

Equities

12 January 2012 | 40 pages

EADS (EAD.PA)

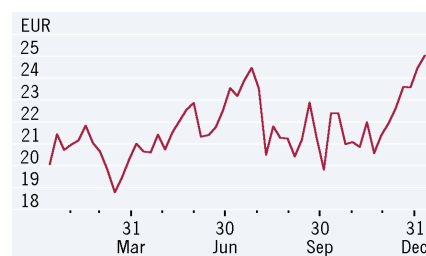
(Still) Positive on EADS for 2012

- Company Update
- Target Price Change
- Estimate Change

- **Conclusion** — EADS may be up 11% in the past month, but it remains one of our top picks for 2012 due to strong EPS growth from a depressed base (65% CAGR 2011E-2013E), visibility (a €500m order backlog / 6-7 years of production), and valuation (c9x 2013E P/E). In this note, we raise our EPS forecasts by 3% in 2012E and 7% in 2013E (revised FX rate + lower net interest forecasts) and reiterate our Buy rating.
- **'Cash Machine'** — A different angle to the EADS investment case. Following detailed analysis of cash flows, we conclude that EADS should become very cash generative in the medium-term as EBIT rises & investment plateaus. EADS is trading on a 2% FCF yield in 2012E, rising to 13% in 2013E and >20% from 2015E. Financial deleveraging & strong EBIT growth could see €80/share on a 3-5 year view (at 10x 2016E EV/EBIT).
- **Currency** — EADS is a major beneficiary of \$ strength vs. the €. We now assume \$1.27/€ (prev. \$1.36/€). A \$71.8bn hedge book (average rate \$1.38/€) mitigates the impact on near-term EPS, but valuation is sensitive. Every 1 \$ cent change in the effective rate (after hedging) impacts EBIT by c€100m (vs. our forecast of €2.5bn in 2012E and €3.5bn in 2013E). A 10% FX movement impacts our DCF by >30%.
- **4 Catalysts** — (1) New Year Press Conference, 17 January. We expect EADS to guide for 2012E book-to-bill of >=1x. Management changes could also be announced. (2) Boeing results, 25 January. Good results and an upbeat outlook could have a positive read-across for EADS. (3) EADS FY11 Results, 8 March. Strong 4Q deliveries (161 vs. 116 in 3Q10A) could result in another positive earnings surprise. We see upside risk to our FY11 EBIT of €1.56bn (vs. guidance €1.45bn). (4) Indian Fighter Jet Decision, tbc. EADS is part of the Eurofighter consortium & owns 49% of Dassault (Rafale).
- **Target Raised to €31 (from €27)** — This reflects higher EPS forecasts and revised FX assumptions. For prudence, our valuation models now assume €1.5bn of A350XWB charges (€2.50/share). Our Target Price implies 11.6x 2013E P/E (vs. long-run average forward P/E of 13.7x) and is now based on a DCF rather than P/E to reflect EPS growth prospects from 2013E onwards and the long-term impact of FX on valuation.

Buy	1
Price (11 Jan 12)	€24.90
Target price	€31.00
	from €27.00
Expected share price return	24.5%
Expected dividend yield	1.2%
Expected total return	25.7%
Market Cap	€20,430M
	US\$26,094M

Price Performance (RIC: EAD.PA, BB: EAD FP)



EADS (EUR)

Year to 31 Dec	2009A	2010A	2011E	2012E	2013E
Sales (€M)	42,822.0	45,752.0	49,192.8	55,670.0	60,050.0
Net Income (€M)	1,078.2	659.3	832.2	1,485.8	2,181.1
Diluted EPS (€)	1.33	0.81	1.02	1.82	2.68
Diluted EPS (Old) (€)	1.33	0.81	1.02	1.77	2.50
PE (x)	18.7	30.6	24.3	13.7	9.3
EV/EBITDA (x)	7.9	9.7	9.9	7.2	5.4
DPS (€)	0.00	0.22	0.30	0.55	0.80
Net Div Yield (%)	0.0	0.9	1.2	2.2	3.2

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

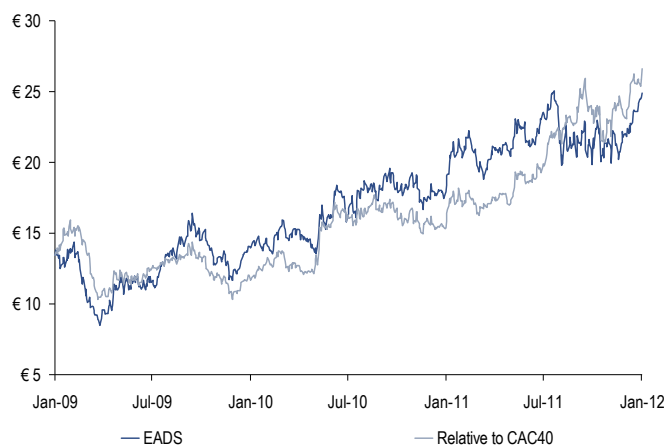
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Fiscal year end 31-Dec	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	18.7	30.6	24.3	13.7	9.3
EV/EBITDA adjusted (x)	7.9	9.7	9.9	7.2	5.4
P/BV (x)	1.9	2.3	2.1	1.9	1.6
Dividend yield (%)	0.0	0.9	1.2	2.2	3.2
Per Share Data (€)					
EPS adjusted	1.33	0.81	1.02	1.82	2.68
EPS reported	-0.94	0.68	0.80	1.82	2.68
BVPS	13.01	10.91	11.62	13.12	15.26
DPS	0.00	0.22	0.30	0.55	0.80
Profit & Loss (€m)					
Net sales	42,822	45,752	49,193	55,670	60,050
Operating expenses	-43,278	-44,666	-47,973	-53,321	-56,710
EBIT	-456	1,086	1,219	2,349	3,340
Net interest expense	-147	-99	-33	-155	-136
Non-operating/exceptionals	-369	-171	-151	16	30
Pre-tax profit	-972	816	1,035	2,210	3,234
Tax	220	-244	-367	-707	-1,035
Extraord./Min.Int./Pref.div.	-11	-19	-16	-17	-18
Reported net income	-763	553	653	1,486	2,181
Adjusted earnings	1,078	659	832	1,486	2,181
Adjusted EBITDA	3,782	2,731	3,004	4,049	5,140
Growth Rates (%)					
Sales	-1.0	6.8	7.5	13.2	7.9
EBIT adjusted	-35.4	-40.7	17.5	67.2	42.2
EBITDA adjusted	-20.0	-27.8	10.0	34.8	27.0
EPS adjusted	-45.7	-38.8	25.8	78.2	46.8
Cash Flow (€m)					
Operating cash flow	2,438	4,996	3,852	2,786	3,929
Depreciation/amortization	1,768	1,536	1,600	1,700	1,800
Net working capital	15	2,819	2,382	250	610
Investing cash flow	-1,853	-2,289	-3,724	-2,333	-2,428
Capital expenditure	-1,957	-2,250	-2,300	-2,400	-2,500
Acquisitions/disposals	77	-80	-1,492	0	0
Financing cash flow	-82	-2,953	-1,382	-546	-747
Borrowings	-151	-2,367	-508	-2	0
Dividends paid	-166	-7	-182	-244	-447
Change in cash	453	-246	-1,254	-92	753
Balance Sheet (€m)					
Total assets	80,304	83,187	87,793	93,310	97,882
Cash & cash equivalent	15,093	16,196	15,890	15,798	16,551
Accounts receivable	5,587	6,632	7,400	8,400	9,100
Net fixed assets	12,586	13,504	15,123	15,823	16,523
Total liabilities	69,663	74,251	78,315	82,573	85,393
Accounts payable	8,217	8,546	9,800	9,300	10,700
Total Debt	4,644	3,746	4,235	4,235	4,235
Shareholders' funds	10,641	8,936	9,478	10,737	12,489
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	8.8	6.0	6.1	7.3	8.6
ROE adjusted	10.0	6.8	9.1	14.8	18.9
ROIC adjusted	10.2	4.7	5.1	7.7	10.4
Net debt to equity	-98.2	-139.3	-123.0	-107.7	-98.6
Total debt to capital	30.4	29.5	30.9	28.3	25.3

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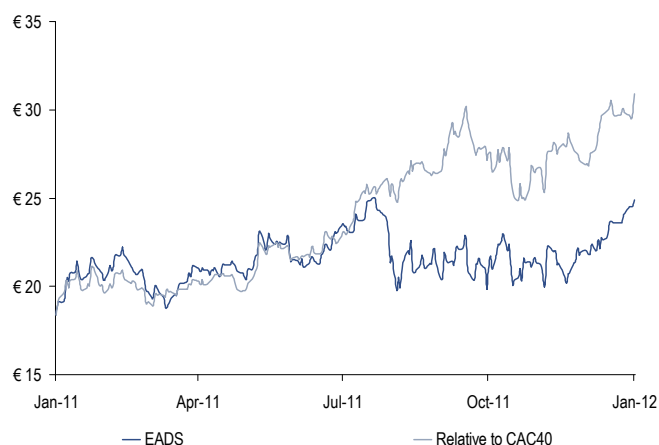
(Still) Positive on EADS for 2012

Figure 1. EADS – 3-Year Share Price and Price Relative Performance



Source: DataStream

Figure 2. EADS – 1-Year Share Price and Price Relative Performance



Source: DataStream

We reiterate our Buy rating with an updated Target Price of €31/share (prev €27). EPS forecasts raised by 3% in 2012E and 7% in 2013E to reflect stronger cash flows and a FX rate of €1.27/€ (prev. \$1.36/€).

Despite the fact that the shares are up by 11% in the past month, EADS remains one of our top picks for 2012 on account of strong earnings growth prospects from a depressed base (65% EPS CAGR 2011E-2013E on 10% Sales CAGR as EBIT margins rise from 2.8% to 5.9%), excellent visibility afforded by a €500bn order backlog (6-7 years worth of production), and an attractive valuation at c9x 2013E P/E. We view EADS as a leveraged play on the civil OE¹ cycle, upon which we remain positive.

In this note, we reiterate our Buy rating with an updated DCF-based one year Target Price of €31/share (previously €27), which implies 11.6x 2013E P/E vs. EADS long run average 12 month consensus P/E of 13.7x since 2000. We have raised our EPS forecasts by 3% in 2012E and 7% in 2013E to reflect a revised FX assumption of \$1.27/€ (previously \$1.36/€) and lower net interest costs (following a detailed review of cash flows).

Our fundamental views on EADS and civil aerospace remain unchanged — see [Growth, Visibility, Value](#) (14 November) and [2012 Outlook](#) (21 December). However, this note introduces a number of new elements.

1. A deep dive into EADS' cash flows suggests that EADS could become highly cash generative in the medium-term as profitability rises and investment plateaus. This introduces another angle to the EADS story, in our view. Aside from the fact that EADS has €11.6bn of Net Cash (2011E) already, we expect FCF to grow rapidly from €0.56/share in 2012E (2% yield) to €3.19/share (13% yield) in 2013E and >€5/share in 2016E (>20% yield). Strong cash conversion helps justify a higher P/E valuation, in our view. Moreover, a combination of strong EBIT growth (from €2.5bn in 2012E to €6.7bn in 2016E) and financial deleveraging (we expect Adjusted Net Debt to fall from €9.2bn 2011E to fall to €2.3bn at 2015E) suggests significant share price upside, with €80/share possible on a 3-5 year view (based on 10x 2016E EV/EBIT)! See Figure 7, p3.
2. Earnings forecasts and valuation updated for an FX rate of \$1.27/€ (previously \$1.36/€). EADS is a major beneficiary of \$ strength vs. the €. The impact on short-term EPS is mitigated by significant hedging, but currency has a significant impact on valuation, in our view, with a 10% move in the spot rate

¹ Original Equipment

raising our DCF value by >30%, *ceteris paribus*. EADS guides that a 1 \$ cent change in the effective rate (after hedging) impacts EBIT by c€100m (vs. €2.5bn EBIT in 2012E and €3.5bn in 2013E). EADS' \$71.8bn hedge book has an average rate \$1.38/€.

3. Previews of 4 forthcoming catalysts, including EADS' New Year Press Conference (17 January) and FY11 results, where we see scope for a strong 4Q margin in Airbus Commercial driven by record deliveries in the quarter. On 5 January, Bloomberg reported that Airbus deliveries could be "several more than 530" in 2011 vs. our previous forecast of 525 and EADS' guidance of 520-530 aircraft. We assume 535, implying 161 aircraft in 4Q11E vs. 116 in 3Q10A. Given high incremental margins per aircraft (c€10-20m EBIT per aircraft), 4Q11 could be very strong and we see upside risk to our forecast of €1.56bn EBIT for FY11E (which is already above EADS' guidance of €1.45bn). See Figure 10.

Figure 3. EADS – Summary Income Statement, 2005A-2016E (€ millions)

	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E	CAGR 2012E-16E
Airbus deliveries	378	434	453	483	498	508	535	582	620	662	682	703	5%
growth	18%	15%	4%	7%	3%	2%	5%	9%	7%	7%	3%	3%	
Sales	€ 34,206	€ 39,434	€ 39,123	€ 43,265	€ 42,822	€ 45,752	€ 49,193	€ 55,670	€ 60,050	€ 66,130	€ 69,700	€ 73,870	7%
growth	8%	15%	-1%	11%	-1%	7%	8%	13%	8%	10%	5%	6%	
Clean EBIT	€2,852	€ 3,759	€ 3,626	€ 3,330	€ 2,148	€ 1,340	€ 1,560	€ 2,525	€ 3,530	€ 4,885	€ 5,750	€ 6,735	28%
margin	8.3%	1.0%	0.1%	6.5%	-0.8%	2.7%	2.8%	4.5%	5.9%	7.4%	8.2%	9.1%	
growth	17%	32%	-4%	-8%	-35%	-38%	16%	62%	40%	38%	18%	17%	
Underlying EPS	€ 2.31	€ 3.05	€ 2.51	€ 2.45	€ 1.33	€ 0.81	€ 1.02	€ 1.83	€ 2.68	€ 3.85	€ 4.61	€ 5.49	32%
growth	27%	32%	-18%	-2%	-46%	-39%	26%	78%	47%	43%	20%	19%	
DPS	0.65	€ 0.12	€ 0.12	€ 0.20	€ 0.00	€ 0.22	€ 0.30	€ 0.55	€ 0.80	€ 1.15	€ 1.38	€ 1.65	32%
growth	0%	-82%	0%	67%	-100%	na	36%	83%	45%	44%	20%	20%	

Source: Company reports and Citi Investment Research and Analysis

4. Earnings forecasts extended to 2016 to demonstrate EADS' strong growth potential beyond 2013 (Figure 3). We expect very strong EPS growth in the near term (+83% YoY in 2012E and +45% in 2013E) from a depressed base, driven by strong sales growth and margin expansion. This is a trend that we expect to continue beyond 2013 and forecast 32% EPS CAGR 2012E-2016E. Our forecasts assume an Airbus Commercial margin of 9.2% in 2015E, which is in line with EADS' target of 10%, before the dilutive impact of early A350XWB deliveries. At the 9M11 results, EADS CFO Hans Peter Ring commented that EADS continues to "...anticipate earnings growth throughout the decade".
5. Updated Valuation Models. In addition to making a number of minor changes to our calculation of Enterprise Value following the recent EADS Global Investor Forum, we also now factor in further charges of €1.5bn in respect of A350XWB into our valuation models. This is simply for prudence/completeness and does not reflect a change in view on the risks associated with A350XWB. Our €31/share Target is based on a DCF but we also value EADS using a range of alternative approaches, including EV/Sales (€38/share at 0.75x 2012E EV/Sales), EV/EBIT (€28/share at 10x 2013E EV/EBIT, discounted back by one year), SOTP (€29/share) and P/E (€33/share based on 13.7x 2013E P/E, discounted back by one year).

'Cash Machine'

We believe that rapid FCF growth is an angle to the EADS investment case that has possibly been overlooked.

Our previous EADS notes have focused largely on earnings as opposed to cash flows. Following a detailed rethink of our cash flow statement, we conclude that EADS should become highly cash generative in the medium-term as profitability rises and capex plateaus. We believe that this introduces another angle to the EADS story, which we believe has possibly been overlooked. On a number of occasions at 2011 Global Investor Forum, CFO Hans Peter Ring described EADS as a "cash machine", which we believe is an apt description, not just because of its €11.6bn of Net Cash, but also due to its strong FCF generation.

Figure 4. EADS – Simplified Cash Flow Statement, 2005A-2016E (€ millions)

	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
Clean EBIT	2,852	3,759	3,626	3,330	2,148	1,340	1,560	2,525	3,530	4,885	5,750	6,735
D&A	1,653	1,691	1,772	1,667	1,826	1,582	1,600	1,700	1,800	1,900	2,000	2,001
Tax	-265	-239	-73	-393	-32	-215	-328	-707	-1,035	-1,482	-1,775	-2,112
Associates/JVs	-174	-106	-257	-161	-107	-104	-106	-109	-118	-131	-138	-146
Movement in Provisions	175	2,150	2,268	1	1,767	334	-650	-650	-650	-650	-650	-650
Working Capital	1,065	-1,303	1,175	155	421	2,756	2,200	550	610	670	710	750
Customer Financing	174	1,160	61	-327	-406	63	182	-300	0	0	0	0
Net Interest	-155	-121	-199	36	-147	-99	-33	-155	-136	-95	-42	25
Capex	-2,818	-2,708	-2,028	-1,837	-1,957	-2,250	-2,300	-2,400	-2,500	-2,500	-2,500	-2,500
Other	-153	-2,334	-3,236	141	-3,005	-620	-506	0	0	0	0	0
Free Cash Flow	2,354	1,949	3,109	2,612	508	2,787	1,620	453	1,501	2,598	3,355	4,103
FCF per share	€ 2.96	€ 2.44	€ 3.87	€ 3.24	€ 0.63	€ 3.44	€ 1.99	€ 0.56	€ 1.84	€ 3.19	€ 4.12	€ 5.04
FCF Yield								2%	7%	13%	16%	20%
Net Acquisitions/Disposals	59	80	245	-53	77	-80	-1,492	0	0	0	0	0
Pension Contributions	0	0	-303	-436	-173	-553	-500	-300	-300	-300	-300	-300
Equity Issued	-101	59	46	63	12	-51	-58	0	0	0	0	0
Dividends Paid	-396	-552	-98	-107	-166	-7	-182	-244	-447	-651	-936	-1,123
Other	-388	-2,796	-204	90	346	25	-134	0	0	0	0	0
Change in Net Debt	1,528	-1,260	2,795	2,169	604	2,121	-746	-90	753	1,647	2,119	2,680
Net Cash (excl Minority & Non Recourse)	6,080	5,133	7,883	9,930	10,449	12,450	11,653	11,563	12,316	13,963	16,083	18,763
Net Cash per share	€ 7.65	€ 6.41	€ 9.82	€ 12.31	€ 12.90	€ 15.36	€ 14.35	€ 14.21	€ 15.14	€ 17.16	€ 19.77	€ 23.06

Source: Company Reports and CIRA Estimates

In the period 2005A to 2011E, EADS generated an average FCF of €2.65/share (range €0.63-3.87).

Forecasting EADS' cash flows is inherently difficult. Historically cash flows have been volatile. However, in the period 2005A to 2011E, EADS generated an average FCF of €2.65/share (range €0.63-3.87). Cash has also surprised positively at every recent set of results, in part due to strong Airbus order flows. Figure 4 shows a summarised cash flow statement, starting at Clean EBIT. Our cash flow assumptions for some of the more historically volatile and less straightforward line items are discussed below:

- **Movement in Provisions** — We adjust EBIT by €650m pa to reflect cash losses on problematic programmes (A400M, A380). At the 2011 Global Investor Forum in the section dedicated to calculating Enterprise Value, EADS disclosed €4.0bn of provisions for problematic programmes, so our forecasts assume that this impacts earnings for 6-7 years. Interesting to note that, historically, provision outflows have only been negative in one of the past 5 years (€-1.3bn in 2006A), suggesting that our forecast of €650m could prove too conservative.
- **Customer Financing** — We assume €300m cash outflows for customer financing in 2012E vs. EADS guidance of a "modest outflow". Our forecast for 2012E is slightly less than the €300-400m pa in the credit crunch period of 08/09. Our overall view is that lessors, Middle East and Asian banks will pick up the slack following the exit of some French banks from the aircraft financing market.

Figure 5. EADS – Working Capital Analysis

	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
A) Airbus Orders (@ List Price)	€ 78,254	€ 53,367	€ 117,323	€ 82,041	€ 23,461	€ 68,210	€ 100,000	€ 46,202	€ 50,710	€ 55,838	€ 59,210	€ 62,817
B) Average FX rate	\$1.24	\$1.26	\$1.37	\$1.47	\$1.39	\$1.33	\$1.39	\$1.27	\$1.27	\$1.27	\$1.27	\$1.27
C=A*B) \$ Orders	\$97,416	\$67,048	\$160,835	\$120,707	\$32,720	\$90,719	\$139,000	\$58,676	\$64,401	\$70,915	\$75,197	\$79,777
D) Gross Aircraft Orders	1,111	824	1,458	900	310	644	1,525	625	666	712	733	755
E) Deliveries	378	434	453	483	498	508	535	582	620	662	682	703
F=D/E) Book-to-bill	2.9x	1.9x	3.2x	1.9x	0.6x	1.3x	2.9x	1.1x	1.1x	1.1x	1.1x	1.1x
G=C/D) \$ Order Value per Aircraft	\$88	\$81	\$110	\$134	\$106	\$141	\$91	\$94	\$97	\$100	\$103	\$106
H) Estimated Discount	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%
I=G-H) Net Order Value per Aircraft	\$53	\$49	\$66	\$80	\$63	\$85	\$55	\$56	\$58	\$60	\$62	\$63
J) Estimated Deposit as % of Aircraft Value	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%	2%
K=I*J) Est. \$ Deposit Receipts / Aircraft	\$1.1	\$1.0	\$1.3	\$1.6	\$1.3	\$1.7	\$1.1	\$1.1	\$1.2	\$1.2	\$1.2	\$1.3
L=D*K/B) Est Airbus Aircraft Deposits	€ 939	€ 640	€ 1,408	€ 984	€ 282	€ 819	€ 1,200	€ 554	€ 609	€ 670	€ 711	€ 754
M) Other Working Capital Items	€ 126	-€ 1,943	-€ 233	-€ 829	€ 139	€ 1,937	€ 1,000	-€ 4	€ 1	€ 0	-€ 1	-€ 4
N) Working Capital Cash flow	€ 1,065	-€ 1,303	€ 1,175	€ 155	€ 421	€ 2,756	€ 2,200	€ 550	€ 610	€ 670	€ 710	€ 750

Source: Citi Investment Research and Analysis and company reports

- Working Capital — Historically very volatile and arguably the hardest item to forecast. We see working capital (excluding customer financing) as 2 distinct elements: i) deposits on Airbus aircraft ordered; ii) traditional working capital associated with day-to-day operations. Figure 5 attempts to split this out. Based on an assumed 40% discount to list prices and a deposit at 2% of the aircraft price, we forecast deposit inflows of €554-754m pa from 2012E to 2016E, assuming just over 1x book-to-bill. Traditional working capital flows are harder to predict. We forecast zero on the basis that EADS is in the privileged position of having minimal working capital requirements due to customer pre-delivery payments, but acknowledge that as production rates increase, working capital requirements may also be commensurately higher.
- Other — Figure 4 shows that the “Other” line in EADS’ cash flow statement has been extremely volatile historically, raging from €-3.2bn to €+141m. We forecast zero going forward. Mark-to-market revaluations of derivative instruments, the unwinding of discounted provisions, exceptional gains/losses, and other non-cash items have all been constituents of the “Other” line historically.

We forecast a sharp increase in FCF from €0.56/share in 2012E to >€5/share in 2016E as underlying EBIT grows and investment requirements plateau.

We expect EADS to become very cash generative in the medium-term. We expect FCF to rise dramatically from 2012 onwards as underlying EBIT rises and capex requirements plateau. We forecast FCF €0.56/share in 2012E rising to €1.84/share rising in 2013E, to €3.19 in 2013E and eventually to €>5.00/share in 2016E.

However we expect FCF to be weaker in 2012E than in 2011E (€0.56/share vs. €1.99/share), despite higher underlying profitability, due to lower Airbus deposit receipts (we expect €+0.5bn in 2012E vs. €+1.2bn in 2011E based on 625 orders in 2012E vs. >1,500 in 2011E per Figure 5), increased capex requirements (€-2.4bn vs. €-2.3bn per Figure 4), and increased customer financing (€-300m vs. €+182m).

Figure 6. EADS Cash Conversion (FCF / Underlying EPS)

	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
FCF per share	€ 2.96	€ 2.44	€ 3.87	€ 3.24	€ 0.63	€ 3.44	€ 1.99	€ 0.56	€ 1.84	€ 3.19	€ 4.12	€ 5.04
Underlying EPS (Citi)	€ 2.31	€ 3.05	€ 2.51	€ 2.45	€ 1.33	€ 0.81	€ 1.02	€ 1.83	€ 2.68	€ 3.85	€ 4.61	€ 5.49
Conversion	128%	80%	154%	132%	47%	423%	195%	31%	69%	83%	89%	92%

Source: Company Reports and CIRA Estimates

Strong cash conversion is supportive of a higher P/E rating, in our view, as EPS is “cash backed”. We forecast cash conversion of 31% in 2012E rising to 69% in 2013E and >90% by 2016E. In the period 2005A-2011E, EADS’ FCF has averaged 161%. Valuation also looks attractive on a FCF yield basis, with EADS currently trading at a 2% FCF yield in 2012E, rising to 7% in 2013E, 13% in 2014E and 16% in 2015E (Figure 4).

Figure 7. EADS – EV/EBIT Valuation

	2012E	2013E	2014E	2015E	2016E
Clean EBIT	2,525	3,530	4,885	5,750	6,735
Target EV/EBIT Multiple	10.0x	10.0x	10.0x	10.0x	10.0x
Enterprise Value	25,250	35,300	48,850	57,500	67,350
Adjusted Net Debt	-9,238	-8,696	-7,310	-5,032	-2,283
Suggested Equity Value	16,012	26,604	41,540	52,468	65,067
per share	€ 19.70	€ 32.70	€ 51.10	€ 64.50	€ 80.00

Source: Citi Investment Research and Analysis

Based on our Net Debt and EBIT forecasts to 2016E and a target EV/EBIT multiple of 10x, we believe that EADS shares could be worth up to €80/share on a 5-year view.

A combination of strong EBIT growth (from €2.5bn in 2012E to €6.7bn in 2016E) and financial deleveraging (we expect Adjusted Net Debt to fall from €9.2bn at 31 Dec 2011 to fall to €2.3bn at 31 Dec 2015) suggests significant share price upside, with €80/share possible on a 3-5 year view (based on 10x 2016E EV/EBIT). This is >3x EADS’ current share price. See Figure 7.

Cash deployment is probably a topic best left for another note. With a strong balance sheet and €11.6bn of Net Cash (before adjustments and €9.2bn of Adjusted Net Debt after), we see acquisitions as the main risk to the EADS investment case. EADS wishes to balance Airbus and non-Airbus activities by 2020E. Given strong growth at Airbus (which EADS’ CEO Louis Gallois describes as a “luxury problem”) and slower growth in the non-Airbus businesses, this necessitates acquisitions. At the recent Global Investor Forum, EADS did not give much away in terms of potential acquisition targets, but the company appears to be considering targets in all areas, including defence. Recent acquisitions have focused on services businesses. We believe that EADS sees itself as pivotal in the potential future consolidation of the European A&D sector. Our view, which we suspect is held by many shareholders, is that EADS should focus on the Airbus and European segments (long-term growth markets) and de-prioritise defence (a market likely to continue to contract in real terms in the long-run).

Currency: Beneficiary of € Weakness

Updating for a spot rate assumption of \$1.27/€ (from \$1.36/€).

In this note, we adjust our earnings forecasts and valuation to reflect a spot rate of \$1.27/€ (previously \$1.36/€) to reflect a significant weakening of the € against the US dollar since the 9M11 results in October. This is the main reason for raising our EPS forecasts (by 3% in 2012E and 7% in 2013E). Figure 8 shows EADS' historical share price relative vs. the €/€ rate. We continue to believe that EADS to be an excellent play on € weakness.

Figure 8. EADS share price relative vs. €/€ FX rate: Jan 2010-date



Source: DataStream

EADS is a major long-term beneficiary of \$ strength.

EADS is a major long-term beneficiary of \$ strength vs. the € on account of significant transactional FX exposure within the core Airbus Commercial business (63% of 2011E Sales). Almost 100% of Airbus Commercial's sales are made in \$, of which around half are naturally hedged by \$ purchases. The remaining costs are in Euros. While EADS has made some progress in its aim to sell more aircraft in Euros to reduce transactional FX exposure, the majority of aircraft sold globally are still priced in US dollars. In our view, EADS' FX sensitivity is one of the factors that differentiate its investment case from that of Boeing: whereas EADS benefits from € weakness, Boeing does not.

Figure 9. EADS – FX Exposure

	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
Average Spot Rate	\$1.24	\$1.26	\$1.37	\$1.47	\$1.39	\$1.33	\$1.39	\$1.27	\$1.27	\$1.27	\$1.27	\$1.27
change	0%	-1%	-8%	-7%	5%	5%	-4%	9%	0%	0%	0%	0%
Hedge Rate	\$1.04	\$1.10	\$1.14	\$1.18	\$1.26	\$1.35	\$1.38	\$1.37	\$1.38	\$1.38	\$1.39	\$1.38
change	6%	6%	4%	4%	7%	-7%	-2%	1%	-1%	0%	-1%	1%
Hedges			\$16,300	\$16,400	\$16,500	\$18,500	\$18,900	\$20,900	\$19,600	\$14,500	\$9,600	\$1,800
Net Currency Position	\$10,900	\$13,300	\$15,700	\$16,400	\$16,500	\$18,500	\$18,900	\$19,800	\$20,800	\$21,800	\$22,900	\$24,000
% Hedged	100%	100%	100%	100%	100%	100%	100%	98%	89%	67%	42%	8%
Effective Rate	\$1.04	\$1.10	\$1.14	\$1.18	\$1.26	\$1.35	\$1.38	\$1.37	\$1.37	\$1.34	\$1.32	\$1.28
movement	-\$0.06	-\$0.06	-\$0.04	-\$0.04	-\$0.08	-\$0.09	-\$0.02	\$0.01	\$0.00	\$0.03	\$0.02	\$0.04
change	-6%	-5%	-4%	-3%	-6%	-7%	-2%	1%	0%	2%	2%	3%
Sequential Impact on EBITA	-€ 640	-€ 700	-€ 500	-€ 490	-€ 890	-€ 940	-€ 250	€ 70	€ 0	€ 300	€ 300	€ 600

Source: Citi Investment Research and Analysis and company reports

Significant hedging means that currency has a limited impact on EPS.

Moving to a spot rate of \$1.27/€ (previously \$1.36/€) raises our 2012E EPS forecast by c2% and our 2013E EPS forecast by c5% (which accounts for the majority of the EPS movements in this note of 3% and 7%, respectively). However, currency actually has a relatively limited impact on short-term earnings forecasts, because EADS has significant hedging in place in the medium-term. At 9M11, EADS' hedge book was \$71.8bn at an average rate of \$1.38/€, which makes EADS one of the largest FX counterparties in the world. We estimate EADS to be almost fully hedged for 2012E, 89% hedged for 2013E and 67% hedged in 2014E (Figure 9). Assuming that the € falls by a further 10 % against the \$ (from \$1.27/€ to \$1.15/€), this would raise our EPS forecasts by a further 1% in 2012E and 6% in 2013E, respectively.

While hedging mitigates the impact of currency on short-term earnings, EADS' long-term valuation is more sensitive as the effects of hedging are only temporary. Because EADS has transactional (as opposed to translational) FX exposure, currency will also impact EADS' achievable mid-cycle margin. In a duopoly with Boeing, a weaker € will either allow EADS to make a higher margin or price its aircraft more aggressively to increase market share.

Per EADS, every 1 \$ cent movement in the effective exchange rate (after hedging) impacts EBIT by ~€100m

EADS guides that every 1 \$ cent movement in the effective exchange rate (after hedging) impacts EBIT by ~€100m (vs. an expected EBIT of €2.5bn in 2012E rising to €3.5bn in 2013E). In the period 2004A-2011E, we estimate that EADS suffered a cumulative EBIT headwind of €4.4bn as EADS' effective exchange rate (after hedging) has worsened from \$1.04/€ in 2004A to \$1.38/€ in 2011E. At the current spot rate of \$1.27/€, this looks set to reverse as hedges expire between now and 2017. Based on a spot rate of \$1.27/€, we expect EADS to benefit from a cumulative FX tailwind of €1.3bn from 2012E to 2016E as the effective FX rate improves (Figure 9).

We estimate that a 10% movement in the FX rate assumption potentially moves fair value by >30%.

Our base-case DCF of €31.20/share (Figure 13) assumes a spot rate of \$1.27/€ and a mid-cycle margin assumption of 7.5% for EADS (Airbus 8.0%). Assuming that the € falls by a further 10 % against the \$ (from \$1.27/€ to \$1.15/€), this would raise our DCF valuation to €43.30/share, based on a revised group mid-cycle margin of 10% (Airbus 10%). So all other things being equal and assuming that no FX benefits are passed back to the customer, a 10% movement in the FX rate potentially moves fair value by >30%.

Catalysts

There are a number of forthcoming catalysts for EADS, as listed below. Additionally it is worth noting that given that the start of A350 final assembly is not until mid-2012, further charges are unlikely in the FY11 or 1Q12 results, in our view. We see upside risk to our FY11E EBIT forecast of €1.56bn, which is already 7% ahead of company guidance of €1.45bn, given very strong Airbus deliveries in 4Q11E (161 vs. 128 in 4Q10A and 116 in 3Q11E).

We do not expect financial guidance for FY12 at the NY press conference, but expect EADS to guide for book-to-bill $\geq 1x$ in 2012E and c580 deliveries.

1) New Year Press Conference (17 January)

EADS will host its annual New Year Press Conference at 1030am CET on Tuesday, 17 January. A webcast will be accessible using the following links: www.eads.com and www.airbus.com. We expect EADS to issue order and delivery guidance for 2012, but do not expect EADS to issue financial guidance for 2012 until the FY11 results (8 March). Our expectations are as follows:

- 535 Airbus deliveries in 2011 vs. company guidance of 520-530. According to a Bloomberg article (5 Jan 2012), Airbus' deliveries in 2011 are likely to be "several more than 530". We believe that additional deliveries are likely to contribute to a strong 4Q for EADS.
- 582 Airbus deliveries in 2012E based on production rates of 40/month for narrow body, 9/month for wide body and 30 A380 deliveries in the year.
- 1,550 gross Airbus orders in 2011 vs. guidance of "around 1,500" as guided at the 9M11 results and 1,521 reported as at the end of November.
- 600-650 gross Airbus orders in 2012E (c1.1x) book-to-bill. We expect EADS to guide for a book-to-bill ratio equal to or greater than 1x in 2012, which is in keeping with comments made at the December 2011 Global Investor Forum. This represents a significant step down vs. book-to-bill of almost 3x in 2011E. We believe that execution and earnings growth, not orders, will be the main driver of share price performance from now.

As a reminder, Airbus currently schedules the following production rates for A320: 36/month from start 2011; 38/month from August 2011; 40/month from 1Q12; and 42/month from 4Q12. For A330, Airbus plans for 9/month from early 2012E rising to 10/month in early 2012E.

There is a possibility that EADS could announce new C-level management at the New Year Press Conference. As a reminder, the current CEO (Louis Gallois), CFO (Hans Peter Ring) and Chairman (Daimler board member Bodo Uder) are all due to stand down in mid-2012 as part of a 5 year rotational agreement. Their replacements have not yet been announced. We believe that the most likely candidates are current Airbus Chief Tom Enders for CEO, Arnaud Lagadere for Chairman, and an internal candidate for CFO.

2) Boeing FY11 Results (25 January)

Citi Analyst Jason Gursky remains very bullish on Boeing, on account of strong expected order flow (driven by the 737MAX), improving sentiment on 787 and stronger cash generation (with higher dividends and share buybacks likely). For more details, see Jason's 2012 outlook note entitled "[Flight Plan 2012: What to Buy This Year](#)", which also contains a detailed preview for Boeing. While the investment cases for EADS and Boeing are different, strong results and an upbeat outlook for Boeing on 25 January is likely to have a positive read-across for EADS, in our view.

Strong results and an upbeat outlook, driven by increased aircraft production, is likely to read across positively to EADS, in our view.

Details and expectations are as follows:

- Conference call 1030am EST, dial in 612-288-0329, password Boeing.
- FY11E Sales: Citi \$68.4bn (+6.3% YoY) vs. Consensus \$68.5bn.
- FY11E Operating Income: \$1,426m (7.2% margin).
- FY11E EPS: \$4.48 vs. consensus \$4.46 (range \$4.00-4.69) and company guidance \$4.30-4.40.

We do not expect a change in stance on production rate increases and expect 611 deliveries in 2012E (+28% YoY), driven mainly by 737 and 787. We also look for an update on the 787 delivery ramp up and the ability to catch up on slowed deliveries.

3) EADS FY11 Results (8 March)

We believe that 4Q could be another strong quarter for Airbus Commercial given record deliveries.

We believe that there is a chance of a positive earnings surprise at the FY11 results, driven by higher than previously guided Airbus deliveries. Margins in the Airbus Commercial business have surprised positively for the past 3 quarters, and given very strong deliveries, we see scope for a repeat in 4Q11. Strong margin performance in 4Q11 is likely to reassure the market of EADS' ability to achieve its Airbus Commercial margin target of 10% in 2015E, before the dilutive impact of A350XWB deliveries. Our key expectations for the FY11E results are as follows:

- Sales: Citi €49.2bn (+8% YoY) vs. Consensus €47.7bn and company guidance of an increase of "more than 4% compared to €45.8bn in 2010.
- EBIT before one-off: Citi €1.56bn (3.2% margin) vs. Consensus €1.32bn (2.7% margin) and guidance of "around € 1.45bn". (NB we believe that consensus EBIT is potentially unreliable as it will contain a mix of pre- and post-exceptional forecasts).
- EPS before one-off: Citi €1.02 vs. Consensus €0.91 and guidance of "around €0.90".
- Free Cash Flow: Citi €1.6bn (before acquisitions) vs. company guidance of "significantly above €1bn" before acquisitions. At 9M11, EADS reported FCF of €0.7bn, with 4Q usually a strong quarter for cash flows.
- FY12 Guidance: We expect EADS to issue full guidance for FY12 at the FY11 results in March. We currently expect EBIT before one-off items of €2.5bn vs. consensus €2.3bn. At present, EADS guides that EBIT before one-off items will "...materially improve thanks to Airbus, with volume increase, better pricing and A380 improvement."

We forecast Clean EBIT of €1.56bn, which is ahead of company guidance of €1.45bn, but still see some upside risk as a result of strong deliveries in 4Q11 at Airbus Commercial.

We forecast Clean EBIT of €1.56bn (3.2% margin) for EADS in FY11, which is already ahead of company guidance of €1.45bn (see above). This implies a 3.0% margin in 4Q11E, which is in line with the 3.3% reported in 9M11 and slightly below 3.6% reported in 4Q10A. We see scope for a positive earnings surprise driven by the Airbus Commercial division, as mentioned previously.

Figure 10. Airbus Commercial – Earnings Forecasts, 2008-2013E (€ millions)

	2008	2009	1Q10	2Q10	3Q10	4Q10	2010	1Q11	2Q11	3Q11	4Q11E	2011E	2012E	2013E
Sales	€ 26,232	€ 26,370	€ 5,989	€ 6,976	€ 7,481	€ 7,227	€ 27,673	€ 6,707	€ 7,757	€ 6,656	€ 9,683	€ 30,803	€ 36,000	€ 39,800
growth	4.0%	0.5%	7.6%	-10.7%	34.2%	-2.6%	4.9%	12.0%	11.2%	-11.0%	34.0%	11.3%	16.9%	10.6%
Clean EBIT margin	€ 2,006	€ 1,036	€ 76	€ 175	€ 27	€ 3	€ 281	€ 165	€ 168	€ 43	€ 84	€ 460	€ 1,350	€ 2,310
	7.6%	3.9%	1.3%	2.5%	0.4%	0.0%	1.0%	2.5%	2.2%	0.6%	0.9%	1.5%	3.8%	5.8%
One-off items	€ 300	-€ 650	-€ 70	€ 60	€ 60	-€ 40	€ 10	-€ 40	-€ 70	€ 40	€ 0	-€ 70	€ 0	€ 0
EBIT PGE margin	€ 2,306	€ 386	€ 6	€ 235	€ 87	-€ 37	€ 291	€ 125	€ 98	€ 83	€ 84	€ 390	€ 1,350	€ 2,310
	8.8%	1.5%	0.1%	3.4%	1.2%	-0.5%	1.1%	1.9%	1.3%	1.2%	0.9%	1.3%	3.8%	5.8%
Deliveries growth	483	498	122	128	130	128	508	119	139	116	161	535	582	620
	6.6%	3.1%	5.2%	-7.2%	25.0%	-8.6%	2.0%	-2.5%	8.6%	-10.8%	25.8%	5.3%	8.7%	6.6%

Source: Company reports and Citi Investment Research and Analysis

We expect Airbus Commercial to report EBIT before one-off items of €460m (1.5% margin) in FY11E, which implies €84m (0.9% margin) in 4Q11E, as shown above in Figure 10. Our earnings forecasts assume 535 deliveries in FY11E, which is in line with the Bloomberg article (5 January), but slightly ahead of company guidance of 520-530. Either way, this implies a very strong 4Q for deliveries (we forecast 161 and guidance implies 146-156 for 4Q).

In 3Q11A, Airbus Commercial reported €84m EBIT (0.9% margin) based on 116 deliveries and €3m (0.0% margin) in 4Q10A, based on 128 deliveries. In 4Q11E, we expect 161 deliveries. Assuming incremental EBIT of €10m per single-aisle aircraft and €20m per twin-aisle would suggest that 4Q11E EBIT could be as high as €290-500m vs. our forecast of €84m. Accurately forecasting profitability at Airbus on a quarterly basis is very difficult and costs also do not accrue evenly throughout the year. However, risks look weighted to the upside into 4Q11, in our view.

4) Indian Fighter Jet Decision (TBC)

We expect a decision to be in early 2012 (possibly imminently) on the M-MRCA Indian fighter jet competition for 126 aircraft (plus options for 63 more). This has been a protracted process to date, but the competition is down to 2 aircraft: the Eurofighter (in which Germany/EADS has a 48% work share and is the nominated prime contractor for India) and the Dassault Rafale (EADS also owns a 49% stake in Dassault Aviation).

We estimate that the contract could have a headline value of \$10-15bn, with the potential for further aftermarket revenues. The contract is likely to include 2 years of support (for aircraft that are likely to have an in-service life of >30 years), weapons, some transfer of technologies and 50% of the value of the tender to be re-invested back in India in defence-related industries (a typical offset arrangement).

Despite the contract having a large headline value (\$10-15bn), we estimate that the deal will be just 1-2% EPS accretive for EADS, BAE Systems and Finmeccanica, on account of being split between the 3 companies and spread over 5-10 years. Aftermarket work could increase this, but we are unlikely to get full details of the deal and pricing could be tough, in our view. A Eurofighter win would at least allow OE production to continue post-2017 and would no doubt be good for sentiment, not just for EADS, but also for BAE Systems and Finmeccanica.

EADS has a 48% work share in the Eurofighter and also owns 49% of Dassault.

EPS Forecasts Raised by 3-7%

We have raised our 2012E EPS forecast by 3% to reflect an FX rate of \$1.27/€ (prev. \$1.36/€) and lower net interest costs.

In this note, we raise our EPS forecasts by 3% in 2012E and by 7% in 2013E, to reflect i) a revised FX assumption of \$1.27/€ (previously \$1.36/€) and ii) lower net interest costs as a result of stronger expected FCF following a reassessment of our cash flow forecasts (see earlier). We have also marginally increased our A320 delivery forecasts to reflect stronger than previously anticipated deliveries in 2011E.

Figure 11. EADS – Summary of Earnings Forecast Changes

	2011E			2012E			2013E		
	New	Old	Diff	New	Old	Diff	New	Old	Diff
Airbus Commercial	30,803	30,300	2%	36,000	34,400	5%	39,800	38,000	5%
Airbus Military	3,000	3,000	0%	3,100	3,100	0%	3,200	3,200	0%
Eurocopter	5,300	5,300	0%	5,800	5,800	0%	6,100	6,100	0%
EADS Astrium	5,300	5,300	0%	6,000	5,900	2%	6,200	6,100	2%
Cassidian	5,600	5,600	0%	5,600	5,600	0%	5,600	5,600	0%
HQ/Other	-810	-810	0%	-830	-830	0%	-850	-850	0%
Sales	49,193	48,690	1%	55,670	53,970	3%	60,050	58,150	3%
Airbus Commercial	460	460	0%	1,350	1,310	3%	2,310	2,150	7%
Airbus Military	20	20	0%	25	25	0%	30	30	0%
Eurocopter	420	420	0%	460	460	0%	490	490	0%
EADS Astrium	300	300	0%	330	320	3%	340	340	0%
Cassidian	390	390	0%	390	390	0%	390	390	0%
HQ/Other	-30	-30	0%	-30	-30	0%	-30	-30	0%
Clean EBIT	1,560	1,560	0%	2,525	2,475	2%	3,530	3,370	5%
Airbus Commercial	1.5%	1.5%	-2bps	3.8%	3.8%	-6bps	5.8%	5.7%	15bps
Airbus Military	0.7%	0.7%	0bps	0.8%	0.8%	0bps	0.9%	0.9%	0bps
Eurocopter	7.9%	7.9%	0bps	7.9%	7.9%	0bps	8.0%	8.0%	0bps
EADS Astrium	5.7%	5.7%	0bps	5.5%	5.4%	8bps	5.5%	5.6%	-9bps
Cassidian	7.0%	7.0%	0bps	7.0%	7.0%	0bps	7.0%	7.0%	0bps
Clean EBITA margin	3.2%	3.2%	-3bps	4.5%	4.6%	-5bps	5.9%	5.8%	8bps
EBIT	1,375	1,375	0%	2,525	2,475	2%	3,530	3,370	5%
Exceptional Items	-52	-52	nm	0	0	na	0	0	na
Net Interest	-33	-31	6%	-155	-166	-7%	-136	-191	-29%
Other Financial Result	-255	-255	0%	-160	-160	0%	-160	-160	0%
PBT (Reported)	1,035	1,037	0%	2,210	2,149	3%	3,234	3,019	7%
Income Tax	-367	-367	0%	-707	-688	3%	-1,035	-966	7%
Minority Interests	-16	-16	0%	-17	-17	0%	-18	-18	0%
Net Income (Reported)	653	654	0%	1,486	1,444	3%	2,181	2,035	7%
Reported EPS	€ 0.80	€ 0.81	0%	€ 1.83	€ 1.78	3%	€ 2.68	€ 2.50	7%
Underlying EPS (Citi)	€ 1.02	€ 1.03	0%	€ 1.83	€ 1.78	3%	€ 2.68	€ 2.50	7%
DPS	€ 0.30	€ 0.30	0%	€ 0.55	€ 0.40	38%	€ 0.80	€ 0.55	45%
FCF (after customer financing)	128	699	-82%	453	6	nm	1,501	490	207%
Net Cash	11,172	11,743	-5%	11,082	11,006	1%	11,835	10,670	11%
Airbus Deliveries:									
A320	424	414	2%	460	450	2%	483	472	2%
A330	86	86	0%	91	91	0%	101	101	0%
A380	25	25	0%	30	30	0%	35	35	0%
Total	535	525	2%	582	571	2%	620	608	2%

Source: CIRA Estimates

Our revised EPS forecasts are now 6% ahead of consensus in 2012E and 15% ahead in 2013E. We have also introduced EPS forecasts to 2016E (Figure 3 and Figure 36) to demonstrate our expectation of continued strong earnings growth beyond 2013.

Target Raised to €31 (from €27)

Our updated DCF-based Target Price of €31 (previously €27) offers c25% expected total return and implies 11.6x 2013E P/E.

We raise our Target Price to €31 (previously €27), which offers 25% expected total return from last night's closing price of €25.03. Following more detailed disclosure at December's Global Investor Forum, we have made a number of changes to our valuation models and approach.

- **DCF-based Target Price** — Firstly, we move from a P/E-based approach to a DCF approach to value EADS. A P/E approach may be simpler, but we believe that valuing EADS on a multiple of near-term earnings ignores both the long-term upside as a result of € weakness vs. the \$ (as the near-term impact is mitigated by significant hedging) and strong EPS growth prospects beyond 2013. Our DCF-based one year Target Price of €31/share implies 11.6x 2013E P/E, which is not dissimilar to the implied 2013E P/E of 10.9x at our previous Target Price of €27 and is below EADS' long-run average 12-month consensus P/E of 13.7x.

Figure 12. EADS – Reconciliation between Reported and Adjusted Net Debt

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
Net Debt / (Cash)	-5,133	-7,883	-9,930	-10,449	-12,450	-11,653	-11,563	-12,316	-13,963	-16,083	-18,763
Pension Provision	4,704	3,875	3,934	4,437	4,233	4,700	4,700	4,700	4,700	4,700	4,700
Government Launch Aid	5,418	5,315	4,920	5,294	6,020	5,869	5,869	5,869	5,869	5,869	5,869
Off Balance Sheet Customer Financing	526	440	415	429	427	500	500	500	500	500	500
Provisions on Programmes	0	3,300	2,700	2,500	1,850	4,000	3,350	2,700	2,050	1,400	750
Customer Advances	6,308	8,420	8,843	8,931	9,085	9,241	9,241	9,241	9,241	9,241	9,241
MV Dassault Stake	-3,141	-2,991	-1,885	-1,936	-3,235	-2,761	-2,761	-2,761	-2,761	-2,761	-2,761
Minority Interests	137	85	104	106	95	43	60	78	97	117	138
Other	0	0	0	0	0	-700	-700	-700	-700	-700	-700
Adjusted Net Debt	8,819	10,561	9,101	9,312	6,025	9,238	8,696	7,310	5,032	2,283	-1,026

Source: Company reports and Citi Investment Research and Analysis

- **Updated Enterprise Value Adjustments** — We expect reported Net Cash of €11.6bn at 31 Dec 2011. However, in our calculation of Enterprise Value we use an Adjusted Net *Debt* figure of €9.2bn, as shown above (Figure 12). Following a session at December's Global Investor Forum dedicated to the calculation of EV, we have made a number of small changes to our EV calculation (the most material being €4bn of Provisions on Programmes vs. our previous assumption of c€2bn). In addition to the company's suggested EV adjustments, we also adjust for Government Launch Aid and long-term Customer Advances, as before.
- **Factoring in €1.5bn of Further A350XWB Charges** — EADS has so far booked €200m of charges on the A350XWB programme. We expect further charges to be booked between now and first delivery (scheduled for 1H14A) in the range of €1-1.5bn. We believe that this is a broadly in line with consensus expectations and is as previously published in our research. However, we now factor in a conservative €1.5bn (€2.50/share) into our valuation models. This is simply for prudence and does not reflect a change in view on the risks associated with the A350XWB programme.

As before, we have tried to assess EADS' fair value using a number of different techniques, which suggest a valuation range of €28-44/share.

Our updated Target Price of €31/share is based on our DCF value of €31.20, rounded, based on a conservative set of assumptions.

Discounted Cash Flow (€31/share)

Figure 13. EADS – Discounted Cash Flow (€ millions)

	2012E	2013E	2014E	2015E	2016E	TV
Airbus Commercial	36,000	39,800	45,300	48,200	51,700	53,300
Airbus Military	3,100	3,200	3,300	3,400	3,500	3,500
Eurocopter	5,800	6,100	6,400	6,700	7,000	7,100
EADS Astrium	6,000	6,200	6,400	6,700	7,000	7,100
Cassidian	5,600	5,600	5,600	5,600	5,600	5,600
Other Businesses	1,260	1,300	1,340	1,380	1,420	1,400
Headquarters/Consolidation	-2,090	-2,150	-2,210	-2,280	-2,350	-2,400
Sales	55,670	60,050	66,130	69,700	73,870	75,600
Airbus Commercial	16.9%	10.6%	13.8%	6.4%	7.3%	3.0%
Airbus Military	3.0%	3.0%	3.0%	3.0%	3.0%	0.0%
Eurocopter	3.0%	3.0%	3.0%	3.0%	3.0%	1.5%
EADS Astrium	3.0%	3.0%	3.0%	3.0%	3.0%	1.5%
Cassidian	3.0%	3.0%	3.0%	3.0%	3.0%	0.0%
Other Businesses	3.0%	3.0%	3.0%	3.0%	3.0%	1.5%
growth	13.2%	7.9%	10.1%	5.4%	6.0%	2.3%
Airbus Commercial	1,350	2,310	3,630	4,440	5,380	4,264
Airbus Military	25	30	35	40	45	53
Eurocopter	460	490	510	540	560	568
EADS Astrium	330	340	350	370	390	391
Defence & Security	390	390	390	390	390	392
Other Businesses	20	20	20	20	20	21
Headquarters/Consolidation	-50	-50	-50	-50	-50	0
EBITA	2,525	3,530	4,885	5,750	6,735	5,688
Airbus Commercial	3.8%	5.8%	8.0%	9.2%	10.4%	8.0%
Airbus Military	0.8%	0.9%	1.1%	1.2%	1.3%	1.5%
Eurocopter	7.9%	8.0%	8.0%	8.1%	8.0%	8.0%
EADS Astrium	5.5%	5.5%	5.5%	5.5%	5.6%	5.5%
Defence & Security	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Other Businesses	1.6%	1.5%	1.5%	1.4%	1.4%	1.5%
margin	4.5%	5.9%	7.4%	8.2%	9.1%	7.5%
Taxation	-808	-1,130	-1,563	-1,840	-2,155	-1,820
NOPAT	1,717	2,400	3,322	3,910	4,580	3,868
Capital Expenditure	-2,400	-2,500	-2,500	-2,500	-2,500	-2,386
% of Sales	4.3%	4.2%	3.8%	3.6%	3.4%	3.2%
Depreciation	1,700	1,800	1,900	2,000	2,001	2,169
% of Sales	3.1%	3.0%	2.9%	2.9%	2.7%	2.9%
Capex/Depreciation	1.4x	1.4x	1.3x	1.3x	1.2x	1.1x
Free Cash Flow	1,017	1,700	2,722	3,410	4,081	3,651
Enterprise Value	36,149	€ 44.40				
Adjusted Net Debt	-9,238	-€ 11.40				
Estimated Further A350 Charges	-1,500	-€ 1.80				
Equity Value	25,410	€ 31.20				

Source: CIRA Estimates

Our updated Target Price of €31/share is based on our DCF value of €31.20 (Figure 13). We assume 10% WACC, 2.3% long-term growth and a mid-cycle margin assumption of 7.5% for the group and 8.0% for Airbus Commercial (at \$1.27/€) vs. company guidance of a 10% Airbus margin in 2015E, before the dilutive impact of A350XWB.

Figure 14. DCF Sensitivity – WACC (Y) vs., Long Term Growth (X)

	1.3%	1.8%	2.3%	2.8%	3.3%
8.0%	€ 41.40	€ 44.80	€ 48.90	€ 53.70	€ 59.60
8.5%	€ 37.10	€ 40.00	€ 43.40	€ 47.30	€ 52.00
9.0%	€ 33.50	€ 35.90	€ 38.70	€ 42.00	€ 45.80
9.5%	€ 30.20	€ 32.30	€ 34.70	€ 37.40	€ 40.60
10.0%	€ 27.40	€ 29.20	€ 31.20	€ 33.50	€ 36.20
10.5%	€ 24.90	€ 26.50	€ 28.20	€ 30.20	€ 32.40
11.0%	€ 22.60	€ 24.00	€ 25.50	€ 27.20	€ 29.10
11.5%	€ 20.60	€ 21.80	€ 23.10	€ 24.60	€ 26.30
12.0%	€ 18.80	€ 19.90	€ 21.00	€ 22.30	€ 23.70

Source: Citi Investment Research and Analysis

Figure 15. DCF Sensitivity – WACC (Y) vs., Airbus Long Term Margin (X)

	7.0%	7.5%	8.0%	8.5%	9.0%
8.0%	€ 43.90	€ 46.40	€ 48.90	€ 51.40	€ 53.80
8.5%	€ 38.90	€ 41.20	€ 43.40	€ 45.60	€ 47.80
9.0%	€ 34.70	€ 36.70	€ 38.70	€ 40.70	€ 42.70
9.5%	€ 31.10	€ 32.90	€ 34.70	€ 36.50	€ 38.30
10.0%	€ 28.00	€ 29.60	€ 31.20	€ 32.90	€ 34.50
10.5%	€ 25.20	€ 26.70	€ 28.20	€ 29.70	€ 31.20
11.0%	€ 22.80	€ 24.10	€ 25.50	€ 26.90	€ 28.30
11.5%	€ 20.60	€ 21.90	€ 23.10	€ 24.40	€ 25.70
12.0%	€ 18.70	€ 19.80	€ 21.00	€ 22.20	€ 23.40

Source: Citi Investment Research and Analysis

Our DCF assumes a WACC of 10%, which we believe broadly equals the cost of equity for EADS. This reflects the fact that EADS currently has reported Net Cash of €11.6bn in 2011E (although it has Adjusted Net Debt of €9.3bn as discussed earlier). A more efficient capital structure could materially raise valuation, in our view. A 50 bps reduction in WACC (from our 10% base case assumption) raises our DCF by 11% to €34.70 (vs. €31.20 base case), per Figure 14. Flexing our Airbus Commercial margin assumption from 8% to 9% raises our DCF by 11% to €34.50 (Figure 15).

EV/Sales (€38/Share)

An EV/Sales approach suggests of €38.30/share assuming a 7.5% mid-cycle margin. The current share price appears to be pricing in a mid-cycle margin of just over 5.5%.

An EV/Sales approach suggests a valuation of €38.30/share assuming a 7.5% mid-cycle margin (Figure 16). We forecast a Clean EBIT margin of 3.2% for EADS in 2011E, rising to 5.9% in 2013E and 8.2% in 2015E. EADS' previous peak margin has been 9.5% (2006A). This approach assumes that a company with a 10% EBIT margin should trade on 1.0x EV/Sales, so based on a mid-cycle margin of 7.5%, EADS should trade at 0.75x EV/Sales.

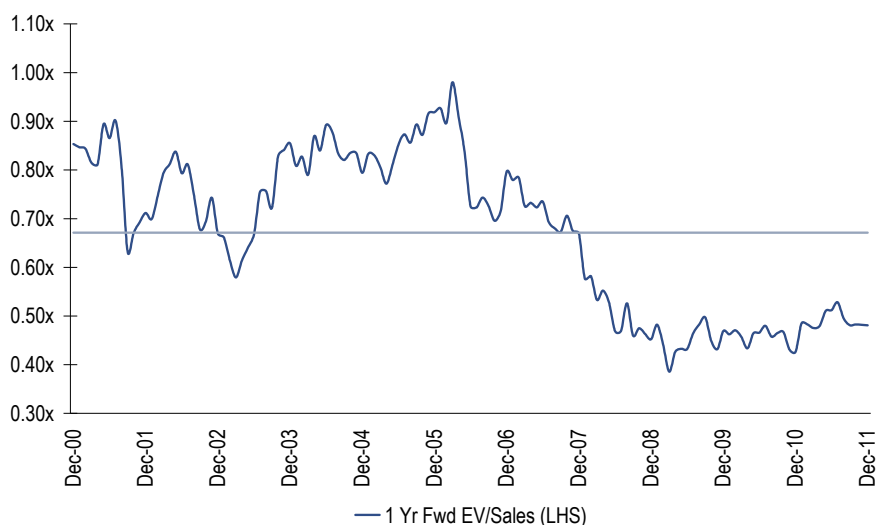
Figure 16. EADS – EV/Sales-based Valuations (€ millions)

	2012E	2013E	2014E	2015E	2016E
Sales	55,670	60,050	66,130	69,700	73,870
Mid Cycle Margin	7.5%				
Target EV/EBIT Multiple	0.75x	0.75x	0.75x	0.75x	0.75x
Enterprise Value	41,890	45,180	49,750	52,440	55,580
Adjusted Net Debt	-9,238	-8,696	-7,310	-5,032	-2,283
Suggested Equity Value	32,652	36,484	42,440	47,408	53,297
per share	€ 40.10	€ 44.80	€ 52.20	€ 58.30	€ 65.50
Discount Rate	10%				
Factor	1.00	0.91	0.83	0.75	0.68
Valuation	€ 40.10	€ 40.70	€ 43.10	€ 43.80	€ 44.70
Estimated A350XWB Charges	-1,500	-1,500	-1,500	-1,500	-1,500
per share	-€ 1.80	-€ 1.80	-€ 1.80	-€ 1.80	-€ 1.80
Valuation	€ 38.30	€ 38.90	€ 41.30	€ 42.00	€ 42.90

Source: Citi Investment Research and Analysis

We accept that some investors may find our mid-cycle EBIT margin of 7.5% for EADS (and 8.0% for Airbus Commercial) optimistic. However, even at a 6.0% margin assumption (and 0.6x EV/Sales), suggested valuation is €27.90.

Figure 17. EADS – Historical Forward EV/Sales



Source: CIRA, DataStream

EADS is currently trading at 0.52x 2012E EV/Sales vs. its historical average of c0.7x forward EV/Sales and peak of c1.0x (Figure 17).

EV/EBIT (€28/Share)

An EV/EBIT approach suggests a valuation of €28/share, based on a target EV/EBIT multiple of 10x applied to 2013E EBIT, discounted back at a 10% cost of equity.

An EV/EBIT approach suggests a valuation of €28/share, based on a target EV/EBIT multiple of 10x applied to 2013E EBIT, discounted back at a 10% cost of equity (Figure 18). We choose to value based on 2013E and discount back, rather than use 2012E as a base year, to reflect significant EBIT growth in 2013E. A 10x EV/EBIT multiple is similar to that used to value other Euro Civil Aero companies.

Figure 18. EADS – EV/EBIT based Valuations (€ millions)

	2012E	2013E	2014E	2015E	2016E
Clean EBIT	2,525	3,530	4,885	5,750	6,735
Target EV/EBIT Multiple	10.0x	10.0x	10.0x	10.0x	10.0x
Enterprise Value	25,250	35,300	48,850	57,500	67,350
Adjusted Net Debt	-9,238	-8,696	-7,310	-5,032	-2,283
Suggested Equity Value	16,012	26,604	41,540	52,468	65,067
per share	€ 19.70	€ 32.70	€ 51.10	€ 64.50	€ 80.00
Discount Rate	10%				
Factor	1.00	0.91	0.83	0.75	0.68
Valuation	€ 19.70	€ 29.70	€ 42.20	€ 48.50	€ 54.60
Estimated A350XWB Charges	-1,500	-1,500	-1,500	-1,500	-1,500
per share	-€ 1.80	-€ 1.80	-€ 1.80	-€ 1.80	-€ 1.80
Valuation	€ 17.90	€ 27.90	€ 40.40	€ 46.70	€ 52.80

Source: Citi Investment Research and Analysis

As noted earlier, this approach suggests significant upside in the long-term as a result of strong EBIT growth (28% CAGR 2012E-2016E) and financial deleveraging.

SOTP (€29/Share)

A SOTP approach suggests €29/share (=0.6x 2012E EV/Sales), again assuming a €1.5bn charge on A350XWB and additionally a 10% conglomerate discount. SOTP is not our preferred approach, due to a lack of comparable listed peers for all divisions (e.g. Airbus Military, Astrium).

Figure 19. EADS – SOTP Valuation (€ millions)

	Total	/ share	Basis	EV/Sales*			EV/EBIT*		
				2012E	2013E	2014E	2012E	2013E	2014E
Airbus Commercial	27,100	€ 33.30	0.80x 2012E EV/Sales	0.75x	0.68x	0.60x	20.1x	11.7x	7.5x
Airbus Military	200	€ 0.20	8.0x 2012E EV/EBIT	0.06x	0.06x	0.06x	8.0x	6.7x	5.7x
Eurocopter	4,400	€ 5.40	0.75x 2012E EV/Sales	0.76x	0.72x	0.69x	9.6x	9.0x	8.6x
EADS Astrium	3,000	€ 3.70	0.5x 2012E EV/Sales	0.50x	0.48x	0.47x	9.1x	8.8x	8.6x
Defence & Security	2,540	€ 3.10	6.5x 2012E EV/EBIT	0.45x	0.45x	0.45x	6.5x	6.5x	6.5x
Other Businesses	-330	-€ 0.40	11.0x 2012E EV/EBIT	0.40x	0.39x	0.38x	11.0x	11.0x	11.0x
Enterprise Value	36,910	€ 45.40		0.66x	0.61x	0.56x	14.6x	10.5x	7.6x
Adjusted Net Debt	-9,238	-€ 11.40							
Estimated A350XWB Charges	-1,500	-€ 1.80							
Equity Value	26,172	€ 32.20							
Conglomerate Discount (10%)	-2,617	-€ 3.20							
Equity Value, Net	23,555	€ 29.00							

Source: Citi Investment Research and Analysis. *Implied.

Airbus Commercial accounts for 73% of the Enterprise Value in our SOTP model. We value Airbus Commercial at 0.8x 2012E EV/Sales, which is consistent with our long-term Airbus margin assumption of 8% and implies a relatively high 20.1x 2012E EV/EBIT for Airbus Commercial, falling to 7.5x in 2014E as EBIT margins recover from a low base.

P/E (€33/Share)

Figure 20. EADS – Historical 12m Consensus P/E, 2000-date



Source: DataStream

Figure 21. Historical 12m Consensus P/E, 1990-date



Source: DataStream

Since 2000, EADS has traded on an average 12-month consensus P/E of 13.7x (Figure 20), which is an 8% premium to the CAC40. Peer Boeing has also traded at an average premium of 6% of the S&P500, with an average 12-month consensus P/E of 16.4x since 1990 (Figure 21).

Figure 22. EADS – P/E Valuation (€ millions)

	2012E	2013E	2014E	2015E	2016E
EPS	€ 1.83	€ 2.68	€ 3.85	€ 4.61	€ 5.49
growth	na	47%	43%	20%	19%
Target P/E	13.7x	13.7x	13.7x	13.7x	13.7x
Valuation	€ 25.00	€ 36.70	€ 52.70	€ 63.20	€ 75.20
Discount Rate	10%				
Factor	1.00	0.91	0.83	0.75	0.68
Valuation	€ 25.00	€ 33.40	€ 43.60	€ 47.50	€ 51.40

Source: Citi Investment Research and Analysis

Applying EADS' historical average P/E of 13.7x to 2013E EPS and discounting back by 1 year suggests a valuation of €33.40.

Applying EADS' average P/E rating of 13.7x to our 2012E EPS forecast of €1.83 suggests a valuation of €25.00/share (Figure 22). However, using 2013E as base year and discounting back at a 10% cost of equity, to reflect strong EPS growth in 2013E (+47%YoY), suggests a valuation of €33.40/share.

We acknowledge that the entire European market is currently trading significantly below its long-term average P/E rating. According to the European Strategy team, the DJ Stoxx is currently trading at a 2012E P/E of c10x. If EADS trades at an 8% premium to the market, this would suggest a target P/E of 10.8x and €26.40/share based on 2013E EPS, discounted back. However, our Strategy team argues that consensus forecasts are probably still too high and that the true 2012E P/E of the European market is probably closer to 13x. Applying an 8% premium to this suggests a target P/E of c14x for EADS.

Mid-Cycle EPS (€44/Share)

We calculate mid-cycle EPS based on 2012E sales and a 7.5% mid-cycle margin of €3.22. This assumes 8.0% mid-cycle margin for Airbus.

We believe that a mid-cycle P/E approach is less volatile and more accurately recognises EADS' long-term earnings potential than using a multiple of near term earnings. Applying a mid-cycle P/E of 13.7x to EADS' theoretical mid-cycle EPS at a 7.5% margin suggests a valuation of €44.10 per share (Figure 23).

Figure 23. EADS – Mid-Cycle EPS Valuation (€ millions)

	Base 2012E	Mid-Cycle 7.5%	Blue Sky 9%	Comments
Airbus	36,000	36,000	36,000	
Non-Airbus	19,670	19,670	19,670	
Sales	55,670	55,670	55,670	2012E Base Year
Airbus	1,350	2,880	3,600	
Non-Airbus	1,175	1,309	1,309	
Clean EBITA	2,525	4,189	4,909	
Airbus margin	3.8%	8.0%	10.0%	Blue Sky scenario assumes 10% margin at Airbus Commercial
Non-Airbus margin	6.0%	6.7%	6.7%	
Clean EBITA margin	4.5%	7.5%	8.8%	
Net Interest	-155	-155	-155	
Other Financial Results	-160	-160	-160	
Clean PBT	2,210	3,874	4,594	
Underlying Tax	-707	-1,240	-1,470	
Rate	32.0%	32.0%	32.0%	
Minorities	-17	-17	-17	
Net Income	1,486	2,617	3,107	
Average Shares	814	814	814	
EPS	€ 1.83	€ 3.22	€ 3.82	
Target P/E	13.7x	13.7x	13.7x	
Valuation	€ 25.00	€ 44.10	€ 52.30	

Source: Citi Investment Research and Analysis

We forecast €1.83 EPS in 2012E based on an expected Clean EBIT margin of 4.5%. Were EADS to achieve our estimated mid-cycle margin of 7.5% in 2012 (which assumes an 8.0% margin at Airbus Commercial at a spot rate of \$1.27/€), mid-cycle EPS would be €3.22/share. Capitalising this at 13.7x P/E suggests €44.10/share (Figure 23). We expect EADS to achieve mid-cycle EPS between 2013E and 2014E (Figure 36).

Placing Airbus on Boeing Commercial's 10% margin would raise our mid-cycle EPS to €3.82.

Our "blue sky" scenario assumes that EADS can earn an 8.8% mid-cycle EBIT margin, based on a 10% EBIT margin at Airbus Commercial. This is in-line with that achieved by Boeing Commercial Aircraft and is consistent with EADS management's long-term target. We calculate a "blue sky" EPS of €3.82, based on 2012E's sales. This is similar to our 2014E EPS estimate of €3.85 (based on €66.1bn Sales and a 7.4% EBIT margin).

Global Perspective: EADS vs. Boeing

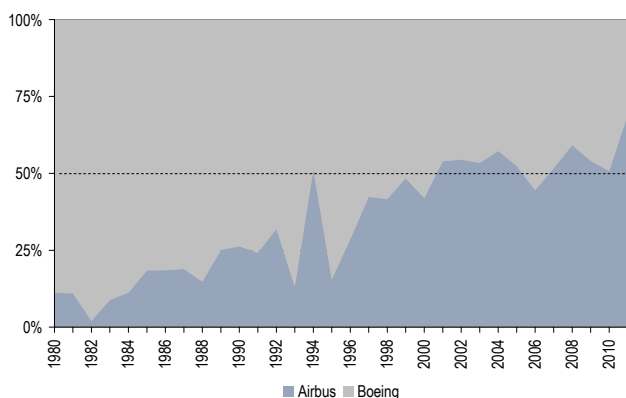
While we are positive on both EADS and Boeing (covered by Jason Gursky in the US), largely on account of our constructive stance on the civil aerospace OE cycle, we appreciate that many investors view the sector from a global perspective and that the investment cases of both EADS and Boeing are different. This section compares and contrasts key metrics for both stocks.

We believe that the investments case of both Airbus and Boeing are attractive for different reasons, but believe that EADS offers potentially greater share price upside than Boeing as earnings recover from a depressed base, but with commensurately higher risks (execution, governance, FX). In terms of size, EADS has a market cap of €18bn (\$25bn) vs. \$50bn for Boeing. EADS has a significantly stronger balance sheet than Boeing, with Net Cash of €11.0bn vs. Net Debt of c\$3.2bn (31 Dec 2010).

1) Market Share

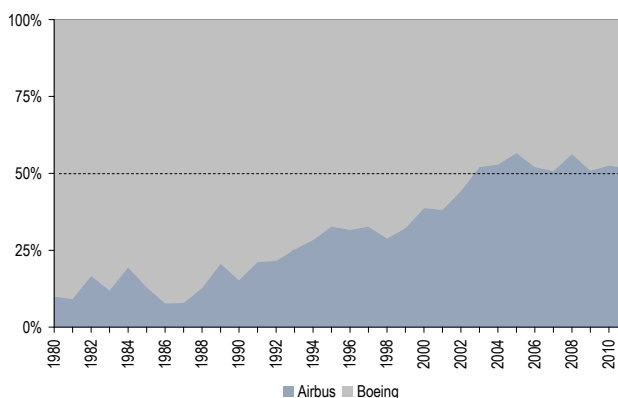
Airbus' market share of deliveries is broadly similar to Boeing's (Figure 25), having entered the market in the early 1970s and achieved equilibrium in the early 2000s.

Figure 24. Airbus & Boeing Market Share (%) – Orders



Source: Company Reports

Figure 25. Airbus & Boeing Market Share (%) – Deliveries



Source: Company Reports

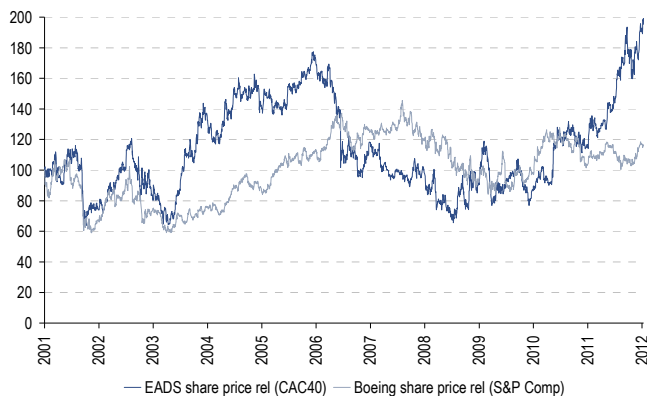
We would note that the historical precedent set by Airbus suggests that the threat of Chinese competition (COMAC) is very long-term in nature, as it took Airbus around 30 years to achieve market equilibrium with Boeing.

However, Airbus is currently winning the order race, with 51% share in 2010 and c72% in 2011E. This is primarily driven by the success of the re-engined A320NEO, which was announced in December 2010, whereas the re-engined Boeing 737 MAX was not announced until July 2011. We see potential for Boeing to catch up in 2012 as order momentum for the 737 MAX picks up. In the long term, we believe that the equilibrium between Airbus and Boeing will be maintained.

2) Share Price Performance

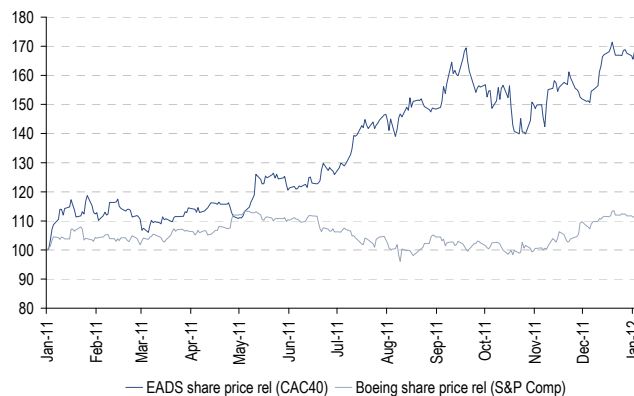
EADS' price relative has significantly outperformed Boeing's price relative since mid-2011, which we attribute in part to the order success of the A320NEO. Given that Boeing has now introduced the 737MAX, 2012 could well be a catch-up year for Boeing orders.

Figure 26. EADS & Boeing Price Relative: Jan 2001-date



Source: DataStream

Figure 27. EADS & Boeing Price Relative: Jan 2011-date



Source: DataStream

Figure 26 shows EADS and Boeing's share price relative performance since 2001 and Figure 27 in the year to date. The price relative performance has been similar for both stocks since 2007, but EADS has materially outperformed Boeing in 2011 (by 26% on an absolute basis and by about 54% relative to their respective markets).

3) Valuation

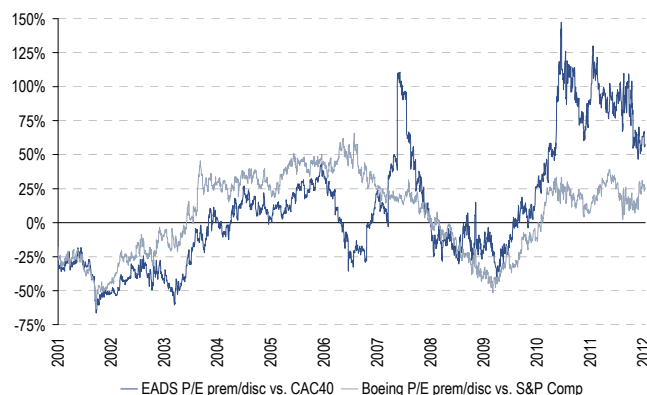
EADS' current 12 month consensus P/E is slightly lower than that of Boeing (14.1x vs. 15.0x for Boeing). On a 2013E P/E basis, EADS is considerably cheaper than Boeing (9.9x consensus 2013E P/E vs. Boeing's 13.0x). This reflects stronger EPS growth from a depressed base (margin improvements) at EADS.

Figure 28. EADS & Boeing 12-Month Consensus P/E: 2001-date



Source: DataStream

Figure 29. EADS & Boeing 12-Month P/E Premium (Discount): 2001-date

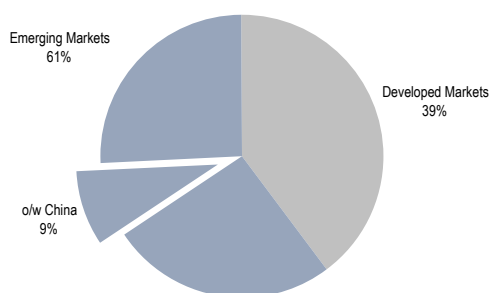


Source: DataStream

Figure 28 shows the current 12-month consensus P/E for EADS vs. Boeing and Figure 29 shows P/E relative for both stocks since 2001. EADS is currently trading on a 12m consensus P/E of 14.1x (a 57% premium to the CAC40) vs. its long-run average of 13.7x (a 8% premium to the CAC40). Boeing is currently trading on a 12m consensus P/E of (a 26% premium to the S&P) vs. its long-run average of 16.1x (a 7% premium to the S&P).

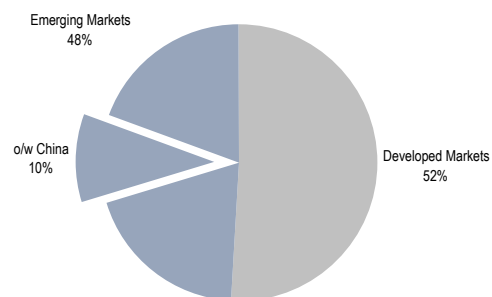
4) Emerging Market Exposure

Figure 30. Airbus Geographical Exposure: Emerging vs. Developed Markets (2010A Revenue)



Source: Company Reports

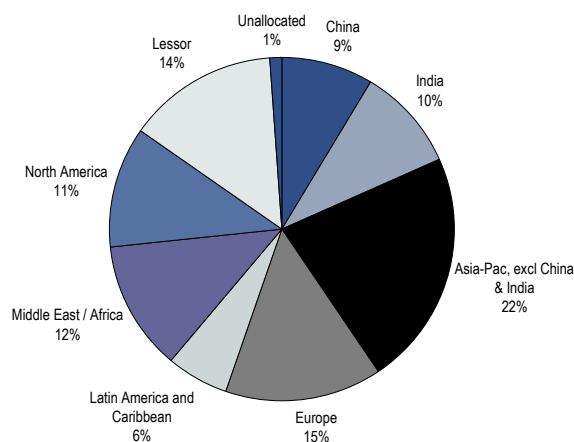
Figure 31. Boeing Geographical Exposure: Emerging vs. Developed Markets (2010A Revenue)



Source: Company Reports

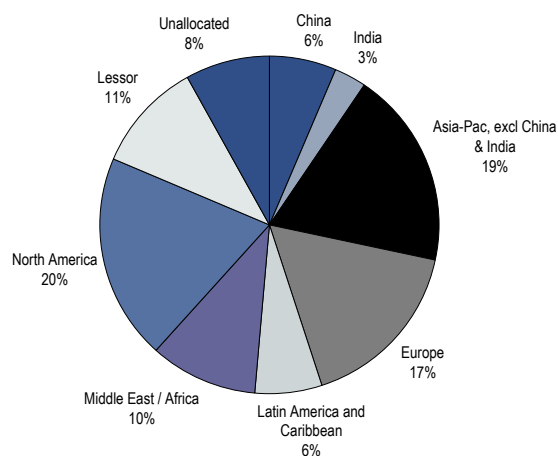
EADS has slightly more EM exposure than Boeing, both in terms of Sales (2010A) per Figure 30 and Figure 31 and its order backlog, per Figure 34 and Figure 35.

Figure 32. Airbus - Order Backlog by Region (30 Sep 2011)



Source: Citi Investment Research and Analysis

Figure 33. Boeing - Order Backlog by Region (30 Sep 2011)

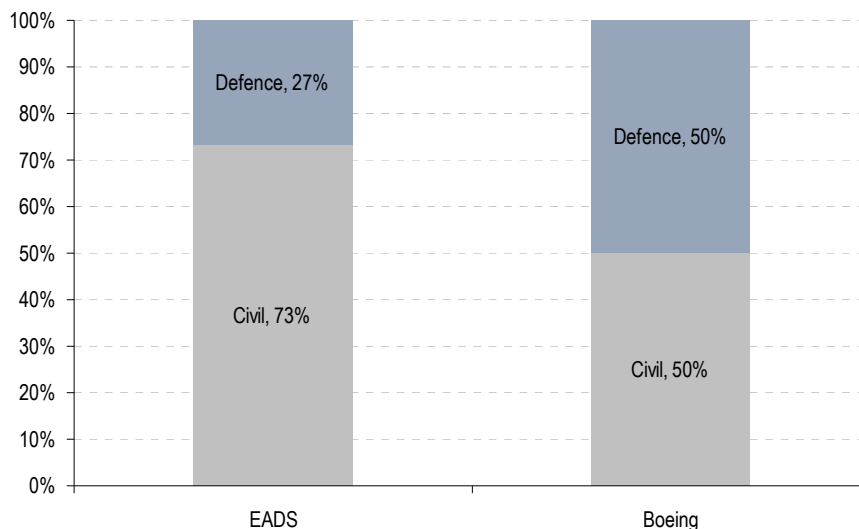


Source: Citi Investment Research and Analysis

End-Market Exposure

Whereas Boeing's portfolio of businesses is evenly balanced between Civil Aerospace and Defence, EADS is more weighted towards Civil Aerospace.

Figure 34. EADS and Boeing End-Market Exposures: 2010A Revenues

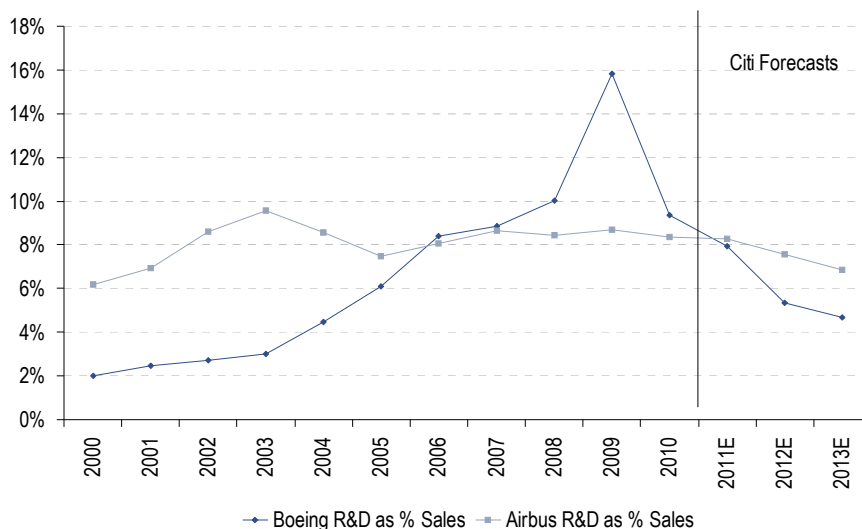


Source: Company Reports

However, EADS' Vision 2020 aims to rebalance the portfolio through organic growth and acquisitions (see the Investment Risks section of this note) to balance exposure away from Airbus and reduce transaction FX risk (\$ exposure).

6) R&D and Product Life Cycle

Figure 35. Airbus Commercial & Boeing Commercial R&D as % of Sales: 2000-13E



Source: Company Reports and CIRA Estimates

While R&D is likely to stay high for EADS in the medium term as A350XWB is developed, it could fall for Boeing as the 787 is delivered.

Financial Statements

Figure 36. EADS - Income Statement 2005-2016E (€ millions)

	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
Airbus Commercial	22,179	25,190	25,216	26,232	26,370	27,673	30,803	36,000	39,800	45,300	48,200	51,700
Airbus Military	763	2,200	1,140	2,759	2,235	2,684	3,000	3,100	3,200	3,300	3,400	3,500
Eurocopter	3,211	3,803	4,172	4,486	4,570	4,830	5,300	5,800	6,100	6,400	6,700	7,000
EADS Astrium	2,698	3,212	3,550	4,289	4,799	5,003	5,300	6,000	6,200	6,400	6,700	7,000
Cassidian	5,636	5,864	5,392	5,668	5,363	5,933	5,600	5,600	5,600	5,600	5,600	5,600
Other Businesses	1,155	1,257	1,407	1,338	1,096	1,182	1,220	1,260	1,300	1,340	1,380	1,420
Headquarters/Consolidation	-1,436	-2,092	-1,754	-1,507	-1,611	-1,553	-2,030	-2,090	-2,150	-2,210	-2,280	-2,350
Sales	34,206	39,434	39,123	43,265	42,822	45,752	49,193	55,670	60,050	66,130	69,700	73,870
growth	8%	15%	-1%	11%	-1%	7%	8%	13%	8%	10%	5%	6%
Airbus Commercial	2,307	2,788	2,693	2,006	1,036	281	460	1,350	2,310	3,630	4,440	5,380
Airbus Military	48	75	-155	107	36	21	20	25	30	35	40	45
Eurocopter	212	257	211	293	263	303	420	460	490	510	540	560
EADS Astrium	58	130	174	234	261	283	300	330	340	350	370	390
Cassidian	201	348	345	408	449	477	390	390	390	390	390	390
Other Businesses	-171	-288	84	43	21	25	20	20	20	20	20	20
Headquarters/Consolidation	197	449	274	239	82	-50	-50	-50	-50	-50	-50	-50
EBIT Before One-Offs	2,852	3,759	3,626	3,330	2,148	1,340	1,560	2,525	3,530	4,885	5,750	6,735
margin	8.3%	9.5%	9.3%	7.7%	5.0%	2.9%	3.2%	4.5%	5.9%	7.4%	8.2%	9.1%
Airbus Commercial	2,307	-572	-881	2,306	386	291	390	1,350	2,310	3,630	4,440	5,380
Airbus Military	48	75	-155	-493	-1,754	21	20	25	30	35	40	45
Eurocopter	212	257	211	293	263	183	300	460	490	510	540	560
EADS Astrium	58	130	174	234	261	283	300	330	340	350	370	390
Cassidian	201	348	345	408	449	457	390	390	390	390	390	390
Other Businesses	-171	-288	84	43	21	25	30	20	20	20	20	20
Headquarters/Consolidation	197	449	274	39	52	-29	-55	-50	-50	-50	-50	-50
EBIT PGE (pre-goodwill/exceptionals)	2,852	399	52	2,830	-322	1,231	1,375	2,525	3,530	4,885	5,750	6,735
margin	8.3%	1.0%	0.1%	6.5%	-0.8%	2.7%	2.8%	4.5%	5.9%	7.4%	8.2%	9.1%
Exceptional Items	-140	-121	-85	-58	-58	-44	-52	0	0	0	0	0
EBIT (Reported)	2,712	278	-33	2,772	-380	1,187	1,323	2,525	3,530	4,885	5,750	6,735
Net Interest	-155	-121	-199	36	-147	-99	-33	-155	-136	-95	-42	25
Other Financial Result	-22	-123	-538	-508	-445	-272	-255	-160	-160	-160	-160	-160
PBT (Reported)	2,535	34	-770	2,300	-972	816	1,035	2,210	3,234	4,630	5,548	6,600
Underlying PBT (EADS)	2,557	3,495	3,140	3,078	1,636	1,021	1,195	2,210	3,234	4,630	5,548	6,600
Underlying PBT (Citi)	2,697	3,616	3,225	3,136	1,694	1,065	1,247	2,210	3,234	4,630	5,548	6,600
Income Tax	-825	81	333	-703	220	-244	-367	-707	-1,035	-1,482	-1,775	-2,112
rate	33%	-238%	43%	31%	23%	30%	35%	32%	32%	32%	32%	32%
Underlying Tax	-872	60	261	-720	203	-306	-383	-707	-1,035	-1,482	-1,775	-2,112
rate	34%	-2%	-8%	23%	-12%	30%	32%	32%	32%	32%	32%	32%
Minority Interests	-34	-16	-9	-25	-11	-19	-16	-17	-18	-19	-20	-21
Net Income (Reported)	1,676	99	-446	1,572	-763	553	653	1,486	2,181	3,129	3,753	4,467
Underlying Net Income (EADS)	1,756	2,431	2,189	2,130	1,134	696	797	1,486	2,181	3,129	3,753	4,467
Underlying Net Income (Citi)	1,854	2,515	2,249	2,170	1,175	727	832	1,486	2,181	3,129	3,753	4,467
EPS (IFRS)	€ 2.11	€ 0.12	-€ 0.56	€ 1.95	-€ 0.94	€ 0.68	€ 0.80	€ 1.83	€ 2.68	€ 3.85	€ 4.61	€ 5.49
Underlying EPS (EADS)	€ 2.21	€ 3.04	€ 2.73	€ 2.64	€ 1.40	€ 0.86	€ 0.98	€ 1.83	€ 2.68	€ 3.85	€ 4.61	€ 5.49
Underlying EPS (Citi)	€ 2.31	€ 3.05	€ 2.51	€ 2.45	€ 1.33	€ 0.81	€ 1.02	€ 1.83	€ 2.68	€ 3.85	€ 4.61	€ 5.49
growth	27%	32%	-18%	-2%	-46%	-39%	26%	78%	47%	43%	20%	19%
DPS	€ 0.65	€ 0.12	€ 0.12	€ 0.20	€ 0.00	€ 0.22	€ 0.30	€ 0.55	€ 0.80	€ 1.15	€ 1.38	€ 1.65
Average Shares	795	800	803	807	810	811	812	814	814	814	814	814
Average Diluted Shares	800	804	806	808	811	811	813	815	815	815	815	815

Source: Company Reports and CIRA Estimates

Figure 37. EADS - Cash Flow Statement 2005-2016E (€ millions)

	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E	2016E
Net Income	1,676	99	-446	1,572	-763	553	653	1,486	2,181	3,129	3,753	4,467
Minority Interests	34	16	9	25	11	19	16	17	18	19	20	21
Depreciation and Amortisation	1,653	1,691	1,772	1,667	1,826	1,582	1,600	1,700	1,800	1,900	2,000	2,001
Valuation Adjustments/others	324	1,553	1,000	1,215	-20	-138	-39	160	160	160	160	160
Cash Tax Adjustment	560	-320	-406	310	-252	29	39	0	0	0	0	0
Disposal of NonCurrent assets	-170	-336	-125	-31	-31	-75	-17	0	0	0	0	0
Associates/JVs	-210	-152	-210	-188	-115	-127	-132	-176	-190	-210	-221	-234
Movement in Provisions	175	2,150	2,268	1	1,767	334	-650	-650	-650	-650	-650	-650
Working Capital/Other	1,239	-143	1,236	-172	15	2,819	2,382	250	610	670	710	750
Cash from Op. Activities	5,281	4,558	5,098	4,399	2,438	4,996	3,852	2,786	3,929	5,019	5,772	6,515
Capex (Gross)	-2,818	-2,708	-2,028	-1,837	-1,957	-2,250	-2,300	-2,400	-2,500	-2,500	-2,500	-2,500
Net Acquisitions/Disposals	59	80	245	-53	77	-80	-1,492	0	0	0	0	0
Dividends from Asso./JVs	36	46	39	50	27	41	50	67	72	79	83	88
Other	-145	53	0	0	0	0	18	0	0	0	0	0
FCF	2,413	2,029	3,354	2,559	585	2,707	128	453	1,501	2,598	3,355	4,103
FCF Pre Cust Financing	2,239	869	3,293	2,886	991	2,644	-54	753	1,501	2,598	3,355	4,103
Contribution to Plan Assets	0	0	-303	-436	-173	-553	-500	-300	-300	-300	-300	-300
Dividends	-396	-552	-98	-107	-166	-7	-182	-244	-447	-651	-936	-1,123
Puttable Instruments	-93	-2,879	0	0	0	0	0	0	0	0	0	0
Equity Issued/Redeemed	-101	59	46	63	12	-51	-58	0	0	0	0	0
FX	17	-57	-117	-50	-50	0	0	0	0	0	0	0
Other	-312	140	-87	140	396	25	-134	0	0	0	0	0
Change in Net Debt	1,528	-1,260	2,795	2,169	604	2,121	-746	-90	753	1,647	2,119	2,680
Net Debt/(Cash) b/f	-3,961	-5,489	-4,229	-7,024	-9,193	-9,797	-11,918	-11,172	-11,082	-11,835	-13,482	-15,602
Net Debt/(Cash) c/f	-5,489	-4,229	-7,024	-9,193	-9,797	-11,918	-11,172	-11,082	-11,835	-13,482	-15,602	-18,282

Source: Company Reports and CIRA Estimates

EADS

Company description

EADS is a European aerospace and defence company centred on Airbus Commercial, which represents c60% of group sales. Airbus Commercial is an "airframer" which manufactures large commercial jet aircraft. The other businesses include Airbus Military (military transport and refueling aircraft), Eurocopter (helicopters), Cassidian (with exposure to MBDA missiles and the Eurofighter programme) and Astrium (satellites and launchers). EADS also has also a 50% stake in ATR, a regional aircraft manufacturer (alongside Finmeccanica).

Investment strategy

We rate EADS Buy. We believe EADS is attractive, forming half a duopoly with Boeing. Civil aerospace remains a long-term growth story, in our opinion. For EADS we forecast strong EPS growth from a depressed growth driven by rising aircraft deliveries, underpinned by the large order backlog. Reduced losses on A380 should also provide an additional boost to EBIT. Although the A350-XWB programme has suffered some delays, the programme continues to receive close management scrutiny which should limit the scale of overall schedule slippages, we believe. EADS' strong balance sheet (with a large net cash position) is also attractive in the current environment of macroeconomic uncertainty.

Valuation

Our one-year Target Price of €31/share is based on our DCF valuation using a conservative set of assumptions, including a 10% WACC, 2.3% long-term growth and a mid-cycle margin assumption of 7.5% for the group and 8.0% for Airbus Commercial (at \$1.27/€) vs. company guidance of a 10% Airbus margin in 2015E, before the dilutive impact of A350XWB. Our DCF based TP implies 11.6x 2013E P/E (vs. EADS' long run average consensus 12m P/E of 13.7x) and 9.2x 2013E EV/EBIT. Our Target Implies 0.6x 2012E EV/Sales vs. mid cycle assumption of 7.5% and 4.5% in 2012E, rising to 5.9% in 2012E.

Risks

The key risks to our investment thesis on EADS are: (1) potential further cost overruns on the A350XWB programme; (2) execution risks surrounding Airbus' plans to ramp up narrow-body production; (3) transactional FX risk; (4) cyclicity and typical aviation risks including terrorism/war and external shocks; (5) increase in demand for vendor financing, worsening cash flows, if credit markets tighten or continued export credit agency support is not forthcoming; (6) Power 8 cost cutting plan failing to achieve the targeted cost savings as incremental savings prove harder to attain. Conversely, restructuring may exceed expectations; (7) continued difficulties ramping up A380 production; (8) continued cost overruns on the A400M military transporter programme; (9) the potential for a late-cycle decline in civil aircraft deliveries; (10) re-engining the A320 could prove technically and commercially risky, and lead to even higher R&D costs at Airbus Commercial;

(11) complex nature of the business, making it difficult to model and hard to value. Recurring non-recurring items can make estimating the underlying profitability of the business tricky.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price. Conversely, if the impact of any of these upside risks is greater than we anticipate, the stock could exceed our target price.

BAE Systems (BAES.L; £3.07; 1)

Valuation

Our 12-month target price of 300p is based c7.3x 2012E EPS, which is a 30% discount to the current 2012E P/E of the FTSE100. This is greater than BAE's long-run average historical discount to the market to reflect significant uncertainty in the outlook for defence spending in US and Europe. Our target price implies 2012E EV/EBIT of 6.2x. Our DCF valuation suggests a fair value of 318p/share based on an 8.4% WACC and no terminal growth.

Risks

The key risks to our investment thesis on BAE Systems are: (1) Following almost a decade of investment account budgetary growth, US Defence Budgets are likely to slow/shrink as the government tries to reduce the unsustainably large fiscal deficit, (2) long-term uncertainty in the UK Defence market due to the MoD's large funding gap, (3) contract execution risk on large programmes, (4) a slowdown in organic sales growth could encourage BAE to seek acquisitions, raising the risk profile of the stock, (5) difficulty forecasting contracted revenues (and reliance on company guidance) leaves potential for negative/(positive) earnings surprises, (6) Saudi Arabian defence spending may slow if oil prices decline. KSA (and the region) in general continues to face unrest and (7) translational FX exposure with US operations.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price. Conversely, if the impact of any of these upside risks is greater than we anticipate, the stock could exceed our target price.

Boeing Co. (BA.N; US\$74.61; 1)

Valuation

In our view, BA shares should trade in line with commercial aerospace peers in light of the market's focus on the commercial side of BA's business. We find peers currently trade at a FTM P/E of 15x, a premium to the market which in our view is driven by aerospace's resiliency. Our target price of \$87 applies a 15x multiple to our updated FTM EPS estimate one year from now.

Risks

The commercial aerospace industry is intrinsically risky given its vulnerability to unpredictable shocks that cannot be incorporated into earnings models, such as terrorism, volatile oil prices, and epidemics. Furthermore, the industry is highly correlated to economic growth, and relies on economic expansion for air traffic growth. The company's other exposure is the defense market, which is subject to changes in public opinion, global threats to the U.S. and its allies, the state of the federal budget, and the condition of existing U.S. and allied military equipment.

Boeing's shares may materially underperform our target price should the broader economy slip back into recession, resulting in decreased airline traffic and plane orders. Shares would also underperform to the extent that DoD budgets were severely cut. The company is also subject to intense commercial competition with Airbus, especially in the narrow-body segment, where defending market share could come at the expense of margin. If the impact on the company from any of these factors proves to be greater/less than we anticipate, we believe the stock will likely have difficulty achieving our target price or could outperform it.

Finmeccanica (SIFI.MI; €2.93; 3)

Valuation

Our target price of €2.60/share is based on 6.0x 2012E EV/EBIT, which is lower than the implied EV/EBIT multiple at our target price for its closest European defence peer, reflecting Finmeccanica's weaker cash flows, restructuring challenges and corporate governance issues. Our target price implies a 2012E P/E of c4.0x which is a significantly lower multiple than Finmeccanica's long run average of c12x since 2003, reflecting a lower growth outlook for defence markets generally and increased gearing at Finmeccanica (with Net Debt per share of €8.08/share at 30 Sep 2011). Our discounted cash flow valuation, based on an 11% WACC and 1% terminal growth rate, suggests fair value of €3.10/share. Our SoPT valuation, after including a 10% conglomerate discount, also suggests a fair value of €3.10/share.

Risks

The key risks to our investment thesis on Finmeccanica are as follows:

Upside Risks: (1) The ongoing restructuring programme could prove more successful in raising margins and improving cash conversion than we expect. (2) Finmeccanica's civil/commercial exposed businesses could start recovering from 2012E. (3) Finmeccanica may be able to dispose off its non-core assets (Transportation, Energy) sooner and/or at a better price than we currently anticipate.

Downside Risks: (1) US Defence Budgets may slow/shrink, following almost a decade of investment account budgetary growth. Around 25% of Sales are exposed to the US. (2) Italian defence spending looks likely to remain under pressure for some time. 20% of Sales are exposed to Italy. (3) The performance of acquired US business DRS may not be as good as expected. (4) Market concerns over debt may continue to weigh on the share price. (5) Translational FX exposure with US operations. (7) Contract execution risk. (8) Restructuring risk.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price. Conversely, if the impact of any of these upside risks is greater than we anticipate, the stock could exceed our target price.

Notes

Notes

Notes

Appendix A-1

Analyst Certification

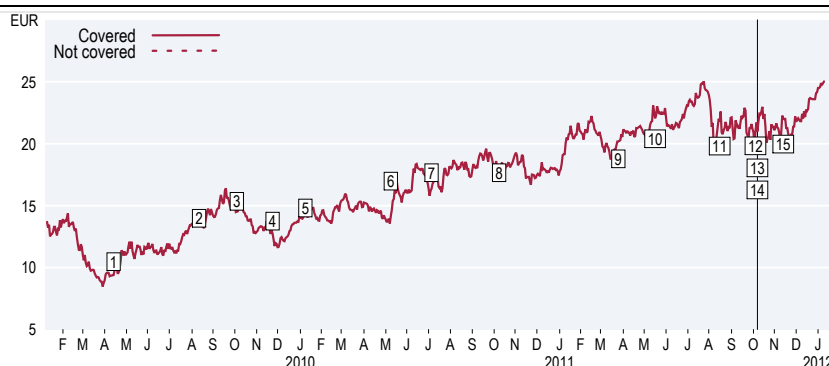
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IMPORTANT DISCLOSURES

EADS (EAD.PA)

Ratings and Target Price History Fundamental Research

Analyst: Jeremy Bragg



	Date	Rating	Target Price	Closing Price
1	14-Apr-09	*2H	10.00	9.40
2	12-Aug-09	2H	*15.00	13.70
3	5-Oct-09	2H	*16.50	14.51
4	24-Nov-09	2H	*14.50	12.75
5	8-Jan-10	2H	*16.00	14.35

* Indicates change

	Date	Rating	Target Price	Closing Price
6	10-May-10	*1H	*18.50	14.16
7	6-Jul-10	1H	*22.50	16.37
8	8-Oct-10	*2H	*19.30	17.98
9	25-Mar-11	2H	*21.00	20.19
10	17-May-11	2H	*23.80	22.05

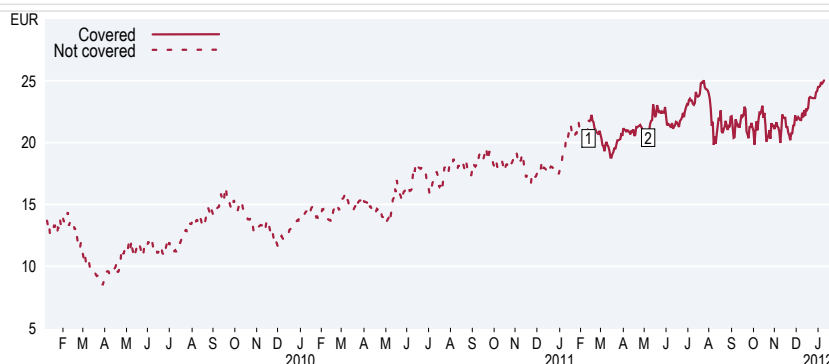
	Date	Rating	Target Price	Closing Price
11	16-Aug-11	2H	*23.00	21.80
12	5-Oct-11	2H	*22.50	20.96
13	7-Oct-11	Stock rating system changed		
14	7-Oct-11	*2	22.50	20.99
15	14-Nov-11	*1	*27.00	22.05

Rating/target price changes above reflect Eastern Standard Time

EADS (EAD.PA)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Jeremy Bragg



	Date	Rating	Target Price	Closing Price
1	11-Feb-11	*ADD LP	-	21.77

* Indicates change

	Date	Rating	Target Price	Closing Price
2	6-May-11	*REM LP	-	20.95

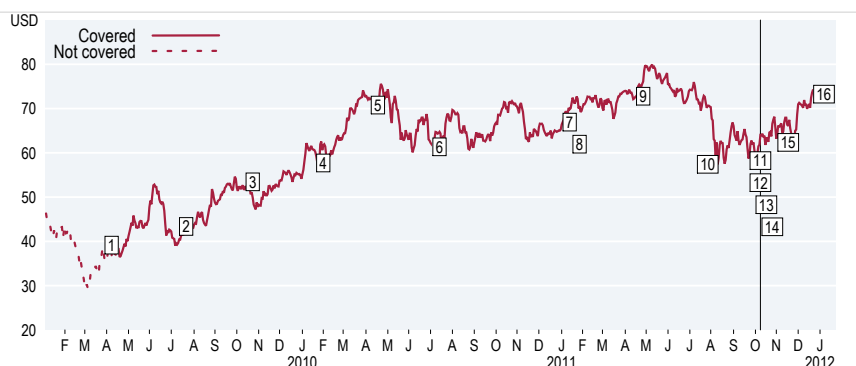
Rating/target price changes above reflect Eastern Standard Time

Boeing Co. (BA)

Ratings and Target Price History

Fundamental Research

Analyst: Jason Gursky
Covered since July 15 2010



	Date	Rating	Target Price	Closing Price
1	8-Apr-09	*2H	*37.00	36.87
2	22-Jul-09	2H	*41.00	42.00
3	23-Oct-09	2H	*50.00	49.89
4	31-Jan-10	2H	*59.00	60.60
5	19-Apr-10	2H	*73.00	70.96
6	14-Jul-10	*1H	*80.00	64.75

* Indicates change

	Date	Rating	Target Price	Closing Price
7	13-Jan-11	1H	*85.00	69.83
8	27-Jan-11	1H	*84.00	70.56
9	27-Apr-11	1H	*90.00	76.12
10	27-Jul-11	1H	*85.00	70.63
11	8-Oct-11	Stock rating system changed		
12	8-Oct-11	*1	85.00	61.81

	Date	Rating	Target Price	Closing Price
13	18-Oct-11	1	*87.00	63.47
14	26-Oct-11	1	*78.00	66.56
15	17-Nov-11	1	*82.00	66.09
16	6-Jan-12	1	*87.00	73.98

Rating/target price changes above reflect Eastern Standard Time

Boeing Co. (BA)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Jason Gursky
Covered since July 15 2010



* Indicates change

Rating/target price changes above reflect Eastern Standard Time

BAE Systems (BAES.L)

Ratings and Target Price History

Fundamental Research

Analyst: Jeremy Bragg



	Date	Rating	Target Price	Closing Price
1	20-Feb-09	1M	*4.60	4.05
2	31-Jul-09	1M	*4.10	3.07
3	5-Oct-09	*1H	4.10	3.38
4	26-Feb-10	1H	*4.25	3.74

* Indicates change

	Date	Rating	Target Price	Closing Price
5	18-Feb-11	1H	*4.20	3.43
6	20-Jul-11	1H	*3.40	3.02
7	16-Aug-11	1H	*3.20	2.62
8	7-Oct-11	Stock rating system changed		

	Date	Rating	Target Price	Closing Price
9	7-Oct-11	*1	3.20	2.69
10	21-Dec-11	1	*3.00	2.73

Rating/target price changes above reflect Eastern Standard Time

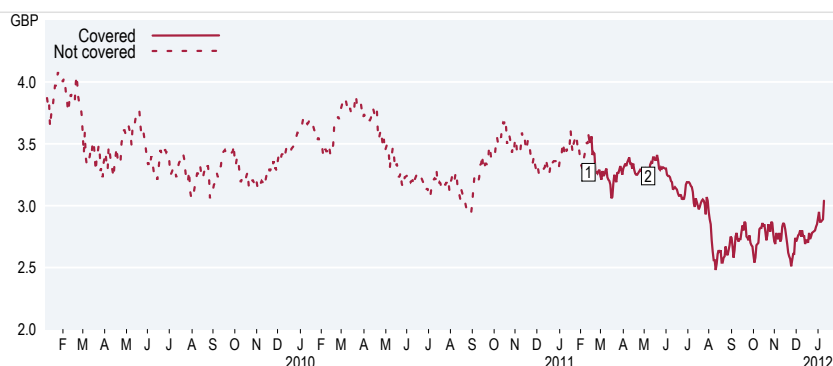
BAE Systems (BAES.L)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Jeremy Bragg



	Date	Rating	Target Price	Closing Price
[1]	11-Feb-11	*ADD MP	-	3.57

* Indicates change

	Date	Rating	Target Price	Closing Price
[2]	6-May-11	*REM MP	-	3.26

Rating/target price changes above reflect Eastern Standard Time

Finmeccanica (SIFI.MI)

Ratings and Target Price History

Fundamental Research

Analyst: Jeremy Bragg



	Date	Rating	Target Price	Closing Price
[1]	16-Mar-09	1H	*12.00	9.00
[2]	5-Oct-09	*1M	*13.50	11.96
[3]	1-Feb-10	1M	*11.50	9.95
[4]	13-May-10	*2M	*10.50	9.63

* Indicates change

	Date	Rating	Target Price	Closing Price
[5]	29-Mar-11	2M	*9.70	9.05
[6]	4-May-11	2M	*9.40	8.98
[7]	20-Jul-11	2M	*8.00	7.53
[8]	16-Aug-11	*3H	*4.00	5.12

	Date	Rating	Target Price	Closing Price
[9]	7-Oct-11	Stock rating system changed		
[10]	7-Oct-11	*3	4.00	5.17
[11]	28-Nov-11	3	*2.60	2.99

Rating/target price changes above reflect Eastern Standard Time

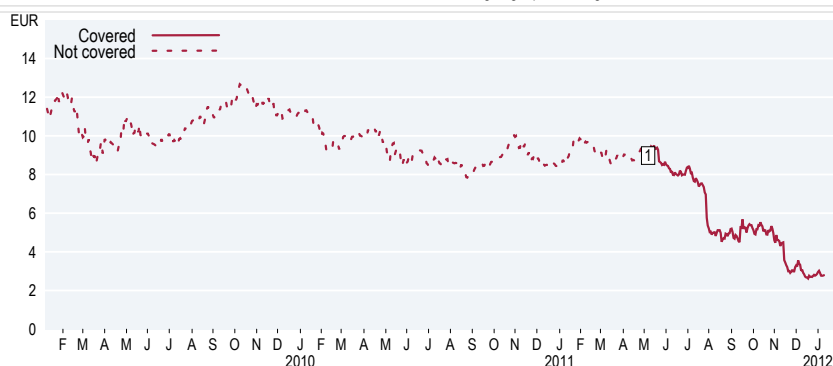
Finmeccanica (SIFI.MI)

Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Jeremy Bragg



	Date	Rating	Target Price	Closing Price
[1]	6-May-11	*ADD LP	-	9.19

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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