Macro-Strategy Key Issue
France: risk scenarios around election and beyond

Economics

Europe including UK

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French Equities too relaxed – CAC 40 gap to OAT spread widest since 2012

This country note on France focuses on the presidential elections of 23 April and 7 May, which are a key concern among investors and are driving a potential dislocation in markets. France rode the cyclical rally in H2-16 and turned a blind eye to the jump in the OAT spread (Fig 1). France normally trades at a 10% P/B discount to Europe; today, it is a mere 15%, while the periphery trades on above-average discounts of closer to 40%. Today vs July 2012 valuations point to potential downside of c.20-25% on a tail-risk outcome. If instead, it's Relief & Reform, we see a turning point for Europe's swing investor. This could close the record $253bn ETF flow gap between the US and Europe (page 2).

Downside (Eurozone break-up fears), upside (reforms and a growth revival)

Opinion polls suggest that the Eurosceptic Front National under Marine Le Pen will make it into the second round of the presidential election, but will then be defeated by either Emanuel Macron or François Fillon from the centre right. If the polls are wrong, a Le Pen victory would likely raise investor fears given her proposal to reintroduce a national currency and to hold a referendum on EU membership. There are several legal hurdles to implementing such an undertaking and the cooperation of parliament would be essential, but, faced with uncertainty and downside risks, Eurozone break-up fears could re-emerge. By contrast, both Macron and Fillon promise substantial reforms, including more labour-market flexibility, raising the retirement age and public-spending cuts. Given France's favourable demographic outlook, productivity-enhancing structural reforms would likely imply an improved longer-run growth outlook.

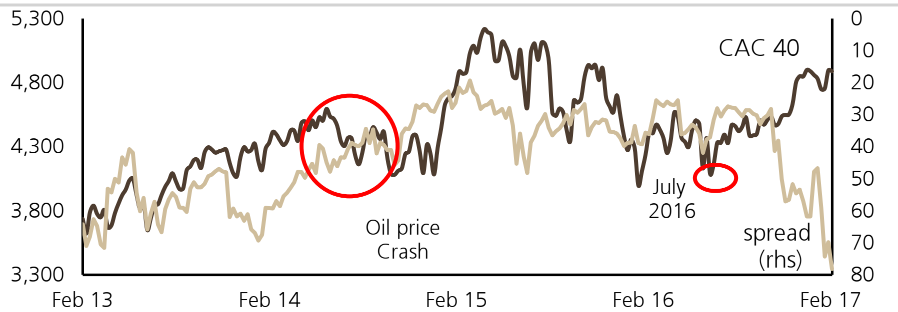
How to invest in a Tail-Risk Scenario? Quality loves a crisis and has lagged

BUY 'havens' that rise 'with' spreads (pages 3, 16-19): Switzerland – Pharma now trades on a cyclical PE. Consider: Danone, L'Oreal, Essilor, Remy and BIC. **SELL** sectors that fall when spreads rise, with domestic exposure and debt, such as Financials, Retail and Utilities. Consider 14 stocks, such as: Soc Gen, BNP Paribas and St Gobain, and the most indebted (pages 18-19).

Political Relief Scenario? Europe vs US, Periphery, Value & Domestic Beta

While the overall upside might be more modest than the potential downside (above), it could re-kindle the risk-on trade as political risk fades. Reform should support French vs Germany: GDP/profits have lagged since 07 (20% gap). On potential labour reform: we highlight companies with higher wage costs in France (pg 15). See all stocks, pg 22.

Figure 1: France OAT spread (vs Bund) & CAC 40 – equities look exposed



Source: Thomson Datastream, UBS European Equity Strategy

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European equities: at a turning point?

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Is this 1) a positive turning point for Europe/France; 2) similar to the stresses faced in July 2012 when the Euro was in question; or 3) something in the middle? France normally trades at a 10% P/B discount to Europe. Today it is on a 15% discount, perhaps a little too complacent given the political uncertainty. In our view, an unpopular outcome that starts break-up conjecture could mean 20-25% downside (July 2012 multiples). But, given the response to the UK 'Leave' vote and Mr. Trump's victory markets could react unexpectedly. Perhaps they look for a currency kicker (appendix). **If markets do focus on a break-up scenario,** we recommend buying investments that rise 'with' periphery bond spreads and have exposure outside of the EU: Switzerland, Defensive Growth & Quality like: Danone, L'Oreal, Essilor, Remy and BIC. On the other hand, we would avoid sectors and stocks with high exposure to France and levels of debt (Banks, Utilities, Telecom & Retail).

Turning point or more Turmoil

France not valued for upsets

More downside on tail risk than upside on relief

Turning point for Europe? US investors want three things

Many international investors walked away from European equities after QE1 (in January 2015) failed to stem the profit rot. Since then, we have been asking US investors what it will take to get them back into Europe? They cite three things:

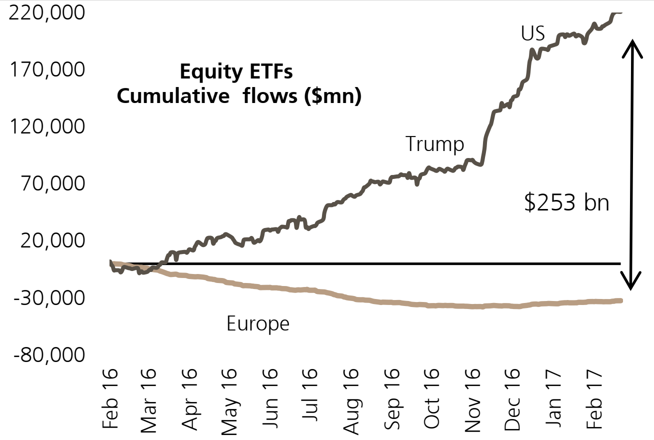
- A year of **'trailing' profit growth –** having been absent for six years;
- A perception the euro area is **restructuring –** France should follow Germany;
- A more **stable euro-area,** with less intra-EU bickering.

A distaste for Europe – ETF flows record gap

Mind the gap = $253bn

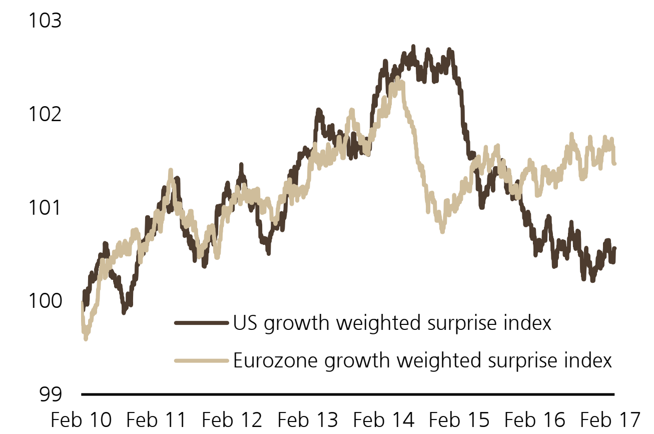
The gap below is unusual. In 2015, more flows went into Europe post QE1 than the US. Today, it has more than reversed, and the gap of $253bn in favour of the US is a record by a wide margin. This ignores economic growth surprises (below).

Figure 2: Equity ETF flows: US vs Europe. Big change from 2015 when Europe was marginally ahead



Source: UBS Global Equity Finance

Figure 3: Flows didn't follow the Eurozone surprise index



Source: UBS Economics and Global Equity Strategy

EU Profit and Valuation gaps to the US 'still' in crisis territory

US equities have beaten Europe by 55% since 2007 and the profit and valuation gaps are still at crisis highs. A growth-friendly outcome could be a turning point: Value rally over? A review of US vs Europe.

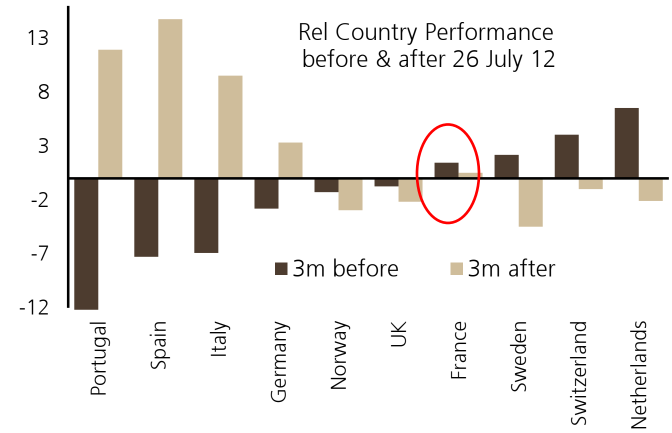
Tail risk: a look back at July 2012

The charts below show us how markets behaved ahead of 26 July 2012 when Mr. Draghi stepped in to save the euro. We acknowledge that Europe is in a different place today, the banks have repaired balance sheets by over $500bn, the austerity drag is largely behind us and credit markets are coming back to life (growing by +2% now). But worries about a Le Pen victory potentially leading to the demise of the euro area could *potentially* trigger a similar reaction.

Last time euro area's longevity was in question

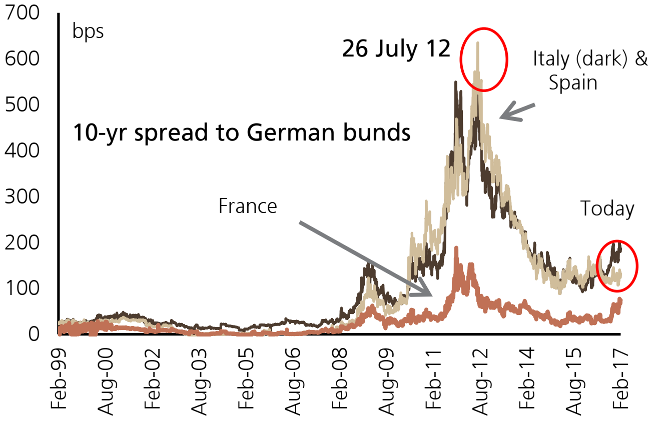
Euro fell > 10% in 1H 12

Figure 4: Country performance, three months before and after: Periphery down and Switzerland up



Source: Thomson Datastream, UBS European Equity Strategy

Figure 5: Spanish bond spread hit 635 bps – France then was more of a haven



Source: Thomson Datastream, UBS European Equity Strategy

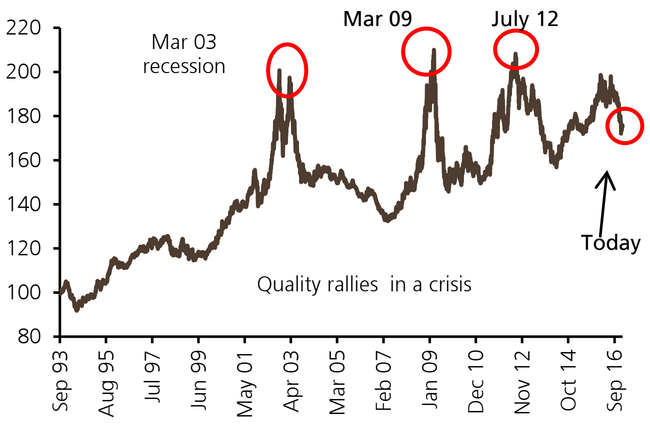
Back in July 2012, Europe's value dispersion gap (a fear indicator as investors crowd into growth) hit a crisis peak – see Value rally over? Global value dispersion gaps. The chart below also shows the race into High (vs Low) Quality. Quality loves a crisis. It also sold off in H2 last year. Note: Quality is measured by high ROCE/profit margins and low stock vol.

Up to July 12 – value dispersion gaps peaked and Quality soared

See appendix

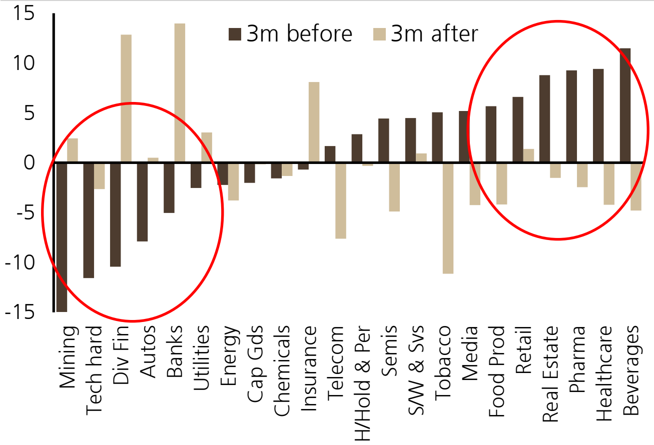
Within sectors, the Cyclicals, Financials and domestic Utilities got hit the hardest. Banks are still highly levered, but not as bad as 2012. See stocks on pages 17-19.

Figure 6: Quality loves a crisis – performance of high vs low quality (within sectors)



Source: UBS Quant and European Equity Strategy

Figure 7: EU sectors Rel Performance around July 2012 – extreme gap between cyclicals and defensives



Source: Thomson Datastream, UBS European Equity Strategy

Macro view: Two elections on investors' minds

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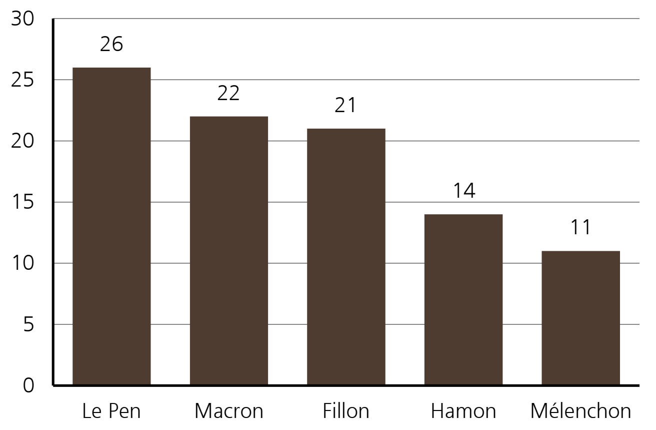
Following the Dutch elections on 15 March, the French presidential elections of 23 April (first round) and 7 May (run-off) are the key focus in the European political calendar. As in other elections, the main worry of investors is a return of Eurozone break-up fears in case the Eurosceptic Front National (FN) wins the elections, given that the reintroduction of a national currency is a key part of its policy proposals. Heightened uncertainty has already contributed to rising Eurozone government bond spreads (see EGB spreads under the spell of politics and Global Rates Landscape).

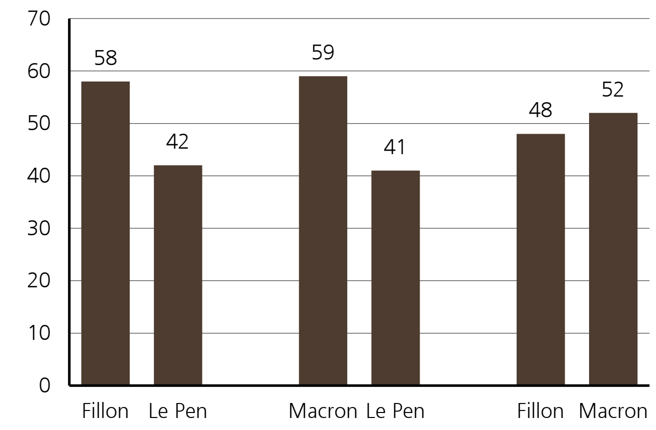
Current opinion polls indeed suggest that the FN's Marine Le Pen would come out ahead in the first round of voting, but then would lose against either Emanuel Macron (the reform-oriented former Economy Minister under President Hollande and founder of the movement En Marche!) or the Republican François Fillon in a second-round run-off. Macron's chances in the second round have been enhanced further by the alliance with François Bayrou announced this week. However, opinion polls remain volatile and the list of candidates is not yet final. So far, the Socialist candidate Benoît Hamon is in third place and not projected to make it into the second round.

Figure 8: Opinion polls for first round voting



Source: Opinionway, 22 February 2017.

Figure 9: Opinion polls for second round run-off



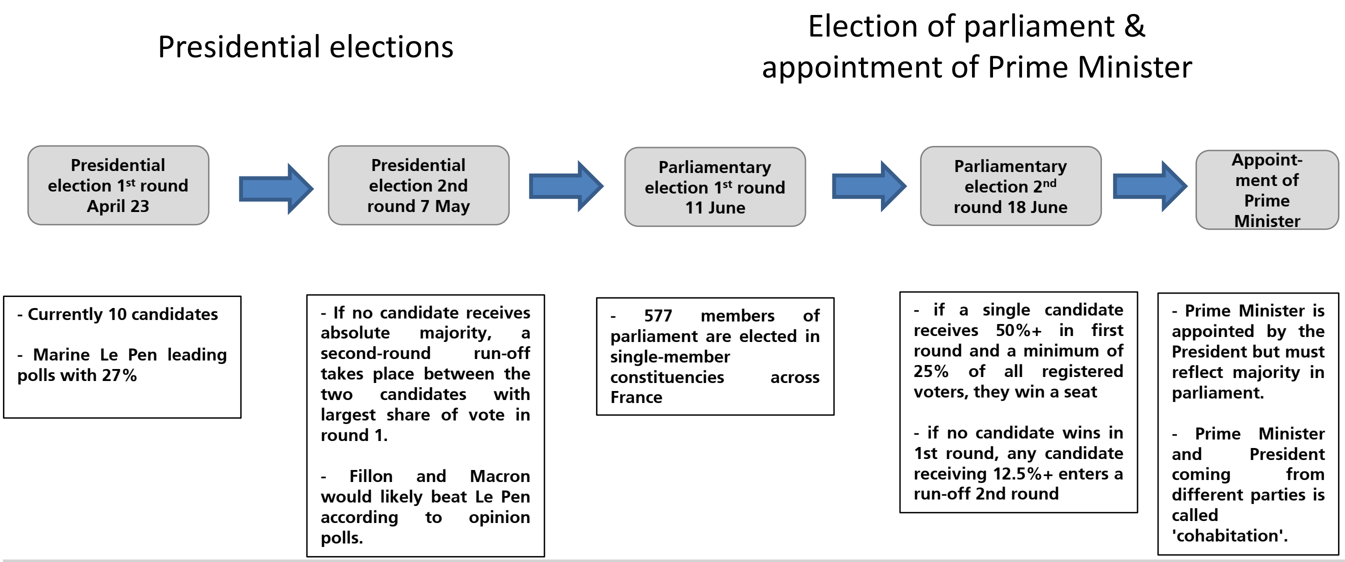
Source: Opinionway, Ifop-Fiducial, 22 February 2017.

Key question for the parliamentary elections: will there be a "cohabitation"?

In addition to the President, the French also elect a new parliament in June (held as a two-round voting system in 577 constituencies on 11 and 18 June), and thus a new Prime Minister. While the Prime Minister is appointed by the President, he needs to reflect the majority in parliament given parliamentary powers to bring down the government in a vote of no confidence. The key question here is whether the President and the majority of members in parliament will come from the same party – which would allow the President to push through his/her policy agenda – or whether France will end up with a so-called "cohabitation" – Prime Minister and President coming from different parties. In the case of a cohabitation, decision-making would be complicated for the President, as parliament would be able to limit his/her legislative agenda. This was the case under the last (1997-2002) cohabitation, between Republican President Chirac and Socialist Jospin.

Opinion polls for the parliamentary elections are scarce and not very timely but have implied that the Front National will not be able to gain a majority in parliament (they currently hold two seats out of a total of 577).

Figure 10: Timeline for French 2017 elections



Source: UBS

Looking beyond the elections: Status quo no more (?)

Most candidates promise a move away from the status quo

There is an important distinction between the French and both the Dutch and Italian elections. In the latter two, the potential scenarios are one where either a Eurosceptic comes into government (polling suggests this is unlikely, see our recent notes Dutch elections: What you need to know and Italy: A step towards earlier elections) or a return to something close to the historical establishment coalitions. By contrast, the status quo is arguably more challenged in the French election. This is because current President Hollande is not a candidate, the Socialist party candidates are so far lagging behind in the polls, while the Front National is aiming for wide-ranging changes to France's EU and Eurozone membership and the frontrunner candidates Fillon and Macron are proposing significant structural reforms.[1] Both the Fillon and Macron proposals entail plans to lower public spending (including reforming the pension system), ease the tax burden and introduce more flexibility into the labour market. Thus, if opinion polls prove correct and one of them becomes president, implementation of some structural reforms becomes more likely. However, as argued before, the composition of parliament will determine how much of their reform agenda they will ultimately be able to implement.

[1] Macron has not yet published a comprehensive formal election programme (this is scheduled for early March), but has provided snippets of his proposals in speeches.

Figure 11: Selected election proposals by the main candidates

Le Pen	Fillon	Macron	Hamon
Reintroduce national currency	Lower income taxes and social security contributions	Lower social security contributions	Introduce basic income
Reform EU (e.g. reintroduction of internal border controls) or organise a referendum to leave the EU	Abolish wealth tax	Reform 35-hour week – introduce more flexibility	Abolish loi El Khomri (which somewhat liberalised employment protection legislation)
Reduce taxes for lower incomes/lower social security contributions	End 35-hour week regulation	More security/defence spending	More security/defence spending
Reduce immigration	Raise retirement age to 65	Introduce flexibility in retirement age	Introduce a tax on robots if they replace ordinary employment
More security/defence spending	More security/defence spending	More European integration (e.g. creation of European Finance Ministry, enhancing Juncker plan)	Increase minimum wage
Lower retirement age to 60 (after 40 years of contributions)	Reduce immigration		Mutualisation of European debt
Taxes on employment of foreign workers	Reduce public spending by €100bn in 5 years		
Introduce monetary financing of government through Banque de France	Increase VAT rate by 2 points		
Reduce administrative burden for employers			
Abolish loi El Khomri (which somewhat liberalised employment protection legislation)			
Maintain 35-hour week regulation			

Source: www.marine2017.fr, www.fillon2017.fr, www.benoithamon2017.fr, various newspaper articles about Macron proposals.

Eurozone break-up fear scenario faces headwinds

There are legal hurdles for a referendum on EU membership

Among the 144 proposals of the Front National programme, the proposal to 'restore the national currency' and to seek a referendum on EU membership (unless the EU agrees to wide-ranging requests to change the EU setup, including re-establishing internal EU border controls) has led to fears of a Eurozone break-up in the event she is elected.

However, it is important to note the hurdles for implementing such an agenda even if Madame Le Pen were to become president. Foremost, EU membership is enshrined into the French constitution under Article 88, which likely would need to be changed. These would be the possible avenues to do so:

First, Article 89 of the constitution states that a constitutional amendment needs to be proposed by the Prime Minister and be passed by both houses of parliament (National Assembly and the indirectly elected Senate). Afterwards, it needs to be submitted to a binding referendum, unless this is avoided by an additional vote with a three-fifths majority in both houses.

Second, the President could call for a binding referendum according to Article 11 to change the constitution and thus by-pass parliament. Alternatively, such a referendum could be on a bill linked to EU membership, such as asking the government to activate Article 50, as in the UK. However, the proposal for such a referendum needs to come from the Prime Minister or, alternatively, the President would need the support of 185 members of both houses and 10% of the electorate to ask for a referendum.

Role of parliament and the Prime Minister is key

The bottom line is that without a majority in parliament (and thus a Prime Minister from the Front National), it would be very difficult to push through an exit from the EU (possibly limiting it to extreme measures, such as the use of exceptional powers for the President according to Article 16 if the country is under threat).

Of course, any attempt to take the country out of the EU and Eurozone would open up questions around existing debt obligations and the remaining Eurozone.

Reforms + good demographics = stronger growth

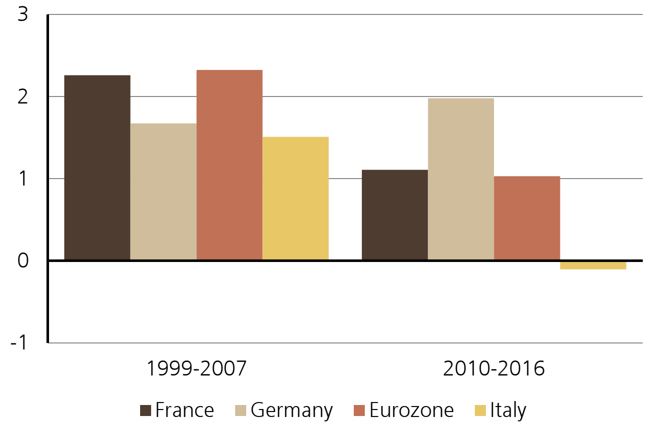
France had higher average GDP growth rates than Germany pre-2008

The potential for a pick-up in structural reforms is an important one for the French macro outlook. French GDP growth has been only half of that in Germany post-2010 and unemployment remains high (albeit falling). It used to be very different: growth on average from 1999-2007 was well above Germany and the European Commission estimated that France's potential growth rate was well above that of Germany and Italy up until a few years ago. A key factor for that outcome pre-crisis was better demographics: the working-age population grew on average by around 0.5% per year in France, but declined on average by 0.5% in Germany. Yet, French growth suffered post-crisis as investment and productivity growth fell.

Demographics are favourable, productivity growth is not

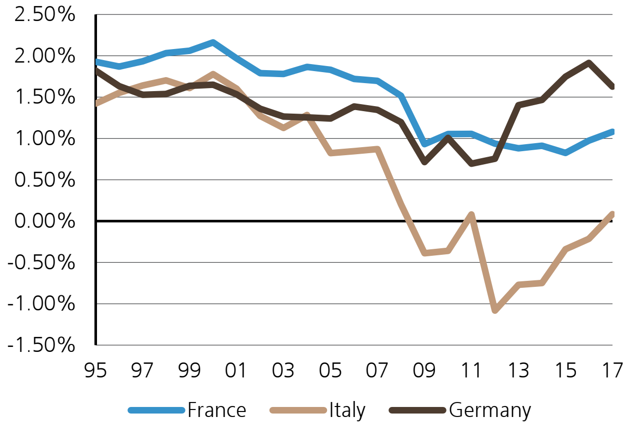
Now, if after the presidential election, France were to enter into a scenario with increased structural reforms that raise potential growth back to its pre-crisis average – in particular by improving productivity growth – the growth outlook for France, in our view, would become much more favourable. This is certainly the case when compared to Italy or Germany, which, just based on demographic projections, should lag France by far going forward.

Figure 12: Actual GDP growth, y/y%, period averages



Source: Haver, UBS

Figure 13: Potential growth, y/y%



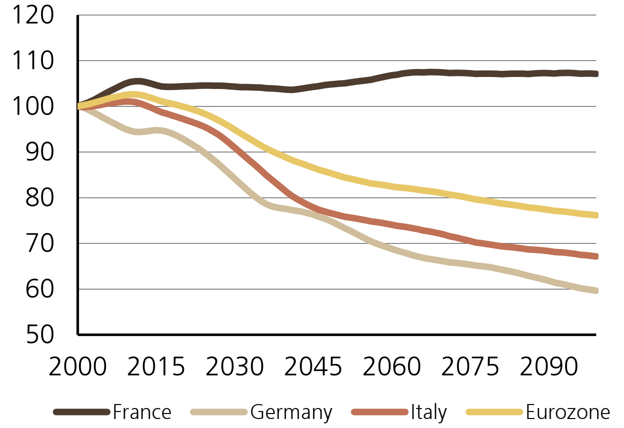
Source: Haver, UBS

Structural reforms could help lift growth

Areas of reform that could lead to higher growth and are frequently pointed out by international organizations include: further liberalising the labour market (employment protection remains among the highest in the OECD), lowering non-wage labour costs (which remain among the highest in the OECD), lowering public spending and raising the retirement age.

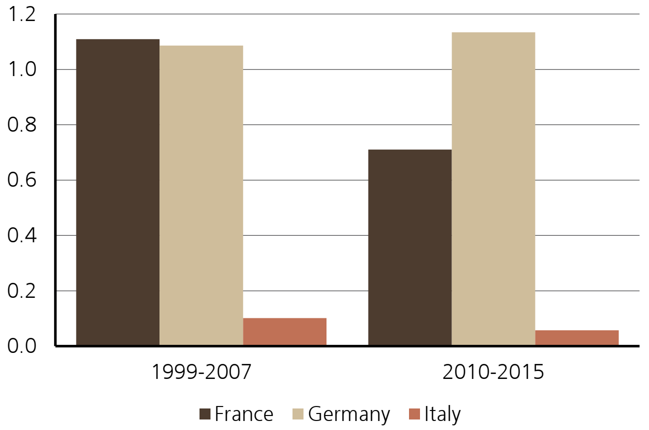
The probability of such a scenario materialising would crucially depend on whether either Macron or Fillon would also be able to achieve a majority in parliament that is supportive of their plans. This would likely be easier for Fillon, who has the backing of the Republican party, than it would be for Macron, whose movement En Marche! has only recently been founded.

Figure 14: Working-age population (15-64 years), actual and projections, 1999=100



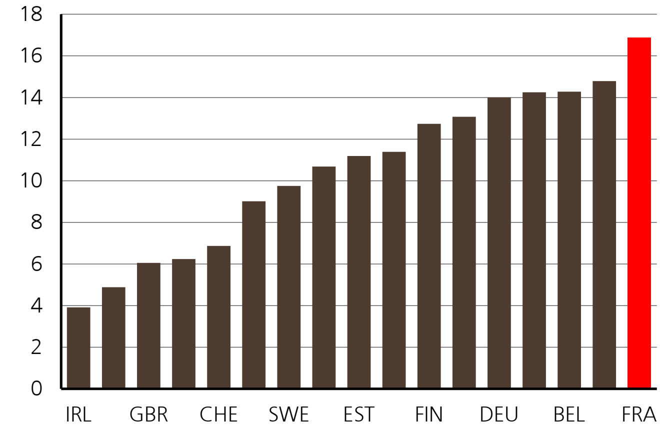
Source: Haver, UN, UBS

Figure 15: Productivity growth, y/y%, period averages



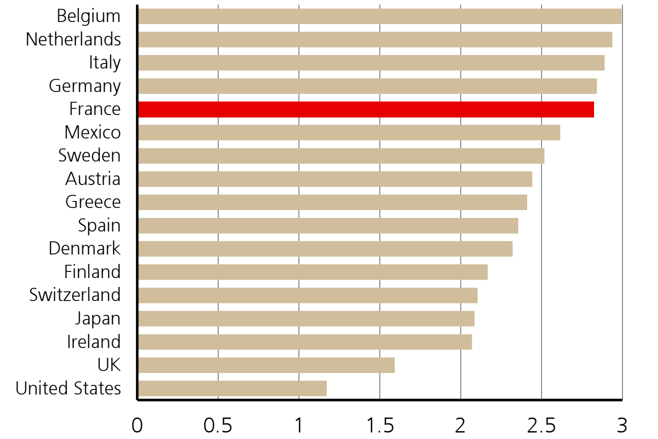
Source: OECD, UBS

Figure 16: Social security contributions, % of GDP, 2015



Source: OECD, UBS

Figure 17: Employment protection legislation, scale from 0 (least restrictive) to 6 (most restrictive), latest year avail.



Source: OECD, UBS

What does a status quo look like?

A "cohabitation" would likely mean continuation of status quo

Overall, thus, we believe that besides the serious downside risk to the market of a return of Eurozone break-up fears, there is also an upside scenario in the French election in case of more reforms – and this has a higher probability, according to current opinion polls. But of course one needs to acknowledge the risk that opinion polls ultimately prove misleading.

In addition, we see two ways of neither the down- nor the upside materialising: first, if neither president obtains a parliamentary majority and is dependent on governing in a cohabitation; and second, if the left-wing candidate Hamon ends up becoming the president (possibly with the support of Mélenchon in the first round, and broad establishment support in the second round). His policies suggest little reform progress (some reforms would be rolled back, according to his program).

What are key signposts to watch going forward to gauge which outcome is more likely?

First, watch for potential changes in the final list of candidates. Watch for potential alliances between the Socialist Hamon and left-wing Mélenchon.

Second, how are opinion polls evolving for the presidential elections – in particular, who will make it into the second round? Will Fillon fall further back vis-à-vis Macron? Can Macron maintain his second place?

Third, polling for the parliamentary elections as they become available (likely mostly after the Presidential elections).

European equities: upside/downside

European equities are still 7% below their 2007 level. However, there could be downside from here. In July 2012 – when the future of the Euro was seen to be in doubt – Europe's PE troughed at 9.2x. In April 2015 (following much hope that QE1 would be the elixir and save the euro area), the European PE peaked at 16.7x. This is quite a wide gap, so we instead focus on Price to Book below.

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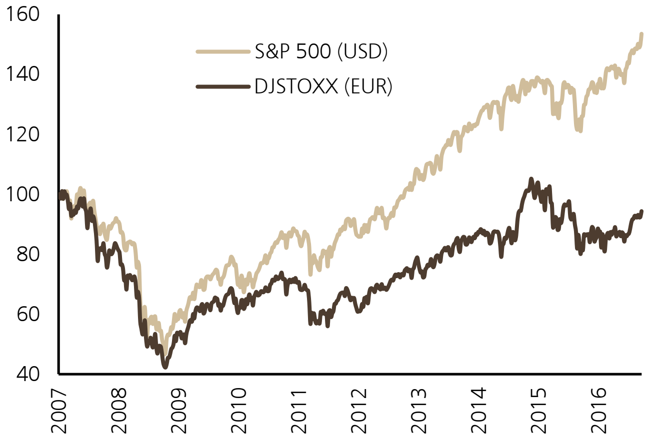
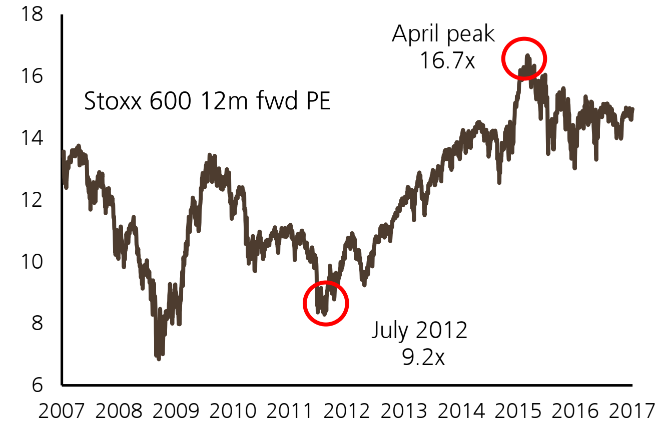
Avoid tail risk = +5-10%

Figure 18: Political risk (and profits) hold back Europe vs the US. Europe lags by 55% since 2007.



Source: Thomson Datastream, UBS European Equity Strategy

Figure 19: European PE. In July 2012 it was 9.2x and in April 2015 a much higher 16.7x.



Source: Thomson Datastream, UBS European Equity Strategy

Scenario 1, Political Relief – Upside Potential = 5-10%

- Initially, relief could push European equities back to the QE1 period of hope when political risk was less of a focus. In April 2015, the PE was 11% higher, or more if this is a TURNING POINT. But for now, we look at a less volatile P/B, which at 1.9x was **6% higher than today's 15.0x**. Longer run, profit recovery could drive this much further – European profits are still 28% below levels seen a decade ago.

We focus more on a less volatile Price to Book to compare

April 15 = 1.9x

July 12 = 1.4x

Scenario 2, Tail-risk/break-up worries – Downside potential = 15-20%

- Fear of a break-up could potentially push the PE back towards the July 2012 level of 9.2x = 39% downside. But given profits are much lower today than in July 2012 (EM and oil price hit after 2012) the PE isn't as comparable. We focus on the less volatile P/Book: it was 1.4 in 2012 vs 1.8x today = 22% downside.

Pan Europe – also depends how the non-euro countries react

Figure 20: Pan-European Valuation Snapshot

Time Period	CAPE	PB	DY	12m Fwd PE
July 2012	12.7	1.4	4.6	9.2
Apr 2015	18.7	1.9	3.3	16.7
Today	17.5	1.8	3.7	15.0
Downside to Jul' 12	-27%	-22%	-24%	-39%
Upside to April'15	7%	7%	11%	11%

Source: Thomson Datastream, UBS European Equity Strategy

French equities: a bit too relaxed

Bonds vs Equities – French bonds spooked

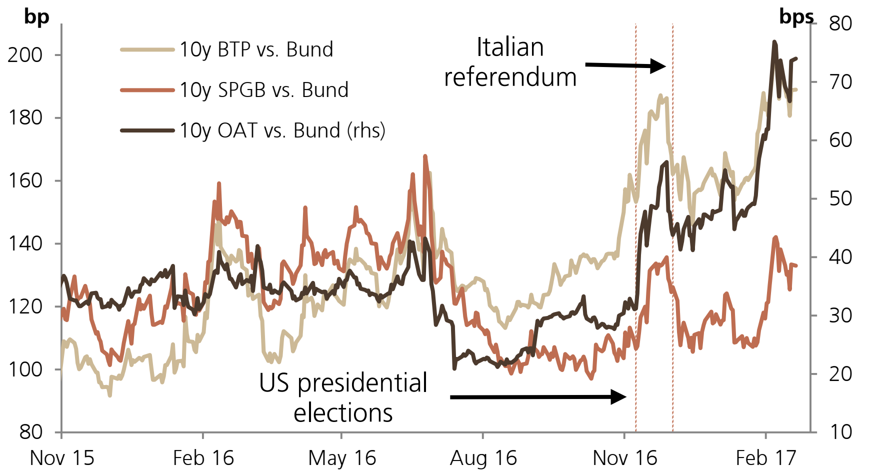
French equities rode the cyclical rally and seem to be ignoring some of the risks. Perhaps they think it won't happen or that a falling currency will rescue it by boosting CAC 40 profits, given 72% of sales are outside France (see appendix).

Equities ignore signal from bond market

The Italian spread jumped ahead of the referendum, but at that time Italian equities were valued for distress: at a 50% discount to Europe on P/B (near July 2012 levels). But France is different – it has been trading more in line with Europe. See our macro strategists' chart and note: EGB spreads under the spell of politics.

Figure 21: Re-pricing of political risk gathers traction again in the EGB space.

Bonds sell off, as expected



Compare today to period ahead of July 2012 (below)

Source: UBS, Bloomberg

Correlation between French Bond spreads and Equities is -0.63

The correlation between bond spreads and the CAC is -0.63 – but that broke down.

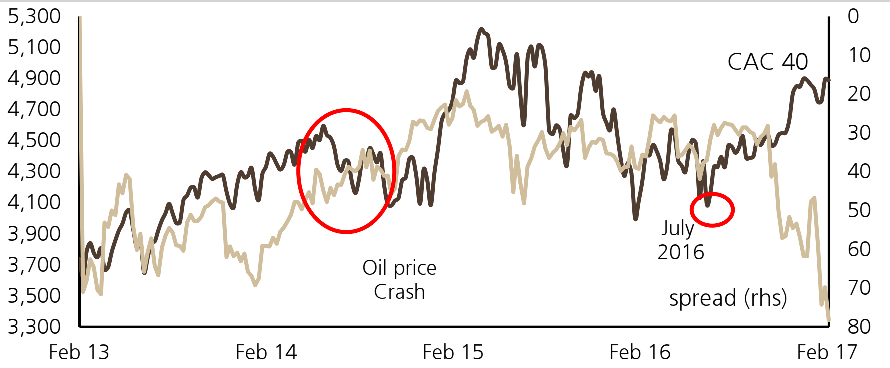
Equities – fail to respond

Over the 3m to May 2012, the OAT spread rose 50bps and the CAC 40 fell 10%. Today: past 3m, the OAT spread is up 40 bps and the CAC is also UP 9%.

Bond/equity corr of -0.63

Figure 22: French bond spread (vs Bund) and CAC 40 – biggest gap since 2012

Equities look exposed to downside



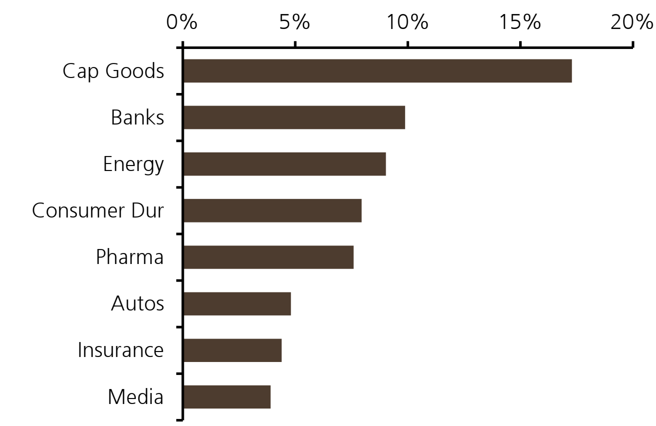
Source: Thomson Datastream, UBS European Equity Strategy. 10-year correlation

France propped up by cyclical rally

French equities beat European equities by 6% during the H2 2016 cyclical rally, compliments of it being the third most cyclical market in Europe. Since 6 July 2016, cyclicals have beaten defensives by about 26% (below). A tail-risk event could disrupt this risk-on trade. Consumption could be hit by rising inflation and capital investment could hit the pause button to reflect on a completely new regime.

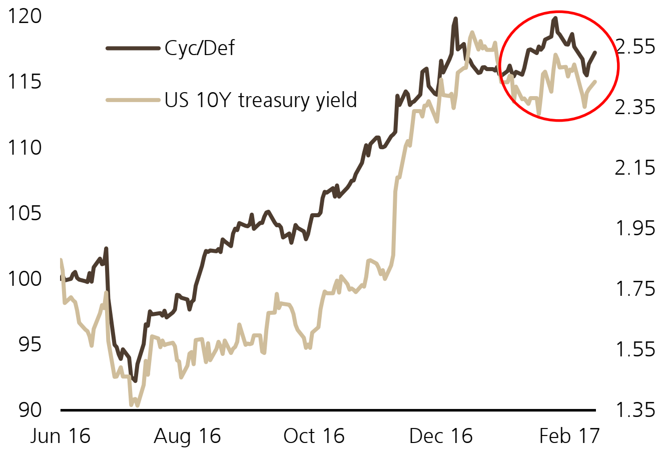
Third most cyclical country in EU

Figure 23: France is > cyclical than EU. Financials, other cyclicals + Energy = 73% of market cap



Source: UBS European Equity Strategy, Thomson Datastream

Figure 24: Europe – Cyclicals/Defensives vs 10y US bond yield



Source: Thomson Datastream, UBS European Equity Strategy

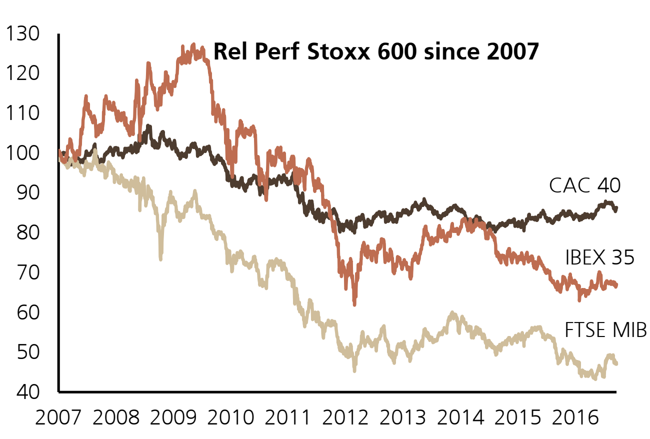
France – still more *haven* than *misbehaven*

On average, France trades on a 10% discount to Europe on P/B. Today, that discount is only 5% wider at 15% – not much, given the political backdrop. Let's compare this to the periphery: the long-run discount to Europe of a combined Italy & Spain is about 16% – today, that discount is more than double, at 37%. Can France continue to trade as a 'haven', or could it tilt towards the more problematic periphery if it suffers a political upset?

France's discount to Europe is modest versus periphery

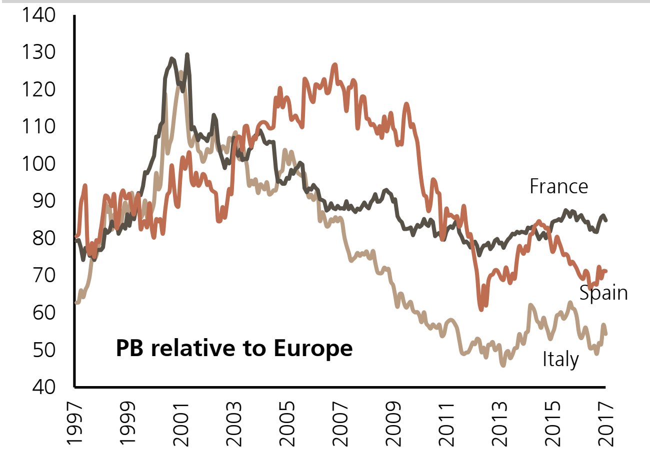
But France is exposed too

Figure 25: Performance – political risk not a big deal



Source: Thomson Datastream, UBS European Equity Strategy

Figure 26: Valuation – France not valued for disruption



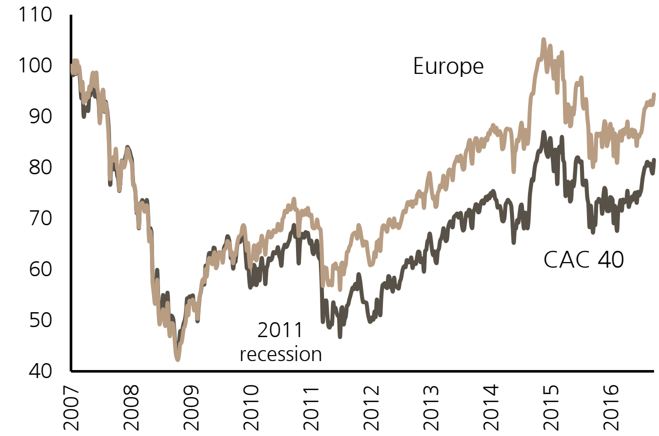
Source: Thomson Datastream, UBS European Equity Strategy

France upside/downside

France tends to move with Europe, albeit it suffered more in the 2011 recession given how cyclical it is. See the wide range of PEs below. In July 2012, France's PE troughed at 8.9x, and by April 2015 it was 16.5x. Again, earnings are volatile and are much lower today than in July 2012 – a PE is not the best measure. We prefer the more stable P/Book, as shown below.

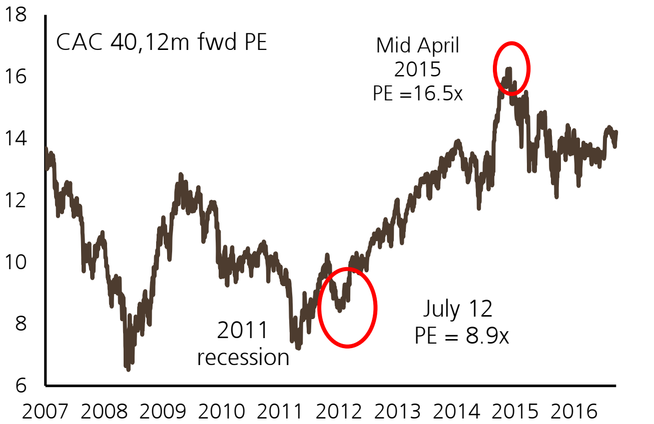
France generally follows the EU – will it this time too?

Figure 27: CAC 40 vs Europe performance since 2007.



Source: Thomson Datastream, UBS European Equity Strategy

Figure 28: French absolute PE today = 14x.



Source: Thomson Datastream, UBS European Equity Strategy

Scenario 1, Political Relief – Upside potential 5-10%

France hasn't suffered that much, so the upside isn't as big. If we look at the price to book of 1.5x today versus the more confident phase in April 2015 (1.7x), it suggests about 13% upside. As shown earlier, France's relative valuation to Europe has only moved down by 5%, suggesting investors are not too worried or have a belief that Europe is also discounting some risk. Either way, we see only modest upside from relief, but not a lot.

We focus more on Price to Book to compare

April 15 = 1.7x

July 12 = 1.4x

Scenario 2, Tail-Risk Worries – Downside potential 20-25%

In July 2012, the French PE was 8.9x versus 14.2x today; so a potential downside of 40%. But again, we prefer a less volatile price to book: July 2012 = 1.1, versus today at 1.5x – or 27% lower than today. This is only a benchmark – as the election draws near, valuations will oscillate and more will become known.

Figure 29: France Valuation table

Time Period	CAPE	PB	DY	12m Fwd PE
July 2012	12	1.1	4.9	8.9
Apr 2015	19.1	1.7	3.2	16.3
Today	18.9	1.5	3.5	14.2
Downside to July '12	-37%	-27%	-40%	-40%
Upside to April '15	1%	13%	9%	15%

Source: Thomson Datastream, UBS European Equity Strategy

Scenario – Political Relief

If Madame Le Pen wins the first (or even second) round, many feel her powers may be limited.

Europe and France win

Political risk down

What to invest in?

1. France – especially if any growth-positive Reform (upside 5-10%)

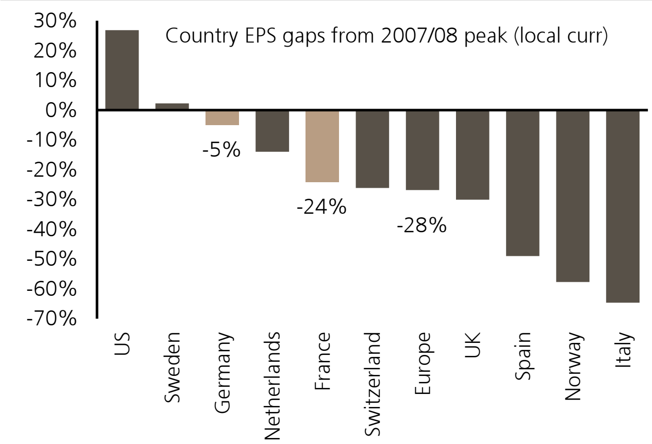
More certainty and growth-friendly reform help profits

While French equities haven't fallen much and disconnected from OATs recently, there may not be a big rally. But if French equities do get disturbed by the bond markets as the election draws nearer, then they should also rise higher when the OAT spread falls, given the longer-run corr of minus -0.63. Plus, if reform is growth-positive, it helps a more cyclical equity market.

Might help French profits catch up with Germany's

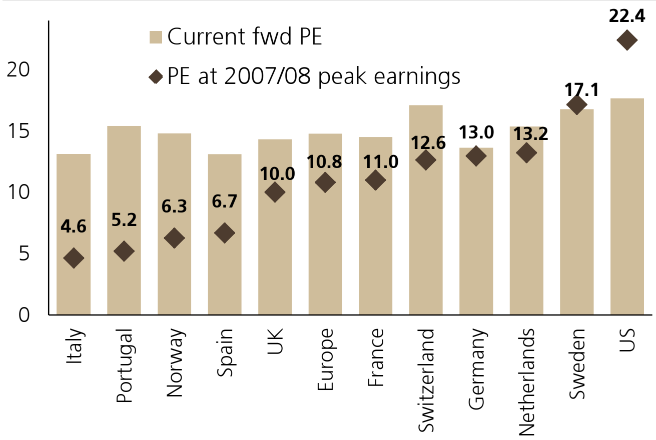
Reform could potentially help France's GDP profit gap to Germany.

Figure 30: EPS levels versus 2007 – France down 24% and Germany down 5%



Source: Thomson Datastream, UBS European Equity Strategy

Figure 31: Country PE – if each country got back to its 2007 EPS (on today's prices)



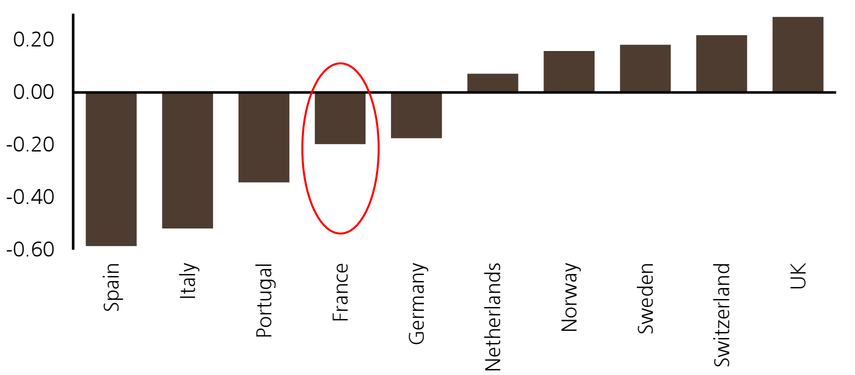
Source: Thomson Datastream, UBS European Equity Strategy

2. Periphery – highly correlated to a troubled bond market

Which are correlated to rising bond spreads?

The chart below shows the obvious – that if spreads fall on euro-area issues, the periphery generally rises.

Figure 32: CORR: Country performance vs Periphery bond spreads during crisis



Source: Thomson Datastream, UBS European Equity Strategy. Corr 5 years over crisis

3. Buy back the tail-risk or Madame Le Pen 'Relative Losers' (see section below)

If we see relief and the tail risk disappears (at least in the medium term) then the stocks that may be held back by the election should rise, if all else is equal.

4. Labour reform – who pays French wages

Wage Reform

Some candidates have flagged labour reform – it could become very topical.

To find the exposure (often not disclosed), we: 1) look at higher wage costs, as a percentage of total operating costs; and 2) multiply that exposure by total sales to domestic France. This is our best estimate of French wages (see proxy below).

Companies with wages in France

Who might pay high wages in France?

Below we show 14 companies that pay a significant portion of wages in France (as estimated using the above). If this is good news for the French market, stocks with a Beta near 1 or above, could react more positively.

Caveat: we use a proxy given poor disclosure

Figure 33: Who benefits from Wage Reform? Companies with wage costs > 20% and Domestic exposure to France > 20%

Company	Sector/Industry	UBS Rating	Beta	Wages as % costs (A)	France Sales Exposure (%) (B)	French wage cost proxy (%) (A*B)
Amundi	Div Fin	Neutral	1.23	64	71	**45**
Gecina	Real Estate	Neutral	0.70	32	100	**32**
Natixis	Banks	Neutral	1.40	60	51	**31**
CASA	Banks	Buy	1.68	53	53	**28**
Soc Gen	Banks	Neutral	1.81	56	48	**27**
Elior Group	Consr Svs	Buy	0.85	48	48	**23**
BNP Paribas	Banks	Neutral	1.26	56	33	**18**
Vinci	Cap Gds	Buy	0.77	30	59	**18**
Orange	Telecom	Neutral	1.02	30	57	**17**
Worldline	S/W & Svs	Buy	0.41	47	35	**16**
Capgemini	S/W & Svs	Buy	1.09	68	21	**14**
Bouygues	Cap Gds	Neutral (UR)	1.11	24	57	**14**
Thales	Cap Gds	Buy	0.76	44	24	**11**
Accor	Consr Svs	Buy	1.09	40	25	**10**

Source: Thomson Datastream, UBS European Equity Strategy

Tail risk: Euro break-up worries rise

If Madame Le Pen starts gaining momentum, we think a fear akin to July '12 could potentially re-emerge. The key question: Is the euro-area viable without France?

Today: can the euro area survive without France?

What to buy in a *euro-area related* risk-off mood?

1. Swiss Equities – the anti-crisis trade

They outperformed 3m ahead of 26 July '12 and are positively correlated to rising periphery spreads. The market is 50% pharma & food producers, it lagged Europe by 8% in 2H last year, and EU pharma is a rare Defensive trading on a Cyclical PE.

2. Quality loves a crisis (page 3) – pick up some bargains

Quality loves a crisis and outperformed ahead of March 2003, March 2009, July 2012 and last year's 11 February market low. In H2 last year, Quality underperformed Value by 31% – see [Macro Keys: Consider lagged Quality.]()

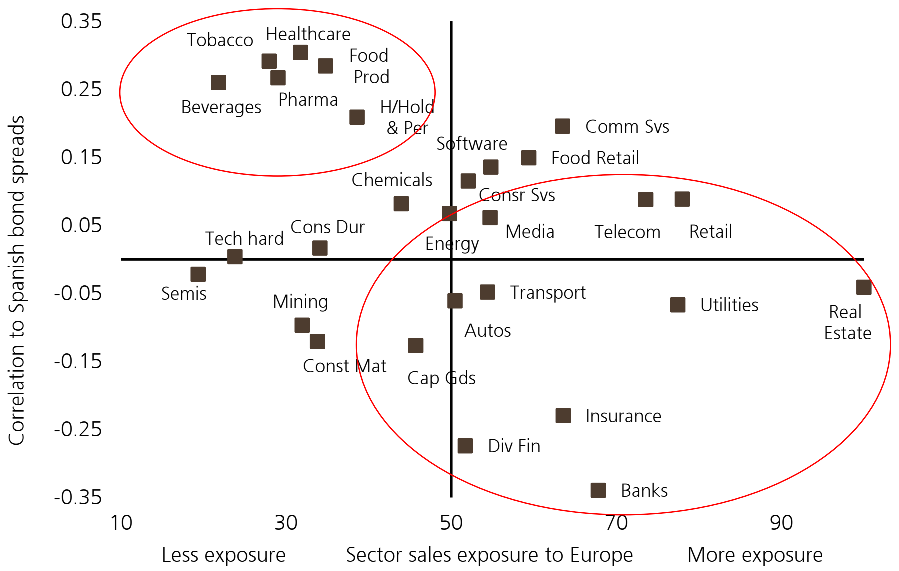
3. Sectors: International/defensive sectors – top left

Upper Left: < exposure to EU and do well when bond yields widen:

Tobacco, Healthcare, Beverages, Pharma, Food Producers and HH

More exposed: Financials, Utilities and Real Estate

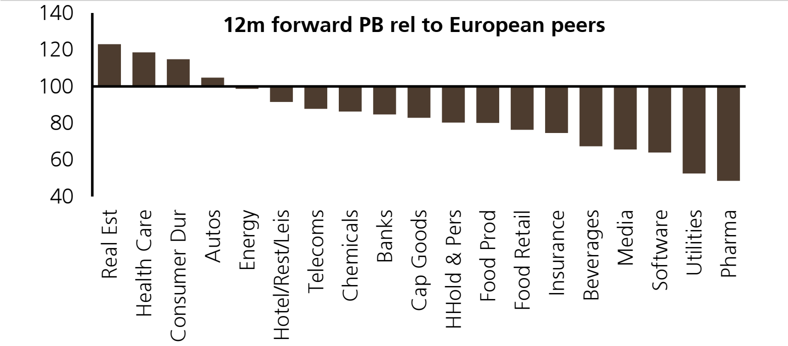
Figure 34: EU sectors. Corr to spreads and sales exposure



Source: Thomson Datastream, UBS European Equity Strategy

- Some of French staples are cheaper than European peers:

Figure 35: French sector valuations versus European peers



Source: Thomson Datastream, UBS European Equity Strategy

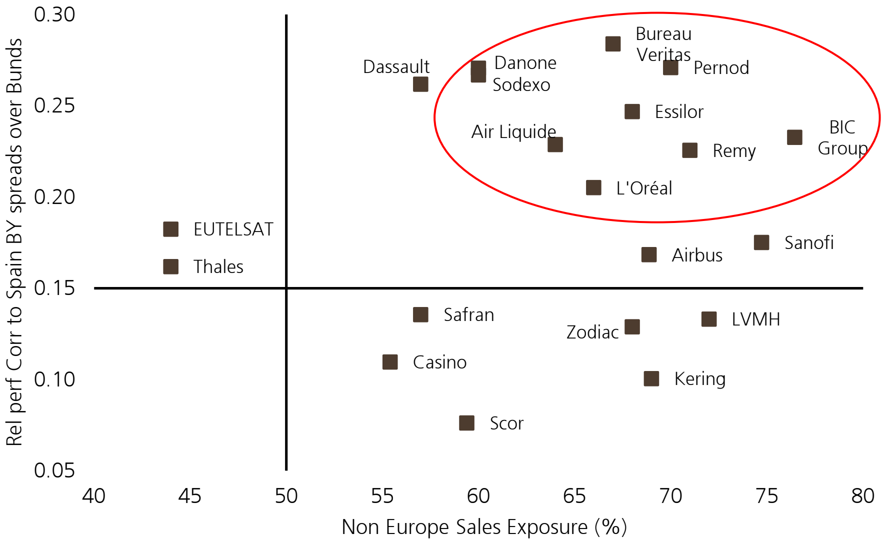
4. Stocks for protection – international tilt that rise *with* spreads

The stocks with less than 40% exposure to Europe and correlation of more than +0.20 to Spanish bond spreads are: BIC, Remy, Pernod, Essilor, Bureau Veritas, Danone, Sodexo and L'Oreal. Most candidates have flagged an increase in Defence spending as well, so there are a few stocks to consider below.

Winners under tail-risk scenario

More details – see back table

Figure 36: 20 least-correlated stocks to bond spreads. Non-Europe exposure and correlation to Spanish bond spread.



Source: Thomson Datastream, UBS European Equity Strategy

Stocks that offer protection – international

Figure 37: Stocks with significant sales outside of EU and positive corr to Spanish spreads

Company Name	Sector/Industry	UBS Rating	Market Cap EUR bn	Last Closing price	Upside to PT (%)	Wages as % costs	Rel Perf E300 2H16	Corr to Spain spreads	Sales outside Europe (%)	2017 PB	2017 PB rel Eur peers
BIC Group	Comm Svs	Neutral	6	118	7	27	-18	0.23	**76**	2.9	56
Remy	Beverages	Neutral	4	86	0	45	-4	0.23	**71**	3.6	119
Pernod	Beverages	Neutral	29	108	1	40	-5	0.27	**70**	2.1	66
Essilor	Healthcare	Buy	23	108	30	29	-21	0.25	**68**	3.2	114
Bureau Veritas	Comm Svs	Neutral	8	19	0	60	-13	0.28	**67**	6.0	115
L'Oréal	H/Hold & Per	Buy	98	177	10	25	-12	0.21	**66**	3.7	81
Air Liquide	Chemicals	Sell	37	103	-15	10	1	0.23	**64**	2.3	88
Danone	Food Prod	Neutral	38	62	3	18	-15	0.27	**60**	2.8	85
Sodexo	Consr Svs	Buy	16	104	13	51	-7	0.27	**60**	4.1	122

Source: Thomson Datastream, UBS European Equity Strategy

Euro comes under pressure

Our house view is for modest appreciation of the euro versus the dollar and the pound. But in this scenario, the euro will potentially sell off. If it does, it helps not only international companies – a 10% fall in the trade-weighted euro would boost profits by 5-6% for Europe as a whole.

What to avoid if tail risk becomes focus?

1. Equity markets – France (downside c.15-20%) and Avoid EU vs US

The euro would come under pressure too – see above

We think this tail risk disrupts the trade into Europe along with France. France isn't really priced for distress and still considers itself a safe haven. But, with a potentially weakening national currency, rising inflation, and companies indebted in Euros, there are risks. Will a currency offset help, similar to what we saw in the UK? While it might help some companies, for the market as a whole we are more sceptical, as shown in Appendix 1.

2. Sectors exposed to Europe and rising spreads (see scatter above)

See sectors in the above scatter-gram with more European exposure and the highest correlation to euro break-up fear. Banks are the stand-out sector to avoid, along with Other Financials, Cap Goods, Utilities and Real Estate. See scatter chart above.

3. Stocks exposed to Europe that fall when spreads rise

CASA, Soc Gen & BNP Paribas, AXA, St. Gobain, Renault, Engie

The stocks below are the most exposed to France *and* the ones with a negative correlation to periphery bond spreads, and many have beta >1x. Watch out for bond spread spikes and market sell-offs.

Figure 38: Stocks with > 25% sales to France, debt and a negative corr to bond spreads.

Company Name	Sector	UBS Rating	Mkt Cap EUR bn	Price	Upside to PT (%)	Beta	Rel Perf E300 2H16	Corr to Spain spreads	Net debt to EBITDA	France Exposure (%)	2017 PB	2017 PB rel Eur peers
Renault	Autos	Buy	24	86	27	1.72	13	-0.10	-1	24	0.8	66
CASA*	Banks	Buy	33	12	14	1.58	40	-0.33	38	53	0.6	72
Natixis*	Banks	Neutral	17	5	-6	1.55	48	-0.25	37	51	0.8	98
Soc Gen*	Banks	Neutral	33	42	8	1.38	38	-0.33	26	48	0.6	75
BNP Paribas*	Banks	Neutral	70	56	8	1.31	26	-0.31	25	33	0.7	84
Amundi	Div Fin	Neutral	9	54	-7	1.27	35	-0.04	0	71	1.3	127
AXA	Insurance	Neutral	56	23	4	1.14	20	-0.27	na	24	0.9	84
Accor	Consr Svs	Buy	11	38	14	1.14	-5	-0.04	1	25	1.8	77
St. Gobain	Cap Gds	Sell	25	45	-19	1.12	20	-0.15	1	25	1.2	46
Carrefour	Food Retail	Neutral	16	22	10	1.12	-10	-0.07	1	47	1.6	91
Vinci	Cap Gds	Buy	38	68	12	1.04	-6	-0.07	2	59	2.3	84
Engie	Utilities	Neutral	27	11	6	1.02	-32	-0.05	2	36	0.6	42
Bouygues	Cap Gds	Neutral	12	35	-2	0.93	25	-0.04	1	57	1.5	55

Source: Thomson Datastream, USB European Equity Strategy, * Leverage for banks is Total Assets/Tier 1 Capital, **Real Estate leverage is Loans to Value

Comment from UBS French Banks analysts – see Thesis Map at back

Wholesale funding needs could cause problems for the banks

"A victory for Marine Le Pen could have wide implications: it could impact market confidence and challenge access to the funding market. In addition, French banks' cross-border business model could be challenged by the possible fragmentation of the single euro currency."

While many of the above stocks are rated Buy, a tail-risk outcome could change that. These banks rely on Wholesale funding, and French (and even Italian) banks could be exposed. French banks might also be seen as at risk if they have trouble paying euro-based obligations while sales revenues are in France.

4. Other concerns

- **French stocks most indebted. A concern is if the local currency changes; however, much of the debt is denominated in euros**

Who has the debt?

Often stocks may have been missed due to a mildly positive correlation (rather than negative) to spreads. Here we look at stocks with greater than 30% sales exposure to France with **material debt.** The debt measures differ for Real Estate and Banks – see the star label below. We use the measure more common for that industry. For Banks, we use Total assets/Tier 1 Capital. For Real Estate, it is Loans to Value.

Stuck in euros if a national currency is introduced?

Figure 39: Stocks heavily indebted that may have missed above list

Company Name	Sector/Industry	UBS Rating	Market Cap EUR bn	Beta	Net debt to EBITDA	France Sales Exposure (%)
CASA*	Banks	Buy	33	1.58	38x	53
Klepierre**	Real Estate	Neutral	11	1.00	37%	37
Natixis*	Banks	Neutral	17	1.55	37x	51
Unibail-Rodamco**	Real Estate	Neutral	22	1.04	33%	53
Icade**	Real Estate	Buy	5	0.97	33%	100
Gecina**	Real Estate	Neutral	8	1.00	30%	100
Soc Gen*	Banks	Neutral	33	1.38	26x	48
BNP Paribas*	Banks	Neutral	70	1.31	25x	33
Elior Group	Consr Svs	Buy	4	0.74	3.0x	48
Engie	Utilities	Neutral	27	1.02	2.3x	36
EDF	Utilities	Neutral	17	1.33	2.2x	53
Vinci	Cap Gds	Buy	38	1.04	2.0x	59
Orange	Telecom	Neutral	38	0.80	1.7x	57
Casino	Food Retail	Sell	6	1.45	1.6x	58

Source: Thomson Datastream, USB European Equity Strategy, * Leverage for banks is Total Assets/Tier 1 Capital, **Real Estate leverage is Loans to Value

- **Avoid EUROPEAN stocks with material exposure to France**

Other European companies exposed – selling to France

While geographical sales data is not always split out, we disclose where the data we have found. This list is not exhaustive, but it might help as a rough guide. This could hurt if a weaker national currency is introduced and inflation hurts real incomes, etc.

Figure 40: European companies where French sales are disclosed

Stock Name	Country	Sector	France sales exposure (%)
Kingfisher	United Kingdom	Retail	37
Abertis	Spain	Transport	37
Aviva	United Kingdom	Insurance	33
Adecco	Switzerland	Comm Sev	22
Generali	Italy	Insurance	16
Randstad	Netherlands	Comm Sev	15
Allianz	Germany	Insurance	10
Lindt & Sprüngli	Switzerland	Food prod	9

Source: UBS European Equity Strategy

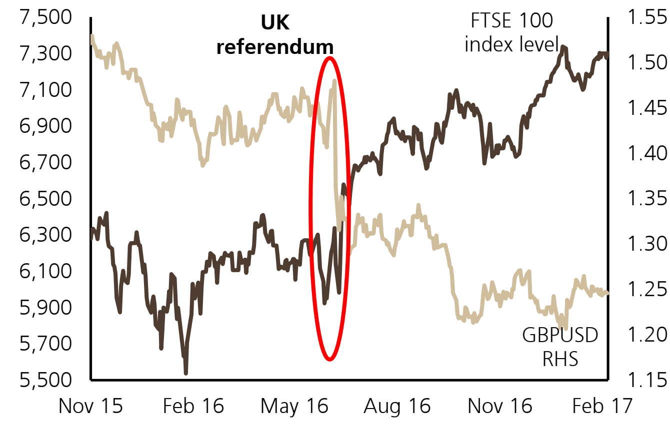
Appendix 1: Currency kicker for France?

A look at the UK

Sterling falls 20% and market up

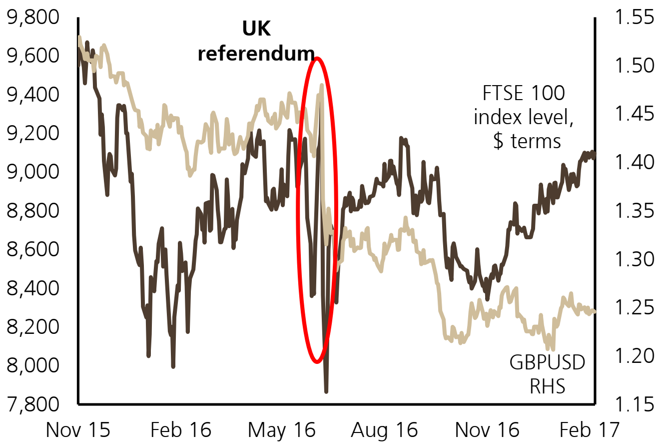
Many thought the UK market would fall post a 'Leave' vote; instead, in local currency, it raced higher, with the FTSE-100 hitting a peak of 7,337.6 months after the UK referendum as sterling fell 20%. But on a USD basis, the market is fairly flat since the vote. For the CAC 40, about 72% of sales leave France and 41% leave Europe, so this could help some companies in the index…

Figure 41: FTSE-100 performance – local curr vs GBP/USD



Source: Thomson Datastream, UBS European Equity Strategy

Figure 42: FTSE 100 performance in $ terms vs GBP/USD



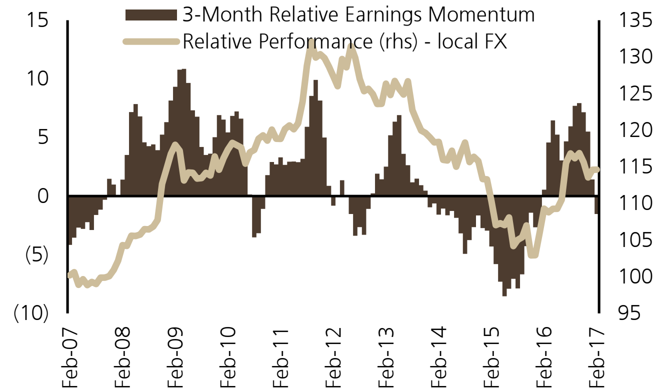
Source: Thomson Datastream, UBS European Equity Strategy

… But, some key differences

- **UK debt is largely paid in sterling** (the home currency); what about French companies with debt in euros and earnings in a national currency?
- **The UK had exemptions from parts of the EU** and was not in the single currency zone. If France leaves, there euro area, there will be disruptions and externalities. Is the CAC denominated in local FX or euro? What happens to other country currencies if France goes national?
- **We have sympathy that there might be a positive outcome for some stocks,** as below, but for markets many questions remain. Plus France isn't valued for disruption.

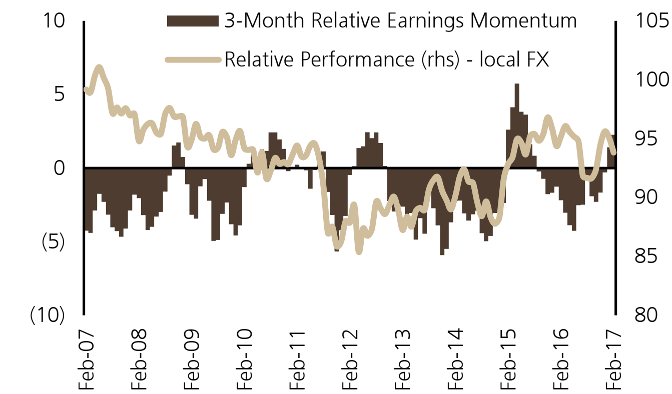
UK profits were boosted given 75% of FTSE-100 sells to outside of the UK (below).

Figure 43: UK – three-month earnings momentum relative to Europe



Source: Thomson Datastream, UBS European Equity Strategy

Figure 44: France – three-month earnings momentum relative to Europe



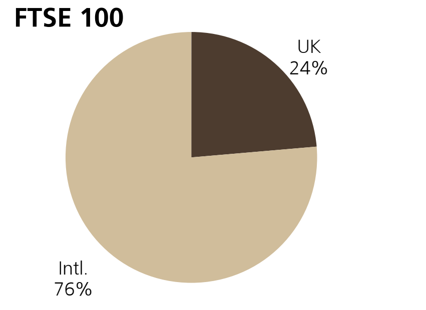
Source: Thomson Datastream, UBS European Equity Strategy

Sales exposure for French Companies:

FTSE 100 has 76% of its sales going abroad. For the CAC 40, it is 72% leaving France and 41% leaving Europe. This becomes relevant if the French currency de-rates from Europe, and/or the euro de-rates from other global currencies.

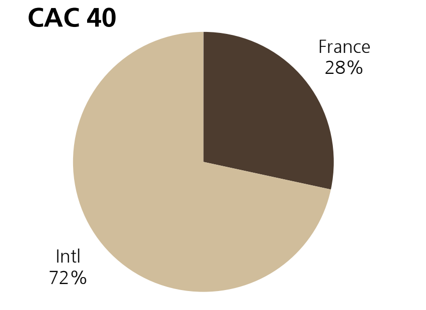
Large international companies benefit – table at back

Figure 45: FTSE 100 – 76% sales ex UK



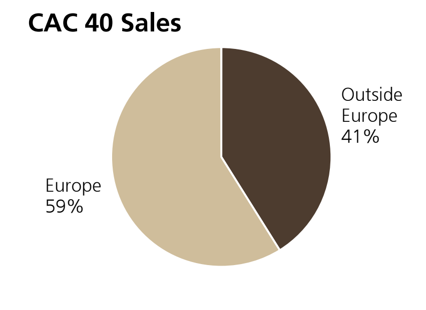
Source: Thomson Datastream, UBS European Equity Strategy

Figure 46: CAC 40 – 72% ex France



Source: Thomson Datastream, UBS European Equity Strategy

Figure 47: CAC 40 – 41% sales ex EU



Source: Thomson Datastream, UBS European Equity Strategy

Appendix 2: French Stocks, sorted by Beta

Figure 48: French Stocks sorted by BETA – a useful guide as news flow changes. See also sales exposure, wages, debt levels and cheapness versus peers to right

Company Name	Sector/Industry	UBS Rating	Market Cap EUR bn	Last Closing price	Upside to target (%)	Wages as % costs	Beta	Rel Perf E300 since 6th July 2016	Corr to Spain spreads	Net debt to EBITDA	France Sales Exposure (%)	Sales outside Europe (%)	2017 PE	2017 PB	2017 DY	Cheap on measures (vs peers)
Vallourec	Energy	Neutral (CBE)	3	7	-4	20	**2.22**	81.6	-0.06	-24.3	3	78	-7.4	1.0	0.0	2
PSA Group	Autos	Neutral	15	18	-24	16	**1.77**	51.9	-0.14	-1.2	25	29	10.2	1.1	0.0	1
Renault	Autos	Buy	24	87	27	13	**1.72**	14.6	-0.10	-0.7	24	31	5.9	0.8	4.3	3
Faurecia	Autos	Sell	6	43	-27	19	**1.72**	31.9	-0.10	0.1	11	45	14.4	1.6	2.0	0
CASA*	Banks	Buy	33	12	14	53	**1.58**	40.4	-0.33	38	53	13	9.7	0.6	5.2	3
Natixis*	Banks	Neutral	17	5	-6	60	**1.55**	49.1	-0.25	37	51	34	13.1	0.8	6.6	2
Rexel	Cap Gds	Buy	5	16	10	12	**1.46**	29.7	-0.09	3.2	20	46	18.4	1.1	2.5	1
Valeo	Autos	Buy	14	60	14	18	**1.45**	34.2	-0.03	0.3	8	50	14.4	3.3	2.7	0
Casino	Food Retail	Sell	6	53	-41	14	**1.45**	-4.7	0.11	1.6	58	42	18.5	1.3	5.9	2
Arkema	Chemicals	Neutral	7	96	-2	14	**1.43**	25.5	-0.09	1.1	19	47	16.1	1.7	2.2	2
Zodiac Aerospace	Cap Gds	Neutral	7	27	9	32	**1.42**	18.4	0.13	2.7	12	68	37.0	2.2	1.2	1
Soc Gen*	Banks	Neutral	33	42	8	56	**1.38**	36.5	-0.33	26	48	19	10.2	0.6	4.9	3
EDF	Utilities	Neutral	17	9	-1	17	**1.33**	-25.1	0.00	2.2	53	9	20.5	0.5	4.7	1
BNP Paribas*	Banks	Neutral	70	56	8	56	**1.31**	25.8	-0.31	25	33	27	10.7	0.7	4.7	3
Airbus Group	Cap Gds	Buy	53	67	15	22	**1.30**	16.6	0.17	-1.9	7	69	20.0	7.2	2.0	0
Schneider Elec.	Cap Gds	Sell	39	66	-21	41	**1.28**	12.2	-0.11	0.6	6	74	18.5	1.6	3.0	2
Amundi	Div Fin	Neutral	9	54	-8	64	**1.27**	34.8	-0.04	-0.3	71	17	15.5	1.3	4.2	1
AXA	Insurance	Neutral	55	22	5	33	**1.14**	19.9	-0.27	na	24	40	8.9	0.9	5.6	3
Accor	Consr Svs	Buy	11	39	12	40	**1.14**	-3.2	-0.04	0.2	25	25	20.4	2.6	2.7	2
Capgemini	S/W & Svs	Buy	14	82	22	68	**1.14**	-3.9	-0.07	0.5	21	36	14.0	1.8	2.1	3
SEB SA	Cons Dur	Buy	6	127	12	19	**1.13**	0.0	0.07	2.2	13	57	16.3	3.2	1.5	1
Alstom	Cap Gds	Buy	6	26	14	32	**1.13**	12.9	-0.11	0.0	19	41	18.5	1.6	0.0	1
Michelin	Autos	Buy	19	107	8	27	**1.13**	12.2	-0.02	0.1	10	61	11.1	1.7	3.3	0
St. Gobain	Cap Gds	Sell	25	46	-19	20	**1.12**	20.6	-0.15	1.2	25	28	16.4	1.3	2.7	2
Carrefour	Food Retail	Neutral	16	22	10	11	**1.12**	-9.4	-0.07	1.1	47	27	13.3	1.6	3.5	3
Bureau Veritas	Comm Svs	Neutral	8	19	-1	60	**1.11**	-13.4	0.28	2.1	12	67	19.3	6.0	2.9	0
Legrand	Cap Gds	Buy	15	55	7	32	**1.11**	3.4	0.04	0.5	20	53	22.2	3.4	2.1	0
STMicroelectronics	Semis	Neutral	12	14	-13	26	**1.10**	151.5	-0.02	-0.3	na	73	19.7	2.6	1.7	3
Atos	S/W & Svs	Buy	11	106	8	52	**1.06**	29.4	0.04	-0.6	16	42	13.4	2.4	1.8	3
Air Liquide	Chemicals	Sell	38	105	-16	10	**1.06**	3.0	0.23	2.9	10	64	19.7	2.3	2.5	1
Eurotunnel	Transport	Buy	5	9	25	34	**1.05**	-12.1	0.04	8.1	na	0	40.4	2.3	2.9	0

Source: Thomson Datastream, USB European Equity Strategy, * Leverage for banks is Total Assets/Tier 1 Capital, **Real Estate leverage is Loans to Value

Figure 49: French Stocks sorted by BETA – a useful guide as news flow changes. See also sales exposure, wages, debt levels and cheapness versus peers to right

Company Name	Sector/Industry	UBS Rating	Market Cap EUR bn	Last Closing price	Upside to target (%)	Wages as % costs	Beta	Rel Perf E300 since 6th July 2016	Corr to Spain spreads	Net debt to EBITDA	France Sales Exposure (%)	Sales outside Europe (%)	2017 PE	2017 PB	2017 DY	Cheap on measures (vs peers)
Kering	Cons Dur	Buy	29	228	12	16	**1.04**	37.5	0.10	1.4	5	69	19.0	2.3	2.1	2
Vinci	Cap Gds	Buy	38	68	13	30	**1.04**	-5.8	-0.07	2.0	59	16	14.7	2.3	3.4	3
Teleperformance	Comm Svs	Buy	6	106	9	74	**1.04**	21.1	0.06	2.0	5	74	17.2	2.9	1.5	1
Unibail-Rodamco**	Real Estate	Neutral	22	218	1	17	**1.04**	-14.6	0.03	33	53	0	18.3	1.0	5.0	2
LVMH	Cons Dur	Buy	95	190	12	17	**1.03**	24.4	0.13	0.3	10	72	20.8	3.3	2.5	0
Pernod	Beverages	Neutral	29	108	1	40	**1.02**	-5.3	0.27	3.1	3	70	19.1	2.0	1.9	2
Engie	Utilities	Neutral	27	11	7	16	**1.02**	-31.5	-0.05	2.3	36	23	12.0	0.6	6.2	3
Ingenico	Tech hard	Neutral	5	81	-1	25	**1.00**	-32.7	0.04	-0.2	na	72	17.8	2.6	1.8	1
Klepierre**	Real Estate	Neutral	11	35	5	21	**1.00**	-21.0	0.02	37	37	0	14.4	0.9	5.4	3
Gecina**	Real Estate	Neutral	8	121	7	32	**1.00**	-16.2	0.02	30	100	0	22.4	0.8	4.0	1
Icade**	Real Estate	Buy	5	69	2	8	**0.97**	-6.2	0.01	33	100	0	14.8	0.9	6.1	3
Remy	Beverages	Neutral	4	86	0	45	**0.96**	-4.3	0.23	1.7	7	71	33.0	3.6	1.9	0
BIC Group	Comm Svs	Neutral	6	118	8	27	**0.96**	-17.7	0.23	-0.6	8	76	18.2	2.9	3.2	2
TOTAL	Energy	Neutral	116	48	1	7	**0.95**	0.1	0.13	0.8	22	30	11.9	1.2	5.1	2
Bouygues	Cap Gds	Neutral	12	35	-2	24	**0.93**	19.4	-0.04	1.0	57	23	16.7	1.5	4.6	3
Dassault Syst.	S/W & Svs	Sell	20	77	-5	68	**0.93**	-0.1	0.26	-1.9	9	57	27.5	4.5	0.8	0
Aeroports de Paris	Transport	Neutral	11	109	-16	32	**0.92**	-5.7	0.18	2.9	18	3	23.9	2.4	2.5	0
Thales	Cap Gds	Buy	19	90	7	44	**0.91**	5.3	0.16	-1.4	24	44	19.1	3.5	2.1	0
Worldline	S/W & Svs	Buy	3	26	18	47	**0.90**	-10.0	0.27	-1.7	35	12	23.1	3.3	0.0	1
Safran	Cap Gds	Sell	27	65	-8	30	**0.89**	-3.0	0.14	-0.5	23	57	17.3	3.9	2.3	1
Sanofi	Pharma	Neutral	107	81	2	35	**0.88**	-6.4	0.18	0.2	na	75	14.2	1.6	4.1	3
Danone	Food Prod	Neutral	37	61	5	18	**0.88**	-17.4	0.27	4.4	10	60	17.5	2.7	2.9	2
Sodexo	Consr Svs	Buy	16	103	13	51	**0.87**	-8.4	0.27	0.7	18	60	19.6	4.1	2.5	0
Scor	Insurance	Neutral	6	33	1	4	**0.85**	16.3	0.08	na	5	59	10.8	1.0	5.2	3
Essilor	Healthcare	Buy	23	108	31	29	**0.84**	-21.1	0.25	1.1	9	68	24.9	3.2	1.5	1
L'Oréal	H/Hold & Per	Buy	97	173	12	25	**0.82**	-13.2	0.21	-0.1	11	66	24.2	3.7	2.1	1
Orange	Telecom	Neutral	38	14	0	30	**0.80**	-8.9	0.06	1.7	57	12	12.7	1.1	4.2	2
EUTELSAT	Media	Neutral	4	18	4	9	**0.79**	-7.4	0.18	3.3	10	44	12.7	1.5	6.2	3
Vivendi	Media	Neutral	23	17	6	15	**0.78**	-11.8	0.05	-0.8	41	35	29.8	1.3	5.9	2
Iliad	Telecom	Buy	12	199	15	8	**0.75**	-0.7	0.17	1.0	100	0	26.5	3.4	0.2	0
Elior Group	Consr Svs	Buy	4	21	10	48	**0.74**	-5.4	0.20	3.0	48	18	16.6	2.2	2.0	2

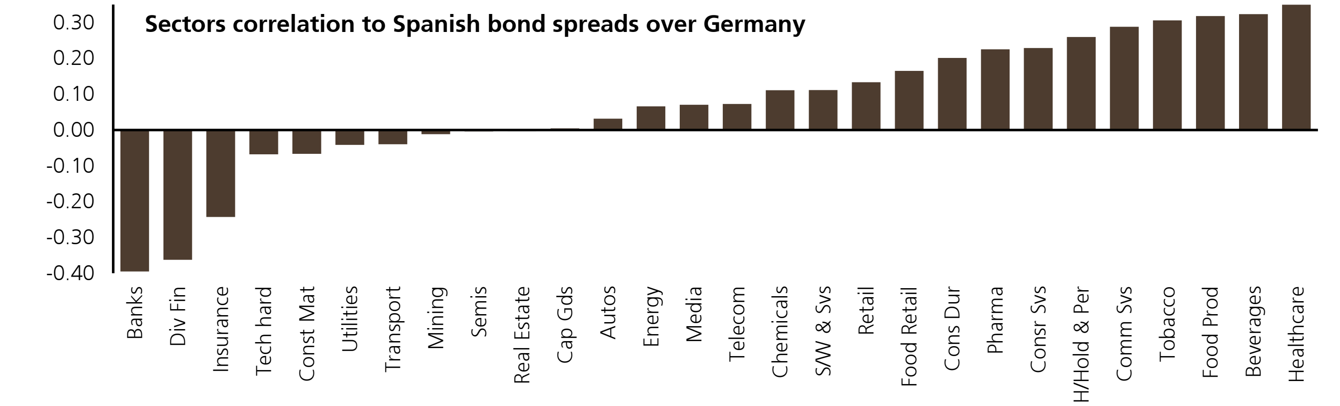
Source: Thomson Datastream, USB European Equity Strategy, * Leverage for banks is Total Assets/Tier 1 Capital

Appendix 3 – Sectors

Correlation to crisis

- Correlation to Spreads

Figure 50: Sectors' correlation to Spanish spreads

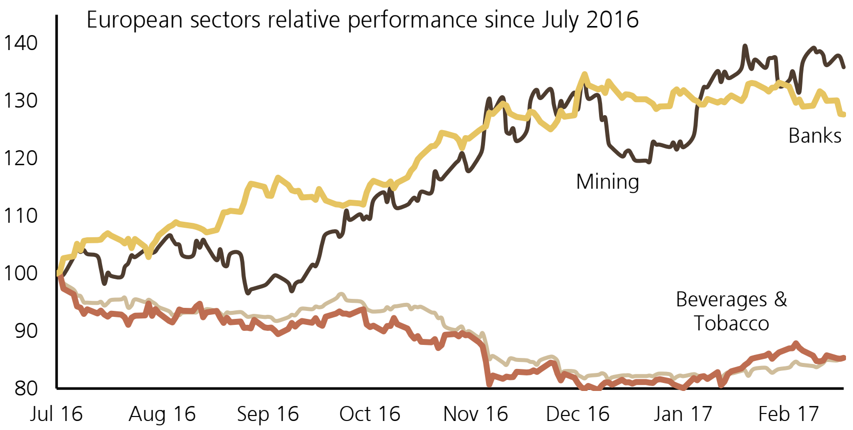


Source: Thomson Datastream, USB European Equity Strategy

Disparity of performance during 2H rally

Some extremes if looking for protection ahead of election.

Figure 51: European Mining and banks vs Beverages and Tobacco relative performance



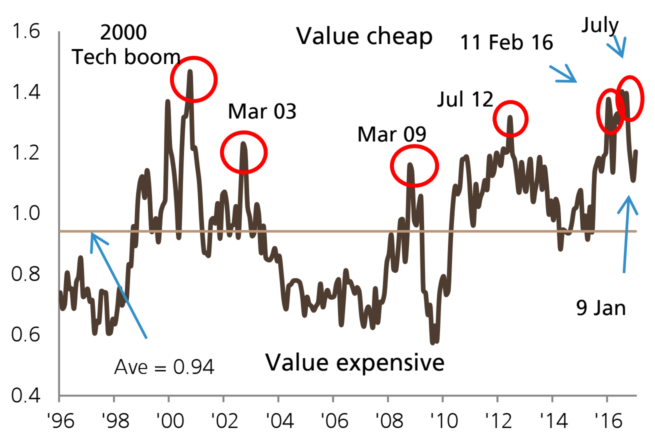
Source: Thomson Datastream, USB European Equity Strategy

Appendix 4 - Value charts

Value beat Quality by 31% in 2H last year (since 6 July). Dispersion gaps are still elevated in Europe and the biggest in the world, but the value rally (value beat growth by 20% since 6 July) is already nearing the magnitude of the March 2009 and July 2012 rallies. See [Value rally over? Global value dispersion gaps](#).

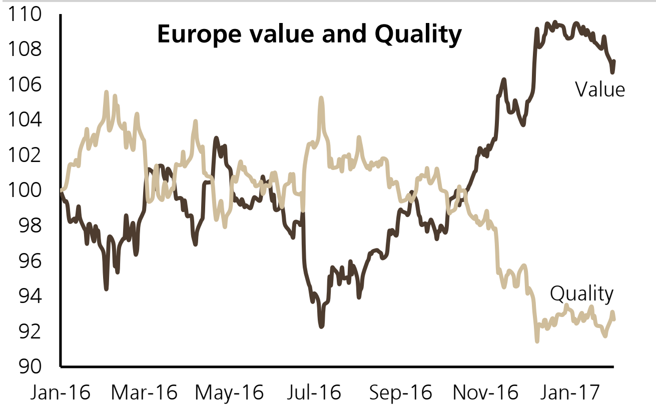
Value dispersion peaked in March 2009 and July 2012

Figure 52: Europe Value gap. Value gaps fell two-thirds from July to early January



Source: UBS Quant and European Equity Strategy

Figure 53: Value outperformed quality by c.30% in 2H 16



Source: UBS Quant and European Equity Strategy

BELOW – SEE ANALYSTS' COMPANY THESIS MAPS

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Can Accor continue to restructure and drive the HotelInvest margin upward?

Yes. The company has driven the EBIT margin of HotelInvest from 4% to over 6% since the Nov 2013 restructuring was announced, and we forecast over 8% by 2018e. Asset-heavy hoteliers all achieve over 10% mid cycle margins, with Accor's HotelInvest margin still materially below these levels.

Q: Will Europe continue to see positive RevPAR growth in 2017?

This is highly likely to be the case, given: (1) forecast global and European positive GDP; (2) the consumer benefiting from cheaper energy costs and travel costs; and (3) European RevPAR is only 3% above previous peaks compared to other more mature markets such as the US nearly 20% ahead.

Q: Can Accor deal with the digital challenges at hand?

Yes, this is likely to be the case, but we do not think that Accor will be immune from pressures brought from OTAs, Metasearch and Shared Accommodation. Nevertheless, Accor is investing hundreds of millions of euros in its digital programme, to safeguard its digital and brand proposition.…

UBS VIEW

Shares undervalued due to concerns around European RevPAR and the cycle: Although we also have concerns how much longer the cycle has to run, we note that European RevPAR relative to the last cycle still remains low and there is self-help with HotelInvest restructuring.…

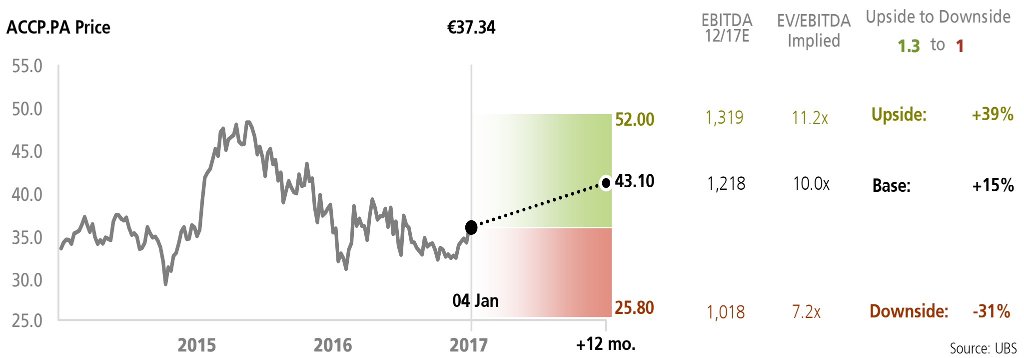
EVIDENCE

French negative RevPAR trends beginning to moderate, and strength in certain European markets such as Spain continues. We have recently seen French RevPAR data become positive, with the potential to continue given the base effect ……

WHAT'S PRICED IN?

At the current Accor multiple we think investors are pricing in material risk that we are near peak earnings (which we do not believe). Furthermore, the multiple remains at a material discount to global peers, with Accor trading at c8x EV/EBITDA.

UPSIDE / DOWNSIDE SPECTRUM



Value drivers	RevPar %	Sales growth	Ebitda margin	Ebit margin	Ebitdar x
€52.0 upside	4.0%	12.7%	20.5%	14.2%	10.2x
€43.1 target	1.5%	10.0%	19.4%	13.1%	9.5x
€25.8 downside	-6.0%	1.9%	17.5%	10.8%	7.5x

ADDITIONAL RESEARCH

16 Ebit beat with improved French performance, Jarrod Castle, 22-Feb-2017.

UBS European Conference 2016, Jarrod Castle, 16-Nov-2016.

Q3 stronger than expected, Jarrod Castle, 18-Oct-2016.

PIVOTAL QUESTIONS

Q: What levels of high-margin retail AUMs can Amundi attract through 2018?

Amundi has been effective in attracting high-margin retail flows from investors outside France, but Amundi's shares will not outperform its peers until French retail investors begin to channel money into investment funds, in our opinion. We now forecast French retail inflows will be ~€30 billion over the next three years (down from €35bn), less than the €45 billion that Amundi is targeting.

Q: Can Amundi achieve its announced 2015-18 AUM and earnings growth targets?

For the most part, we think so. This means the firm should grow its earnings by at least 5% a year (we forecast 6% growth). The only target we think Amundi will miss is its goal of attracting €45 billion of retail inflows over 2016-18 – we forecast €30 billion of inflows over this period.

Q: Can Amundi successfully integrate Pioneer?

We think so, though we think it will fall short of some of its synergy targets. Nonetheless, we believe the deal will generate shareholder value and we look favourably upon the combination.

UBS VIEW

Given the strong run-up over the past two weeks, Amundi shares are trading with the expectation of a successful completion of the Pioneer acquisition. As a stand-alone entity, Amundi seems well positioned for a recovery of French retail inflows – a recovery that has yet to transpire. French investors have lagged those in other European countries with regard to investment in asset management products. Any signs of a French retail recovery would likely lead to stronger earnings and a more positive view on the firm.

EVIDENCE

Household balance sheets highlight the recent boom in asset management products in all the major European countries, except France. Growth in unit-linked products in France over the past three years and a decline in domestic deposit interest rates have not translated into increased retail flows.

WHAT'S PRICED IN?

The market has already priced in a large portion of the upside related to Amundi's announced acquisition of Pioneer. We believe upside catalysts for Amundi would include a) an improvement to the risk aversion currently exhibited by French retail investors and b) stronger realization of merger synergies in the coming years.

UPSIDE / DOWNSIDE SPECTRUM

Value drivers	Net Retail Inflows per Annum	Total Synergies from Pioneer Deal
€63.00 upside	€16bn	€220 million
€50.00 base	€12bn	€130 million
€41.50 downside	€8bn	€80 million

Source: UBS

COMPANY DESCRIPTION

Amundi is a large asset manager, domiciled in France. Based on its AuM base, the firm is a top 10 global asset manager with €987 billion of AuM at the end of March 2016. Amundi...

ADDITIONAL RESEARCH

Q4 2016 Results: A beat on earnings and flows, Michael Werner , 10 February 2017.

Amundi-Pioneer Merger Scenarios, Michael Werner, 15-Dec-2016 (XLS).

Raising Price Target & Updating Merger Model to Reflect Terms of ..., Michael Werner, 14-Dec-2016.

It's official - Amundi to acquire Pioneer for €3.55bn, Michael Werner, 12-Dec-2016.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Can BNPP meet its 2020 targets?

Yes, but not all. At group level, we expect a 2016-20e revenue CAGR of 2.6% combined with a 63% cost/income ratio, both being in line with management forecasts. But our 2020e RoE of 9% remains 1% shy of management's target. This is due, we think, to a slightly higher cost of risk than anticipated by management and a higher capital base. Once rebased on a 12% CET1 ratio (similar to management), our 2020E RoE is just 50bps short of the 10% management target.

Q: Can BNPP maintain a steadily growing dividend profile?

No. With €3bn of restructuring costs now backed in our 2017-20e estimates, we believe BNPP's 2017e DPS will fall in 2017e to €2.6 from €2.7 in 2016 despite accounting for a 50% dividend payout ratio from 2017 (vs. 45% in 2016).

UBS VIEW

BNPP continues to evolve in an environment where banks need to adapt to both regulation and digitalisation. In addition, interest rates remain low, and growth opportunities are scarce, with loan growth still subdued, particularly in Eurozone. Given the lack of catalysts ahead, we reiterate our Neutral rating.

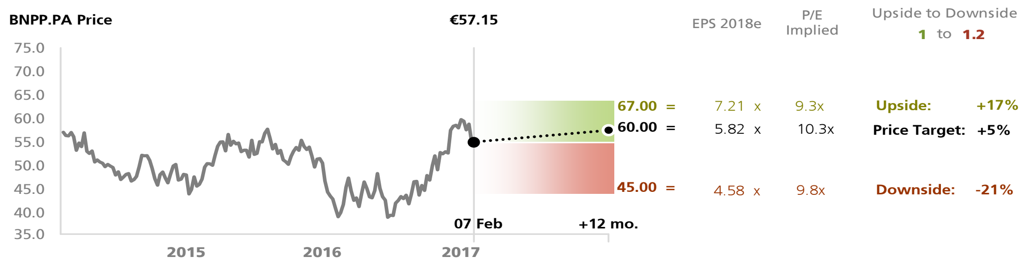
EVIDENCE

The debate on capital floors is still ongoing at Basel and consensus could take place during the course of 2017. It's possible that the market has become too complacent on banking regulation. We will continue to monitor these regulatory developments closely.

WHAT'S PRICED IN?

BNPP is trading at 0.9x 2017E TNAV for a prospective RoTE of c.10%, which leaves the stock fairly valued, in our view.

UPSIDE / DOWNSIDE SPECTRUM



Value drivers	Global markets revenue (EURm)	Cost income ratio	EPS 2018e (EUR)	% from spot	Implied P/TNAV 2017e
EUR67 upside	8,607	56%	7.21	17%	1.01x
EUR60 base	6,148	74%	5.82	5%	0.91x
EUR45 downside	3,689	115%	4.58	-21%	0.69x

Source: UBS

COMPANY DESCRIPTION

BNP Paribas SA is a universal bank headquartered in Paris with four domestic retail banking markets: France, Belgium, Italy and Luxembourg. It has other retail banking operations...

ADDITIONAL RESEARCH

Lack of catalyst ahead – reiterate Neutral, Lorraine Quoirez, 08-Feb-2017.

New 2020 RoE target of just 10%, Lorraine Quoirez, 07-Feb-2017.

Q3 a good quarter, reiterate Neutral, Lorraine Quoirez, 28-Oct-2016.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: What is the chance for a consolidation in French telecoms over the next 12 months?

Notwithstanding three years of failed attempts, we still see around a 50% chance for in-market consolidation to materialise over the medium term: 1) the level of pricing and returns in the French telecom industry are by far the lowest among the top seven markets in Europe (OPCF/PoP at €80 vs. €107 European average); 2) the acceleration of fibre roll-out will trigger further pressure on capital intensity and increase the need for larger scale; 3) the consolidation of the French market could theoretically allow for material value creation that would benefit all players; 4) as time goes by, the value-creation potential is reduced as more overlapping infrastructure is deployed. That said, we acknowledge that the upcoming French presidential elections (May 2017) reduce visibility on the institutional framework and may reduce the chances of a deal materializing before then.

Q: Will the competitive dynamics in the French Telco market cause further margin decline?

No. We do not expect the competitive dynamics in the French market to imply further material margin dilution. Three main reasons: 1) the French market has the lowest pricing and the lowest OPCF/POP among the most advanced markets, so room for further downside appears limited; 2) most of the disruption registered over the last two years resulted from some commercial strategies that appeared not financially viable and rather aimed at building a stronger bargaining position in M&A talks; 3) growing capital intensity (fibre upgrade) should force more rationality. We currently forecast EBITDA margin at B. Tel to expand by 500bp by 2025E. However, we remain sceptical of the value-creation potential of B. Tel on a standalone basis, amid its limited scale and infrastructure in the fixed business.

UBS VIEW

We maintain our Neutral stance on the stock. The potential growth of infrastructure spending, coupled with the possible consolidation of the French telecom market are clear positive catalysts. However with the stock close to 5 years high we believe the market would need stronger visibility on the outlook of both the construction business and the telecom unit for further upside. Stock trades at 11.7x on EV/Current Op Profit (vs. 5-year average at 13.1x) with a 4.5% dividend yield.

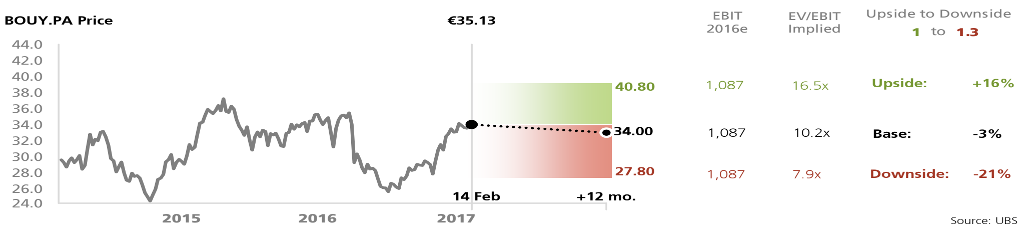
EVIDENCE

1) Our proprietary cross country analysis highlighting the low level of pricing and CF generation in the French telecom market relative to the major European markets; 2) Early evidence of encouraging price trends in the French telecom market; 3) Outlook for the French construction market.

WHAT'S PRICED IN?

Investors' feedback suggests the stock is broadly factoring in the following: 1) limited chance of consolidation of the telecom market and a valuation of B. Tel at ~€5.0bn (or ~5.3x EV/EBITDA, slightly below sector avg); 2) a recovery of the Construction unit with implied EV/Current Op Profit at ~9.6x.

UPSIDE / DOWNSIDE SPECTRUM



Value drivers	Disposal of B. Telecom	EV of B. Telecom
€40.8 upside	YES	€8.5bn
€34 base	50% probability of disposal	€5.9bn
€27.8 downside	NO	€3.2bn

Source: UBS

COMPANY DESCRIPTION

Bouygues comprises five consolidated divisions: Bouygues Telecom (90.5% stake), TF1 (TV broadcaster, 43.7% interest), Construction (100% owned, large French/international...

ADDITIONAL RESEARCH

Waiting for the investor day – stay Neutral, Giovanni Montalti, 15-Feb-2017.

Q3 ahead of expectations, Giovanni Montalti, 16-Nov-2016.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Is the 12.5-13.0% margin target achievable?

In 2015, Capgemini set a goal of reaching a 12.5-13.0% operating margin in the medium-term (2018-19). We see the target as credible, subject to economic conditions remaining supportive...

Q: When will Capgemini reach €1bn in FCF?

Last year, Capgemini delivered €815m of equity FCF, and guidance this year is for more than €850m and allows for the first payment of coupons on iGate-related debt. We think it likely that Capgemini will deliver €1bn in equity FCF in 2018; possibly even as soon as 2017...

UBS VIEW

Capgemini is Europe’s largest quoted IT services company and its most global one, with almost a third of sales coming from North America. It has an advanced offshore proposition, and as this scales from 55% today, margins should benefit further. A 12.5-13.0% margin target for 2018/19 is supported by a tidying-up of the outsourcing portfolio and increased focus on newer "digital" technologies. A 5-7% organic growth goal has proved more elusive, however, although we do see the scope for the business to accelerate through the course of 2017 as headwinds from the ASPIRE ramp-down fade.

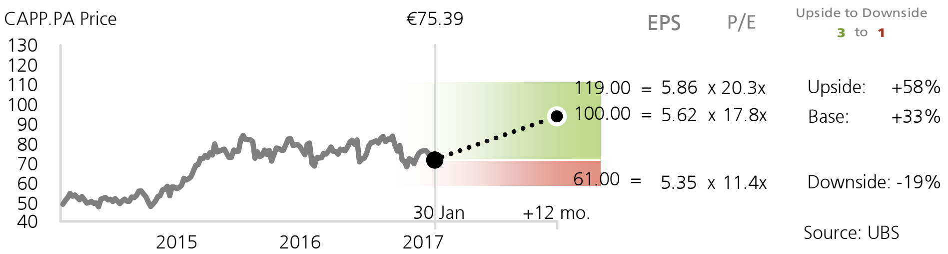
EVIDENCE

We have analysed Capgemini's margin profile against Accenture when it was of a similar size to Capgemini today. This gives us some comfort over the achievability of management's margin goals, which should see continued benefits from higher gross margins as offshoring levels increase. Cash flow should continue to grow with profits and the group remains open to inorganic expansion.

WHAT'S PRICED IN?

90% of Capgemini's valuation is underpinned by the current earnings continuing into perpetuity, and 6% by our near-term earnings estimates. This means the market is discounting just 1% long-term earnings growth, which seems too cautious to us...

UPSIDE / DOWNSIDE SPECTRUM



Value drivers	Sales growth (2017E)	Operating margin expansion (2018E)	Equity FCF yield	EV/NOPAT multiple
€119 upside	5.0%	+50bp	4%	19x
€100 base	2.4%	+30%	5%	15x
€61 downside	0.0%	+0bp	6%	11x

Source: UBS

COMPANY DESCRIPTION

Capgemini is Europe's largest domiciled IT services group with over 180k staff, but still less than 5% share in this fragmented market. The US$11bn acquisition of Ernst & Young's...

ADDITIONAL RESEARCH

On the road with management, Michael Briest, 22-Feb-2017.

US re-acceleration to drive a re-rating in 2017, Michael Briest, 16-Feb-2017.

Weak Q4 growth likely outweighs strong cash flow, Michael Briest, 16-Feb-2017.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Can CASA meet its €4.2bn net income target in 2019?

Yes, in 2019e we see CASA producing a net income group share of €4.4bn, albeit this accounts for the acquisition of Pioneer. Excluding Pioneer, we estimate CASA should still produce a net income of €4.1bn, very close to management's target of €4.2bn.

Q: Will the Danish Compromise be removed?

No, not anytime soon. The Danish Compromise, a favourable capital treatment for insurance holdings in Europe, adds c.300bps to CASA's CET1 when compared to the full deduction method, but it's unlikely to be removed soon.

UBS VIEW

We expect a positive earnings revision for CASA, partly as the market looks slow to factor in the Pioneer acquisition, which should be 6% EPS accretive. We also feel confident that management can pay a minimum €0.60 DPS pa to 2019e, equivalent to an attractive dividend yield of 5%.

EVIDENCE

As per our recent note, margins in French Retail banking continue to be negatively impacted by home loan renegotiations, and CASA is no exception to that. We expect renegotiations to remain at an elevated level in 16Q1, but we expect a gradual slowdown from 2017, leading us to pencil in a more moderate decline in NII in French retail in 2017 when compared to 2016. Interest-rate movements, customers and banks' behaviours are all difficult to predict with accuracy; hence, we will be monitoring these trends closely.

WHAT'S PRICED IN?

CASA is currently trading at 0.9x TNAV for a prospective RoTE of 10% and a dividend yield of 5%.

UPSIDE/DOWNSIDE SPECTRUM

Value drivers	CIB revenues (€m)	CIB cost income ratio	2018e EPS (€)	% from spot	Implied P/TNAV 2017e
€15.2 upside	5,900	46%	1.57	25%	1.2x
€13.2 base	4,713	56%	1.28	8%	1.0x
€10.1 downside	3,526	73%	0.99	-17%	0.8x

Source: UBS

more→

COMPANY DESCRIPTION

Crédit Agricole SA is the listed entity of the Crédit Agricole Group, a French universal banking group. The bank's main activities include retail banking with operations in France...

ADDITIONAL RESEARCH

Buy: delivery to continue after a transformational 2016, Lorraine Quoirez, 17-Feb-2017.

Clarification of dividend policy underpins the investment case, Lorraine Quoirez, 8-Nov-2016

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: To what extent will contract losses and voluntary exits weigh on short-term growth?
We expect to see voluntary exits negatively impact growth by c2ppts in 2016 and c1pt 2017. But this should be more than offset by some significant new contract wins.

Q: Could Elior potentially return additional cash to shareholders?
Yes...but not yet. We believe the market, given the M&A strategy, is not pricing in any cash returns. However, even in our M&A scenario, Elior could return c€240m in 2020e.

Q: How much are future acquisitions worth today?
c€4.50 per share. We do not think the market assigns any value to future acquisitions. We expect to see regular upgrades to consensus numbers as deals are announced.

Q: Does the online takeaway market represent a threat to the contract catering business?
We think this could *become* a pivotal question, but for now believe it is a manageable threat.

UBS VIEW

A resilient growth story with exposure to accelerating travel growth trends: We expect Elior to deliver an EPS CAGR of c12%, before the impact of acquisitions, and expect to see regular consensus earnings upgrades as M&A deals are announced. We also see scope for a cash return by 2020, in spite of the acquisitive growth strategy.

EVIDENCE

Revenue growth of more than 4% pre-acquisitions: In our M&A scenario, Elior would reach 2.2x net debt/EBITDA by 2020e, and be able to return c€340m to shareholders to stay at 2.5x levered. Our M&A DCF model implies the current value of future M&A is €4.50 per share, if executed successfully.

WHAT'S PRICED IN?

Despite a very bullish sell-side, we think the market still underappreciates the Elior story: We think the market assigns zero value to future acquisitions, and also no value to the cash that would otherwise accumulate in a zero-M&A scenario.

UPSIDE / DOWNSIDE SPECTRUM

Value drivers	2017E organic growth	2017E EBITDA margin	Implied EBIT 2017E	EV/EBIT multiple	Acquisitions – value per share
€31.00 upside	5.0%	9.2%	€398m	16.0	€4.5
€23.60 target	3.6%	8.9%	€374m	14.7	€0
€14.50 downside	-0.2%	7.8%	€297m	14.0	€0

COMPANY DESCRIPTION

Elior is the fourth-largest contract caterer (70% of revenues) and third-largest concessions caterer (30% of revenues) in the world, skewed towards Europe, with growth opportunities in the US and UK.

ADDITIONAL RESEARCH

Solid Q1 revenues, FY outlook confirmed, Chris Stevens, 27-Jan-2017.

FY EBITDA slight beat, EPS and DPS beat ..., Chris Stevens, 09-Dec-2016.

Growth accelerates in Q3, despite France impact, Chris Stevens, 28-Jul-2016.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Can Natixis pay a EUR0.35 DPS in 2017e?

Yes, we think it can, although in our numbers this implies a dividend payout ratio as high as 86%, not far off the 100% limit above which ECB approval is required. In our view, Natixis generates sufficient capital to sustain a €0.35 DPS in 2017e, but we would need to monitor closely the performance of the business as the business model is significantly geared to volatile operations, namely CIB and Asset Management.

Q: Can Natixis produce an 11.5-13% RoTE in line with management's target?

No. Excluding Coface, we see Natixis producing a 9% ROTE in 2017e, going up to c.11% in 2020e. For profitability to improve further, we believe Natixis would have to make an RoE-accretive acquisition and/or benefit from a lower tax rate in US.

UBS VIEW

Natixis is trading at a TNAV multiple of 1.1x for a prospective RoTE of 11% in its core business. To us, this implies the stock is fairly valued. Simultaneously, Natixis is significantly geared to the US, making our estimates sensitive to movements in EURUSD and to a potential US tax rate change in particular.

EVIDENCE

A third of Natixis' pre-tax profit is generated in the US. This means that Natixis is geared to movements in EURUSD but also to potential US corporate tax cuts, something we do not factor into our estimates.

WHAT'S PRICED IN?

Assuming that the right P/E multiple for NGAM is 15x mid-way between Amundi's and the average for US asset managers, the market looks to be valuing Natixis ex NGAM at c.10x P/E, which supports our view that Natixis is fairly valued.

UPSIDE / DOWNSIDE SPECTRUM

Value drivers	CIB revenues (EURm)	CIB cost income ratio	EPS 2018e (EUR)	% from spot	Implied P/TNAV 2017e
EUR6.7 upside	4,611	52%	0.61	23%	1.5x
EUR5.0 base	3,607	59%	0.45	-8%	1.1x
EUR3.3 downside	2,604	71%	0.28	-39%	0.7x

Source: UBS

COMPANY DESCRIPTION

Natixis SA is the listed subsidiary of the BPCE group, a French mutual group and retail bank. The listed entity has no retail network and hence no direct exspoure to retail...

ADDITIONAL RESEARCH

Good 16Q4, fairly valued but gearing to US could be a..., Lorraine Quoirez, 13-Feb-2017.

Delivering on our dividend expectations, Lorraine Quoirez, 09-Feb-2017.

16Q4 Preview: Natixis likely to match last year dividend..., Lorraine Quoirez, 09-Feb-2017.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Is price competition likely to increase in the French market and further impact earnings?

No, we expect the French market to gradually stabilise, for three main reasons: 1) the French market has the lowest pricing and the lowest OpCF/POP among the most advanced markets, so room for further downside appears limited; 2) most of the disruption over the past two years has resulted from commercial strategies less focused on financial viability and more on establishing strong positions in sector consolidation; 3) over the coming quarters, growing capital intensity (fibre upgrade) should prompt greater rationality.

Q: Can the balance sheet support an increased dividend payout ratio at Orange SA?

Yes. Orange has one of the strongest balance sheets among European telecoms with ND/EBITDA at 1.8x expected at the end of 2016E vs the sector on 2.1x. However, the board may prefer to wait for earnings to stabilise over a few quarters before any decision to increase dividends is taken. Therefore, we do not expect any increase in the dividend before the one to be paid out of 2017 earnings at the earliest. Our current forecast on a cautious basis is for flat €0.60 DPS over the entire horizon.

UBS VIEW

We see the French market as one of the most attractive in Europe. A few points: 1) It is among the most concentrated in Europe with four integrated players. 2) Capex upside risk is lower relative to the sector average as the companies' guidance are already set on the most capital-intensive architecture (FTTH). 3) OpCF/POP and OpCF margin are the lowest among the top-seven European markets, suggesting limited scope for further downside. The French operations represent c60% of Orange OpCF. We believe Orange has an attractive equity story thanks to its position as the dominant player in the French market and its strong balance sheet. It may also benefit from the potential upside from in-market consolidation in France. We confirm our Neutral rating with a price target of €14.4. The stock is trading at 5.1x 2016E consensus EV/EBITDA and 11.2x consensus 2016E EV/Op CF.

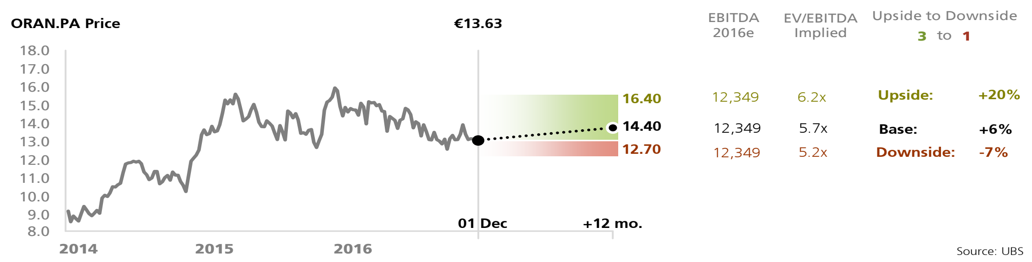
EVIDENCE

1) Proprietary analysis on the relatively low level of pricing and CF in the French market; 2) French consumer survey: "UBS Evidence Lab: Sector risk/reward attractive – mobile data upside" 8 September.

WHAT'S PRICED IN?

Investor feedback suggests the stock is factoring in the following: 1) gradual stabilisation of the earnings in France; 2) growing likelihood of increases to DPS in the medium term; 3) limited probability of in-market consolidation; 4) concerns on potential M&A strategy out of France.

UPSIDE / DOWNSIDE SPECTRUM



Value drivers	2019-2025E French revenue CAGR	2019-2025E French EBITDA margin improvement
€16.4 upside	1.7%	300bps
€14.4 base	0.5%	-
€12.7 downside	-0.7%	-300bps

Source: UBS estimates

COMPANY DESCRIPTION

Orange is the former French telecom incumbent, with a leading position in both the fixed (c40% fixed broadband subscriber market share) and mobile segments (c35% mobile subscriber...

ADDITIONAL RESEARCH

French competitive environment set to stabilise, Giovanni Montalti, 02-Dec-2016.

Encouraging progression in Q3, Giovanni Montalti, 25-Oct-2016.

French MSR a touch light vs. consensus, Giovanni Montalti, 26-Jul-2016.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Can SocGen benefit from the economic recovery in CEE?

Yes, we see CEE contributing to 15% of group profit by 2019E from c.3% back in 2015 and c.10% in 2016. We expect revenue growth of 7% pa on average for the region, with Russia growing the most. Under our assumptions, the CEE operations produce a 2019E RoE of 14% compared to 10% in 2016.

Q: Can SocGen offset the decline in revenues in French retail by cutting costs?

No. Opex should continue to grow over the next few years despite a further decline in revenues due to heavy investments in digitalisation. This should result in the closing of six back-office centres and a 20% reduction of the branch network, but the full benefit should only be seen in 2020E.

UBS VIEW

We see little in the way of short-term catalysts but similarly there is less room for disappointment after the 16Q4 results publication as management confirmed our view that French retail revenues would continue to be under pressure. Post the share-price fall over the past month, SocGen shares now trade at 0.7x 2017E P/TNAV for a prospective RoTE of 8%, which led us to upgrade the stock to Neutral from Sell.

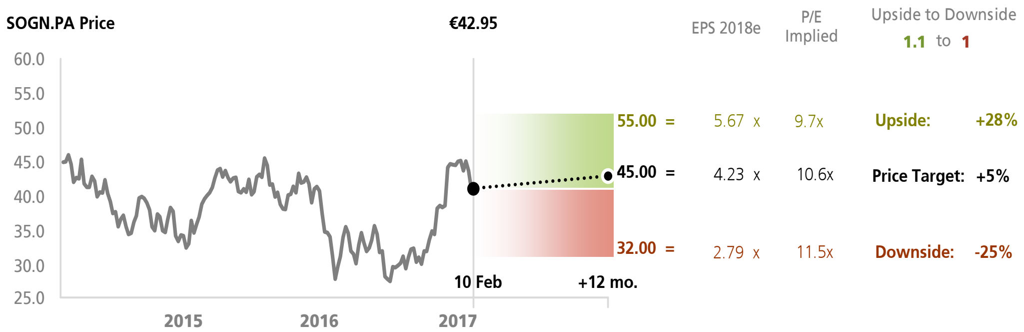
EVIDENCE

With the full-year results, management confirmed our well-documented view that French retail revenues were going to remain under pressure as the low-interest-rate environment continues to hurt margins and because home-loan renegotiations peaked again in 16Q4. In this context, management guidance is for a revenue decline in French Retail banking of -3.5% at worst. In 2017, we pencil in a 3% underlying revenue decline.

WHAT'S PRICED IN?

SocGen is currently trading at a 2017E P/TNAV of 0.7x for a prospective RoTE of ~8%, which seems fair to us as it implies a cost of equity of c.10%, broadly in line with the COE assumption we use in our sum-of-the parts valuation.

UPSIDE / DOWNSIDE SPECTRUM



Value drivers	Global markets revenues (EURm)	Global markets cost income ratio	Implied EPS 2018E (EUR)	% from spot	Implied/P/TNAV 2017E
EUR55 upside	7,944	58%	5.67	28%	0.95x
EUR45 base	6,263	71%	4.23	+5%	0.77x
EUR32 downside	4,582	94%	2.79	-25%	0.55x

Source: UBS estimates

COMPANY DESCRIPTION

Societe Generale SA is a universal bank, headquartered in Paris. It is engaged in retail banking, both in France and internationally, as well as in corporate and investment banking...

ADDITIONAL RESEARCH

Upgrading to Neutral: Disappointment now in the price, Lorraine Quoirez, 13-Feb-2017.

16Q4: Beat on cost of risk, Lorraine Quoirez, 09-Feb-2017.

16Q3 a good quarter, more to come from International..., Lorraine Quoirez, 09-Feb-2017.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Can Thales continue to lead its peer group on organic growth?

Yes. Thales' organic growth has turned earlier and faster than its European defence peers. We think that Thales can continue to lead on organic growth at 4-6% pa as the order-book momentum remains strong, and it is well exposed to emerging market budgets and France. Defence budgets in these areas could be stronger than the overall global average at 3.5%pa over 2016-21E – please refer to our "2017 Sector Outlook".

Q: Can Thales beat its mid-term margins targets?

Yes. Thales' 2017e/2018e EBIT margin target is 9.5-10%. We model mid-term group margins moving to 10.4% underpinned by: 1) margin recovery in Transport from breakeven to 6.5%, 2) DCNS margin improvement from breakeven to 4.5%, 3) €40-50m FX transactional benefits starting 2018e.

UBS VIEW

After several years of organic revenue declines, Thales has moved to 4-6%pa organic growth on the back of strong emerging markets order intake and improving defence outlook. This is driven by an increased impetus in French government spending in defence, which appears to be more fully funded than previously, as well as being backed up by recent Rafale export orders. Based on its strong international exposure, we think that Thales can remain at the top end of its peer group on organic growth. In addition, further margin improvement (mainly self-help) from current levels should lead to 11.5% CAGR in EBIT over 2016-18e.

EVIDENCE

We have taken a deep dive into defence budgets. We also benchmark Transportation and DCNS against peers – this gives us confidence in the long-term margin improvement.

WHAT'S PRICED IN?

We reverse-engineer our Thales DCF, and conclude that Thales shares are pricing in an organic revenue CAGR of 4% for 2016-21E. This compares to our expectations of 5.5% growth, driven by good growth in the Defence, Civil Aerospace and Transport divisions.

UPSIDE / DOWNSIDE SPECTRUM

Value drivers	LT EBIT margin	EBITA CAGR	Cash conversion
€108 upside	11.5%	9.4%	95%
€96 base	10.6%	8.2%	91%
€76 downside	9.0%	2.5%	80%

Source: UBS

COMPANY DESCRIPTION

Thales is an aerospace and defence company with two divisions: (1) Defence & Security: defence electronic systems, air defence and missile systems, avionics, radar, communication…

ADDITIONAL RESEARCH

Already on the "Long Promised Road", Celine Fornaro, 01-Feb-2017.

Q3 Sales 6.5% above consensus expectations, Celine Fornaro, 19-Oct-2016.

Profit growth potential well understood, but …, Cristian Nedelcu, 18-Oct-2016.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Does Vinci suffer from rising bond yields?
It depends. So long as real bond yields do not significantly increase, rising bond yields are broadly value-neutral as the concession assets are inflation-linked.

Q: Can Vinci create value with M&A (how will FCF be applied)?
Yes. Vinci's track record of M&A execution is strong, with attractive returns generated from major historical deals. With over €3bn of FCF generated over 2016-20E and shareholder returns of €1.5bn, we estimate there is over €1.5bn of annual fire-power for acquisitions.

Q: Can margins expand from current levels?
Yes. In contracting we expect a gradual cyclical increase in margins over the next years to 4.4% by 2020E from 3.4% in 2015. In motorways we expect further EBITDA margin expansion to 74.8% by 2020E from 72.2% in 2015 as assets mature.

UBS VIEW

We see value in Vinci with good momentum in the concession business and recovery in contracting. At c8% 2017E FCF yield, rising to nearly 10% by 2020E, Vinci screens attractively given the exposure to stable and growing concessions, which account for 70% of our SOP valuation.

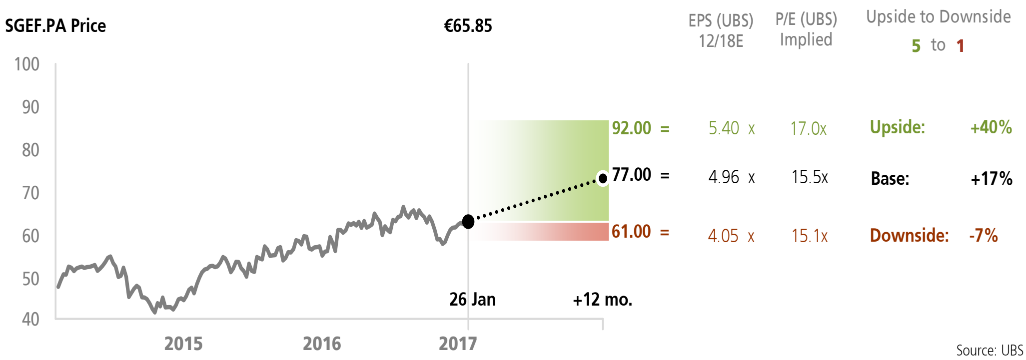
EVIDENCE

APRR motorway traffic has continued to be robust in Q4. Forward airport capacity also points to continued momentum into 2017. Order intake momentum points to improved conditions in contracting over the next 2-3 years.

WHAT'S PRICED IN?

We calculate that the shares are currently implying an equity IRR of 11.7%, which we believe is attractive in the current low-yield environment. We see a compelling risk-reward ratio of 5:1 at the current share price.

UPSIDE / DOWNSIDE SPECTRUM



Source: UBS

Value drivers	2017-18 motorway sales growth (%)	Motorway WACC (%)	Airport WACC (%)	2018E contracting margin (%)	2018E EPS
€92 upside	3.6%	7%	6-7%	4.5%	€5.39
€77base	3.0%	6%	7-8%	4.2%	€4.96
€61 downside	1.9%	5%	8-9%	3.0%	€4.96

Source: UBS

COMPANY DESCRIPTION

Vinci is the world's leading concession and construction/contracting group. Some 84% of revenues are derived from Europe (58% in France). Following the 2006 ASF acquisition, the...

ADDITIONAL RESEARCH

Strong momentum leads to earnings beat, Gregor Kuglitsch, 07-Feb-2017.

More than just a bond proxy, Gregor Kuglitsch, 27-Jan-2017.

Feedback from Vinci Energies Capital Markets Day, Gregor Kuglitsch, 05-Dec-2016.

UBS Research THESIS MAP

PIVOTAL QUESTIONS

Q: Will Worldline achieve its organic revenue CAGR and margin targets out to 2019?

We believe it will. We assume a 6% organic CAGR (target 5-7%) and expect the OMDA margin to expand to 22.6% (target 22-22.5%) by 2019. We believe the key markets in which Worldline operates have scope to support this level of growth on an organic basis (improving GDP and exposure to markets with lower payment penetration), and are encouraged that key customer/contract risk is now significantly reduced. The company has also shown a strong ability to manage its margins, and the synergies from the Equens acquisition should support margin expansion to the targeted level.

Q: Will Worldline benefit from regulatory changes in European payments?

Yes. We expect implementation of PSD2 payment legislation in Europe is likely to lead banks increasingly to consider either increased usage of outsourcing partners or selling their payment-processing businesses. While it could pose challenges to some card-based payment businesses over time, we see three factors that support the position of Worldline in this environment: (1) its pan-European presence; (2) its breadth of bank engagements (>250); and (3) its ambition to be a consolidator, and the funding capacity it has for M&A.

UBS VIEW

We rate Worldline Buy as: (1) while we are only in-line with consensus on 2018E EPS, we believe upcoming new European legislation in payments (PSD2) offers upside optionality as banks may look to outsource more of their payment processing operations, with Worldline well positioned; (2) we believe the company has heavily reduced its key contract risk, with its largest customer contracted out to 2021 and no other contract worth more than 1.5% of sales; and (3) our work on Worldline's end-markets suggests that its organic growth target of 5-7% is well underpinned by improving GDP growth and relatively low levels of payment sophistication in some of its key markets.

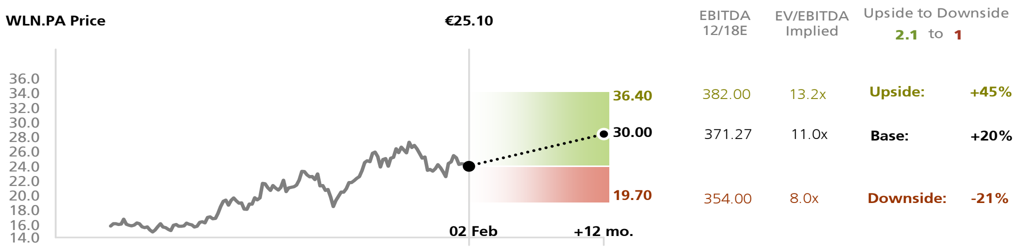
EVIDENCE

We have reviewed Worldline's historical performance against targets (generally strong execution) and the trends in each of its key markets, some of which demonstrate relatively low levels of payment sophistication. We have also conducted a detailed review of the upcoming EU legislation to assess its potential impact on Worldline.

WHAT'S PRICED IN?

Based on a DCF-sensitivity model, we believe the market is pricing in c5.5% growth for Worldline and the EBITDA margin expanding gradually to 22% by 2022. This compares with Worldline's target to grow 5-7% in 2017-19, and an EBITDA margin of 22-22.5% in 2019.

UPSIDE / DOWNSIDE SPECTRUM



Source: UBS

Value drivers	Revenue CAGR '17-'22E	EBITDA margin '22E	Implied '18 revenues	Implied '18 EBITDA	EV/EBITDA multiple '18E
€36.4 upside	7.0%	25.0%	1,714	382	13.2
€30.0 base case	5.5%	24.0%	1,706	371	11.0
€19.7 downside	3.0%	21.0%	1,650	354	8.0

Source: UBS

COMPANY DESCRIPTION

Worldline is a broad and highly diversified payment processing and IT services business in Europe. The company provides payment acceptance solutions to merchants (30% of sales),...

ADDITIONAL RESEARCH

A solid finish; well-placed to benefit from '17 trends, David Mulholland CFA, 22-Feb-2017.

Diversification and regulation create opportunities, David Mulholland CFA, 03-Feb-2017.

Valuation Method and Risk Statement

Risks include macroeconomic variables (such as GDP growth rates and inflation), economic slowdown, a weakening currency, global economic events, and government policy changes.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report. For a complete set of disclosure statements associated with the companies discussed in this report, including information on valuation and risk, please contact UBS Securities LLC, 1285 Avenue of Americas, New York, NY 10019, USA, Attention: Investment Research.

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UBS Investment Research: Global Equity Rating Definitions

12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	45%	29%
Neutral	FSR is between -6% and 6% of the MRA.	39%	27%
Sell	FSR is > 6% below the MRA.	15%	16%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 31 December 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

KEY DEFINITIONS: Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months. **Market Return Assumption (MRA)** is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium). **Under Review (UR)** Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation. **Short-Term Ratings** reflect the expected near-term (up to three months) performance of the stock and do not reflect any change in the fundamental view or investment case. **Equity Price Targets** have an investment horizon of 12 months.

EXCEPTIONS AND SPECIAL CASES: UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; **Neutral:** Neutral on factors such as structure, management, performance record, discount; **Sell:** Negative on factors such as structure, management, performance record, discount. **Core Banding Exceptions (CBE):** Exceptions to the standard +/-6% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Company Disclosures table in the relevant research piece.

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UBS Securities France S.A.: Nicolas Langlet.

Company Disclosures

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Abertis[2]	ABE.MC	Buy	N/A	€13.91	23 Feb 2017
Accor[5, 7]	ACCP.PA	Buy	N/A	€37.80	23 Feb 2017
Adecco[5, 6b, 6c, 7, 13]	ADEN.S	Neutral	N/A	CHF71.30	23 Feb 2017
Aeroports de Paris[22]	ADP.PA	Neutral	N/A	€106.75	23 Feb 2017
Air Liquide	AIRP.PA	Sell	N/A	€102.65	23 Feb 2017
Airbus Group SE[4, 5, 7]	AIR.PA	Buy	N/A	€69.05	23 Feb 2017
Allianz S.E[4, 5, 6a, 7]	ALVG.DE	Buy	N/A	€165.65	23 Feb 2017
Alstom[7]	ALSO.PA	Buy	N/A	€25.80	23 Feb 2017
Amundi SA[5, 7]	AMUN.PA	Neutral	N/A	€53.41	23 Feb 2017
Arkema[13]	AKE.PA	Neutral	N/A	€93.53	23 Feb 2017
Atos	ATOS.PA	Buy	N/A	€108.60	23 Feb 2017
Aviva[5, 7]	AV.L	Buy	N/A	507p	23 Feb 2017
AXA[5, 7]	AXAF.PA	Neutral	N/A	€22.60	23 Feb 2017
BIC Group	BICP.PA	Neutral	N/A	€117.60	23 Feb 2017
BNP Paribas[2, 4, 5, 6a, 7, 22]	BNPP.PA	Neutral	N/A	€55.62	23 Feb 2017
Bouygues	BOUY.PA	Neutral	N/A	€36.02	23 Feb 2017
Bureau Veritas	BVI.PA	Neutral	N/A	€18.89	23 Feb 2017
Capgemini	CAPP.PA	Buy	N/A	€80.91	23 Feb 2017
Carrefour SA	CARR.PA	Neutral	N/A	€22.39	23 Feb 2017
Casino Guichard Perrachon SA[4, 7]	CASP.PA	Sell	N/A	€52.47	23 Feb 2017
Crédit Agricole SA[1, 4, 5, 6a, 7]	CAGR.PA	Buy	N/A	€11.39	23 Feb 2017
Danone	DANO.PA	Neutral	N/A	€62.79	23 Feb 2017
Dassault Systèmes	DAST.PA	Sell	N/A	€76.92	23 Feb 2017
EDF[7]	EDF.PA	Neutral	N/A	€9.09	23 Feb 2017
Elior Group	ELIOR.PA	Buy	N/A	€21.25	23 Feb 2017
Engie[7]	ENGIE.PA	Neutral	N/A	€11.27	23 Feb 2017
Essilor International[7]	ESSI.PA	Buy	N/A	€107.85	23 Feb 2017
EUTELSAT Communications	ETL.PA	Neutral	N/A	€17.98	23 Feb 2017
Faurecia	EPED.PA	Sell	N/A	€43.25	23 Feb 2017
Gecina	GFCP.PA	Neutral	N/A	€120.65	23 Feb 2017
Generali[2, 4, 5, 7]	GASI.MI	Buy	N/A	€14.36	23 Feb 2017
Groupe Eurotunnel SA[5]	GETP.PA	Buy	N/A	€8.81	23 Feb 2017
Icade SA	ICAD.PA	Buy	N/A	€67.98	23 Feb 2017
Iliad	ILD.PA	Buy	N/A	€197.15	23 Feb 2017
Ingenico Group[5]	INGC.PA	Neutral	N/A	€79.22	23 Feb 2017
Kering[7]	PRTP.PA	Buy	N/A	€230.45	23 Feb 2017
Kingfisher[7]	KGF.L	Neutral	N/A	322p	23 Feb 2017
Klepierre SA[4, 5, 7]	LOIM.PA	Neutral	N/A	€35.62	23 Feb 2017
Legrand	LEGD.PA	Buy	N/A	€54.13	23 Feb 2017
Lindt & Sprüngli[4, 5, 6b, 6c, 7, 13]	LISN.S	Neutral	N/A	CHF65,435.00	23 Feb 2017
L'Oréal	OREP.PA	Buy	N/A	€176.90	23 Feb 2017

Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
LVMH Moet Hennessy Louis Vuitton SA[7]	LVMH.PA	Buy	N/A	€192.20	23 Feb 2017
Michelin	MICP.PA	Buy	N/A	€107.75	23 Feb 2017
Natixis SA[5, 7]	CNAT.PA	Neutral	N/A	€5.25	23 Feb 2017
Orange[5, 16]	ORAN.PA	Neutral	N/A	€14.61	23 Feb 2017
Pernod Ricard	PERP.PA	Neutral	N/A	€109.00	23 Feb 2017
PSA Group	PEUP.PA	Neutral	N/A	€18.45	23 Feb 2017
Randstad	RAND.AS	Neutral	N/A	€54.88	23 Feb 2017
Remy Cointreau	RCOP.PA	Neutral	N/A	€85.98	23 Feb 2017
Renault[7]	RENA.PA	Buy	N/A	€85.41	23 Feb 2017
Rexel	RXL.PA	Buy	N/A	€15.20	23 Feb 2017
Safran SA[5, 7]	SAF.PA	Sell	N/A	€65.99	23 Feb 2017
Saint Gobain[5]	SGOB.PA	Sell	N/A	€45.27	23 Feb 2017
Sanofi[7, 16]	SASY.PA	Neutral	N/A	€80.13	23 Feb 2017
Schneider Electric[5]	SCHN.PA	Sell	N/A	€64.79	23 Feb 2017
Scor[2, 4, 5, 7]	SCOR.PA	Neutral	N/A	€34.13	23 Feb 2017
SEB	SEBF.PA	Buy	N/A	€125.15	23 Feb 2017
Société Générale[2, 4, 5, 6a, 7, 22]	SOGN.PA	Neutral	N/A	€41.95	23 Feb 2017
Sodexo	EXHO.PA	Buy	N/A	€103.30	23 Feb 2017
STMicroelectronics[5, 7, 16]	STM.PA	Neutral	N/A	€14.27	23 Feb 2017
Teleperformance	ROCH.PA	Buy	N/A	€105.35	23 Feb 2017
Thales[7]	TCFP.PA	Buy	N/A	€88.99	23 Feb 2017
TOTAL[5, 7, 16]	TOTF.PA	Neutral	N/A	€48.29	23 Feb 2017
Unibail-Rodamco[2, 4, 5, 7]	UNBP.AS	Neutral	N/A	€218.05	23 Feb 2017
Valeo	VLOF.PA	Buy	N/A	€59.63	23 Feb 2017
Vallourec[20]	VLLP.PA	Neutral (CBE)	N/A	€5.72	23 Feb 2017
Vinci	SGEF.PA	Buy	N/A	€68.17	23 Feb 2017
Vivendi	VIV.PA	Neutral	N/A	€16.99	23 Feb 2017
Worldline SA	WLN.PA	Buy	N/A	€27.43	23 Feb 2017
Zodiac Aerospace	ZODC.PA	Neutral	N/A	€27.24	23 Feb 2017

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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