

4 CAC 40: highest corporate earnings since 2010 with more surprises in store!

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CAC 40 earnings at an all-time high since 2010

In 2016, **CAC 40 cumulative net earnings shot up 38%**¹. Totalling €73 billion, they hit their peak level since 2010 (Chart 1). **The financial structure of the CAC 40 also significantly relaxed.** Excluding the banking sector, the net debt to equity ratio dropped from 36% in 2015 to a 10-year low of 30% in 2016! (Chart 2).

Top profit-earners included the same trio as in 2015: BNP-Paribas (€7.5bn, +17%), Axa (€5.7bn, +7%) and Total (€5.6bn, +23%). **The biggest improvements** were recorded by newcomers such as ArcelorMittal, LafargeHolcim and Safran, all three of which are now in the black. Meanwhile, Technip, Peugeot, Bouygues and Solvay posted gains of more than 50%. Finally, **only three companies recorded losses** (Engie, Nokia and Publicis) versus four in 2015 (ArcelorMittal, Engie, LafargeHolcim and Safran), and while gas company Engie (formerly GDF-Suez) was in the red for the second year in a row, it did manage to cut its losses by close to 90% between 2015 and 2016.

Of course, these spectacular improvements need to be taken with a pinch of salt because they are largely based on the reduction of non-recurring expenses, down from €25bn to €10bn between 2015 and 2016. Bear in mind that in 2015, ArcelorMittal, Engie and LafargeHolcim altogether recorded asset impairments of nearly €18bn, primarily consisting of write-downs triggered by the collapse of metal and energy prices.

Similarly, the 2016 erosion of CAC 40 revenues (-1.1% reported, -2.7% like-for-like) **puts a dampner on the much-vaunted impact of the improved economic environment in Europe.** Counteracting the cyclical turnaround in Europe, CAC 40 companies were hurt by the steep drop in emerging currencies or the decline in interest rates, penalising international or financial names depending on the case.

While it is important to consider the progress made in 2016 in perspective, the trend is encouraging nonetheless:

- First, the **increase in earnings was more broadly distributed than usual.** Of the 40 companies in the index, only 11 saw their earnings decrease in 2016, compared with 15 in 2015 and as many as 26 in 2008!
- In addition, **the opposing forces** weighing on CAC 40 revenues **started to ease up in the second half** (H2). A sharp improvement was observed over the course of the year, with comparable revenues at -0.5% in H2 versus -4.9% in H1.
- Finally, **the steep drop in non-recurring expenses recorded in 2016 was not merely an accounting feat.** It also reflected a real improvement in the environment. Since the start of 2016, as concerns over Chinese growth have dissipated, metal and energy prices have significantly climbed. Oil prices rose from \$36 at end-2015 to \$57 at end-2016, while steel and gas prices rebounded by 56% and 59%, respectively, in 2016 (chart 3).

Sectorwise, **the 2016 improvement in CAC 40 earnings**, up +€20.1bn and +38%, **can be primarily attributed to the Energy & Commodities sector coming out of the red** (Δ +€10.1bn), reduced losses in **Utilities** (Δ +4.1bn) and significant gains in **Industry & Chemicals** (Δ +€5.1bn and +58%) and **Consumer goods** (Δ +€3.2bn and +22%); together, these sectors made up 58% of the CAC 40 market cap.

To gauge the impact of the **normalisation of commodity prices**, the cumulative earnings of the three **Energy & Commodities** companies (ArcelorMittal, Total and Technip) rose by **€10bn** between 2015 and 2016, accounting for half

¹ +38% (aggregate data) and +20% weighted by market cap

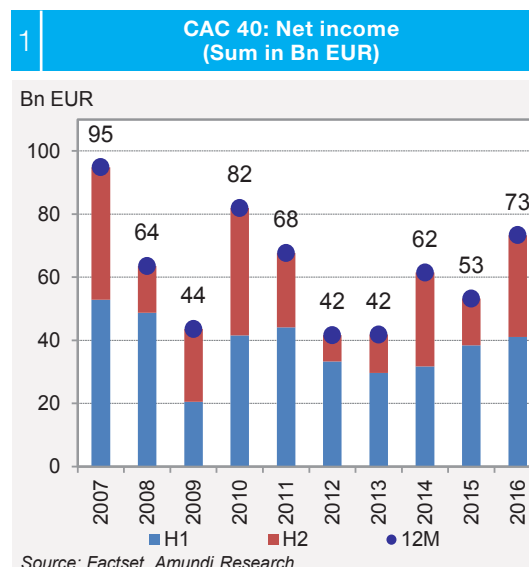
The essential

In 2016, CAC 40 cumulative net earnings shot up 38% to their best level since 2010. This improvement still owed a lot to reduction of non-recurring expenses that weighed on 2015, but the trend is clearly encouraging. Activity picked up significantly between the first and second half. The normalisation of commodity prices should reduce write-downs even further.

CAC 40 earnings should surprise on the upside once again in 2017, especially in light of low consensus predictions (+5% according to the IBES consensus). Between the acceleration of nominal growth, a less negative forex effect, ongoing normalisation in the Energy & Commodities sector, and the automatic turnarounds of Airbus, Engie, Nokia and Publicis, a +16% rise in CAC 40 earnings is entirely plausible.



2016 earnings at a record high since 2010



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the increase in CAC 40 earnings! Similarly, in **Utilities**, the 90% reduction in **Engie's** losses is largely attributable to lower provisions for impairment, with an impact of -€3.8bn on net income in 2016 versus -€6.8bn in 2015.

The Automotive sub-sector was noteworthy in the Consumer Goods sector (+22%). Driven by an upturn in vehicle registrations (+6.5%) in Europe, this sub-sector recorded a +€2.1bn increase in profits, i.e. an average improvement of +38%, with +21% for Renault, +27% for Valeo, +43% for Michelin and +92% for Peugeot! Among other Consumer Goods names, Oréal's reported earnings shed 6%, compared with increases of +11%, +34% and +43% respectively for LVMH, Pernod Record (fiscal year at end-June) and Danone. Restated for non-recurring items, their differences were much narrower. Pernod Ricard's restated net income would have been up +2%, Oréal's +5% (impairment loss on two subsidiaries: *Magic* and *Clarisonic*), Danone's +7% and LVMH's +11%.

The Industry & Chemicals sector (+58%) managed to overcome the stagnation of Saint-Gobain (+1%) and Air Liquide (+5%), and more importantly the nose-dive of Airbus (-63%) due to massive provisions (€2.2bn) on the A400 M. The sector **bounced back** thanks largely to LafargeHolcim and Safran successfully getting out of the red, the turnaround for Bouygues (+81%) and Solvay (+53%), and strong showings by Legrand (+14%), Vinci (+22%) and Schneider (+24%).

Unlike these sectors, Consumer Services (Δ -€2.3bn, -41%) and Technology (Δ -€2.1bn, -78%) saw their earnings decline. Despite the progress achieved by Accor (+9%) and Kering (+17%), Consumer Services suffered from simultaneous downtrends recorded by Sodexo (-9%), Carrefour (-24%), Vivendi (-35%) and especially ad agency **Publicis** (-158%). Publicis was forced to book a write-down of €1.4bn owing to problems faced by US digital subsidiary *Sapient*, bought at the end of 2014 for €3.0bn. In Technology, **Nokia** tipped the scales with a net loss of -€0.9bn versus a profit of +€1.2bn in 2015. Corrected for non-recurring expenses subsequent to the acquisition of Alcatel Lucent, its reported net income (non-IFRS) would only have fallen 10%.

Midway between sectors posting the biggest improvements and those on the decline were Financials (Δ +€1.3bn, +6%), Healthcare (Δ +€0.5bn, +9%) and Telecoms (Δ +€0.3bn, +11%). Financials continued to suffer from the unsupportive interest rate environment. They also had a high comparison base to deal with: 2015 earnings had doubled with the elimination of the record fine levied on **BNP** in 2014. In Healthcare, **Sanofi's** consolidated net income rose 10% to €4.3bn, although it was helped by lower impairments than in 2015 (Δ -€0.5bn). Sanofi's economic performance, undermined by high start-up costs and a negative forex effect, was actually down 1% restated. In Telecoms, **Orange's** earnings (+11%) were boosted by improvements achieved in 2015 (+187%) to a record high since 2011.

The earnings improvement should accelerate in 2017

After this rundown of CAC 40 earnings in 2016, what can we expect to see in 2017? The IBES consensus predicts that CAC40 EPS will climb another +5%, versus +13% for the euro zone as a whole. Excluding exceptional policy circumstances, such as Frexit, which threaten to distort CAC 40 earnings, **the consensus is on the low side in our view.** Combining macro and microeconomic factors, **another increase in cumulative CAC 40 earnings of around +16%²** is within reach, as we see it.

On the macroeconomic front:

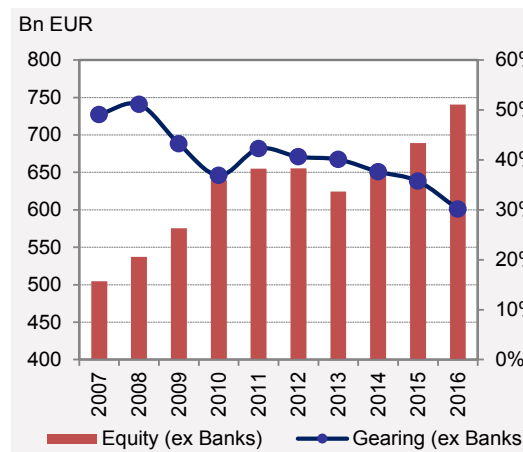
- Real GDP growth in 2017 should be slightly stronger than in 2016, both in France (+1.3% versus +1.1%) and the World (+3.2% versus +3.0%), which is good for the top line of CAC 40 companies and hence for their margins.
- Sales growth will be on an even better track considering that **inflation in developed countries is expected to reach 2%** for the first time in five years, compared with +0.2% in 2015 and +0.8% in 2016. After years under



The rebound in 2016 earnings is predominantly attributable to the normalisation of commodity prices

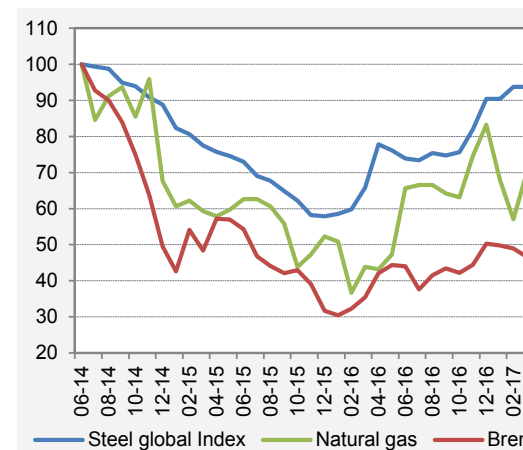


2 CAC 40: Total Equity in Bn EUR and Gearing in % (Right S, Net debt/Equity)



Source: Factset, Amundi Research

3 Commodity prices, index 100 on June 30 2014



Source: Datastream, Amundi Research

² +15% weighted by market cap

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the threat of deflation and falling commodity prices, this trend will give companies back their pricing power. It is even more crucial given how much bigger the impact of price rises is compared to volume increases.

- Furthermore, **the forex effect should be slightly more favourable in 2017 than in 2016.** Although the dollar was stable against the euro in 2016, the pound sterling (-12% over the full year) and emerging currencies depreciated. This year, the euro should weaken slightly against the dollar (1.08 versus 1.11), and while the pound sterling is likely to continue having a negative impact (-5% over the full year), emerging currencies are expected to appreciate somewhat (barring any extreme protectionist measures).

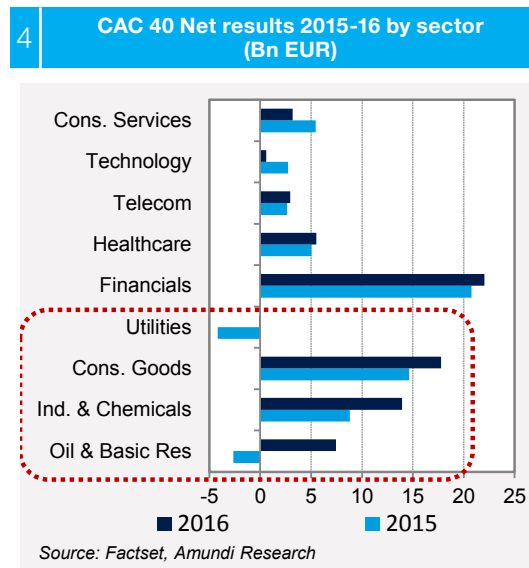
Finally, on the microeconomic front, we predict that:

- **the Energy & Commodities sectors will continue improving** ($\Delta +\text{€}3.0\text{bn}$, +40%) **as will Industry & Chemicals** ($\Delta +\text{€}1.5\text{bn}$, +11%). For Energy & Commodities, the stabilisation of Brent oil prices at around \$50 versus \$44 in 2016, coupled with Chinese growth, should bring asset impairment down even further. The sector's comparison base will also continue to be positive. At end-2016, its cumulative earnings represented only 36% of 2007 cumulative earnings (77% for the CAC 40). In addition to the acceleration of nominal growth, the Industry & Chemicals sector will be driven by the take-off of Airbus. By way of precaution, our assumptions on Airbus are significantly below the consensus (i.e. $\text{€}1.6\text{bn}$ in 2017^e versus $\text{€}2.6\text{bn}$ according to the consensus and $\text{€}1.0\text{bn}$ in 2016) due to the persistent lack of visibility on certain programmes.

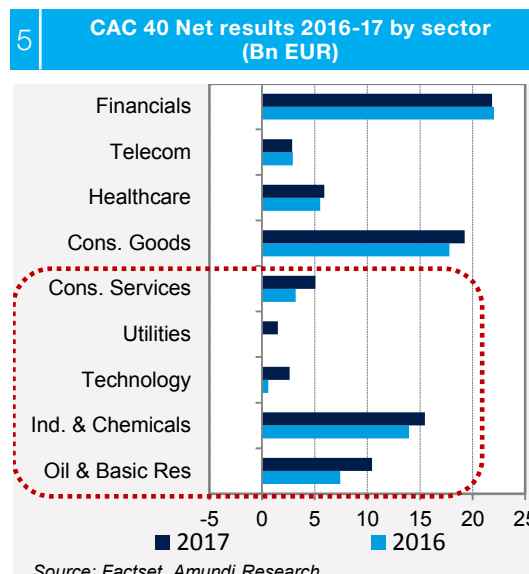
- **Nokia, Engie and Publicis will get out of the red**, in the wake of non-recurring expenses totalling over $\text{€}7\text{bn}$ last year. This in turn should trigger a major **rebound in Technology** ($\Delta +\text{€}2.0\text{bn}$, > 100%), **Utilities** ($\Delta +\text{€}1.6\text{bn}$, after losses of $\text{€}0.1\text{bn}$ in 2016) **and Consumer Services** ($\Delta +\text{€}1.9\text{bn}$, +59%). Our 2017 assumptions for Engie are also below the consensus ($\text{€}1.0\text{bn}$ versus a range of $\text{€}2.1\text{bn}$ to $\text{€}2.4\text{bn}$). In Consumer Services, while Vivendi should remain under pressure, Accord, Carrefour and Kering should be able to improve their results. From a more general standpoint, we would stress that the **comparison base** for of 2016 versus 2007 earnings in all three sectors is very positive, at 42% for Consumer Services, 8% for Technology and -3% for Utilities!

- **for the rest, cumulative growth in other sectors should only be +3%:** +8% for Consumer Services (vs. +22% in 2016), +7% for Healthcare (+9% in 2016), -1% for Financials (+6% in 2016) and -3% for Telecoms (+11% in 2016). We are little surprised to find Financials at the bottom of the ranking; the expected decrease in the number of non-performing loans and steepening of the yield curve should fuel earnings growth for banks. Is it because of a relatively difficult comparison base, given that Financials were more resilient than average, contrary to accepted views³? Or will analysts keep raising their forecasts, as they have for the last six months? Time will tell!

Ultimately, despite any reservations one might have on a given sector, the earnings improvement trend begun in 2016 should pick up in 2017. Given the wariness surrounding the equity markets in general, and the shadow cast over France due to the upcoming elections, it is not small thing for the CAC 40 to be in such good health.



“The turnaround is set to gather pace in 2017.”



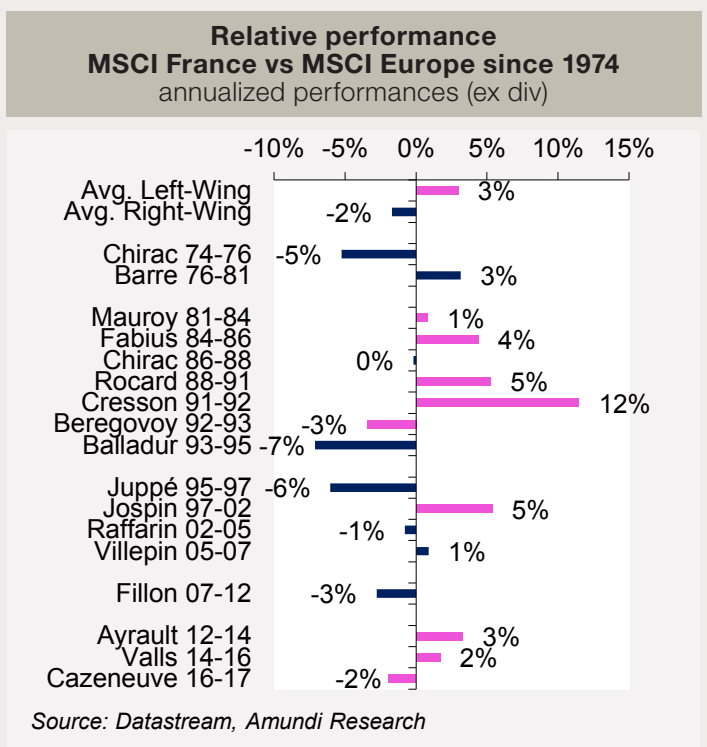
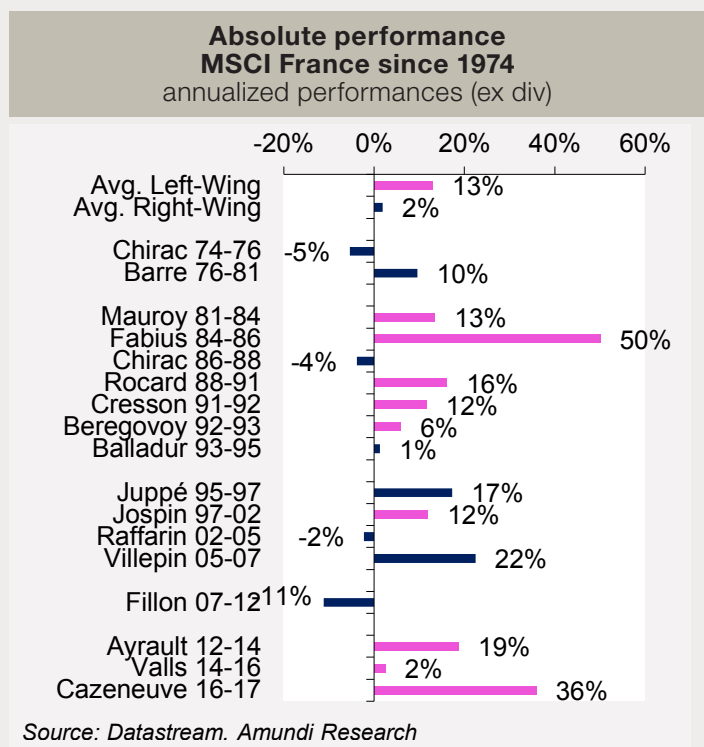
³ At end-2016, Financial company earnings represented 115% of their 2007 starting point, or even 95% excluding the Kerviel scandal, versus 77% for the CAC 40.

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> French equities and political regimes

The next French presidential election will be held from 23 April to 7 May. The second round will likely pit Marine Le Pen (Front National) against Emmanuel Macron (En Marche) or François Fillon (Republicans). She will most likely be beaten in the second round, but after the Brexit referendum and Donald Trump's election, investors are on their guard. Under the circumstances, politics - usually relegated to the background - have once again become a key focus for the markets, so we decided to examine how French equities have fared under different majorities since 1974^(*). Empirically, the French market has done better under left-wing administrations, including co-habitations, than under right-wing administrations (see chart). This is true in absolute and relative terms compared to other European markets. The disqualification of the left-wing party in round one and the potential victory of a "left and right-wing" candidate would be unprecedented, however.

(*) Stockprices from May 19, 1974 to March 30, 2017



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