Energy & Services separately.

- We apply sector multiples for the construction business, i.e. 6x the 2017e EBIT. This is slightly below a median multiple for our sample (cf. table below) but a simple average excluding Hochtief and Balfour Beatty, whose multiples are higher (reflecting in our view notably the diversification strategy), gives an EBIT multiple in line with our assumptions.

- For the electrical/energy engineering and services to industry businesses, the range in transaction multiples is fairly wide: 9x EBIT for the acquisition of Emil Lundgren by Vinci in 1999, 10x 2015 EBIT for that of Cegelec by LBO France in 2006, 12.5x the 2005 EBIT for that of Spie by PAI or even 11x EBIT (estimated based on a 5% margin). Spie is currently trading at close multiples of close to 10x. We nonetheless apply a forward EV/EBIT of 9x, knowing that it is a business whose weight in the Bouygues sum of the parts is modest and, especially, the fact that it does not generate the same level of margin as a Vinci Energies or a Spie, hence the small discount.

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

Fig. 7: Valuation

EURm	Valorisation
EV/EBIT FW Building (x)	6.0
EV/EBIT FW Energy (x)	9.0
EBIT FW (2017) Building	311
EBIT FW (2017) Energy	51
EV Building	1,865
EV Energy	461
EV	**2,327**
Debt/Cash	3,187
Plus financial assets/associates	287
Less minorities	36
Less provisions for pensions	135
Plus/less other adj.	0
Equity	**5,629**

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

Fig. 8: Sector multiples – Energies & Services

Energy		EV/Sales			EV/EBIT			P/E	
x	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
SPIE	0.9	0.7	0.6	15.1	11.1	10.0	13.9	14.1	13.0
CAPE	0.5	0.5	0.5	7.2	9.1	8.2	7.2	9.0	8.2
CAVERION	0.5	0.4	0.3	17.8	39.6	11.2	18.2	30.9	14.9
ELTEL	0.6	0.5	0.5	15.0	13.9	10.4	11.8	15.5	11.9
Median	**0.6**	**0.5**	**0.5**	**15.1**	**12.5**	**10.2**	**12.8**	**14.8**	**12.4**

Share prices on 9/10/16
Source: IBES; Bryan, Garnier & Co ests

In the energies and services to industry businesses, the multiples for Spie (EUR5.3bn of sales, France), Cape (United Kingdom GBP700m of sales in 2015), Caverion (EUR2.4bn of sales, Finland) and ELtel (EUR1.3bn of sales, Sweden) are presented above. Admittedly these stocks are not perfect comparatives for Bouygues Energy & Services, but they do give an idea of the possible multiples for the sector. Our chosen valuation multiple of 9x EBIT might seem conservative but the size and profitability of the Bouygues subsidiary do not rank it amongst the most efficient players in the sector.

Fig. 9: Sector multiples – Construction

Contractors		EV/Sales			EV/EBIT			P/E	
x	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
HOCHTIEF	0.3	0.4	0.4	10.7	11.3	10.3	39.3	24.4	22.0
Balfour Beatty	0.1	0.2	0.2	-6.9	21.2	9.7	NM	24.4	16.5
Carillion	0.3	0.4	0.3	6.4	7.0	6.7	7.2	7.3	7.0
Strabag	0.1	0.2	0.2	4.7	6.9	7.0	20.1	12.9	12.7
Astaldi	0.5	0.4	0.4	5.6	4.5	4.1	4.0	4.2	3.1
Salini Impregilo	0.5	0.3	0.2	7.9	6.0	4.6	15.7	13.4	8.7
Mota-Engil	0.8	0.6	0.6	11.4	9.7	7.1	18.7	6.5	6.9
Median	**0.3**	**0.4**	**0.3**	**6.4**	**7.0**	**7.0**	**17.2**	**12.9**	**8.7**

Share prices on 9/10/16
Source: IBES; Bryan, Garnier & Co ests.

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

In the construction businesses, we have selected the least diversified construction stocks, and particularly those whose level of diversification remains limited. We exclude stocks like Skanska, whose property development arm (all segments) accounts for 44% of the 2015 EBIT, Ferrovial (whose construction activities contribute less than half of its sales), ACS, OHL, etc.

On the other hand, we include the following stocks: Hochtief, Balfour Beatty and Carillion (with one snag given their PPP portfolios), Strabag (which also includes concessions and property), Astaldi, Salini Impregilo and Mota Engil. We derive a median 2017e EV/EBIT multiple of 7x. We nonetheless continue to use a multiple of 6x, our sample including several stocks whose multiples are probably inflated by other activities like property and private public partnerships.

3.3.3. Colas valuation

We currently value Colas at a multiple of 8x the 2017e EBIT. This is slightly higher than the multiple we have hitherto applied (7x), in that **1)** the environment for road works is expected to see a considerable improvement in France in the coming quarters/years, which should be reflected in a normalisation of the competitive environment, **2)** Colas benefits from fairly specific exposure to North America (22% versus 10% for Eurovia at Vinci), where the outlook linked to FAST is particularly strong **3)** Colas also benefits from its status as a global leader. In any case, 8x remains realistic: Bouygues currently holds 96.6% of the Colas share capital but, in July 2000, the construction Group launched a Public Exchange Offer on the shares it did not own in the road subsidiary, i.e. 43.18% - and paid over 8x EBIT, adjusted for Cofiroute. It is worth adding that, in 2004, Vinci valued Eurovia based on multiples of around 7x EBIT. Nonetheless, in 1999, the Entreprise Jean Lefebvre minorities were purchased on the basis of 6x EBIT.

Furthermore, we also take into account the Colas financial assets, and particularly the 31.8% stake in TIPCO Asphalt, which is listed on the Bangkok stock market.

On the basis of a 2017e EBIT of EUR382m, the Enterprise Value stands at EUR3bn, and the Equity at EUR4bn, versus around EUR4.4bn based on the current share price. Our Colas valuation thus remains significantly below the level of the current share price. This is due to the fact that, in our view, the very small free float (less than 4%), combined with a degree of speculation (relating to a possible offer from Bouygues for the minorities) considerably pollute the share price.

Fig. 10: Valuation of Colas

EURm	Valuation
EV/EBIT FW Roadworks (x)	8.0
EBIT 2017	382
EV	**3,057**
Debt/Cash	587
Plus financial assets/associates*	710
Less minorities	36
Less provisions for pensions	284
Plus/less other adj.	0
Equity	**4,035**

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

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

Fig. 11: Valuation of the financial assets owned by Colas

EURm	FY15	H116
JV/associates in the Colas balance sheet	307.0	317.0
Less TIPCO Asphalt book value	84	92
plus TIPCO Asphalt market value	283	283
Other financial assets (mostly financial receivables)	212	202
Revalued financial assets	**718**	**710**

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

3.3.4. Valuation of Bouygues Immobilier

We apply sector multiples, namely the EBIT multiples of the listed property development companies Nexity and Kaufman & Broad. Admittedly the sample is limited, but these sector multiples are fairly stable over time.

Fig. 12: Valuation

EURm	Valuation
EV/EBIT FW Property dev. (x)	7.0
EBIT FW (2017)	180
EV	**1,257**
Debt/Cash	1
Plus financial assets	15
Less minorities	3
Less provisions for pensions	75
Plus/less other adj.	0
Equity	**1,195**

Source: IBES; Bryan, Garnier & Co ests.

Fig. 13: Sector multiples

Property dev.		EV/Sales			EV/EBIT			P/E	
x	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
NEXITY	0.7	0.6	0.6	9.3	8.1	6.7	20.4	19.0	15.9
KAUFMAN	0.6	0.8	0.7	6.9	9.5	8.6	20.0	15.4	12.8
REALITES	-	-	-	6.8	10.4	7.0	-	10.7	8.2
Median	**0.6**	**0.7**	**0.6**	**6.9**	**9.5**	**7.0**	**20.2**	**15.4**	**12.8**

Share prices on 9/10/16
Source: IBES; Bryan, Garnier & Co ests.

3.4. Valuation of Bouygues Telecom

Our DCF model values the Bouygues Telecom equity at **EUR5.2bn**, for a total enterprise value of **EUR6.3bn.** We thus value Bouygues Telecom at **6.9x our 2016e EBITDA**, for a **2016-18 CAGR of 15.3%**, whereas the European operator average is a multiple of **7.5x 2016e EBITDA for a 2016-18 CAGR of 6.6%**.

Our model is based on the following assumptions:

- We factor in **no positive** effects linked to a possible sector consolidation in France.
- **Sales:** we are forecasting average annual sales growth of **4.0% over 2016-19** (of which 4.6% in 2017, vs 1.6% in 2015 and 4.5% in 2016), driven by a **continued strong commercial performance** and a **deceleration in the pace of ARPU decline** for fixed and mobile.
- **EBITDA:** EBITDA growth is expected to remain strong in the next few years, averaging **15.0% over the 2016-19 period** (of which 19.9% in 2017, vs 8.4% in 2015 and 21.9% in 2016), mostly driven by growth in the customer base and the on-going cost saving plans.
- **CAPEX maintained at an annual EUR814m over the long term**, net of any infrastructure sales (particularly pylons and antennas), and excluding the acquisition/payment of licences.
- **WCR:** we include the EUR116m payment for the 700MHz licence at the end of 2016, then a further EUR116m in 20017 and EUR116m in 2018.
- **We use a pre-tax cost of net debt of 4.2%, and a tax rate of 34.3%.**
- We apply a discount rate of **6.81%**, with a beta of **1.0**, corresponding to a Bouygues two-year historic beta vs the CAC40, increased by 0.2 to isolate the telecoms business (for comparison, we use a beta of 0.8 for Iliad, 0.95 for Orange, 1.1 for SFR and 1.2 for Altice). We also use a risk premium of **7.0%** and a risk-free rate of **1.6%**.
- Our growth rate to perpetuity is **1%**.

Fig. 14: Calculation of the discount rate

Inputs	
Risk Free rate	1.6%
Market risk premium	7.0%
Β	1,0
Cost of Equity	**8.46%**
Cost of Debt after taxes	2.8%
Gearing	41%
WACC	**6.81%**

Source: Bryan, Garnier & Co ests.

Fig. 15: DCF model

EURm	2015	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e
Sale	**4505**	**4707**	**4925**	**5120**	**5273**	**5431**	**5539**	**5595**	**5651**	**5707**	**5764**	**5822**
Change in sales		4,5%	4,6%	4,0%	3,0%	3,0%	2,0%	1,0%	1,0%	1,0%	1,0%	1,0%
EBIT	**-134**	**36**	**211**	**381**	**477**	**517**	**544**	**557**	**571**	**585**	**600**	**614**
As % of sales	-3,0%	0,8%	4,3%	7,4%	9,0%	9,5%	9,8%	10,0%	10,1%	10,3%	10,4%	10,5%
Tax rate	34,0%	5,3%	26,5%	34,3%	34,3%	34,3%	34,3%	34,3%	34,3%	34,3%	34,3%	34,3%
Net Op. Profit after Tax	**-88**	**34**	**155**	**250**	**313**	**339**	**357**	**366**	**375**	**385**	**394**	**403**
+ D&A and prov.	898	899	908	858	858	861	863	865	866	867	868	872
Cash flow from op.	810	933	1063	1108	1171	1200	1220	1231	1242	1252	1262	1275
- Net investments (incl. Freq.)	-822	-1084	-930	-930	-814	-814	-814	-814	-814	-814	-814	-814
- change in WCR	-84	4	-39	-17	-14	-14	-10	-5	-5	-5	-5	-5
Free cash Flow	-96	-147	94	162	344	372	396	412	423	433	443	456
Discounted FCF		-144	86	139	276	280	279	272	261	250	240	231
Sum of disc. FCF		**2168**										
+ disc. terminal value		**4162**										
- net debt		-1131										
+ financial assets		10										
Valuation		**5210**										

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

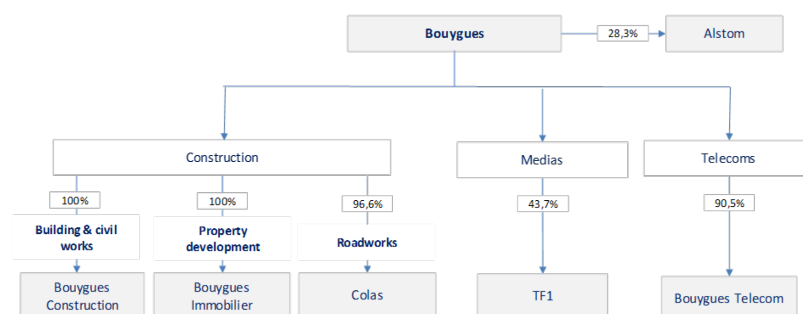
Please see the section headed “Important information” on the back page of this report.

4. Bouygues Group: presentation

4.1. Activities and strategy

The Bouygues Group has three main businesses: construction and public works with Bouygues Construction, Bouygues Immobilier (property development) and Colas (transport infrastructure and, in particular, roads), media with the TF1 Group and telecoms with Bouygues Télécom. Bouygues also owns a 28.3% stake in the Alstom Group whose business is focused on rail transportation.

Fig. 16: Structure of the Bouygues Group and the main activities



The construction activities currently generate 80% of the Group's sales and 88% of current operating income, and are also the biggest contributors to free cash flow generation (before WCR and payment for telecoms licences), notably since the difficulties encountered by Bouygues Telecom following the arrival of Free Mobile on the market in early 2012.

Fig. 17: Breakdown of the Group's financial results by business

	2011	2012	2013	2014	2015	2011-2015 CAGR
Revenues (net of intra Group)	**32706**	**33547**	**33345**	**33138**	**32428**	**0%**
Construction	24375	25753	26275	26515	25963	
TF1	2620	2621	2470	2243	2004	
Bouygues Telecom	5741	5226	4664	4432	4505	
Holding & others	120	123	119	128	135	
Current operating income	**1819**	**1286**	**1344**	**888**	**941**	**-15%**
Construction	1020	949	1030	841	831	
TF1	283	258	223	143	158	
Bouygues Telecom	561	122	125	-65	-11	
Holding & others	-45	-43	-34	-31	-37	
Free Cash flow before change in WCR and frequencies	**862**	**724**	**821**	**397**	**251**	**-27%**
Construction	605	812	821	437	487	
TF1	150	161	149	52	65	
Bouygues Telecom	208	-89	25	138	-125	
Holding & others	-101	-160	-173	-230	-176	
Net Debt (+ = net cash)	**-3862**	**-4172**	**-4427**	**-3216**	**-2561**	**-10%**
Construction	3404	3281	3316	3785	3837	
TF1	-40	237	188	497	701	
Bouygues Telecom	-581	-650	-783	-765	-890	
Holding & others	-6645	-7040	-7148	-6733	-6209	

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

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

Concerning the foundations of the Group's present strategy, we would point to the following three key points:

- **A resolute diversification strategy,** which enables the Group to absorb difficult environments in some of its businesses.
- The **maximisation of the interests of the individual businesses in their capacity as autonomous entities,** rather than a rationale based on vertical integration, cross-selling and synergies. For example, Bouygues Immobilier does not prioritise Bouygues Construction for the construction of its property development programmes, while Bouygues Telecom and TF1 do not benefit from exclusive partnerships. In the construction businesses, a partnership rationale may be put in place when this constitutes an advantage within the framework of a response to a call to tender.
- A **strong social dimension**, illustrated in particular by a workplace dialogue which is a key management focus and by employee shareholders owning 21.4% of the share capital at the end of H1 2016 (and 28.6% of the voting rights).

4.2. Shareholder structure and governance

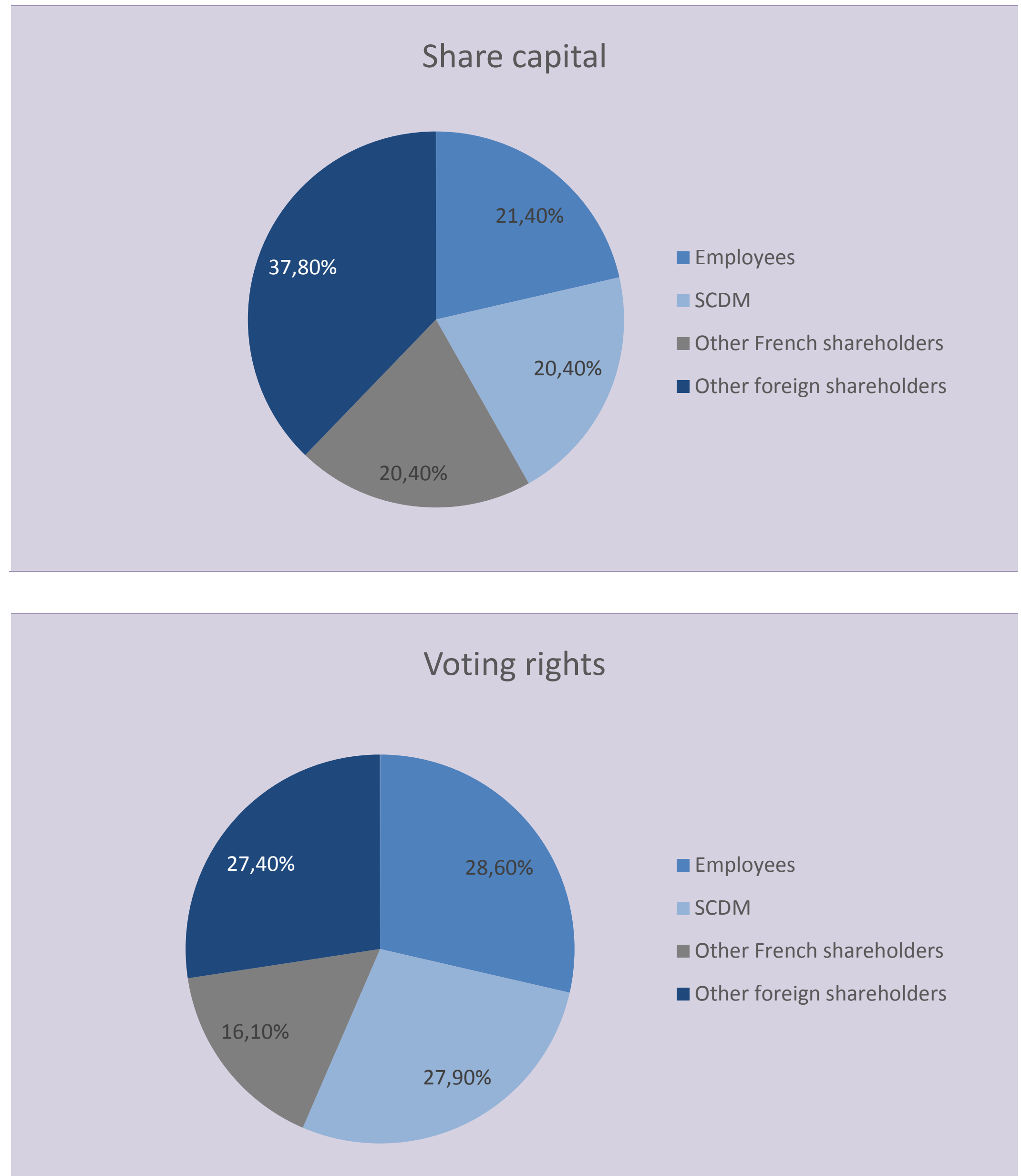
Bouygues is **20.4% held** (27.9% of the voting rights) by the company SCDM, itself controlled by **Martin and Olivier Bouygues**.

Martin Bouygues, 64 years old, is the Group's Chairman and Chief Executive Officer. Olivier Bouygues, who is two years older than his brother, is Deputy Chief Executive Officer. Two new Deputy Chief Executive Officers were appointed in August 2016: Philippe Marien, Chief Financial Officer and Senior Vice-President, Human Resources, Information Systems and Innovation for the Group, and Olivier Roussat, Chairman and Chief Executive Officer of Bouygues Telecom. Martin Bouygues, who is planning his succession and who we expect to step down by 2018, also appointed his son Edward and nephew Cyril to the Group's Board of Directors in April 2016.

Martin Bouygues likes to surround himself with a close-knit team of experienced colleagues with a long-track record with the Group, all of whom share values similar to his own. While the successor to Martin Bouygues will no double seek to stamp his mark on the Group, in our view he will be the guarantor of a form of moral heritage and will continue the Group's management based on the same philosophy as Martin Bouygues.

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

Fig. 18: Bouygues shareholder structure (end 2015)



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

Amongst the non-French shareholders, the First Eagle fund owns 6.61% of the share capital and 5.21% of the voting rights.

For the past ten years, the Bouygues Group has paid its shareholders a stable annual dividend of €1.6 per share.

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

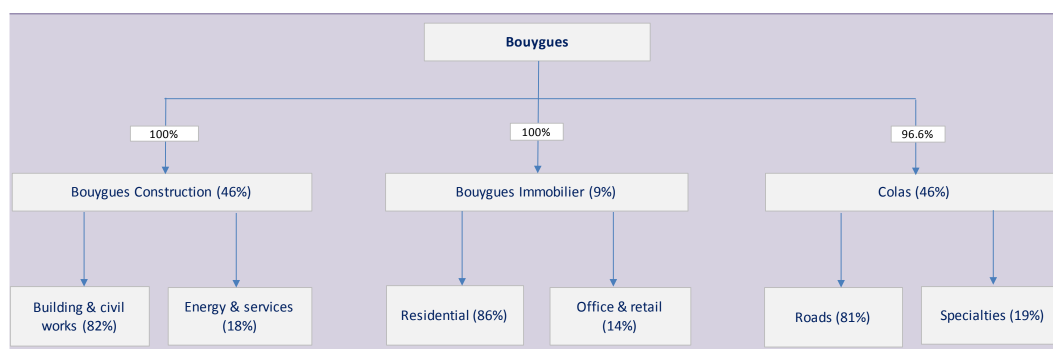
5. Construction activities: c.90% of current EBIT

5.1. Similar to Vinci and Eiffage but some differences

The construction activities contributed 80% of the Bouygues Group's sales, 88% of EBIT and 61% of cash flow in 2015.

The Bouygues construction activities regroup three divisions: Bouygues Construction, Colas and Bouygues Immobilier. In 2015, this historic business was to generate 80% of sales, 88% of current EBIT and 61% of the Group's consolidated cash flow. The bulk of FCF is also generated by these activities which are, moreover, in a net cash position. We would also highlight the fact that these are activites which traditionally require little or even no invested capital. Only Colas has a significant level of assets, mainly in the form of aggregate quarries, construction equipment and asphalt and emulsion plants.

Fig. 19: Simplified organisational chart for the Bouygues construction activities*



** In brackets: percentage of divisional sales*
Source: Company Data; Bryan, Garnier & Co ests.

Fig. 20: 2015 key figures

EURm	*Building & civil works*	*Energy & services*	Bouygues Construction	Bouygues Immobilier	Colas	Total contracting	in % of consol.
Revenues	*9,857*	*2,118*	11,975	2,304	11,960	26,239	80%
Revenues (net of intra-group)			11,776	2,291	11,896	25,963	80%
Current EBIT	*292*	*57*	349	138	344	831	88%
Margin (%)	*3.0*	*2.7*	2.9	6.0	2.9	3.2	
CF (rep.)	*395*	*72*	467	120	670	1257	61%
Capex			-214	-13	-311	-538	28%
FCF, as reported	*113*	*41*	154	61	272	487	-225%
Net debt	*-3,131*	*-141*	-3,272	-5	-560	-3,837	-150%

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

Bouygues differentiates itself from the other two French construction companies Vinci and Eiffage in several ways:

Concessions are not a priority

1) The size of its concessions portfolio, which is far more modest than those of Eiffage and expecially Vinci. At the end of 2015, the Group did not participate in the privatision of the three large French

motorway concession companies (ASF, APRR and Sanef), arguing that these assets bore more relation to financial assets. Thus within Bougues there are no issues with non-recourse debt or relating to political risk and no significant contribution from concessions at EBIT level. Furthermore, the Group seems to prioritise minority stakes in this business: it holds 45.85% in Adelac (A41 North in the Haute-Savoie, 20km), 33% in the Consortium Stade de France and 22% in Hermes Airports (concession on two airports in Cyprus), but has sold its 33% stake in ALIS (Autoroute de Liaison Seine-Sarthe, the A28) and its 48.6% stake on the concession company for the Riviera Marcory Bridge in Abidjan. Is this relatively modest exposure a handicap for the Bouygues Group? Not necessarily in our view but it is certainly is a powerful differentiating factor. Investors in Vinci and Eiffage will probably mostly be interested in the defensive aspect of these two companies with, particularly in the case of Vinci, a non-neglible bias towards growing the concessions portfolio. Investors in Bouygues will probably be looking more for upside potential, either via the rerating of the construction activities (which are currently being ignored, in our view, by at least part of the market) or by via a possible reconfiguration of the French telecoms sector.

An Energies division which is yet to take off

2) The electrical engineering (and related) and business services activities regrouped within Bouygues Energies et Services are not often showcased in that they are embedded within Bouygues Construction (as are the concessions) and are also fairly modest in size (EUR2bn of sales vs EUR3.6bn for Eiffage and more than EUR10bn for Vinci Energies) with a lower level of profitability (2.3% vs 5.6% and 3.7% for the Vinci and Eiffage divisions, respectively). However, this is a business which is destined to grow, particularly through targeted, mostly-international acquisitions. This is positive in that there is real potential to develop this activity and improve its profitability.

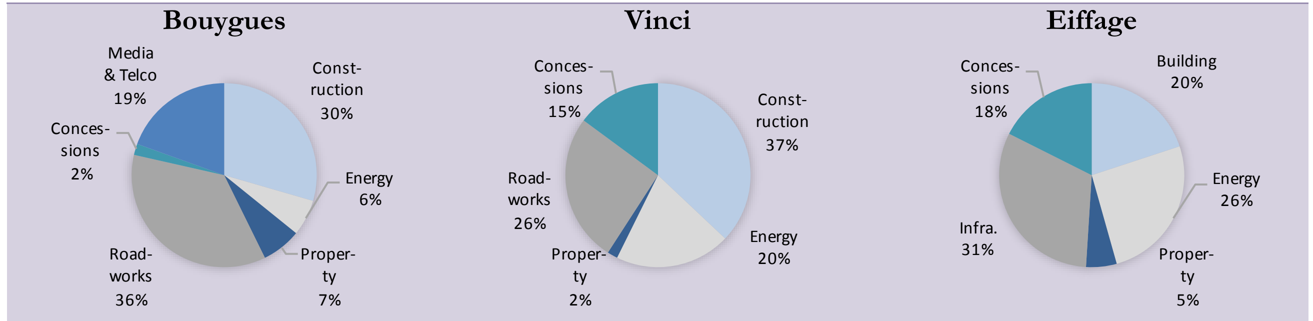
3) On the other hand, the Property division is far larger (EUR2.3bn of sales) at Bouygues than at Vinci (especially) and Eiffage (EUR700m and EUR740m, respectively). This business is also a fully-fledged division whereas it sits apart from the business units alongside the holding company at Vinci and inside the construction division at Eiffage.

A Property division whose size makes it one of the co-leaders in the French market.

4) Bouygues has a more international spread of business (**outside Europe**): 28% of sales versus 16% for Vinci and just 3% for Eiffage. The Group is known in particular for some of its projects in Asia and particularly in Hong Kong.

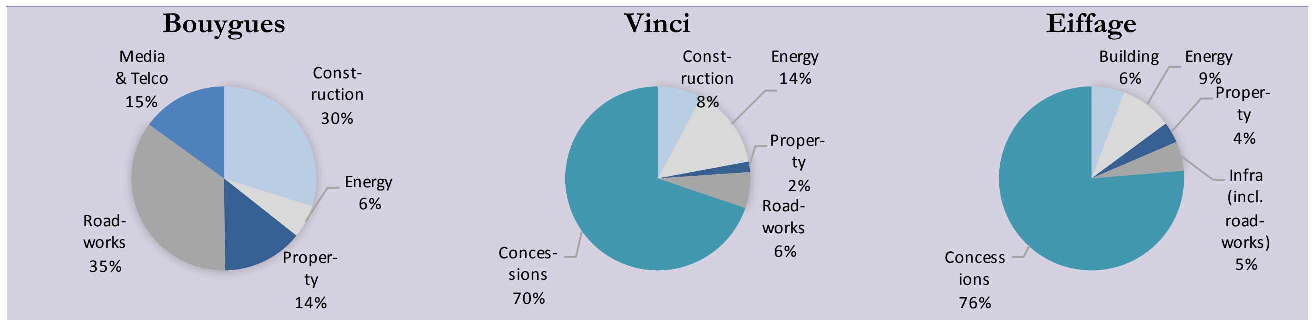
Please see the section headed "Important information" on the back page of this report.

Fig. 21: Breakdown of sales by division*



** before holding andt/or elimination when appropriate*
Sources: Bouygues, Vinci, Eiffage, Bryan, Garnier & co

Fig. 22: Breakdown of current operating profit by division*



** before holding and/or elimination, when appropriate*
Sources: Bouygues, Vinci, Eiffage, Bryan, Garnier & co

5.2. A positive outlook for all the businesses

5.2.1. A steady improvement in operating margin

In the construction businesses, we see the Bouygues strategy as, in some respects, fairly similar to that of a Vinci or an Eiffage. Admittedly, as we have seen, the business mix may be different but, fundamentally, the priority for all these construction companies is managing the construction cycles as effectively as possible: the focus is not on sales growth but rather on project selection so as to be able to manage risk and operating margins; diversification towards activities with a more technical bias which are particularly relevant outside France and, lastly, international markets to generate more growth. Combining a high level of technicality and international business is the right idea in that it enables Bouygues to compete on complex (and thus risky) projects where the competition is less intense, enabling the negotiation of better prices – and ultimately the more effective management of the risk/return ratio while generating more top line momentum.

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

Fig. 23: Key figures for the construction activities

EURm	2013 PF	2014 PF	2015E	2016E	2017E	2018E	2019E
Sales B. Constr.	11101	11726	11975	11650	11825	12180	12545
Sales Colas	12845	12396	11960	11338	11474	11818	12173
Sales B. Immobilier	2510	2775	2304	2505	2918	3220	3388
Sales y/y% B. Constr.	4.3	5.6	2.1	-2.7	1.5	3.0	3.0
Sales y/y% Colas	-1.5	-3.5	-3.5	-5.2	1.2	3.0	3.0
Sales y/y% B. Immobilier	4.8	10.6	-17.0	8.7	16.4	10.4	5.2
Current operating profit B. Constr.	437	335	349	339	362	391	422
Current operating profit Colas	390	332	344	361	382	411	442
Current operating profit B. Immo.	178	174	138	153	180	200	212
Current op. margin (%) B. Constr.	3.9	2.9	2.9	2.9	3.1	3.2	3.4
Current op. margin (%) Colas	3.0	2.7	2.9	3.2	3.3	3.5	3.6
Current op. margin (%) B. Immo.	7.1	6.3	6.0	6.1	6.2	6.2	6.3
Net profit group share B. Constr.	277	254	276	283	308	327	346
Net profit group share Colas	312	604	234	274	331	352	373
Net profit group share B. Immo.	101	102	77	87	105	118	125
FCF (as reported) B. Constr.	331	199	154	229	236	249	262
FCF (as reported) Colas	378	154	272	266	349	399	451
FCF (as reported) B. Immobilier	110	84	61	93	107	119	126
Net cash (+) / debt (-) B. Constr.	3006	2900	3272	3187	3098	2993	2881
Net cash (+) / debt (-) Colas	31	682	560	587	650	711	801
Net cash (+) / debt (-) B. Immobilier	271	203	5	1	-3	-17	-38

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

Our forecasts factor in the above elements. We have very little sales growth in the construction activities but in our view the Group will be able to manage, and even slightly (and steadily) improve its operating margin. The Bouygues guidance by division is as follows:

- For the construction activities as a whole, the Bouygues Group expects an improvement in its operating margin in 2016 and 2017, but does not quantify this precisely (although it seems clear that this progression will be limited).
  - Bouygues Immobilier sales should grow in 2016 and the operating margin improve by several basis points. It is broadly stable in our model (annual 5bps increase) having seen a stready decline since 2010.

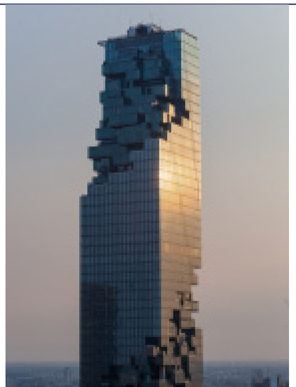
No top line growth in 2016. However, operating margins should increase by several tens of basis points in the road and property businesses.

- The Colas top line is likely to be penalised by scope and negative currency effects. The decline in sales (on an organic basis) is expected to approach 2%, negatively impacted by France, delayed calls to tender in Eastern Europe and the Fort McMurray forest fire in Canada. The Group confirms that the road works market in France is currently bottoming out after double-digit declines in 2014 and 2015. The operating margin is expected to improve despite the (limited) negative impact of the disposal of the Asian operations, whose operating margin is close to 8%, to Tipco Asphalt (Tasco). On the other hand, the closure of SRD in Dunkirk will have a positive effect on the current operating margin in 2016, the 2015 losses having had a cEUR77m negative impact on the current operating profit. We still expect some losses in 2016 but they will be booked as exceptionals. The Dunkirk site is currently being permanently shutdown, knowing that the 'oils' activity had been closed back in 2014. Lastly, it is worth reiterating that, in 2012, the Group launched a first road optimisation plan with the merger of three brands (Sacer, Screg and Colas) then, as of the end of 2013, a second plan to transform the organisation and operating modes, aimed at improving the operating margin over two years in a sustainably weak market. In any case, our forecasts include all the above.

- Bouygues Construction sales will be slightly down this year, consistent with the 1.6% fall in the order book at end June, not including negative currency effects mainly due to Sterling. The operating margin is likely to be stable in 2016 before seeing a gradual improvement as of 2017.

5.2.2. A risk profile under control

Manahakhon Tower



Source: Bouygues, Bryan, Garnier & co

We are not big fans (in stock market terms) of Bouygues Construction's major projects like the Monaco extension, the Hong Kong-Zhuhaï-Macao Bridge (the longest sea crossing in the world), the Baluarte Bridge in Mexico (situated 2,000m above sea level) and the (fascinanting) 'pixilated' Mahanakhon Tower in Bangkok. Admittedly these projects undeniably constitute a remarkable showcase for the Group's expertise and its ability to deliver on time, manage technical projects in challenging environments, contain costs and, more generally, make its mark in international markets.

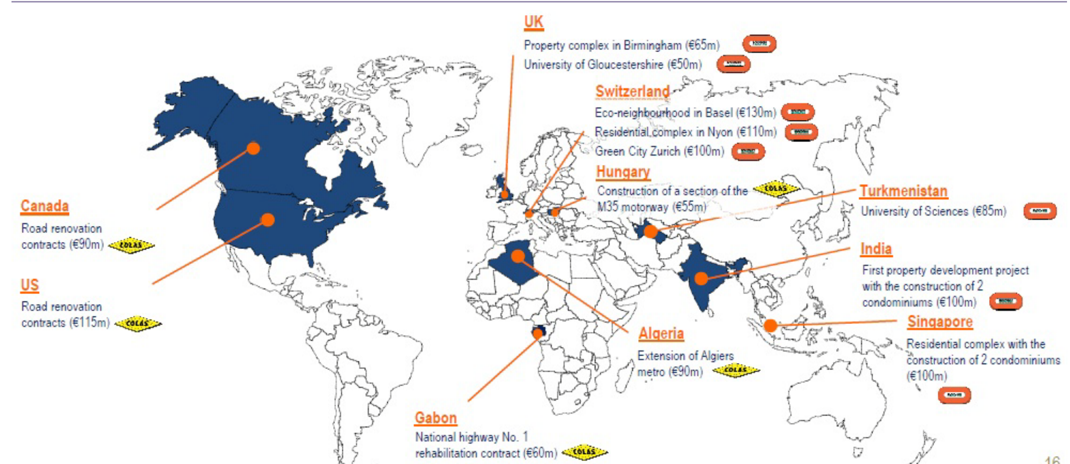
However, we perceive an element of risk here which is absent at Colas and, to a lesser extent, at Bouygues Energy & Services, where the cornerstone of the business comprises a multitude of small and medium-sized contracts: averaging EUR100k at Colas and probably around EUR20k at Bouygues Energies & Services (if we refer to the past data dislosed by Vinci for its Energies division). The level of risk is much lower in these businesses where operating margins are not necessarily more modest, on the contrary (but with a certainly higher level of capital intensity at Colas, where there are substantial mining assets).

We don't, however, want to give a false impression of Bouygues Construction. All the major order wins in international markets during the first half concern projects whose size does not exceed EUR130m. There is thus no reason to believe that the Group cannot manage its risk in that the very large projects outside France do not represent the bulk of the construction projects. Admittedly the Group has also signed a EUR200m contract to build the Alto Tower in La Défense and the Calais extension for EUR300m but these projects are situated in France (and moreover they are reasonable in size).

It is nonetheless worth bearing in mind that losses can arise on some construction projects and, in this event, are liable to have a material negative impact on the share price.

Concerning the Hinkley Point C project in the United Kingdom, Bouygues TP, in a JV with Laing O'Rourke, has been named 'preferred bidder' on several civil engineering tranches (worth around GBP2bn according to the press). The UK construction company welcomed the UK government's decision to approve the project. Nevertheless, Bouygues has not communicated recently on the subject and the project is not yet in the order book. In our view, this seems likely to be the case by the end of the year.

Fig. 24: Main international contracts signed in H1 2016



Source : Bouygues, Bryan, Garnier & co

We also had some concerns regarding the weight of property development within Bouygues, again for risk-related reasons. It should however be recognised that Bouygues has a real ability to manage its margin over the long term – more than groups like Nexity or Kaufman & Broad over the 2002-15 period, for example, even if its level of profitability is lower in absolute terms (see our comparison in the section on Bouygues Immobilier). This leads us to believe that the risk within Bouygues Immobilier is effectively contained. This is obviously a strength, while the profitability of these businesses is higher than that of the construction businesses.

5.3. Towards an upturn in the construction cycle in France

Most of the leading indicators and business surveys confirm that the sector is close to the bottom of the cycle in France, or has even been reached in some activities. This is true for virtually all the market segments and is naturally a strongly positive support for the whole sector, and particularly for the construction companies Vinci, Eiffage and Bouygues.

In France, construction is picking up while the decline in public works is slowing

On the construction materials side, the DLR (French National Federation of Distribution, Leasing and Maintenance companies for the construction and handling industries) indicators are also positively oriented: materials distributors posted y/y growth in sales of 32% in the Q2 (with however few participants in the DLR survey) and those of equipment leasing companies some 6%.

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

Fig. 25: Key indicators for France

y/y % unless otherwise stated	Q115	Q215	Q315	Q415	Q116	Q216	FY16e
Cement consumption (SFIC)	-9.9	-6.1	-7.0	1.2	1.9	-	flattish
Aggregates shipments (Unicem)	-14.7	-9.8	-8.4	-2.6	-0.7	-2.0	-1.0
RMX shipments (Unicem)	-10.1	-7.1	-7.4	0.3	0.9	-1.1	1.0
Bricks shipments (Unicem)	-10.4	-12.0	-8.5	-0.6	3.1	-0.2	-
Tiles shipments (Unicem)	-13.9	-4.3	-8.6	-4.7	2.6	-6.4	-
Total Materials	-	-8.2	-7.9	-0.6	1.5	-2.6	-
Lead indicators							
Housing starts (gov.)	-2.2	-0.9	5.1	4.4	4.3	5.4	-
Housing permits (gov.)	-10.7	4.4	2.4	14.6	6.7	12.1	-
Sales (reservations) (gov.)	18.6	28.0	20.4	11.0	17.7	18.7	15 to 20
Non-res. volumes (surface - starts)	-13.0	-8.2	-9.0	-2.9	9.9	-	-
By market segments							
New Residential (FFB)	-	-	-	-	-	-	5.5
New Non-residential (FFB)	-	-	-	-	-	-	-5.3
New	-	-	-	-	-	-	1.6
Renovation (FFB)	-	-	-	-	-	-	0.4
Total Building (FFB)	-	-	-	-	-	-	0.9
Public works (FNTP)	-12.0	-6.0	-7.0	-	0.0	0.0	-3.0
o/w RoadWorks (URSIF)	-22.1	-11.7	-12.1	-	0.0	-2.5 for H1	-1.5

Sources: Unicem, SFIC, FFB, FNTP, CAPEB, INSEE, URSIF, French Ministry of Ecology, Bryan, Garnier & Co

The materials distributors posted y/y growth of 32% in sales in the Q2 and equipment leasers 6%.

In public works in France, the opinion survey trends are consistent with the volumes of work realised. There has been a marked improvement in 2016. The French road industry association USIRF recently stated that sales for the road works sector in France rose by +15.3% y/y in August, i.e. a very limited fall of -1% YTD.

Fig. 26: Bottom of the cycle for Public Works

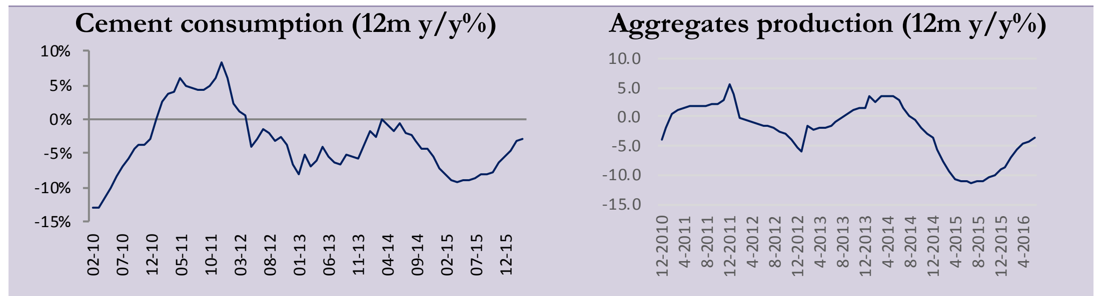
Sources: INSEE, FNTP, Bryan, Garnier & co

We are witnessing similar trends in the construction materials market. Cement consumption in France was up by +2% YTD (at end March) and aggregates production down by -1.6% at end June. While it is worth tracking these indicators, the Bouygues Group, as with Vinci and Eiffage, is to some extent able to 'beat the market' given their ability to win contracts which are not that accessible to companies which are more modest in size.

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

Aggregates production is improving but remained down at end June: -1.6% y/y in YTD and -3.5% over a rolling 12 months

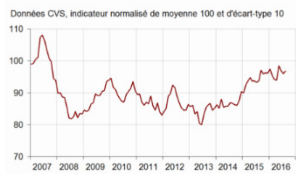
Fig. 27: Gradual recovery in the construction materials market



Sources: SFIC, Unicem, Bryan, Garnier & co

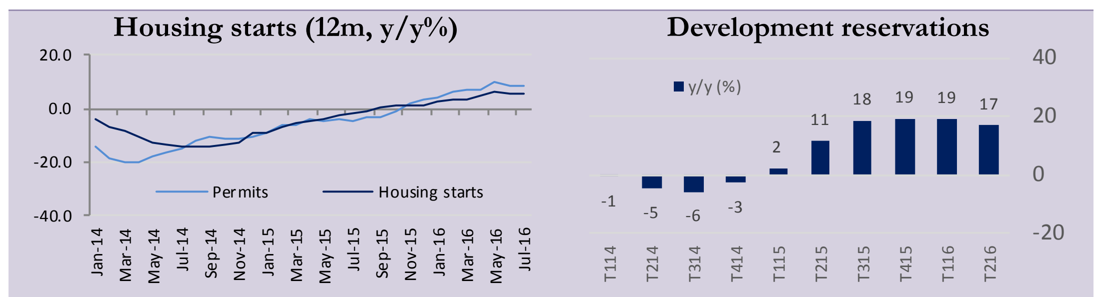
The new residential segment is clearly positively oriented, driven by a favourable environment: historically low interest rates, Pinel scheme, improved Zero Interest Mortage scheme and even a relatively robust household confidence index. All of this is being reflected in a very strong rebound in property development reservations. This is less the case for housing starts and permits although a gradual improvement is still very apparent. Bouygues Immobilier reservations were up by +22% y/y at end June in France, a performance slightly above that of the market.

Household confidence



Source: INSEE, Bryan, Garnier & co

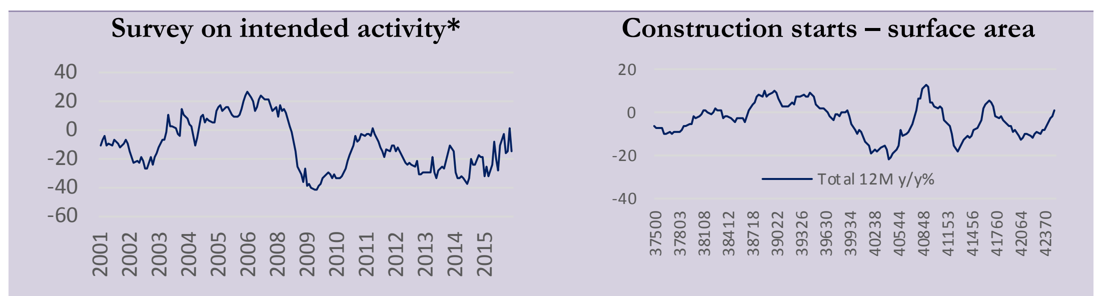
Fig. 28: Residential construction – very marked support from the Pinel scheme



Sources : Ministry for the Environment, Bryan, Garnier & co

Non-residential construction is also showing signs of a recovery. Construction starts were up by nearly 1% over a rolling 12 months at the end of May and the INSEE surveys are also fairly positively oriented.

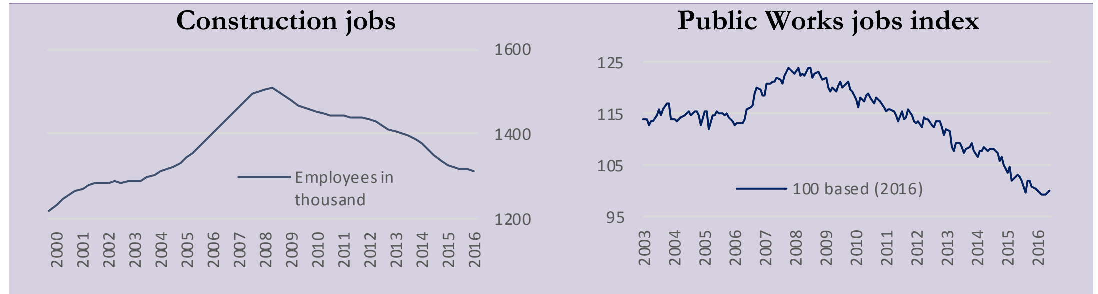
Fig. 29: A gradual pick-up in non-residential construction



** new non-residential excluding housing, adjusted for seasonal variations*
Sources: INSEE, Ministry for Equipment, Bryan, Garnier & co

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

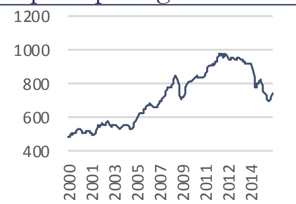
Fig. 30: Employment bottoming out



Sources: INSEE, FNTP, Bryan, Garnier & co

No surprise at the level of employment which remains under pressure. More recently we have seen some signs of stabilisation. All this would seem to confirm that we are probably close to the bottom of the cycle.

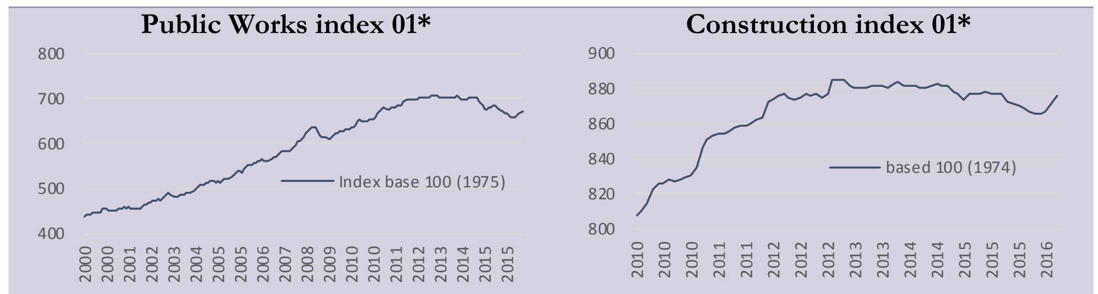
Public Works index of asphalt paving*



** rebased as of the October 2014 data*
Source: INSEE, Bryan, Garnier & co

Lastly, prices are stable overall. We need to bear in mind the fact that for road works in particular there has been a real drop. Half of the 10.5% decline in sales at Eurovia in Q1 2016 is explained by price reductions. Price falls also explain the pressure on operating margins (below 3% for Colas in 2014 and 2015).

Fig. 31: Stabilisation in prices



Re-based as of the October 2014 data
Sources: INSEE, Bryan, Garnier & co

6. Bouygues Construction

Bouygues Construction contributes 36% of Bouygues sales and 37% of current EBIT. Figures comparable to those of Colas.

6.1. A strong international presence

Bouygues Construction regroups the purely construction activities, i.e. the Construction and Public Works and Electrical Engineering businesses (amongst others), together with with Bouygues Energy & Services (formerly ETDE), which regroups the network infrastructure, facilities management and electrical and thermal engineering businesses. Bouygues Energy & Services contributes only 18% of Bouygues Construction's sales and 14% of EBIT. Furthermore, Bouygues Construction is even more international than Colas, with particularly high exposure to Asia and the Middle East (24% of sales). The Group is notably present in Hong Kong and Singapore.

The Group is organised around eight entities:

- Bouygues Bâtiment Ile-de-France, active in public equipment, private non-residential, housing and industrial engineering. This division includes, in particular, Brézillon but also the property developer *linkcity*;
- Bouygues Entreprise France-Europe, present outside the Paris region in France and in the neighbouring countries (Belgium, Switzerland, Monaco, Spain).
- Bouygues Bâtiment International, active world-wide.
- Bouygues Travaux Publics, present in France and internationally in civil engineering works.

An undisclosed concessions portfolio but certainly modest relative to that of Vinci

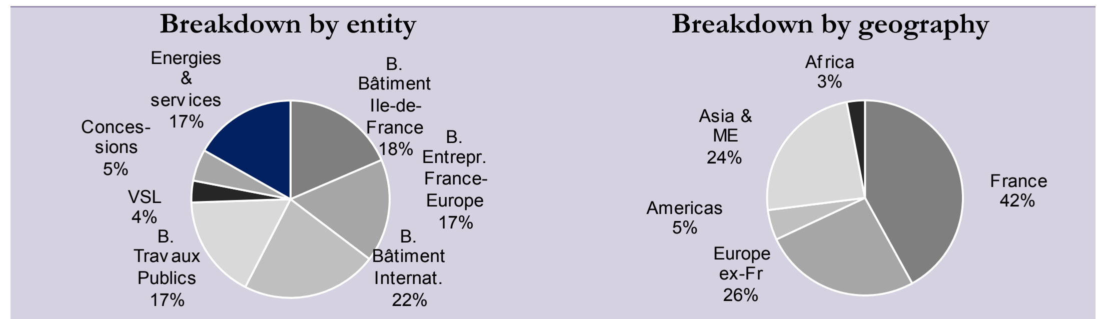
- Bouygues Concessions, which manages transport infrastructure globally. This is a smaller division than that of Vinci or even Eiffage. Remember that Bouygues chose not to participate in the privatisation process for the motorway concession companies in late 2005 and early 2006.
- Two specialised entities:
  - VSL, in pre-tensioning (which improves the load-bearing properties of concrete) and active in the cable-stay bridges and ground improvement markets,
  - DTP, in high-added-value terrestrial infrastructures (road works, open cast mines, etc.). The company directly owns some 1,300 pieces of equipment.

An Energies division in the making whose sales are 5x more modest than those of Vinci Energies and 1.8x those of Eiffage Energies – for an op. margin some 230bps and 140bps lower, respectively.

- Lastly, Bouygues Energies & Services, like Vinci Energies, Eiffage Energies and Spie, present in a wide range of activities: energy networks (electricity, water, gas, etc.) telecoms infrastructure (high speed internet, mobile networks, etc.), communication systems/IT (voice, data), public lighting, electrical (heavy current, low current…supplying electricity to customers though the design, installation and maintenance of electrical infrastructures) and climate (heating, air conditioning, ventilation) engineering, industrial maintenance, facility management (building maintenance, various services), illumination (historic monuments), security (video-surveillance, access control, etc.).

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

Fig. 32: Sales: a highly diverse mix of geographies and businesses

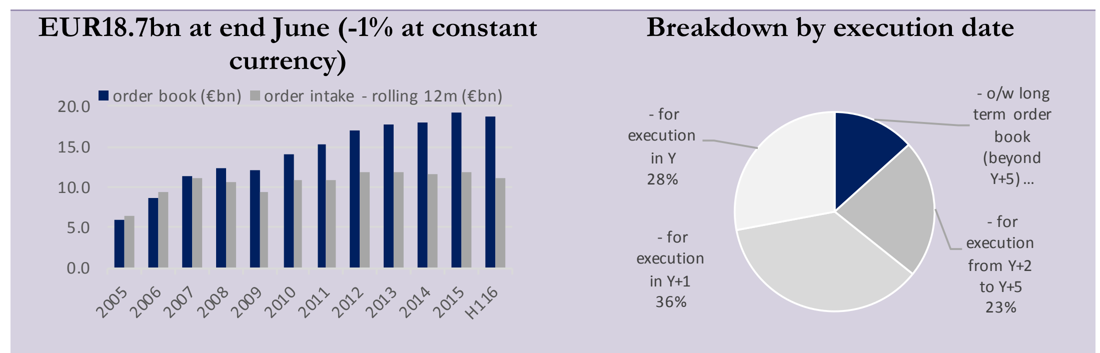


Source: Bouygues Construction, Bryan, Garnier & Co ests.

6.2. Awaiting Grand Paris

The order book was broadly stable (-1% y/y) at EUR18.7bn to end June 2016, of which 56% outside France. During the first half, order intake was down by 11%, although up by 5% excluding NorthConnex (twin-tube motorway tunnel realised in Australia in H2 2015 for EUR895m) and not very accurately reflecting the Group's present dynamic. Order intake is very volatile in nature and just one project can significantly impact the quarterly or even half yearly variations.

Fig. 33: Consolidation of the order book



Source: Bouygues Construction, Bryan, Garnier & Co ests.

It is worth highlighting, in particular, the fact that a number of very large contracts had not yet been included in the order book at end June 2016, and notably the firsr EUR840m tranche of the Monaco offshore extension contract. This contract alone represents the equivalent of c.4.5% of the order book at end June. Furthermore, the Group should continue to be one of the major beneficiaries of the Grand Paris infrastructure project.

6.2.1. The new Grand Paris

The Grand Paris Express and the Eole extension together represent some EUR30bn of works through to 2030.

We generally take into consideration, firstly **1)** some EUR25bn for the Grand Paris Express, which comprises four new underground lines around Paris (including line 15 bypassing the French capital but also line 17 which will top at CDG airport) and two extensions (line 14 to St Denis in the north Orly to the south and line 11 eastbound from Mairie des Lilas) and, secondly, **2)** the 55km extension of the RER E westbound from Eole for just under EUR4bn.

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

The two combined represent works of around EUR30bn by 2030, i.e. around EUR2bn per year, to which we need to add the associated works which could mean an incremental EUR2bn to EUR3bn per year. The total amount dedicated to transport infrastructure could thus approach an annual EUR5bn, compared with a public works market of EUR40bn. While this is significant, we need to remember that public works are currently emerging from a difficult period with one quarter of activity lost since 2007/2008 according to the FNTP, i.e. more than EUR10bn. More than the Grand Paris and Eole projects will thus be needed to rebalance the market although this is obviously a (big) step in the right direction.

The financing is assured by the fiscal revenues earmarked for the Société du Grand Paris, which will also be able to raise debt and benefit from any commercial revenues linked to the operation of the infrastructure. The French State could also provide financial support.

Bouygues is obviously very well placed to capture a signifiant market share in that these works are mostly underground, complex and in theory only accessible to large companies.

- Several contracts have recently been attributed:

  - In a consortium with Eiffage, for the EOLE project (RER E extension to western Paris) Bouygues Group won the contract to build the Porte Maillot station, combined with a 6.1km tunnel between Saint-Lazare and La Défense. Bouygues' share of the works amounts to EUR200m. For its part, with Spie Batignolles, Vinci won the contract to build a new station under the CNIT at La Défense and the adjacent tunnels). This is a contract worth EUR496m, with the work being staggered between mid-2016 and 2021. These are complex works (underpasses, tunnels) in a challenging environment.

  - Still within the framework of the Grand Paris project, Bouygyes also won the EUR80m contract to build an ecodistrict in Bagneux, which will benefit from the line 4 extension, and the Grand Paris station for line 15.

  - With Colas, the Group is also responsible for the line 14 extension in the Batignolles zone, together with the Fort d'Issy-Vannes-Clamart station for line 15.

6.2.2. Other key projects

- The Group won the contract for the Monaco offshore extension. This is a particularly substantial major project with works amounting to around EUR1bn. The first EUR840m tranche of the order is not yet in the order book.

- We would also highlight a number of contract wins during the first half, particularly in construction: Basel ecodistrict (EUR130m), a housing contract in Nyon (EUR110m) and the Green City Zurich development projects (EUR100m) for Switzerland, together with housing projects in India (EUR100m) and Singapore (EUR100m).

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

6.3. An increase in operating margin as of 2017

Accounting principle: sales are determined using the percentage-of-completion method. This corresponds to the most up-to-date estimate of the sale price of the project, multiplied by the pcrcentage of completion, i.e. the actual progress made on realising the works.

At cash flow level, the construction company generally receives advance payments on the works then additional installments as the work progresses. Costs are recognised as they are incurred. If a project looks likely to prove unprofitable, a provision is passed to cover the terminal loss.

Fig. 34: Key figures

EURm	2013 PF	2014 PF	2015E	2016E	2017E	2018E	2019E
Building & civil works	9586	10049	9857	9561	9705	9996	10296
Energies & services	1515	1677	2118	2089	2120	2184	2250
Sales	11101	11726	11975	11650	11825	12180	12545
Building & civil works y/y%	5.4	4.8	-1.9	-3.0	1.5	3.0	3.0
Energies & services y/y%	-1.7	10.7	26.3	-1.4	1.5	3.0	3.0
Sales y/y%	4.3	5.6	2.1	-2.7	1.5	3.0	3.0
Current operating profit	437	335	349	339	362	391	422
Current op. margin (%)	**3.9**	**2.9**	**2.9**	**2.9**	**3.1**	**3.2**	**3.4**
Net profit group share	277	254	276	283	308	327	346
Cash Flow clean	400	250	656	407	413	429	446
Free Cash Flow	241	78	442	190	193	202	212
FCF (as reported)	331	199	154	229	236	249	262
Net cash (+) / debt (-)	3006	2900	3272	3187	3098	2993	2881

Source: Bryan, Garnier & co

Fig. 35: Key ratios

EURm	2013 PF	2014 PF	2015E	2016E	2017E	2018E	2019E
Gearing (%)	-329	-345	-350	-333	-311	-291	-270
Net debt / EBITDA (x)	-4.5	-4.6	-6.1	-5.9	-5.5	-5.0	-4.6
EBIT	437	335	349	339	362	391	422
EBIT margin (%)	3.9	2.9	2.9	2.9	3.1	3.2	3.4
Tax (%)	35.8	33.4	31.8	31.8	31.8	31.8	31.8
NOPAT	281	223	238	232	247	267	288
Capital Invested	-1229	-962	-1214	-1205	-1193	-1174	-1148
ROIC (%)	-22.8	-23.2	-19.6	-19.2	-20.7	-22.7	-25.1

Source: Bryan, Garnier & co

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

7. Colas: FCF generation

7.1. Robust fundamentals

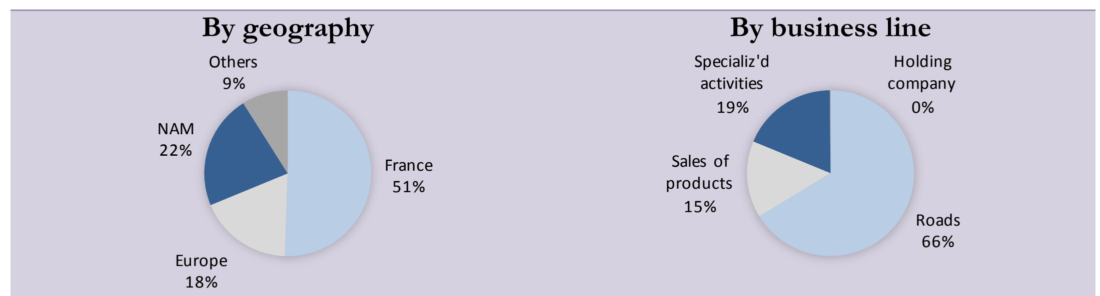
In 2015, Colas contributed 46% of construction division sales and 37% of Bouygues Group sales. In terms of cash generation, the impact is even more marked since 56% of construction division FCF (as disclosed by the company) is generated by the road works business (in 2015, knowing that the reported FCF is negative at Group level).

56% of the construction division's FCF is generated by Colas

A little over half the activity is in France. This makes Colas the roads major which is the most present in international markets (49% of sales vs 43% for Eurovia in the Vinci Group probably around 20% for Appia in the Eiffage Group), particularly in the United States (one fifth of sales are realised in North America). While two thirds of the top line are realised in pure road works (paving of asphalt), 15% of sales comes from the sale of materials (aggregates, asphalt, etc.) to third parties and virtually one fifth from specialized activities (mostly in France), and in particular, railways with Colas Rail, including in the United Kingdom with several rail maintenance contracts. In this respect, as part of a consortium (Colas share 60%) Colas Rail Ltd won the GBP1.2bn contract over ten years to build the Birmingham tramway extension.

Not only roads: 20% of sales come from specialized activities including rail

Fig. 36: Breakdown of Colas sales in 2015



Sources: Colas, Bryan, Garnier & co

Colas's current operating margin has remained fairly stable over a long period, even if certain elements have negatively impacted profitability in some years. In 2014 and 2015 in particular, the sale of refined products (SRD subsidiary) was to lead to current operating losses of EUR64m and EUR77m respectively. The activity was penalised by the decline in the oil price and by difficult markets in Western Europe which together led to price falls for refined products (bitumen, lubricants, fuels, etc.) while the prices of the raw materials required for the production process (reduced crude oil) did not fall by the same magnitude. SRD is in the shut-down process currently and no longer generates sales (Bouygues is seeking a buyer for the storage activity).

Adjusted for the EUR77m loss in 2015 for sales of EUR120m, Colas's current operating margin would have been 3.6%.

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

Fig. 37: Current operating margin over the long term

EURm	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Current operating profit*	220	299	292	262	289	422	524	638	682	541	365	466	406	390	332	344
Operating margin (%)	3.4	4.1	3.9	3.5	3.6	4.4	4.9	5.5	5.3	4.7	3.1	3.8	3.1	3.0	2.7	2.9
Op. margin adjusted from SRD (%)**	-	-	-	-	-	-	-	-	-	-	-	-	3.4	3.5	3.3	3.6

** current result as of 2005*
*** SRD was not consolidated prior to 2012*
Source: Company Data; Bryan, Garnier & Co ests.

Either way the margin has remained solid and virtually consistently above 3% while sales have been under pressure (-3.5% in 2013 and 2014), penalised by a French road works market in crisis (road market sales in France down by -11% in 2014 and -8% in 2015). This margin resilience, that can also be seen at Eurovia (Appia no longer publishes separate accounts and is now part of Eiffage's infrastructure division), is explained by a number of factors which are specific to Colas and its business:

Robust fundamentals:

1) modest average contract size

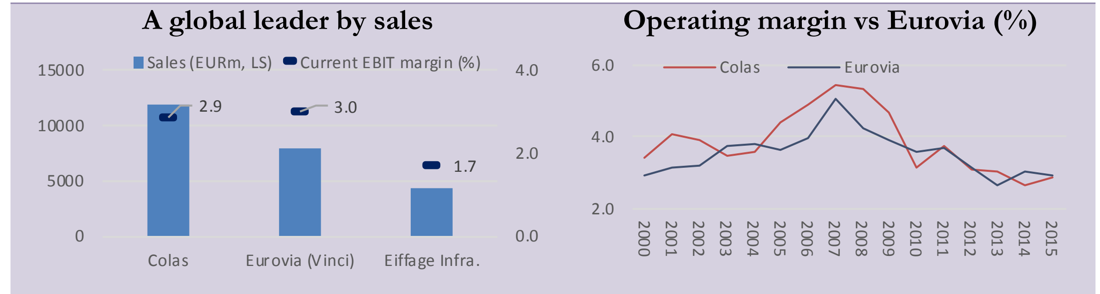
2) effective cost management

3) weight of the international business

- Sales are mainly composed of a multitude of medium-sized projects: nearly a hundred thousand per year worth an average of EUR100,000. Note that a large proportion of activity is generated by maintenance (70% of sector works in France according to USIRF), which is more recurring than new works and inevitably smaller in size.
- The ability to absorb fluctuations in the bitumen price since these are directly passed on to customers. In the case of the longest contracts, there are indexation clauses. Colas can also build up bitumen reserves, or even use hedging.
- Colas is vertically integrated: the Group has 714 quarries and gravel pits world-wide, 129 emulsion and binder plants, 553 asphalt mixing plants, 197 ready mixed concrete plants and a bitumen production factory (not including SRD which is now closed). These assets enabled it to produce 95 million tonnes of aggregates in 2015 and, for example, 39 million tonnes of asphalt. Authorised aggregate reserves stand at 2.6 billion tonnes, i.e. 31 years of production. This vertical integration strategy enables Colas to manage its sourcing, control product quality and avoid (if possible) any procurement – in this case more expensively – from third parties.
- A highly decentralised organisation, to be close to customers (of whom more than half are local authorities) and be able to optimise the supply of materials. This is a type of organisation that we deem normal for the sector.
- The ability to manage its costs, and particularly personnel expenses (c. 30% of operating costs), thanks to fixed term contracts and, to a lesser extent, sub-contracting. Note that, in the United States, so-called seasonal contracts can represent up to half the total contracts in peak activity periods.
- The ability to develop the business internationally. In 2015, North America in particular generated an operating margin of 5%, markedly higher than the overall Group level, perhaps thanks to the relatively higher proportion of product sales in the mix (25% versus around 10% in France).

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

Fig. 38: (Current) operating margin for Colas



Sources: Colas, Vinci, Eiffage, Bryan, Garnier & co

7.2. Trends

7.2.1. Emerging from recession in France

The road works market, which represented EUR12bn of the c.EUR40bn generated by the public works sector in 2015, has been in recession for much of the past decade. Activity declined by 35% over seven years (to 2015) according to URSIF, mostly under the effect of a reduction in local authority investment (mainly towns and to a lesser extent departments and regions), which makes up some 50% of the industry's sales, penalised by a combination of negative factors:

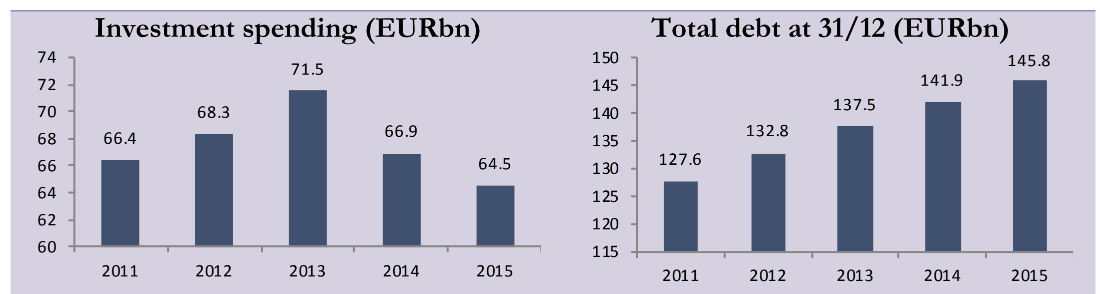
A recession in the sector dating back seven years

- The 2008 economic crisis, which negatively impacted the economic players and households and thus the local taxes raised which represent around 60% of local authority revenues.

- The municipal elections in March 2014. New teams put in place after an election generally distance themselves from the projects of the previous teams, something which has been reflected in pressure on road works.

- A reduction in French State contributions to the local authorities, via the EUR11bn reduction in the DGF general operating grant (*dotation globale de fonctionnement*) between 2014 and 2017: EUR1.5bn in 2014, EUR3.5bn in 2015 and 2016 and EUR2.6bn in 2017 – compared with EUR3.6bn before the announcement from François Hollande last June. The extra EUR1billion concerns only the municipalities, which saw their initial EUR2bn cut reduced to EUR1bn. Note that, of the some EUR190m of local authority revenues in 2014, around one fifth (EUR40bn) came from the DGF.

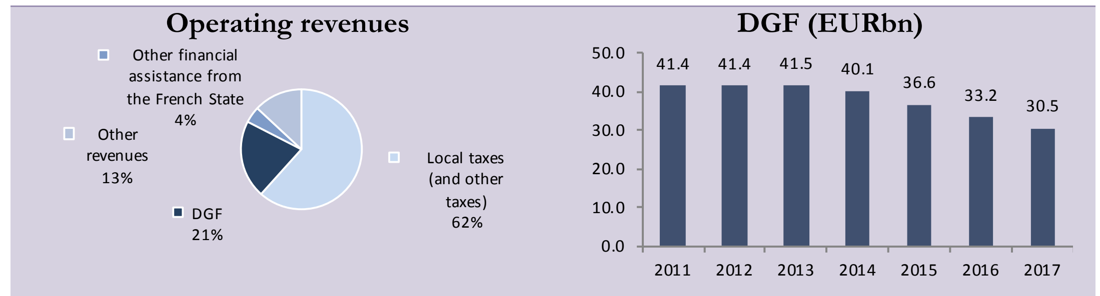
Fig. 39: Local authority investment and debt*



** All local authorities: municipalities, groups of municipalities with tax-levying powers, department and regions*
Source: French Local Authority Financing Report; Bryan, Garnier & co

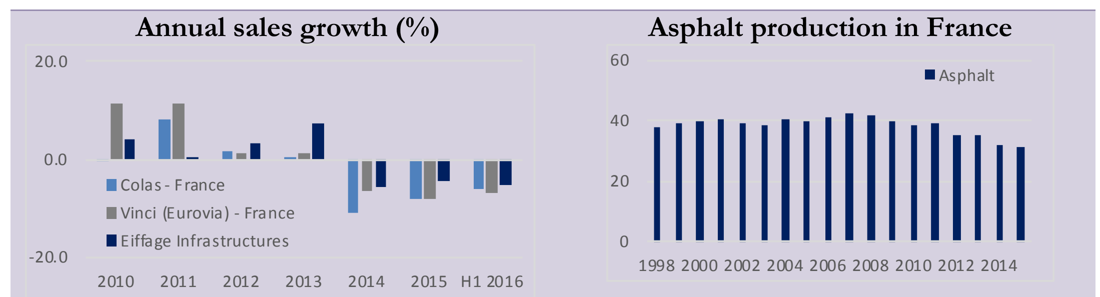
Please see the section headed "Important information" on the back page of this report.

Fig. 40: Weight and trend in the DGF general operating grant



DGF: Dotation Globale de Fonctionnement or general operating grant
Source: Les Echos according to the DGFIP; Rapport de l'Observatoire des Finances Locales; Bryan, Garnier & co

Fig. 41: Relative performance of the three majors



Source : Company, URSIF, Bryan, Garnier & co

7.2.2. Why the situation could stabilise

In addition to the commentary from industry professionals who consider that the road cycle has bottomed out in France, there are a number of factors which are liable to progressively support the sector as of the 2016 second half and during 2017:

Road cycle to bottom in 2016

- All the commentary coming from the road majors (Colas, Eurovia, Eiffage) suggests that the market for road works has now bottomed out. The last monthly survey from France's road industry association the URSIF (*Union des Syndicats de l'Industrie Routière Française*) confirms this: sector sales progressed by +15.3% y/y in August, albeit still down by 1% YTD. The industry order book was up by 3.7% at the end of August 2016 versus its level of end August 2015.

A small improvement in the financial health of local authorities (main customer for the sector)

- The **situation of the local authorities** (number one customer for the roadbuilders) has improved (a little).
  - In early June, President Hollande announced a smaller reduction in the grants to local authorities for 2017, thereby improving their budget outlooks by an extra EUR1bn.
  - At the same time came the announcement that the EUR1bn local investment support fund launched in January 2016 was being maintained and increased by EUR200m for 2017. To date we don't know how much of the first EUR1bn has been finally invested in that not all investment is necessarily eligible for the fund. In particular, EUR500m is expected to be devoted to, amongst other things. thermal renovation, renewable energy development, housing construction and public equipment projects in the event of population growth.

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- The growth in existing property transactions will bring in more revenues for local authorities via property transfer taxes (directly linked to the number of property transactions and their prices) which represent the bulk of notary costs. Transactions in existing properties thus progressed by 16% in 2015 and by 18% in 2016 to end May.

- This dynamic is explained by both a favourable comparison base (or an upturn in the transaction cycle), a low interest rate environment (1.77% on average, excluding insurance/security costs according to Les Echos on 2 June citing the French mortgage observatory - *Observatoire Crédit Logement/CSA*) and the success of the new Zero Interest Mortgage scheme. Since 1 January 2016, this scheme (still subject to income conditions) can now finance up to 40% (versus 18% to 26% previously) of the total acquisition cost of a 'first' principal residence, including in existing housing provided that works (renovation, fixtures and fittings, etc.) represent 25% of the overall cost of the transaction (at least one third of the purchase value). The repayment conditions are also flexible (households on the most modest incomes won't have to repay anything for a 15-year period).

- That said, of the some EUR200bn of resources, around 55% comes from local taxation, of which property transfer taxes represent only a relatively modest portion. The tax revenues generated by property transfer taxes (equal to 5.7% of the sale price, of which 1.2% for the local authority portion) thus amounted to EUR12bn in 2015.

Fig. 42: Recovery of property transfer taxes

In EURm (France excluding Mayotte)	2013	2014	2015*	2015*/2014
Departments	7350	7914	9276	17.2%
Municipalities	2165	2138	2366	10.6%
Total	**9515**	**10052**	**11642**	**15.8%**

** including departmental property transfer taxes for the Lyon metropolitan area (EUR230m)*
Source: DGFiP, Médoc; Bryan, Garnier & Co ests.

- Lastly, Standard & Poors has stressed that, in 2015, the local authorities did not need to borrow to finance their investments. A portion of this improvement thus naturally ensures from the fall in investment (Les Echos, 5/10/16).

- In addition to supporting property transactions, a low interest rate environment also favours a government policy of stimulating the economy via infrastructure investment.

■ More works on the **motorway side**:

- The EUR3.2bn motorway stimulus plan signed in 2015 (which does not correspond to a government stimulus policy since the State is financing nothing) should generate works starting from the end of 2016. Colas is expected to participate in that it has negotiated with the government that around half of the works should be entrusted to construction companies which are independent from concession companies.

Support from the motorway stimulus plan (plans?)

- There is also the hope that the government manages to finalise the negotiations on the new EUR1bn investment plan announced by the Secretary of State for transport Alain Vidalies on 18 September 2016. It is probably too early to consider this new plan as a done deal since the financing has yet to be finalised. The most positive scenario would see the works beginning at the end of 2017.

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7.2.3. Brexit: what is the risk for Colas?

The Bouygues Group generates EUR2bn of sales in the United Kingdom, of which around one half for Colas. While the risk on activity exposed to residential property seems to us to be real, the business risk for Colas, which is more active in road and rail network maintenance (generally through five, eight or even ten-year contracts like the contract recently won in Birmingham) seems in our view more limited. Furthermore, Colas is well positioned to benefit from the infrastructure plan in the United Kingdom: GBP15bn through to 2020 (1,300 extra lane miles). Lastly, the activity is local and the impact of Sterling depreciation is thus essentially at the level of accounting consolidation in euros. It could eventually have a negative mix effect on the Colas consolidated margin but to date the Group has expressed no concern on this subject. Furthermore, we should stress that the Group hedges on Sterling.

Brexit: Colas less at risk than the property activities

However, it is difficult to deny that a recession would have negative consequences for the business environment. A deep recession could also stymie any fiscal stimulus by the government.

7.2.4. A key presence in the United States

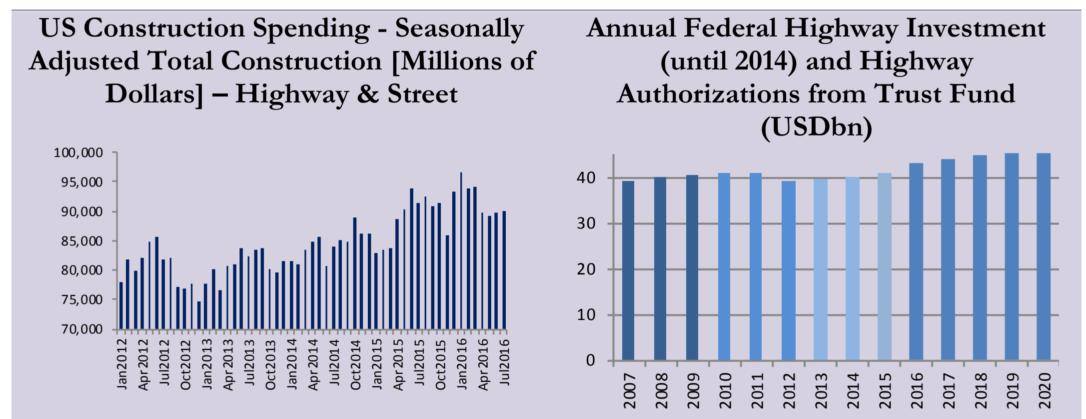
In North America, Colas is particularly present in the eastern and central United States and in the Rockies. The Group is also active in Western Canada, the area with most exposure to the oil and gas sector. In Canada, the Group should benefit from the Trudeau plan, foreseeing CAN125bn of investment in infrastructure over ten years.

In the United States, the Group should also benefit from the signature of the infrastucture plan: the FAST Act. The Fixing America's Surface Transportation Act corresponds to an investment budget of USD305bn over five years, of which around USD225bn earmarked for motorways, i.e. an annual average of USD45bn versus USD41bn in 2015. This level of investment is not materially higher than the figure for the past few years in the United States. On the other hand, it is the first time that a plan with visibility beyond two years has been signed since 2005. This increased visibility should start to bear fruit.

USD225bn of financing for motorways over five years in the United States

Financing at federal level accounts for 30% of the total annual budget allocated to motorways (USD160bn). The principle is as follows: for a State to be able to benefit from this fnancing, it first needs to finalise the project for which it wishes to obtain the financing and back it.

Fig. 43: Construction spending in the US and financing authorisations

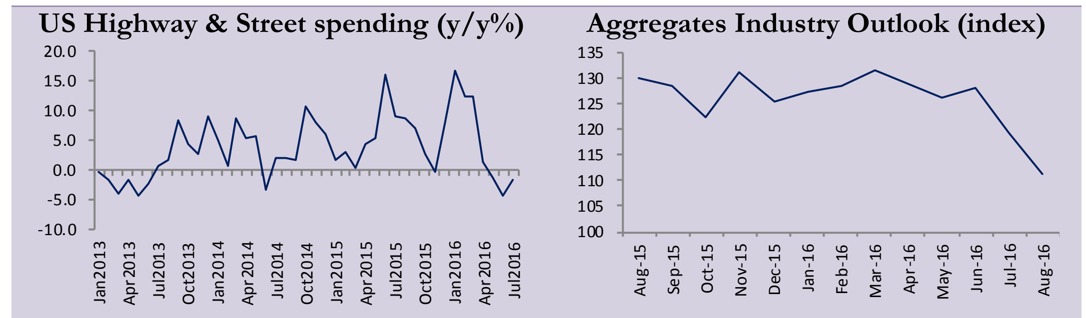


Sources:

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

It is, however, legitimate to question the sustainability of the US construction trends. The construction spending dynamic has experienced a considerable slowdown in 2016, even if it remains positive. Furthermore, the Aggregates Industry Outlook, a monthly survey of materials industry professions saw a significant down-turn recently.

Fig. 44: Some uncertainties in the United States



Sources: Census bureau (Construction spending); Aggman.com (aggr. industry outlook); Bryan, Garnier & co

7.3. Towards a rebound in margins

Insofar as possible, we strive to maintain, for the current financial year, some consistency between the order book dynamic and the trend in sales. We refrain from too much modeling beyond this, due to the multitude of medium-sized projects in this type of activity and an ultimately only modest level of visibility on the order book, limited to five to seven months. For 2016, we apply the company's guidance (credible in our view), namely a -c2% organic decline in sales, a negative currency effect (Canadian dollar and Sterling) and the exit from SRD and some of the Asian activites (sold to Tipco in early 2016). For the medium term, we progessively apply growth approaching the level seen in France and internationally since 2006, i.e. 0% (versus the -0.4% seen since 2006) for France and 3% (vs 3.3% seen historically) internationally. We see little reason to believe that the current macro environment in France is conducive to a rebound in volumes.

Organic sales decline of c2% in 2016

Concerning the operating margin, it is difficult to be particularly aggressive and we remain close to 3%. The sale of some Asian entities to Tipco, whose operating margin approaches 8%, is likely to slightly dilute the Colas margin (estimated impact of between 5bps and 10bps). It is of course perfectly possible for margins to return to their historic levels (5.5% in 2007), but not within the framework of our top line growth scenario. It seems unlikely that the players will be able to regain their maximum level of margin without a pick-up in volumes. In summary, we expect the players' tendancy to squeeze pricing to win contracts during a period of scarcity to prevail. The crisis since 2008 has shown this very clearly.

Fig. 45: Key figures

EURm	2013 PF	2014 PF	2015E	2016E	2017E	2018E	2019E
France	7388	6582	6044	5864	5952	6130	6314
International	5457	5814	5916	5474	5523	5688	5859
Sales	12845	12396	11960	11338	11474	11818	12173
France y/y%	0,3	-10,9	-8,2	-3,0	1,5	3,0	3,0
International y/y%	-3,8	6,5	1,8	-7,5	0,9	3,0	3,0
Sales y/y%	-1,5	-3,5	-3,5	-5,2	1,2	3,0	3,0
Current operating profit	390	332	344	361	382	411	442
Current op. margin (%)	**3,0**	**2,7**	**2,9**	**3,2**	**3,3**	**3,5**	**3,6**
Net profit group share	312	604	234	274	331	352	373
Cash Flow clean	841	583	675	675	751	809	870
Free Cash Flow	552	127	364	222	292	336	383
FCF (as reported)	378	154	272	266	349	399	451
Net cash (+) / debt (-)	31	682	560	587	650	711	801

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

Fig. 46: Key ratios

EURm	2013 PF	2014 PF	2015E	2016E	2017E	2018E	2019E
Gearing (%)	-1	-23	-21	-21	-22	-24	-26
Net debt / EBITDA (x)	0,0	0,9	0,7	0,7	0,7	0,7	0,7
EBIT	390	332	344	361	382	411	442
EBIT margin (%)	3,0	2,7	2,9	3,2	3,3	3,5	3,6
Tax (%)	33,7	25,3	29,8	29,8	29,8	29,8	29,8
NOPAT	259	248	241	253	268	289	310
Capital Invested	2681	2859	2741	2790	2838	2895	2960
ROIC (%)	9,6	8,7	8,8	9,1	9,4	10,0	10,5

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

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8. Bouygues Immobilier

8.1. A leader in France

Bouygues is one of the leading property development players in France. With more than 12,000 reservations in 2015, its market share is around 11%, just behind Nexity's 11.5%, while Vinci Immobilier and Eiffage Immobilier are more modest in size (c.4,200 and c.3,700 reservations in 2015, respectively). The property development activity could enable the construction groups to transfer volume to their building operations although in practice only 20% to 30% of the Bouygues Immobilier programmes are built by Bouygues Construction.

Bouyg. Immo. footprint

Source: Bouygues, Bryan, Garnier & co

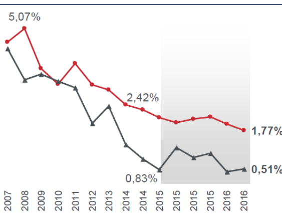
Bouygues Immobilier is mostly present in France, which regroups more than 90% of its branches. The Group is mainly exposed to the residential segment (c. 85% of sales). It benefits from a very strong presence in the Ile-de-France, with a market share of 18% (2011 data).

8.2. A market yet to recover but positively oriented

The context is favourable to the residential sector in France:

- Interest rates are at historic lows. According to the French mortgage observatory (*Observatoire Crédit Logement CSA*), the average mortgage interest rate was 1.55% in July 2016 (with a fixed-rate low of 1.36% over 15 years).

A decline in interest rates*

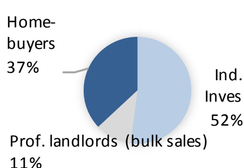


** Average mortgage interest rate*
Source: Nexity, Bryan, Garnier & co

- The environment is fairly healthy: mortgage lending is subject to strict rules (based on income and not the value of the asset, no remortgaging as in the United Kingdom), most mortgages are at fixed interest rates, the default rate was under control at 1.55% in 2015 versus 1.69% in 2001 according to the French prudential supervisory authority (*Autorité de Contrôle Prudentiel*) (source: cBanque.com), and the level French household debt is still modest relative to the European average, as is its percentage of ownership (c.65% vs 70% for the EU average, 2014 figures, Eurostat).

- The Pinel scheme replaced the Duflot scheme on 1 September 2014. Its expiry has been extended from the end of December 2016 to the end of 2017 (announced by François Hollande on 8 April 2016). Investors benefit from a tax break calculated on the purchase price of a new (or renovated) property equal to 12%, 18% or 21%, provided that the asset is rented for 6, 9 or 12 years, all this being subject to conditions capping the rents and based on tenant income. The tax break is based on a combined ceiling of EUR300,000 and EUR5,500 per m² and may not exceed EUR63,000 on the most favourable scenario (2% reduction on EUR300,000 over the first nine years, i.e. EUR6,000 per year or EUR54,000 and 1% in the three following years, i.e. a total of EUR63,000) The Pinel scheme has been better received than the Duflot. It is more flexible (multiple choices of rental duration) and enables the asset to be rented to ascendants or descendants. The Pinel scheme mostly explains the proportion of private investors within Bouygues Immobilier's reservations (52% at end June 2016, versus 37% for owner-occupiers and 11% in bulk sales).

Reservations at end June.



Source: Bouygues Immobilier, Bryan, Garnier & co

- The LMNP (non-professional furnished landlord) scheme is also a positive support for activity. It enables investment in a highly diverse range of assets (student residences, long-term care homes for the elderly, etc), entrusting the management to a third party, and benefiting from tax

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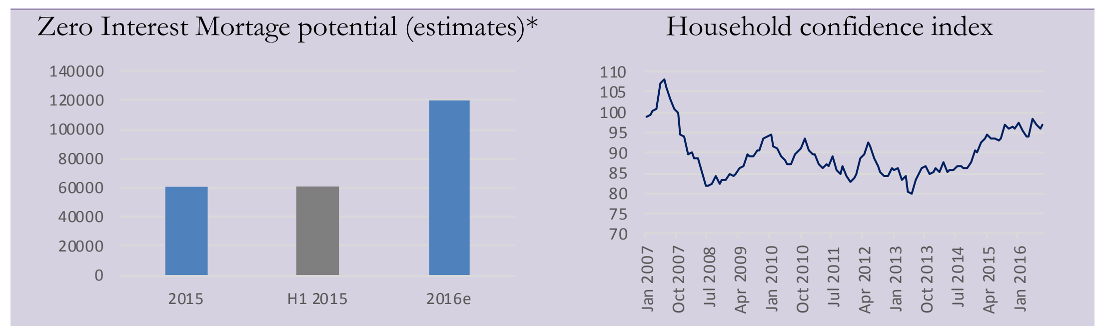
breaks (TVA recovery, rents free of tax for twenty years or reduction in tax when opting for the Censi-Bouvard scheme).

- The Zero Interest Mortage scheme has also been adjusted. As of 1 January 2016, it enables the financing over a 20 to 25 year duration of up to 40% of the purchase of a main residence (new build or now an existing home if the works represent 25% of the total cost of the transaction) versus 18% to 26% previously; the maximum incomes have been increased (EUR74,000 versus EUR72,000 in zone A for a couple with two children and the repayment deferred (5, 10 or 15 ans, depending on income).

- The household confidence index is also encouraging.

Fig. 47: An environment favourable to residential property



**In units, for the individual homes market and property developers*

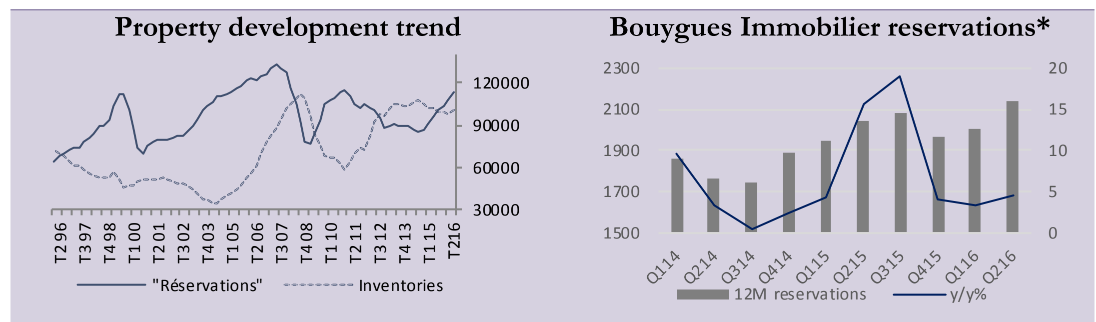
Sources: Les Echos and Nexity (Zero Interest Mortgage), INSEE (confidence index), Bryan, Garnier & co

- It is also worth mentioning that Nexity in particular points to a potential structural need estimated at 800,000 homes per year (although this figure is also contested elsewhere), whereas the housing starts over a rolling 12 months stood at close to 360,000 units at the end of July 2016.

Property development reservations have thus clearly accelerated since the launch of the Pinel scheme in late 2014. Having been in steady decline since 2011, reservations progressed by +7.5% in Q4 2014, +19% in 2015 and +18% in H1 2016.

Reservations up by +18% in France in H1 2016

Fig. 48: A positive dynamic for reservations in new residential in France



* reservations in EURm (left scale)

Sources: Ministry for Equipment, Bouygues Immobilier, Bryan, Garnier & co

This favourable context including, in particular, the new Zero Interest Mortgage scheme no doubt explains the apparent return of owner-occupiers and first-time buyers. The trend in the market thus looks fairly healthy, especially since the level of inventory is gradually falling. The situation is not yet balanced, however and inventories themselves remain at a high level. Moreover, in Q2 2016, they even increased by 4% on a sequential basis (in France, based on figures released by the Ministry). This increase is the result of an acceleration in the number of properties coming to the market, particularly since the end of 2015. Provided the market remains dynamic this will not necessarily be a serious problem but, in the event of a market downturn, it would be legitimate to question the nature and location, etc….of these inventories. At Bouygues level, we shall thus be watching the direction in any unsold properties very closely.

The phases of property development

With off-plan sales risk is deemed to be well contained. Off-plan selling effectively enables property developers to transfer ownership of the home as of the notarial act. Below we set out the key stages of a property development programme which is sold off plan.

The highly-regulated practice of selling off plan protects the market from downside risks very effectively

- Prospecting for land. In general, a developer will look to sign unilateral sale promises subject to conditions precedent (granting of the construction permit, cleared of any claims). Nine months are required before the launch of the pre-marketing phase, the time needed to obtain the construction permits. So that developers never find themselves owning real estate which is difficult to sell, the purchase of land never precedes the pre-marketing launch.

- Pre-marketing is launched. When 20% of the lots have been reserved, the land is then purchased. This level is generally reached a year after the launch of the project.

- At a pre-marketing reservation rate of 40%, the works can begin. Construction is entrusted to the entities of Bouygues Bâtiment and usually starts 15 months after the launch of the operation.

- No projects are launched without prior reservations. Achieving a reservation threshold is also positive at the financial flows level since, with an off-plan sale, the purchaser pays the developer 5% (maximum) of the provisional sale price (when the signature of the sale takes place within 12 months; beyond this the maximum is 2%).

- Still based on this 40% threshold, the marketing can begin with the notarised sales. Legally, once the first lot is sold, the developer is required to deliver it and must thus complete the whole building.

- Once the owner, the purchaser must pay the developer the different installments: 35% of the price of the property on completion of the foundations, 70% once the property is watertight, 95% on completion of the works and 5% on delivery. In accounting terms, however, the property developer's sales will lag the advance payments received from customers. Sales are calculated by multiplying the progress on the construction process (as a function of the costs observed, the latter being recognised as they are incurred) by the number of notarised sales. This is thus very progessive and the developer will initially be loss-making.

- Delivery can take place up to three years after the launch of the operation.

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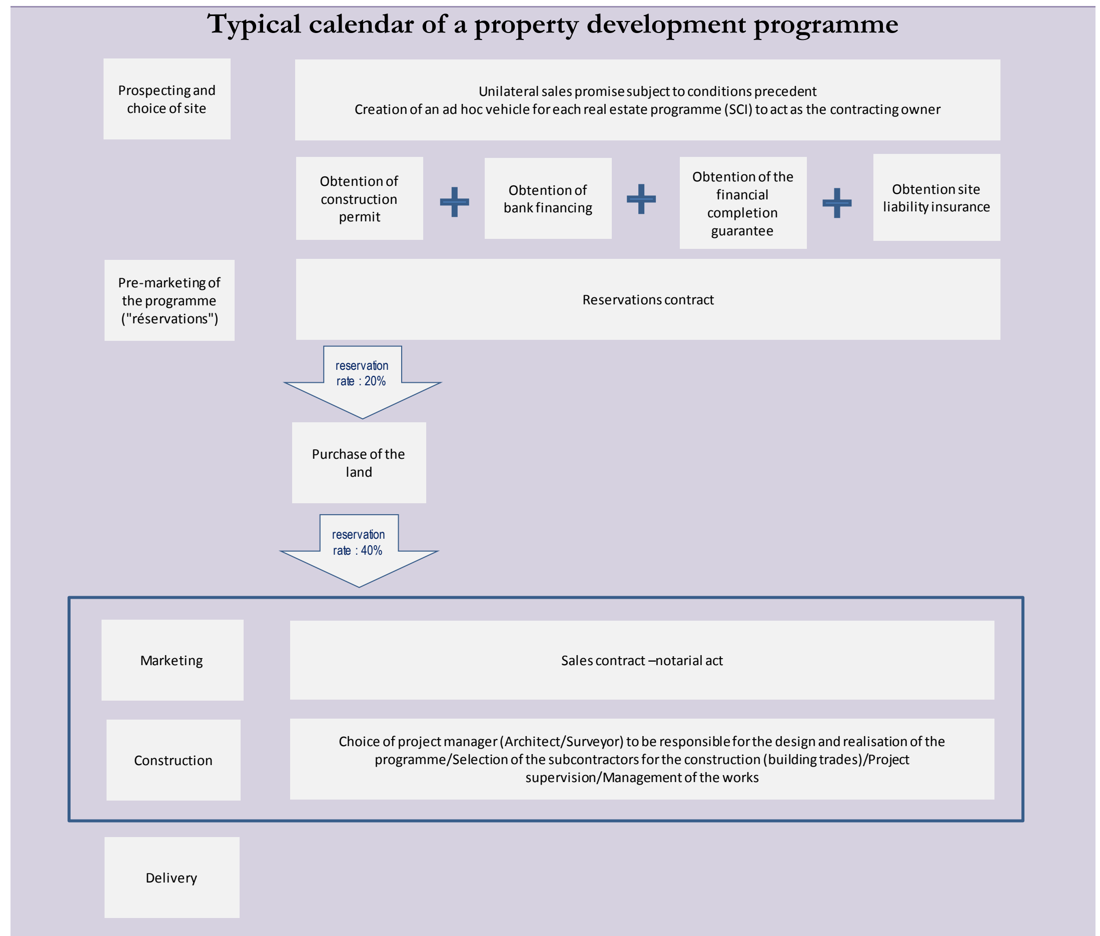
Fig. 49: Phases of a property development programme



Sources: Bouygues Immobilier, Bryan, Garnier & co

Commercial property

Since 2010, an average of around 17% of Bouygues Immobilier's sales have been realised in the tertiary segment (office property, retail). In 2015, tertiary represented 14% of sales and the Ile-de-France two-thirds of the reservations in volume. Of all the Bouygues construction activities, this is the business whose sales are the most volatile with significant variations linked to the scale of the projects delivered.

The recent trends in the market look to be pretty positive, particularly in the Ile-de-France, with take-up of 1.1 million m², up by 20% in H1 2016. This dynamic was reflected in the 16% increase in commercial property reservations at Bouygues Immobilier during the first half.

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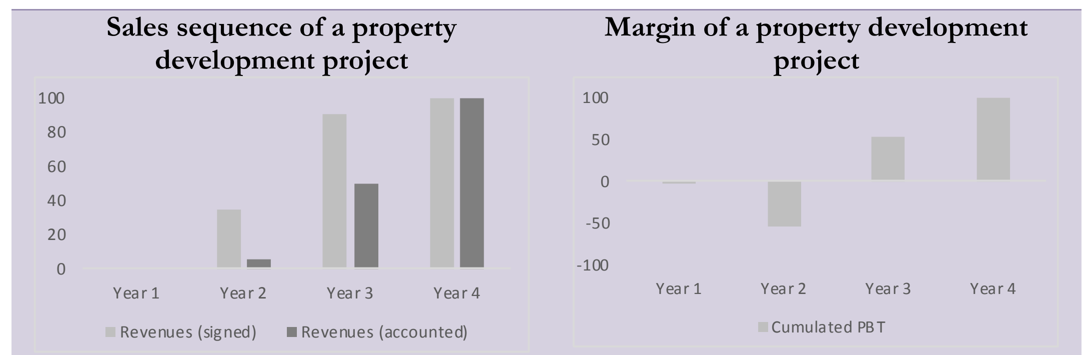
8.3. Forecasts

Our scenario is similar to the one followed for Vinci and Eiffage. In our view the Group is going to focus on preserving its margin and managing its risks. Within this framework, our sales growth estimates are modest while we expect the operating margin erosion at Bouygues Immobilier to progressively come to an end. It is remarkable to note that, from its 10.9% peak in 2006, Bouygues Immobilier's operating margin has been declining relentlessly year after year with the exception of 2010 (and even then only thanks to a favourable comparison base).

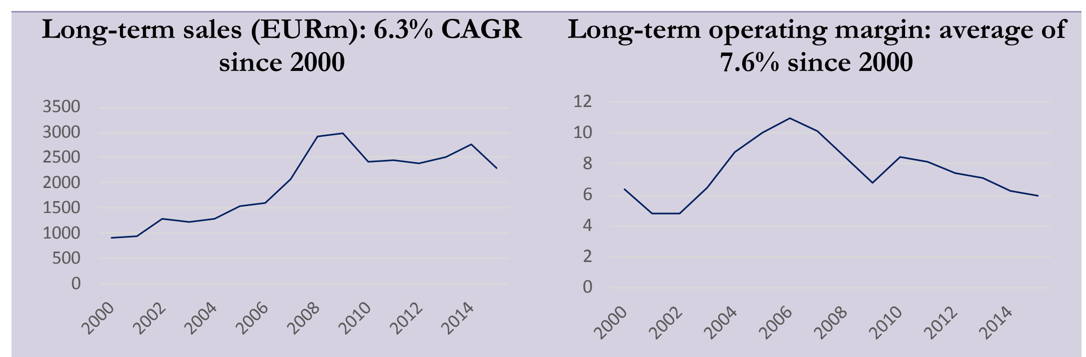
At accounting level, sales are recognised on a percentage-of-completion basis, consistent with customer payment installments (although the two do not progress in a homogeneous manner). The percentage-of-completion is calculated by multiplying the degree of physical progress on the project by the notarised sales (building permit free of all claims). The percentage-of-completion is calculated based on the costs recognised as a proportion of the total project costs. The costs are, however, booked as they are incurred. Hence, a property development programme will initially be loss-making. The financing is done though the working capital requirement.

Fig. 50: Accounting sequence of a property development programme



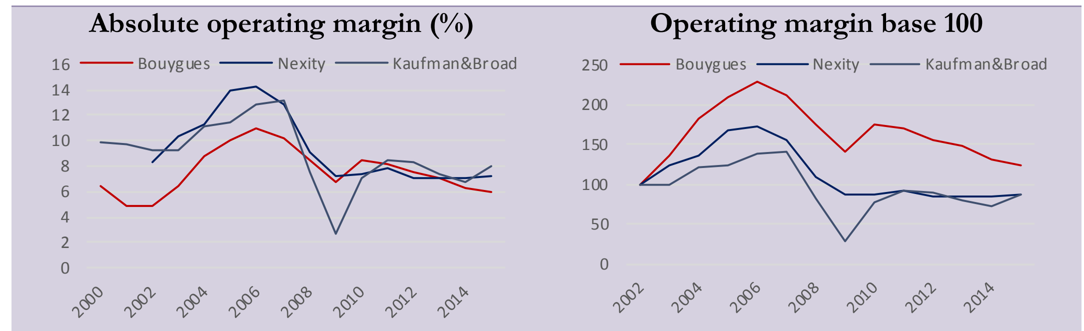
Sources: Les Nouveaux Constructeurs, Bryan, Garnier & co

Fig. 51: Long-term performance of Bouygues Immobilier



Sources: Bouygues, Bryan, Garnier & co

Fig. 52: Profitability versus Nexity and Kaufman & Broad



Sources: Bouygues, Bryan, Garnier & co

Fig. 53: Forecasts – key figures

EURm	2013 PF	2014 PF	2015E	2016E	2017E	2018E	2019E
Residential	2128	2120	1989	2061	2347	2584	2717
Commercial	382	655	315	445	570	636	671
Sales	2510	2775	2304	2505	2918	3220	3388
Residential y/y%	-0.7	-0.4	-6.2	3.6	13.9	10.1	5.1
Commercial y/y%	51.0	71.5	-51.9	41.1	28.3	11.4	5.6
Sales y/y%	4.8	10.6	-17.0	8.7	16.4	10.4	5.2
Current operating profit	178	174	138	153	180	200	212
Current op. margin (%)	**7.1**	**6.3**	**6.0**	**6.1**	**6.2**	**6.2**	**6.3**
Net profit group share	101	102	77	87	105	118	125
Cash Flow clean	67	76	-73	84	96	105	111
Free Cash Flow	57	63	-86	73	83	91	96
FCF (as reported)	110	84	61	93	107	119	126
Net cash (+) / debt (-)	271	203	5	1	-3	-17	-38

Sources: Bouygues, Bryan, Garnier & co

Fig. 54: Key ratios

EURm	2013 PF	2014 PF	2015E	2016E	2017E	2018E	2019E
Gearing (%)	-53	-40	-1	0	1	3	7
Net debt / EBITDA (x)	1.4	1.2	0.0	0.0	0.0	-0.1	-0.2
EBIT	178	174	138	153	180	200	212
EBIT margin (%)	7.1	6.3	6.0	6.1	6.2	6.2	6.3
Tax (%)	36.7	37.0	36.6	36.6	36.6	36.6	36.6
NOPAT	113	110	88	97	114	127	134
Capital Invested	347	385	550	557	566	576	587
ROIC (%)	32.4	28.5	15.9	17.4	20.1	22.0	22.9

Sources: Bouygues, Bryan, Garnier & co

9. TF1

This note does not include an in-depth analysis of the TF1 Group. On the basis of its market value, TF1, in which Bouygues holds a 43% stake, represents less than 10% of the Group's total valuation. We do however present a summary of the business below, highlighting the main future challenges for the TF1 Group.

9.1. Presentation of the Group

The TF1 Group has three business segments:

- **Freeview TV**: with, notably, the TF1, NT1, TMC, HD1 and LCI channels. These channels are all available within the framework of the freeview DTT proposition. TF1 is the leader in the main advertising "women aged under 50 purchase decision-makers" target market. In 2015, TF1 achieved 98 of the 100 best audience ratings. For its part, TMC is the benchmark channel amongst the DTT freeview channels with the highest evening ratings. LCI was added to the DTT freeview channels on 5 April 2015, joining i-télé, BFM TV and Franceinfo in the competitive 24-hour news segment.

- **Other TV channels and related activities**: with, notably, the channels TVBreizh, Ushuaïa TV, Serieclub and Histoire. These channels are available within the framework of Pay-TV packages.

- **Studios and entertainment**: TF1 Studio, TF1 Entertainment, Newen, Teleshopping, etc. This entity includes all the Group's in-house production and programme rights acquisition and distribution activities in a wide range of areas: films (remember that, as are all French television companies, TF1 is required to dedicate 3.2% of its advertising revenues to co-producing European films, of which 2.5% to original works in French), entertainment and games, magazines, TV series, sports, animation and short films.

The following table details the revenues generated by the Group's different activities in H1 2016.

Fig. 55: Revenue breakdown for the TF1 Group in H1 2016

	Revenues (EURm)	Revenue mix
Channels	**838**	**82%**
Freeview channels	**762**	**74%**
of which advertising	736	72%
of which others	26	3%
other channels	**76**	**7%**
Studios and entertainment	**187**	**18%**
Total	**1025**	

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

Advertising revenues still represent nearly three-quarters of the Group's total revenues, which remain very dependent on advertisers. The Group's business model is, however, experiencing some significant pressure as outlined in the following section.

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

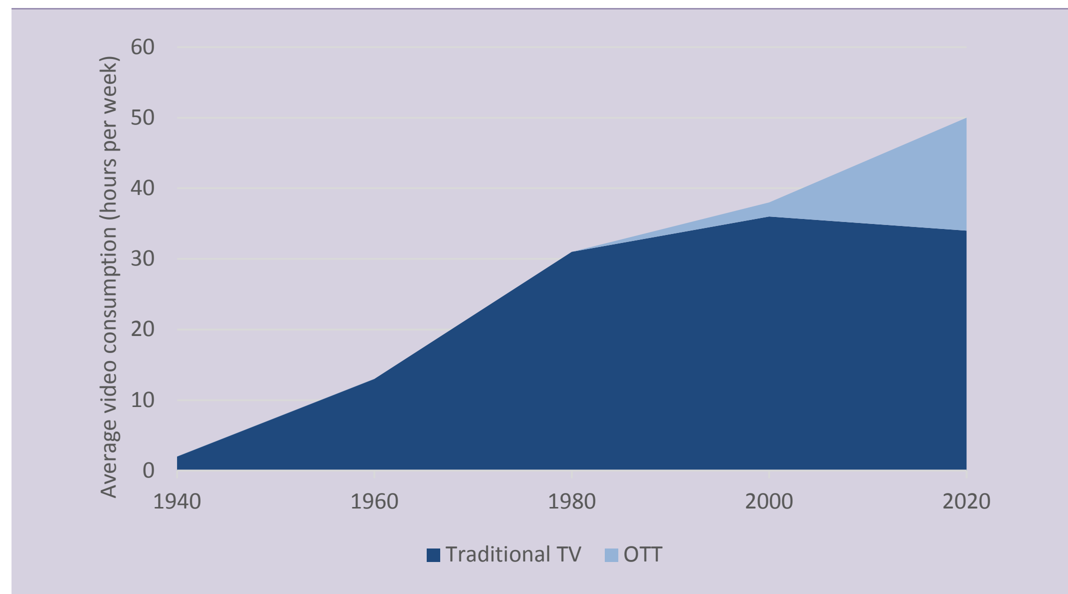
9.2. Changes in the media sector and the challenges for the Group

Like many "traditional" media players, the TF1 Group is having to contend with multiple challenges arising from new technologies and changes in content reception modes: **1/** Digitalisation (consumption of content on multiple screens), **2/** delinearisation (growth in video on demand services) and **3/** increasing competition from OTT platforms (Youtube, SVOD Netflix/CanalPlay/SFR Play, and new Molotov-type players) which are transforming the traditional broadcasting and distribution channels. All these changes are likely to **call into question the historic business model based on the construction of programme schedules and advertising.**

Faced with these digital-based threats, the vocation of the "**e-TF1" entity is to develop the Group's digital activities.** It offers notably a "replay" programme proposition (TF1, TMC, NT1 and HD1), available on an array of platforms/devices: TV operators (IPTV), PCs, tablets, smartphones. E-TF1 is ranked the number four video platform in France behind Youtube (Google), Facebook and Dailymotion (Vivendi). In H1 2016, 555 million e-TF1 videos were viewed, growth of 21% relative to H1 2015. TF1's catch-up TV performed well with a 2.3% increase in Catch up audience draw vs Live.

As shown in the following chart, the growth in audio-visual content consumption is now driven by **OTT usage** and we are even witnessing the progressive **cannibalisation** of traditional TV by the new platforms. For example, in the North American market, BCG expects the "non-linear" proportion of TV usage to increase from the current 25% to 50% by 2018.

Fig. 56: Traditional TV and OTT video consumption (world)



Source: BCG.

To respond to this disruption in its business model, the TF1 Group has engaged in **negotiations with the operators** to make them pay for the availability of its free view channels in their IPTV packages. Currently TF1 pays for access to the terrestrial spectrum but is then paid for its catch-up TV service which the operators include in their IPTV offers. On the other hand, at present there are

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no financial flows between TF1 and the operators for the DTT channels. The operators are now a key distribution channel for TF1 but access to TF1 is also vital for the operators who need to include the Group's channels in their offers. Since the content proposition is becoming increasingly critical for the operators, TF1 is looking to transform the power balance in its favour.

While the content offered by media players is becoming increasingly vital for the telecoms operators this doesn't necessarily prove the superiority of the media/telecom convergence model which is synonymous with vertical integration and exclusivity strategies.

Like Vivendi during the Jean-René Fourtou era (which notably owned the Canal+ Group and SFR), Bouygues does not focus on potential media/telecoms synergies between TF1 and Bouygues Telecom. Bouygues encourages each of its subsidiaries to **maximise their own interests** on a stand-alone basis. Bouygues Telecom is thus looking to offer, via **commercial partnerships**, the most extensive content offer of the highest-possible quality and has no exclusivity deals with TF1 to use or promote the latter's content. In this, the strategy is similar to that of Orange, but differs from the Altice strategy based on vertical integration, common telecoms/media branding (e.g.: SFR Sport channels), and promoting its proprietary content (even if there is no claim to an exclusivity strategy).

At this stage, we apply **no competitive premium** to the highly integrated, or telecom/media convergent players in the French market. It is, however, in our view key for TF1 to **successfully navigate the digital migration which is currently under way.** As successive generations unfold (and in particular the "millennial" generation graduates to fully-fledged consumer status), the television consumption mode is seeing a radical transformation. Within this context, for TF1, being backed by Bouygues Group is a strength when it comes, for example, to reinforcing content, financing acquisitions and competing more effectively with the "GAFAs" by strengthening the ties with Bouygues Telecom were this to become necessary.

The Group's profile is likely to see a profound transformation in the next five years. The following forecasts in our model are based on the assumption that the TFI Group will be able effectively to negotiate **its digital shift and adapt to the new ecosystem.**

Fig. 57: TF1 P&L forecasts

EURm	2015	2016e	2017e	2018e	2019e
Revenues	**2004**	**2137**	**2052**	**2152**	**2052**
Programming costs	-956	-1018	-980	-1080	-980
Other costs and provisions	-853	-870	-870	-876	-882
EBITDA	**195**	**249**	**202**	**196**	**189**
Depreciation and amortization	-37	-182	-156	-156	-156
Current EBIT	**158**	**67**	**46**	**40**	**33**
Non recurring charges	-17	-86	0	0	0
EBIT	**141**	**-19**	**46**	**40**	**33**

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

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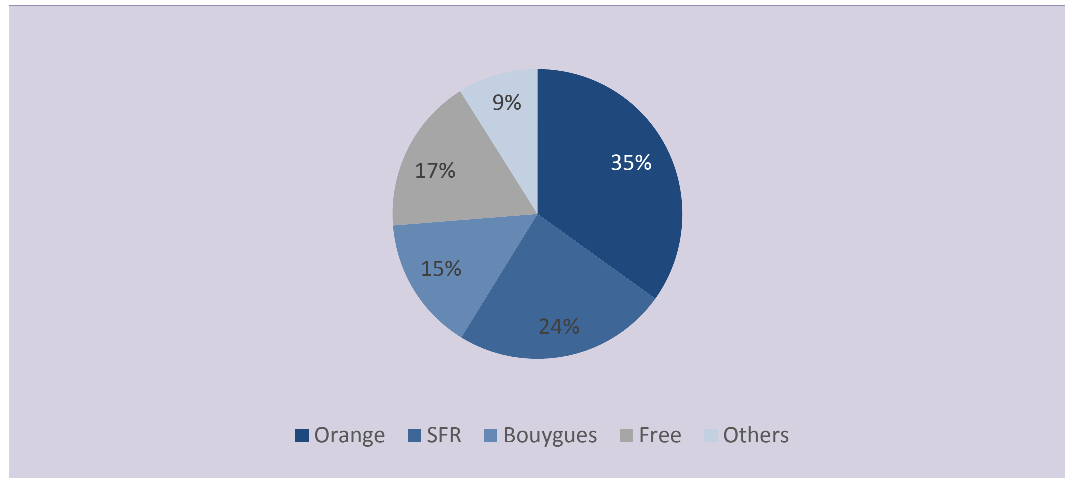
10. Bouygues Telecom

10.1. Competitive landscape

Bouygues Telecom is present in fixed and mobile telecom services in the French BtoC and BtoB markets, the latter segment representing less than 10% of the Group's revenues.

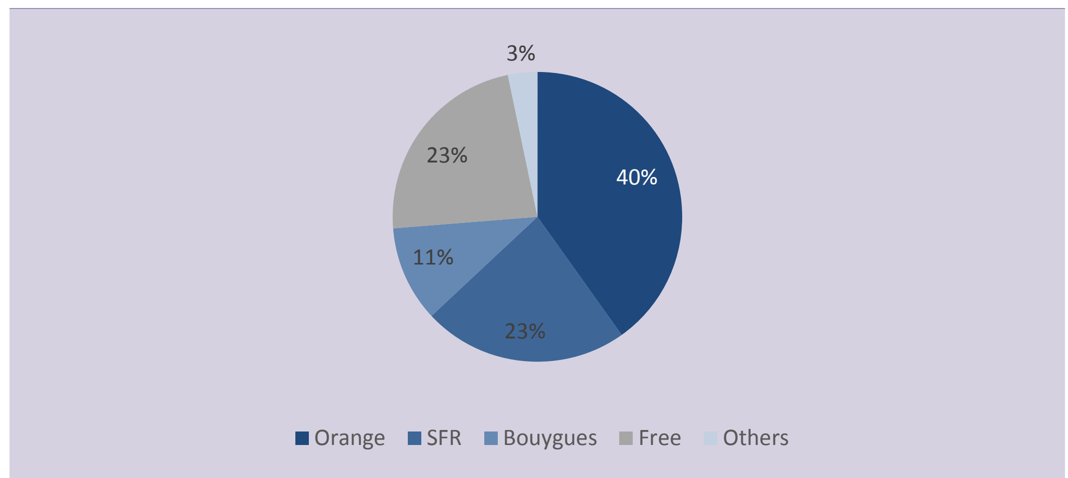
The following charts show Bouygues Telecom's market share and those if its main competitors in the mobile telephony and fixed internet access markets at the end of the 2016 first half.

Fig. 58: Mobile market shares (excluding M2M cards)



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

Fig. 59: Fixed market shares (high and very high speed internet)



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

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10.2. Turnaround plan: business viability a key concern

In order to fully grasp the current challenges, we need to take a quick look back at the history and trajectory of Bouygues Telecom since its inception.

Bouygues Télécom was created in 1994 by Martin Bouygues, in partnership with JC Decaux (who still owns nearly 10% of the share capital) and BNP, before its commercial launch in 1996. Bouygues Telecom was then to **dynamise a competitive environment marked by a duopoly** consisting of Itineris (France Telecom) and SFR, who had launched their services a few years previously.

Suffering from an initial shortfall in mobile network coverage (only recently reabsorbed thanks to 4G), Bouygues Telecom's development strategy focused on tariff innovation**. Bouygues Telecom was to invent the idea of a "communication package"** and launch, with Neo in 2006, the first offer of unlimited calls to all operators. In 2008, the group was also to launch the first 4P offer (fixed + mobile) with Ideo.

Bouygues' development was, however, to be **mostly focused on mobile.** In 2008, Bouygues Télécom launched its own box, supported by the acquisition of the Club Internet network, but was to remain far behind its competitors in the fixed market:

- In 2008 SFR purchased Neuf Cegetel, enabling it to acquire a base of more than 3 million fixed customers
- Orange, given its historical position in fixed telephony, is an internet access provider of choice
- Iliad has operated in the internet access market since 1999, a market it revolutionised with the launch of the first box in 2002.

After years of strong growth which saw Bouygues Telecom reach EUR1.37bn of EBITDA in 2010 for a 27% EBITDA margin, the company **suffered more than its competitors from the arrival of Free Mobile in January 2012**. The violence of the shock for Bouygues Telecom is explained by two main factors:

- Bouygues Telecom is positioned as a challenger in head-on competition with Free.
- Bouygues Telecom is the smallest mobile operator, whose profitability threshold is thus more rapidly at risk.

Despite the launch of B&You in the low cost segment and the tariff repositioning for the high end offers aimed at giving the operator's competitiveness renewed momentum, in 2014 EBITDA collapsed to EUR694m and the company reported a EUR65m current operating loss. It could no longer fund its investment. As of the end of 2012, Bouygues Telecom sold 2,000 telecom towers to an infrastructure fund for more than EUR200m, and a EUR678m recapitalisation plan was unwritten by its parent company. In 2014, following the failed acquisition attempt on SFR (Vivendi preferred Altice-Numericable to Bouygues Telecom), Bouygues Telecom launched a EUR300m cost-saving plan, based notably on a voluntary departure plan targeting 20% of headcount.

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However, all the cost-saving measures were not enough to ensure the viability of Bouygues Telecom. **A critical commercial relaunch thus took place in 2014** based on three pillars:

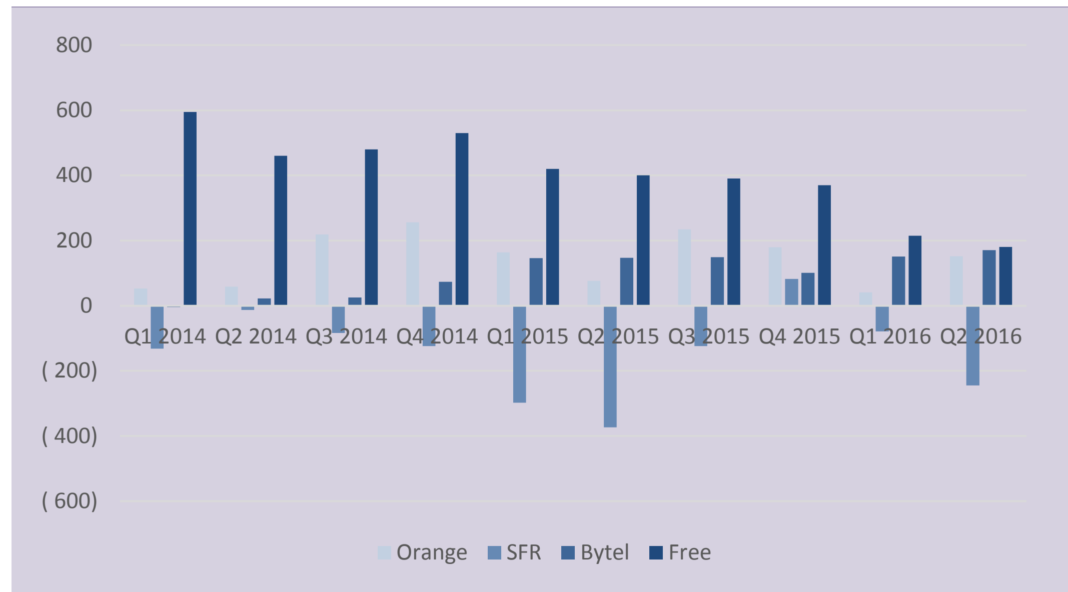
- In March 2014, Bouygues Telecom launched the **ADSL box priced at EUR19.99**, constituting a 30% discount to the standard market price. It had little to lose, inflicting damage on its competitors and thus reinforcing its fixed customer base, a key element in a market which is becoming increasingly convergent.

- In November 2014, Bouygues Telecom **merged its "B&You" low cost offer with its premium Bouygues Telecom proposition,** thereby offering low cost tariffs in stores. It ran the risk of cannibalising its premium offers with high ARPUs but was able to leverage its distribution network costs (550 stores) to accelerate the acquisition of high-margin mobile customers.

- Taking advantage of the authorisation to re-utilise the 1800MHz frequencies deployed on its network and its choice of a single RAN technology as of 2011 to deploy 4G, Bouygues Telecom was then able to leverage the promise of the "largest national 4G network", open as of late 2013.

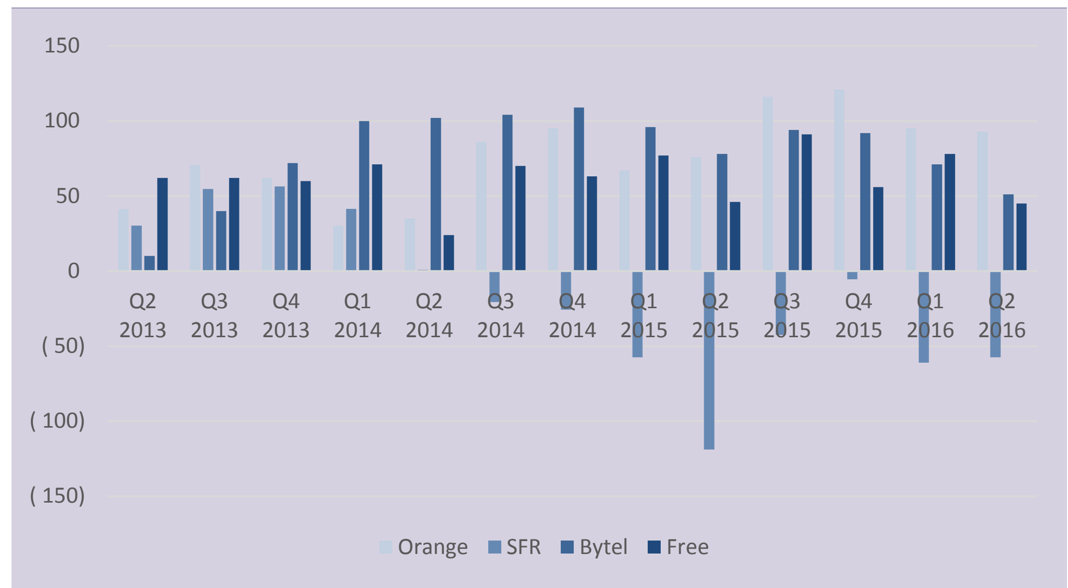
Bouygues Telecom thus combined low cost tariffs and a promise of high service quality. This strategy was to prove **successful** for the company and the commercial turnaround has been spectacular, as illustrated in the two charts below. Naturally the ARPU suffered but, in 2015, Bouygues Telecom returned to sales and EBITDA growth, with respectively +1.6% and +8.4% vs 2014.

Fig. 60: Net mobile subscription sales excluding M2M



Source: Company Data.

Fig. 61: Net fixed sales



Source: Company Data.

Supported by these positive results, at its Investor Day in late 2015 Bouygues Telecom announced an **EBITDA margin target of 25% by** 2017 and 35% over the longer term. This growth will be underpinned by, firstly, a **gain of one million customers in fixed and one million in mobile** over the 2015-17 period and, secondly, the reinforcement of the cost-saving plan by EUR400m between 2013 and 2016 (following the 2011-13 plan to save EUR600m), while maintaining the capex budget at **under €800m**. In our view, the achievement of these targets would be likely to secure the future of this activity over the medium term: a target EBITDA margin of **between 25% and 30%** should enable Bouygues Telecom to **cover annual investment** of around €800m while ensuring a **return on invested capital** above its cost of capital.

Bouygues Telecom's current remarkable performance is ensured by the combination of attractive price positioning (low cost proposition available in stores), **temporary co-leadership in 4G and a context of excessive churn at SFR.** However, while the plan is now on the right track, the question now is 1/do these targets look realistic by 2017-18? **2/**and what about the business beyond this period?

To this end in the next few sections we take a closer look at the two factors which seem to us to be key to the success of the plan:

1/ The sustainability of the commercial performance, under "decent" ARPU conditions, to secure the growth in EBITDA.

2/ The ability to achieve an adequate presence in optical fibre despite a limited capex budget.

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

10.3. Is Bouygues Telecom's commercial performance sustainable?

10.3.1. Mobile

As outlined above, the turnaround in Bouygues Telecom's mobile performance is based on the combination of three factors:

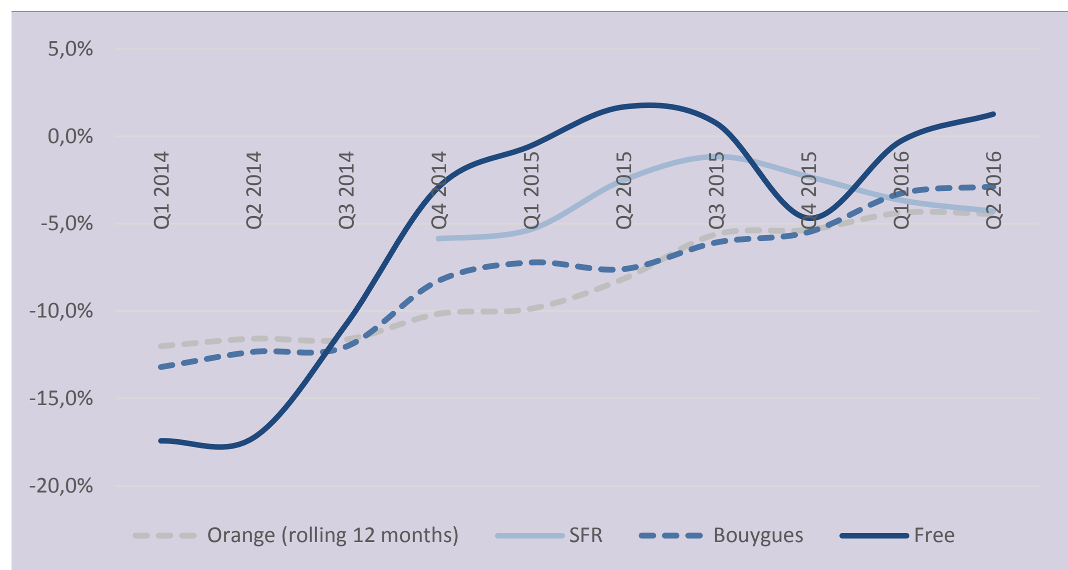
- **Co-leadership in 4G coverage**, alongside Orange.
- The **repositioning of the offers** in late 2014 with, notably, the launch of B&You in stores, as the SIM-only offer of the operator.
- A market fed by **SFR's poor performance.**

In our view, **this "alignment of the planets" is temporary.**

SFR is effectively investing heavily in the deployment of its 4G network, and pursuing the pooling of its network with Bouygues Telecom, which should enable it to **close most of its lag** by 2018, particularly in zones with lower density (in high density zones, Bouygues Telecom is pursuing the densification of its network). In parallel, the internal changes implemented by SFR's new management should also contribute to the company's commercial recovery.

This recovery for SFR will automatically reduce the number of customers returned to the market and the relative advantage currently enjoyed by Bouygues Telecom in 4G (even if its network will continue to gain in terms of quality, catching up with notably the quality of the legacy operator in zones of lower density). It should also be accompanied by **lower promotional intensity** and thus a stabilisation or even a recovery in ARPU, driven notably by an improvement in the market's ability to **monetise the growth in data usages** ("up" migration game and/or content services). We expect these changes to take place by **H2 2017.**

Fig. 62: Trend in mobile subscription ARPUs



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

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

In line with the assumptions outlined above, the following table shows our growth estimates for Bouygues Telecom's existing mobile business, its ARPU and mobile net adds over the next three years with a slowdown in volume growth in parallel with the stabilisation in ARPU. In this respect, it is important to note that Bouygues Telecom also put through **mobile price increases** in early 2016 with, notably, +EUR1 on B&You 2h and +EUR5 on Sensation 3Go, in parallel with the enrichment of its "fair use" data (moving to 5Go). SFR also increased the prices of its Power range early in the year (even going to far as to apply the increase across its existing customer base) It is, however, too early at this stage to talk of a real "spontaneous market repair" for mobile, in that promotional intensity remains very high in this market.

Fig. 63: Mobile outlook for Bouygues Telecom: ARPU, net sales and revenues

	2014	2015	2016e	2017e	2018e	2019e
Mobile network services revenues (EURm)	2976	2842	2952	3085	3206	3330
Mobile postpaid net adds (k)	116	543	530	423	312	240
Mobile postpaid ARPU (EUR)	26,1	24,3	23,7	23,3	23,1	23,1

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

In a French market where fixed/mobile convergence is a key tool in recruiting and securing customer loyalty, the mobile market cannot be analysed on a stand-alone basis. Even if Bouygues Telecom no longer offers a "bundling discount" (since its tariff re-positioning in fixed it has, however, continued to offer multi-line discounts) it will find it difficult to maintain good performances in mobile without effective positioning in fixed internet access.

10.3.2. Fixed internet

Bouygues Telecom's good performances in fixed are mainly attributable to the fact that its tariff positioning is the **most aggressive in the market**, while continuing to offer a **high-quality product and service.**

Between box capex, distribution and customer service costs, and the regular DSL payments to France Telecom, in our view Bouygues Telecom **makes very little money directly from its fixed line business with this tariff positioning.** However, a good performance in this segment seems to us vital for the following two reasons:

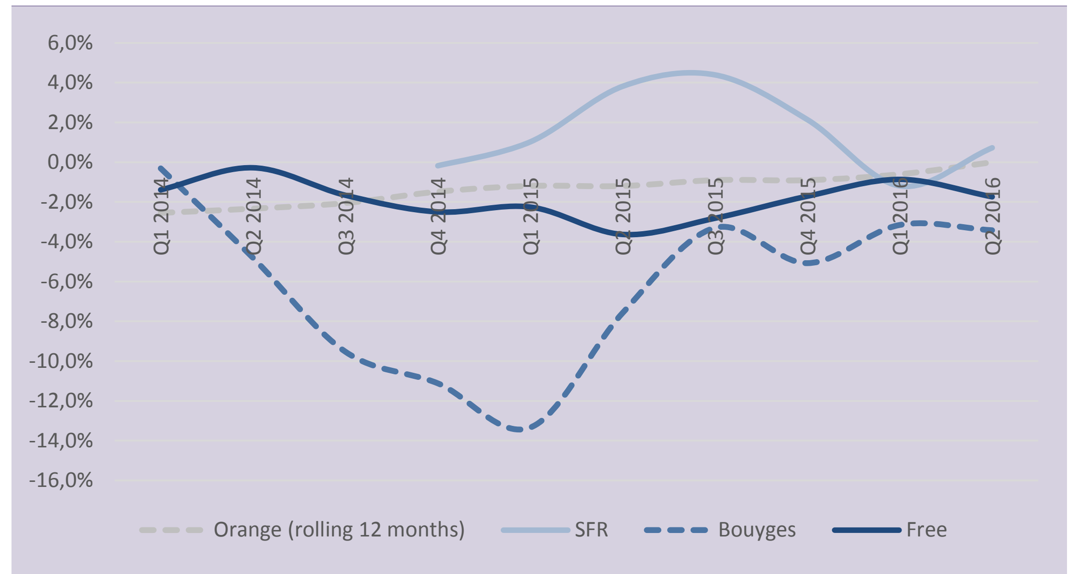
- In the short term, fixed line is a key tool in mobile customer **recruitment and securing their loyalty** via, notably, the 'cross-sell' mechanism.

- In the medium term, with the growth in multi-screen content services, the ability to offer a **homogeneous customer experience in fixed and mobile** seems vital.

Furthermore, the fixed market is showing some **signs of an improvement**. ARPUs are stabilising and three of the four players increased their prices in early 2016. This was notably the case for Bouygues Telecom with, in particular, the introduction of an incremental charge of EUR3 for box rental. This tariff adjustment on the part of the most aggressive player in the market should help to encourage an overall move towards recovery in the fixed market.

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

Fig. 64: Trend in Fixed ARPUs



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

There is, however, likely to be some erosion in Bouygues Telecom's performance over time caused by three main factors: **1/** a progressive weakening in the net growth of the market. **2/** a return to competitiveness for SFR, which is currently underperforming relative to its ambitions (in the same way as for mobile, this recovery for SFR could also contribute to accentuating the fixed market repair mentioned above). **3/** the lag built up in optical fibre relative to its competitors, and Orange and SFR in particular, in parallel with the growing importance of this technology in the eyes of customers.

The following table sets out our growth estimates for the Bouygues Telecom fixed business, with its ARPU, net adds and revenues over the next three years.

Fig. 65: Fixed outlook for Bouygues Telecom: ARPU, net adds and revenues

	2014	2015	2016e	2017e	2018e	2019e
Fixed network services revenues (EURm)	893	983	1078	1164	1238	1301
Fixed net adds (k)	415	360	271	213	155	113
Fixed ARPU (EUR))	31,1	28,8	28,1	28,0	28,2	28,4

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

One big question mark remains at this stage: the impact of the development of the optical fibre market on Bouygues Telecom's performance and position in the market over time. This important question will be addressed in the next section.

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

10.4. Is the growth of the optical fibre market a threat to Bouygues Telecom?

10.4.1. Is optical fibre an absolute necessity?

If there remains a major question mark regarding the outlook for Bouygues Telecom then optical fibre is it. Here we firstly analyse the importance of this new technology in the fixed internet access market.

As presented below, the optical fibre technologies (here we combine FTTH Fibre and FTTB/FTTLA Cable) enable the achievement of theoretical download speeds some 50 times faster than the ADSL technology. The difference is even more notable for uploading where only the optical fibre technologies enable the achievement of ultra-fast speeds.

Fig. 66: ADSL and optical fibre bandwidth

	ADSL	Fibre
Maximum download speed (theoretical) – Mbps	20	1000
Maximum download speed (recorded average) - Mbps	5-10	~ 300
Maximum upload speed (theoretical) - Mbps	1	200-300
Maximum upload speed (recorded average) - Mbps	~ 0,5	~ 100

Source: NPerf, Garnier & Co ests.

The faster speeds are driven by a transformation in the nature of internet use:

- **Dematerialisation**: multiplication of digital content with the disappearance of physical channels (Video On Demand, Streaming musical, online gaming)
- **Delinearisation**: growth in on-demand streaming offers (video on demand subscriptions, catch up TV, etc.)
- **Multi screens**: option of accessing the same content via multiple devices, with the multiplication of simultaneous uses in homes
- **Changes in standards** and notably the growth in ultra-high definition video

The following table illustrates the speeds required for the different forms of video streaming, based on the different compression standards.

Fig. 67: Bandwidth requirements for SD, HD and UHD uses

	SD (720x576)	HD (1980x1080)	Ultra HD (3840x2160)
MPEG2	2-3	12-20	na
MPEG4 (H.264)	1-1,5	6-10	30-50
HEVC	0,5-0,75	3-5	15-25

Source: Accenture.

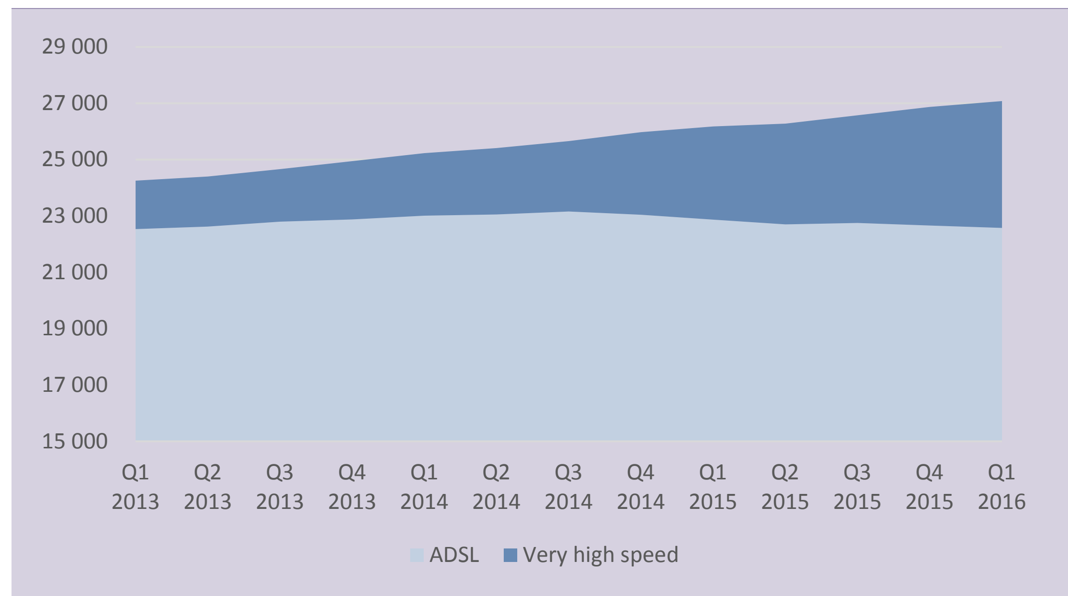
Please see the section headed "Important information" on the back page of this report.

Even with the most advanced compression standards (HEVC), DSL is clearly incapable of delivering high definition streaming to several simultaneous users.

Inversely, for "basic" uses within homes without multiple simultaneous connections, high quality DSL accesses (i.e. not too far away from the operator's network equipment – DSLAM) **are currently still perfectly adequate.** In terms of high upload speeds these are only useful for large social network or cloud users who upload massive amounts of their content to the network.

Let us now take a look at the optical fibre commercial performances in the French market. The following chart shows the trend in the total internet access market in France.

Fig. 68: Trend in the French internet access market

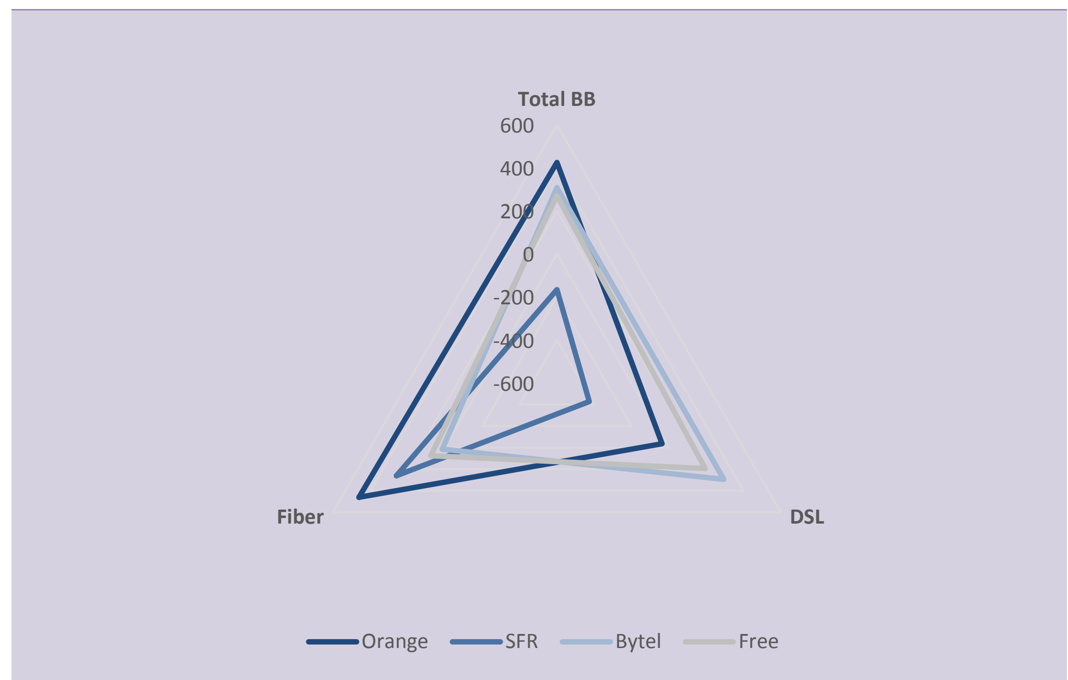


Source: ARCEP.

Since the end of 2014, we note that **ADSL has been in decline, the overall market growth being driven by optical fibre**. This growing part of the optical fibre market is being fed by new entrant customers but also largely by **DSL migration to optical fibre**. **At this stage, however, it would be wrong to conclude that a good performance in optical fibre is required for a good performance in overall internet access.**

The following chart effectively shows the relative performances of the different players in terms of DSL and very high speed internet net adds (on a rolling basis over the last four quarters). While Orange is outperforming its competitors as a whole by leveraging its leadership position in terms of optical fibre recruitment, we note that: **1/** Free and Bouygues Telecom continue to deliver good overall performances despite having little presence in optical fibre recruitment, and **2/** that inversely SFR is losing a large number of customers despite its strong positioning in optical fibre.

Fig. 69: Relative performance of the players, high and very high speed net adds (last twelve months)



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

It seems that **criteria other than technology** are currently required to perform well in the internet access market. Amongst these criteria, as highlighted by the Bouygues Telecom strategy, **price remains primordial**. In this regard it is interesting to note that operator promotional activity involves both ADSL and optical fibre offers, and that the **pricing of the optical fibre proposition is virtually identical to that of the ADSL offers.** As we have seen, the faster speeds offered by fibre are not required by all customers. Furthermore, in most cases, signing up to an optical fibre offer requires connection work in the customer's home. **In these conditions it is currently difficult to ensure massive optical fibre recruitment while looking to charge a tariff premium.**

The question then becomes: how much longer can the operators perform without an expanded optical fibre offer? **In our view, this situation is sustainable for several more quarters but will no longer be viable in one or two years' time.** On this time scale, we expect the growing adoption of new uses (development of content and ultra HD video equipment, growth in streaming/replay consumption, multiplication of simultaneous multi-screen uses, growing exchanges with the cloud), in parallel with the ongoing deployment of optical fibre in new areas of France to contribute to making fibre a decisive market factor. We thus expect the **competitive price advantage currently enjoyed by Bouygues Telecom to trend down over time.** The less effort Bouygues Telecom devotes to fibre deployment, the greater this decline in performance will be. In the next section we analyse Bouygues's investment capability in optical fibre.

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

10.4.2. Can Bouygues Telecom compete on equal terms with the optical fibre leaders?

The following table sets out the deployments to date and the stated ambitions of the different players in the very high speed fixed market.

Fig. 70: Optical fibre networks and deployment ambitions

	Orange	SFR	Bytel	Free
Available fibre sockets (Q2 2016, unitsM)	**5,9**	**8,5**	**1,6**	**3,1**
Current estimated Fibre roll out speed (new socket / year)	**1,8**	**1,6**	**1**	**1,2**
Announced target number of sockets	12	12	8,5	9
Target timing (end of period)	2018	2017	not avail.	2018
Target roll out speed (new socket / year)	**2,4**	**2,3**	**not avail.**	**2,4**

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

Bouygues Telecom currently has the **least extensive optical fibre network** but makes up for its fixed very high speed coverage shortfall thanks to a **white label contract** with the SFR cable network covering 8 million sockets in very high density and average density zones. We estimate the monthly price paid by Bouygues Telecom within the framework of this contract at between EUR15 and EUR20. The **profitability is thus very limited on these customers**, explaining why Bouygues Telecom is currently not directing much effort at their recruitment: the "fill" rate for optical fibre/cable sockets (number of FTTH/Cable customers expressed as a percentage of the total number of available proprietary or white label sockets) at Bouygues Telecom is **5.2%**, vs **8%** for Free and more than **20%** for Orange and SFR.

Bouygues Telecom claims to have secured the deployment of 8.5 million sockets but does not specify the time scale. These 8.5 million sockets break down into 3.5 million in high density zones, 3 million in medium density zones and 2 million in public initiative networks, where Bouygues Telecom will be supported in its services deployment by Bouygues Group subsidiary **Axione.**

The ambitions posted by the various players combine high and medium density areas and public initiative network zones, either under proprietary ownership or as co-investments. **At first glance the targeted roll out rates appear very similar and well above those recorded in the past few quarters** (if we assume that the Bouygues Telecom target will be achieved at the end of 2018). And yet, the available capex budgets are not of the same magnitude for the four operators. This apparent inconsistency between the stated targets and individual investment capabilities can be explained, in particular, by the co-investment models in the different zones.

In particular, the co-investment model in an average density zone (around 10 million sockets across the territory) enables the operators to sign **co-financing contracts** on a certain number of defined agglomerations. On the agglomerations in question, one of the operators effectively deploys the sockets while its partner co-invests by 5% tranche as it acquires market share. For example, an operator who has signed a co-investment agreement on an agglomeration comprising 100 sockets effectively has 100 sockets on which it can propose commercial offers to its customers but will initially co-finance only 5% of the relevant sockets. This is the case until its market share exceeds 5%, the threshold triggering the purchase of another 5% tranche. Furthermore, it is important to note that co-investment can take the form of either a one-off capex payment (purchase of a commercialisation right: IRU model) or a monthly rental. In the same way, in a public initiative network zone,

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commercial operators have the option to lease the network infrastructure from the operators responsible for its deployment. These specificities explain why **operators can post similar deployment goals without necessarily committing to the same level of capex.**

In terms of Bouygues Telecom, we estimate the total capex budget required for the deployment of the targeted 6.5 million new sockets at **c. EUR1.7bn,** as illustrated in the following table.

Fig. 71: Estimated deployment cost for Bouygues Télécom optical fibre – target of 8.5 million sockets

	CAPEX / socket (EUR)	Available sockets June 2016 (M units)	Target (M units)	Roll out Cost (EURm)
Very dense areas	125	1.6	3.5	240
Medium dense areas	500	0	3	1500
Non dense areas	0	0	2	0
All areas		**1.6**	**8.5**	**1,740**

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

Here we assume that 100% of the medium density areas are purchased in IRUs and 100% of the public initiative network sockets are leased. The deployment cost in high density areas is reduced by the co-investment agreement with SFR in this zone (-50%). To this we need to add the "Backhaul" investment enabling the extremity of the optical fibre infrastructure to be connected to the network core, this investment also being required for the connection of the 4G mobile antennas.

Bouygues Telecom has two main levers to support the financing of the costly optical fibre deployment:

- The sale of mobile antennas to specialised infrastructure managers (Cellnex, FPS Towers, etc.). At the beginning of the year, Bouygues Telecom sold 230 telephony towers to Cellnex for EUR80m. Bouygues Telecom still has some 500 telephone towers which could be sold. On our estimates such a sale could raise between EUR150m and EUR200m.

- The savings generated though to 2019 by the pooling of the mobile network with SFR. We estimate the annual capex gain to be EUR70m (of a total opex + capex of EUR100m).

Since the company has access to these two sources of financing, and **on a 2020 perspective, the target of 8.5 million connectable sockets seems to us to be compatible with an annual investment budget of EUR800m** (subject to Bouygues Telecom maintaining a box strategy comparable to the present one, i.e. low cost equipment thanks, notably, to the partnership with Android).

Furthermore, it is worth reiterating two important points here concerning the medium density zone:

- Given the 5% tranche mechanism, **the capex commitment will be made in parallel with optical fibre customer wins.** The cost savings from ADSL unbundling (payments to Orange) will thus, to a certain extent, support the investment spending.

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- It is **not necessary to commit to the capex on 100% of a given agglomeration to be able to propose a commercial offer in the zone**, so long as the infrastructure operator has deployed the sockets and a co-investment contract has been signed on the relevant agglomeration.

In addition to the financial aspect, being a co-investor frees the company from the **heavy operational commitment** involved in the industrial deployment of such networks.

On the other hand, being a co-investor has a number of **disadvantages:**

- **Reduced commercial effectiveness**: the operator responsible for deployment has control over the environment and the timing, and is thus in a better position to recruit customers

- An **ultimately higher cost**: the price paid for sockets purchased in IRU form is higher than the deployment cost and increases over time. As for the leasing model, at c. EUR15 per month it is still more expensive than the cost saving on ADSL unbundling.

Given its size, Bouygues Telecom seems in our view condemned to suffer from a **structural competitive disadvantage in optical fibre,** particularly relative to Orange and SFR. In the past, when the market had only three players, Bouygues Telecom was able to manage this deficiency in its mobile network through innovative tariff positioning. However, should acceleration prove necessary, we see the issues for Bouygues Telecom as follows:

- Either **revise up its capex budget,**

- Or resort to **massive use of the leasing model** and/or commercial partnerships of the type already concluded with SFR,

- Or compensate for the infrastructure deficiency in optical fibre via **reinforced low cost positioning.**

- Or a combination of the above.

All the solutions outlined above would over time imply **significant pressure on the operator's profitability.**

In effect, it might be argued that Bouygues Telecom's small size and thus limited investment capability will weigh even more on its competitiveness and profitability in a market environment where **value will be created not by growth in the penetration rate but by the ability to innovate**. In our view, the "fibre" factor will in time result in Bouygues Telecom's **structural profitability being below that of its peers,** in a market which would continue to comprise four operators. This is the reason why the long-term forecasts in our model **do not reach the 35% EBITDA margin long-term target flagged by management.** Our estimates do, however, show the company reaching the 25% target more rapidly (in 2017) given the positive short and medium-term outlook.

Another path remains open to Bouygues Telecom: increase its prices in fixed. This would require the company to be in a position to maintain a strong commercial performance while reducing the price differential with the competition. This scenario could be envisaged by 2018/2019 when the 4G

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mobile network will have become more dense and subject to the customer base having reached critical mass on this time scale. While we expect Bouygues Telecom to benefit from a progressive market repair in fixed, at this stage we do factor any potentially significant price increase from Bouygues Telecom into our valuation.

10.5. What might be a future market scenario and what would be the impact on the valuation of Bouygues Telecom?

10.5.1. Market change scenario

In our view, there are currently **two macro scenarios regarding market change:**

- **Enforced consolidation.** The competitiveness of the players in their headlong rush to sign customers exacerbates the aggressive round of promotional one-upmanship which is annihilating any chance of an ARPU increase. This is the mobile market's current configuration, particularly in the low cost segment. On this scenario, Bouygues's competitive advantage in 4G is eroded and its competitive disadvantage in optical fibre accentuated. Bouygues Telecom is forced into playing the role of a low cost supplier given, notably, an inadequate financing capability, and is ultimately forced into a merger.

- **Spontaneous market repair.** The different players gradually emerge from their aggressive promotional strategies, implement tariff increases and follow each other down this virtuous path (at the required initiative of SFR and especially Orange as "market maker"). This is what we appear to be seeing at present in the fixed market, in a very preliminary form. On this scenario, Bouygues Telecom regains some investment leeway and is assured of profitable and sustainable growth. Consolidation remains an option here, initiated by Bouygues Telecom.

We retain scenario 2 for the assumptions in our model for the following four reasons:

- **The current situation is not sustainable** and all the players are in dire need of a market repair: market volume will gradually dry up, Bouygues Telecom needs to finance its investment in optical fibre, SFR needs to reimburse its debt and pursue a premium strategy which is being thwarted at present by an inadequate level of service quality, Iliad is going to have to move from a volume to a value-based rationale and stabilise its activity in France to secure its growth in Italy, while Orange needs to consolidate its status and notably push up its stock market valuation so as to be in a strong position to participate in any consolidation transactions at European level.

- The **opportunities for ARPU appreciation are real** in the market, subject to more healthy competition: monetisation of the growing data uses and the related new services, in particular content-rich offers. This is not a market situation where an absence of innovation would rule out the implementation of price rises.

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- This is a **scenario compatible with the ARCEP policy**, which is now oriented towards innovation, investment and service quality as opposed to the price factor which had been the alpha and omega of French telecoms regulation for many years.

- No acquirer/seller couple currently stands out. In our view, such a transaction is likely to be **politically impractical** in the run-up to the forthcoming elections and it is **difficult to discern the real position of Martin Bouygues** on the subject, given the unfolding of events in recent years (proposed merger with Orange then attempted acquisition of SFR in 2014**,** turning down flat of the Altice offer then announcement of a stand-alone business plan in 2015, new merger attempt with Orange in early 2016 before the breakdown of negotiations after three months).

Our valuation thus includes no transaction premium linked to the sale of Bouygues Telecom or to another consolidation scenario and thus to the realisation of cost synergies or an accelerated market recovery, the latter representing at this stage no more than a potential **opportunity**.

We do however discuss below the consolidation scenarios which could be envisaged.

10.5.2. Impact of a possible consolidation

While **we rule out a return to consolidation in the short term for our base case**, **consolidation remains possible over the medium term** even on a scenario where a spontaneous market repair might have begun to take place.

In our view the impending election period in France is not conducive to a major market transaction emerging in the short term, notably involving Orange. Furthermore, we do not see the succession of Martin Bouygues by 2018 as a significant catalyst potentially influencing the Group's strategy with regard to the different consolidation scenarios.

The following table presents a summary of the pros and cons, as well as the probability of the main potential consolidation scenarios.

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Fig. 72: Consolidation scenarios, advantages/disadvantages and probabilities

Buyer	Seller	Pros	Cons	Probability
Orange	Bouygues	Relationships between M Bouygues and S Richard	Regulatory issues	++
		Workforce and social considerations	Execution complexity	
		Consistency with Martin Bouygues's will to stay in Telecoms	Political considerations	
Bouygues	SFR	Existing network agreements	Valuation discussions	+
		Opportunity for Altice to reinvest in USA	Timing unfavourable to SFR (low market valuation, integration	
		Fixed/Mobile complementarity	still ongoing)	
SFR	Bouygues	Existing network agreements	Workforce and social considerations	-
		Fixed/Mobile complementarity	Inconsistency with Martin Bouygues's will to stay in Telecoms	
Iliad	Bouygues	Execution and regulatory considerations	Relationships between Martin Bouygues and Xavier Niel	--
		Mobile infrastructures complementarity	Inconsistency with Martin Bouygues's will to stay in Telecoms	
			Workforce and social considerations	

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Bouygues	Iliad	Execution and regulatory considerations	Relationships between Martin Bouygues and Xavier Niel	---
		Complementarity of mobile infrastructures	Xavier Niel not a seller	

Source: Garnier & Co ests.

Amongst the two scenarios we deem to be the most likely: **1/** a return to the plan already envisaged with Orange in early 2016, or **2/** the acquisition of SFR by Bouygues.

A Bouygues Telecom-Orange merger, impact on the transactional value of Bouygues Telecom

By way of introduction, it is worth remembering the two main reasons which led Martin Bouygues to walk away in April 2016: **1/** execution risks linked notably to the conditions imposed by Iliad, **2/** the requirements of the French State shareholder in Orange, in terms of valuation and control over the share capital which were difficult for Bouygues to accept. Press reports, which were not denied by the interested parties, pointed to a **significant improvement** in these points of contention in the days following the refusal from Martin Bouygues but it was no doubt too late to change his mind. We thus believe that in any case the deal was very close to being realised.

Within the framework of a transaction with Orange, we would expect the **transactional value of Bouygues Telecom to be relatively stable over time**, irrespective of the market trend. In other words, in walking away from the transaction with Orange earlier this year (and with SFR in mid-2015) we don't see Martin Bouygues **running much risk of a material reduction in the transactional value of his subsidiary**. On the contrary, he is betting that the future value of the company will be at least the same, or even higher, given the fact that the revenue growth continues as we show hereafter (on the other hand this decision pushes out the materialisation of the goodwill generated by the cost synergies arising from a merger with a market competitor until an undetermined future date).

We estimate the transactional value of Bouygues Telecom (i.e. the price a potential buyer is prepared to pay to acquire the company) to be the sum of the following three elements:

- **The operational value of the business post-cost synergies** enabled by the elimination of overlaps between the acquirer and the target (mainly fixed and mobile networks, IS, distribution, overheads). On a first approach (leaving aside restructuring costs), the relevant cost synergies are such that the value of the target can be captured directly in a multiple of its sales. Here we estimate this figure to be EUR8bn, which is to say 2x Bouygues Telecom's 2015 sales (also equivalent to 6x the 2015 EBITDA plus 50% of the discounted synergies totaling EUR7bn. Note that, within the framework of a transaction, the acquirer generally only accepts to pay the seller a fraction of the potential synergies). This value is thus destined to increase over time, as the target wins customers and grows its sales.

- **The "market repair" effects** enabled by market consolidation: reduced pressure on prices, sharing of the market flows between three players instead of four, savings on loyalty and acquisition costs. Currently and for the entire French market, we see these effects reaching around €10bn. Within the framework of a transaction it would, however, be difficult to arrive at an objective estimate. They are very dependent on the profile of the operator (as a function of its size, business model and specific strengths/weaknesses in the market) and appear to us to be primarily an adjustment tool to be used for the negotiations and the price paid for the target.

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- **The value of the assets to be divested** within the framework of the merger: mobile antennas, optical fibre infrastructure, frequencies, distribution network. A figure of around EUR1.5bn was mentioned during the recent merger discussions with Orange.

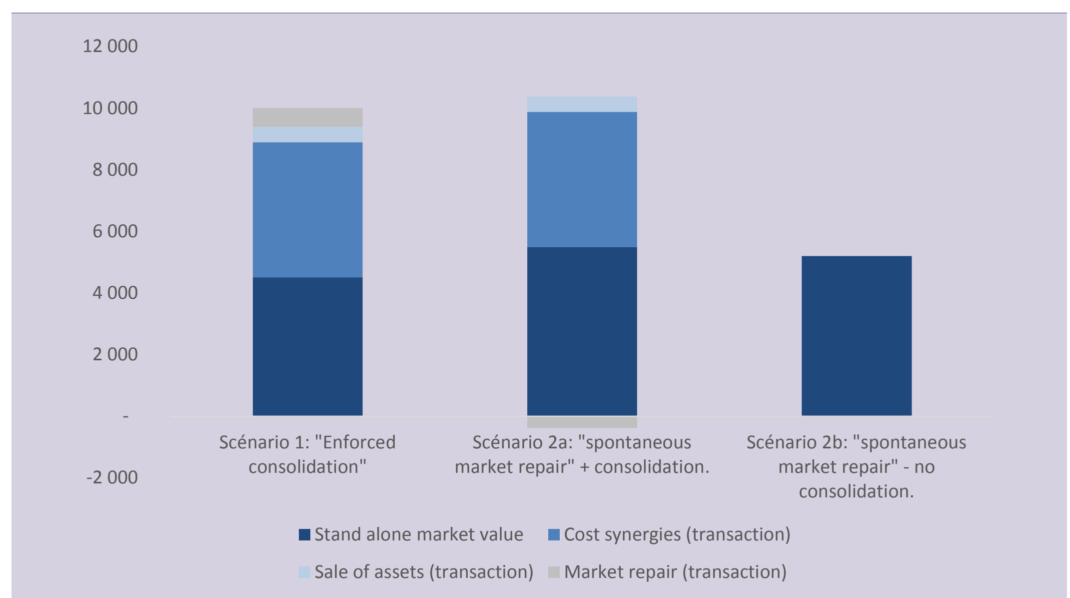
According to the information made public, the transactions envisaged with SFR in mid-2015 and Orange in early 2016 valued Bouygues Telecom at around EUR10bn. This valuation could break down as follows 1/ a valuation of EUR8bn for Bouygues Telecom post-cost synergies (i.e. twice the 2015 "network" sales), 2/ EUR1.5bn of proceeds on the divestment of redundant assets (frequencies, mobile network and stores), and 3/ the balance (c. EUR500m) representing goodwill in respect of "market repair".

On our scenario 1 of on-going price pressure leading to enforced consolidation, the intrinsic value of Bouygues Telecom, even post synergies, would be under pressure given the fact that customer value is itself under pressure. And the value of the assets to be sold would also diminish over time. However, the **impact of the potential market repair in such a market configuration would be multiplied ten-fold.** Assuming 66% depreciation in the market value of the assets divested and zero growth in Bouygues Telecoms revenues, the growing urgency of a market repair might justify EUR1bn compensation for the corresponding loss of value. The objection might be that, in such a situation, a weakened Bouygues Telecom would not have the upper hand in the negotiations. Were this to be true, it does however seem reasonable to count on **reinforced competition between the potential buyers** resulting in a deal within a context where market repair would have become critical.

In our scenario 2 of spontaneous market repair, the loss of value for the assets divested would be **broadly offset by the increase in the value of Bouygues Telecom produced by the growth in its sales**. Based on an economic asset value of two times revenues, a 10% increase in revenues would be "enough" to offset a EUR1bn fall in the value of the assets divested. We see this revenue growth as being compatible with the base scenario of Bouygues Telecom pursing its activity. And even if the impact of a market repair on this scenario would be weaker, it still looks enough to reach a transactional value of EUR10bn.

The different scenarios on market change and the corresponding valuations of Bouygues Telecom are summarised in the following chart.

Fig. 73: Valuation of Bouygues Telecom on the different market change scenarios



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

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Chance of SFR being acquired by Bouygues Telecom: level of credibility?

Following the latest consolidation rumours in mid-September (denied by Bouygues) and excluding the fact that Orange plays a central role every time, in our view the **scenario of a potential acquisition of SFR by Bouygues could resurface.** Remember that Bouygues was beaten by Altice/Numericable in its attempted acquisition of SFR from Vivendi in early 2014.

This scenario makes sense to us for the following reasons:

1/ Firstly, from an **industrial standpoint**, Bouygues Telecom needs **very high speed fixed broadband**, which SFR has, while **SFR needs a high-quality mobile network**, which Bouygues Telecom has. Remember that the two parties are already linked, in both fixed and mobile, by infrastructure sharing agreements. 2/ Altice is currently **bogged down with SFR, whose turnaround is taking time and which is suffering from a significant lag in terms of its mobile network**. For us this currently represents the main operational factor in doubt concerning the outlook for Altice. In our view, selling SFR and prompting a market consolidation while retaining a minority stake to benefit from market repair, and then reinvesting the proceeds from the sale in a market offering more opportunities like the United States is a scenario which could make sense for Patrick Drahi.

Of course this scenario also raises some difficulties: can we really see Patrick Drahi selling his biggest subsidiary purchased barely two years ago, which is at the heart of his convergence plan, and which is still in the restructuring phase? Is this the best time to sell the business, just as SFR is probably at a low point in terms of valuation. Will the two parties be able to agree on an acceptable valuation given this context? What would the governance look like for the new entity?

Many points remain unresolved but **do not make this scenario unrealistic**. In our view, a 20% premium to the current SFR share price, valuing the company at close to the multiples at which it was sold in 2014 (c.7x EV/EBITDA) would be unlikely to leave Altice indifferent and would create value for Bouygues. Various modes of financing could be envisaged by Bouygues (debt, a Bouygues capital increase and/or a listing of Bouygues Telecom, as evoked in 2014). For illustration purposes, with 100% of debt at Bouygues level you could achieve debt ratios of below 4x net debt/2016[e] EBITDA post synergies, as seen in the following table.

Fig. 74: Bouygues-SFR merger scenario

	2016e	2016e	2016e	2016e	2016e
	Bouygues	Bouygues Tel	SFR (excl. Media)	Bouygues + SFR	Bouygues Telecom + SFR
EBITDA	2637	917	3970	7096	5375
Net debt	3099	1131	14098	26790	24822
Net debt/EBITDA	**1,2**	**1,2**	**3,6**	**3,8**	**4,6**
SFR Equity Value (current)				11420	
Transactional premium				20%	
SFR Equity Value (transaction)				**13704**	
SFR EV (transaction)				27802	
SFR EV/EBITDA (transaction)				**7,0**	
Altice's remaining stake in SFR				30%	
Bouygues Cash out (100% debt funded)				9592,8	
Expected synergies (annual run rate)				488,66	
				10%	

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

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11. Appendices

Fig. 75: Bouygues P&L

	2015	2016e	2017e	2018e	2019e
SALES	**32428**	**31906**	**32822**	**34018**	**35058**
Other revenues from operations	92	137	144	144	144
CURRENT OPERATING PROFIT	**941**	**1021**	**1245**	**1437**	**1600**
Other operating income and expenses	-273	-273	-100	-50	-50
OPERATING PROFIT	**668**	**748**	**1145**	**1387**	**1550**
COST OF NET DEBT	-275	-248	-226	-230	-230
Other financial income and expenses	6	2	0	0	0
Income tax expense	-118	-191	-315	-397	-453
Joint ventures and associates	199	90	138	153	158
NET PROFIT FROM CONTINUING OPERATIONS	480	401	742	913	1024
NET PROFIT	**480**	**401**	**742**	**913**	**1024**
Net profit attributable to non-controlling interests	77	41	77	77	77
Net profit attributable to the Group	**403**	**360**	**665**	**836**	**947**

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

Fig. 76: Bouygues revenue breakdown by business

	2015	2016e	2017e	2018e	2019e
SALES	**32428**	**31906**	**32822**	**34018**	**35058**
Other revenues from operations	92	137	144	144	144
Construction	**26239**	**25494**	**26217**	**27218**	**28106**
ow Bouygues Construction	11975	11650	11825	12180	12545
ow Bouygues Immobilier	2304	2505	2918	3220	3388
ow Colas	11960	11338	11474	11818	12173
TF1	**2004**	**2064**	**2052**	**2052**	**2052**
Bouygues Telecom	**4505**	**4707**	**4925**	**5120**	**5273**
Holding and others	**135**	**139**	**132**	**132**	**132**
Intra group adj.	**-455**	**-497**	**-504**	**-504**	**-504**

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

Fig. 77: Bouygues current operating profit breakdown by business

	2015	2016e	2017e	2018e	2019e
CURRENT OPERATING PROFIT	**941**	**1021**	**1245**	**1437**	**1600**
Construction	**832**	**853**	**924**	**1002**	**1076**
ow Bouygues Construction	350	339	362	391	422
ow Bouygues Immobilier	138	153	180	200	212
ow Colas	344	361	382	411	442
TF1	**158**	**67**	**46**	**40**	**33**
Bouygues Telecom	**-11**	**134**	**311**	**431**	**527**
Holding and others	**135**	**-33**	**-36**	**-36**	**-36**

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

Fig. 78: Bouygues Cash Flow

	2015	2016e	2017e	2018e	2019e
Net Profit	**480**	**401**	**742**	**913**	**1024**
D&A	1454	1589	1593	1602	1613
Cost of net debt	275	248	226	230	230
Taxes	118	191	315	397	453
Others	-260	2	0	0	0
CASH FLOW (before interest and taxes)	**2067**	**2431**	**2876**	**3142**	**3320**
- Cost of net debt	275	248	226	230	230
- Income tax expense	118	191	315	397	453
- Net capital expenditure	1890	1678	1656	1716	1737
ow Bouygues Construction	*214*	*217*	*220*	*227*	*234*
ow Bouygues Immobilier	*13*	*11*	*75*	*14*	*15*
ow Colas	*311*	*454*	*359*	*473*	*487*
Ow TF1	*58*	*190*	*188*	*188*	*188*
ow Bouygues Tel (incl. Licenses)	*1289*	*804*	*814*	*814*	*814*
FREE CASH FLOW – Bouygues definition	**-216**	**314**	**679**	**800**	**900**
CHANGE IN WORKING CAPITAL*	203	145	10	-3	-297
FREE CASH FLOW – BG definition	**-13**	**459**	**688**	**796**	**603**
Others Investing cash flow	1194	637	-116	-116	0
Others Financing cash flow (dividends…)	-1568	-639	-642	-642	-642
Cash tax adjustment (not incl. In WCR)	-76	-140	0	0	0
FX	143	-49	0	0	0
Cash variation	**-320**	**268**	**-70**	**38**	**-39**

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

Fig. 79: Bouygues Net debt

	2015	2016e	2017e	2018e	2019e
NET DEBT	**-2561**	**-2563**	**-2633**	**-2595**	**-2634**
ow constr	0	3187	3098	2993	2881
ow colas	0	587	650	711	801
ow immo	0	1	-3	-17	-38
ow tf1	0	165	152	156	155
ow bytel	0	-1131	-1159	-1067	-793
ow holding	0	-5371	-5371	-5371	-5371

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

Fig. 80: Bouygues Telecom P&L

	2015	2016e	2017e	2018e	2019e
SALES	**4505**	**4707**	**4925**	**5120**	**5273**
SALES FROM NETWORK	3825	4031	4249	4444	4630
of which fixed sales from network	*983*	*1078*	*1164*	*1238*	*1301*
of which mobile sales from network	*2842*	*2952*	*3085*	*3206*	*3330*
of which other sales	*680*	*676*	*676*	*676*	*642*
Purchases used in production	-709	-714	-736	-756	-758
Personnel costs	-491	-493	-450	-455	-459
External charges	-2142	-2185	-2229	-2273	-2319
Taxes other than income tax	-138	-141	-148	-154	-158
Net depreciation and amortisation expense	-773	-793	-800	-800	-800
Net charges to provisions and impairment losses	-2	-8	-8	-8	-8
Other income and expenses from operations	-261	-239	-244	-244	-244
EBITDA	**752**	**917**	**1099**	**1219**	**1315**
EBITDA Margin (% of sales from network)	**19,7%**	**22,7%**	**25,9%**	**27,4%**	**28,4%**
CURRENT OPERATING PROFIT	-11	134	311	431	527
Other operational revenues and expenses	-123	-98	-100	-50	-50
OPERATING PROFIT	-134	36	211	381	477
Cost of net debt	-8	-10	-10	-10	-9
Other financial income and expenses	-8	-7	-8	-8	-8
Taxes	51	-1	-51	-124	-158
% of taxable income	-0,34	0	0	0	0
Joint ventures and associates	34	0	0	0	0
NET PROFIT	**-65**	**18**	**141**	**238**	**302**

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

Fig. 81: Bouygues Telecom Cash Flow

	2014	2015	2016e	2017e	2018e	2019e
Net Profit	**-45**	**-65**	**18**	**141**	**238**	**302**
D&A	773	773	793	800	800	800
Cost of net debt	8	8	10	10	10	9
Taxes	-33	-51	1	51	124	158
Others	94	-11	31	0	0	0
CASH FLOW (before interest and taxes)	**797**	**654**	**853**	**1003**	**1173**	**1269**
- Cost of net debt	8	8	10	10	10	9
- Income tax expense	-33	-51	1	51	124	158
- Net capital expenditure (incl. Licenses cash)	684	825	1036	930	930	814
FREE CASH FLOW - Bouygues definition (incl. Licenses cash)	**138**	**-128**	**-195**	**11**	**109**	**288**
CHANGE IN WORKING CAPITAL*	24	-84	4	-39	-17	-14
FREE CASH FLOW - BG definition	**162**	**-212**	**-190**	**-28**	**92**	**275**

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

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

Fig. 82: Cost of TF1 programming (H1 2016)

	Cost	Cost mix
Entertainment, games, magazines	143	28%
Movies (cinema)	70	14%
Series and other fictions for TV	170	33%
Sports (excl. UEFA 2016 championship)	22	4%
Information	67	13%
Young, animation	8	2%
UEFA 2016 championship	38	7%
Total	**518**	**x**

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

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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 57.1% NEUTRAL ratings 31.2% SELL ratings 11.7%

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