

7 September 2012 | 24 pages

Aerospace & Defense (GICS) | Aerospace & Defense (Citi)  
Europe | United Kingdom

# Meggitt Plc (MGGT.L)

## Upgrading to Buy

- **Summary** — We upgrade Meggitt from Neutral to Buy on account of its solid earnings growth prospects and an attractive valuation and view the current share price as a good buying opportunity for this high-quality civil aerospace name. We have raised our 12E-14E forecasts by 1-4%. Meggitt offers 11% EPS CAGR 2011A-16E, driven by 7% organic sales CAGR and margin upside. Meggitt is trading on 10.2x 13E P/E vs. its long-run average of 11.3x.
- **Good Organic Growth Prospects** — Meggitt forecasts 6-7% organic sales CAGR 10A-15E (Citi 7%). We are bullish on the growth prospects in Civil Aero & Energy, where Meggitt has secured some large contract wins. Although there is arguably some downside risk to Meggitt's defence business (40% of the group) in the event of sequestration in the US, this is also the case for other stocks in the sector. In 1H12 MGGT delivered 8% organic growth, above its mid-term target, despite soft growth in the civil aero aftermarket, highlighting the diversity of the group.
- **Margin Upside** — We see further upside to Meggitt's already impressive margins from FY13E, driven by a recovery in high-margin civil aftermarket revenues, further cost savings as part of the "Raising the Bar" initiative and realisation of merger synergies from PSA. In FY12E, we forecast broadly flat margins vs. 24.7% in FY11A despite the dilutive impact of a full-year contribution from the PSA acquisition and a £10m FX headwind, rising to 26.2% by 2016E.
- **M&A** — We see scope for MGGT to supplement its organic growth through acquisitions, and its track record has historically been good, in our view, with merger synergies targets set on acquisition generally exceeded. We also see MGGT itself as a potential acquisition candidate given strong FCF, a large installed base of aircraft, sole-source supplier positions on several aircraft platforms & an attractive valuation.
- **Target Raised to 500p** — We raise our Target Price to 500p, based on DCF, which is the same method with a consistent set of assumptions that we use to value MGGT's civil aerospace peers. Our Target Price implies 12.9x 13E P/E & 11.5x 13E EV/EBIT and offers 29% ETR.

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

<b>Buy</b>	<b>1</b>
<i>from Neutral</i>	
Price (06 Sep 12)	£3.97
Target price	£5.00
<i>from £4.00</i>	
Expected share price return	26.1%
Expected dividend yield	2.9%
<b>Expected total return</b>	<b>29.0%</b>
Market Cap	£3,103M
	US\$4,934M

## Price Performance (RIC: MGGT.L, BB: MGGT LN)



## Meggitt Plc (GBP)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Sales (£M)	1,162.0	1,455.3	1,633.4	1,749.8	1,876.9
Profit Before Tax (£M)	256.1	323.0	363.2	400.6	449.9
Basic EPS (p)	27.8	31.9	35.3	38.7	43.4
Basic EPS (Old) (p)	27.8	31.9	35.2	38.2	41.8
PE (x)	14.3	12.4	11.2	10.3	9.2
EV/EBITDA (x)	11.2	9.8	8.6	7.5	6.6
DPS (p)	9.2	10.5	11.6	12.7	14.0
Net Div Yield (%)	2.3	2.6	2.9	3.2	3.5

## Jeremy Bragg

+44-20-7986-1089  
jeremy.bragg@citi.com

## Devang Doshi

devang1.doshi@citi.com

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

Citi Research is a division of Citigroup Global Markets Inc. (the "Firm"), which does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the Firm may have a conflict of interest that could affect the objectivity of this report. Investors should consider this report as only a single factor in making their investment decision.

MGGT.L: Fiscal year end 31-Dec						Price: £3.97; TP: £5.00; Market Cap: £3,106m; Recomm: Buy					
Profit & Loss (£m)	2010	2011	2012E	2013E	2014E	Valuation ratios	2010	2011	2012E	2013E	2014E
Sales revenue	1,162	1,455	1,633	1,750	1,877	PE (x)	14.5	12.5	11.3	10.3	9.2
Cost of sales	-640	-840	-919	-974	-1,017	PB (x)	1.9	1.7	1.6	1.5	1.4
Gross profit	522	616	714	776	860	EV/EBITDA (x)	11.2	9.8	8.6	7.5	6.6
Gross Margin (%)	44.9	42.3	43.7	44.3	45.8	FCF yield (%)	5.9	6.1	4.2	6.2	7.4
EBITDA (Adj)	364	429	478	529	581	Dividend yield (%)	2.3	2.6	2.9	3.2	3.5
EBITDA Margin (Adj) (%)	31.4	29.4	29.3	30.3	31.0	Payout ratio (%)	33	33	33	33	32
Depreciation	-29	-32	-39	-47	-50	ROE (%)	10.2	11.4	11.4	12.0	13.1
Amortisation	-32	-37	-39	-48	-51	Cashflow (£m)	2010	2011	2012E	2013E	2014E
EBIT (Adj)	304	360	400	435	480	EBITDA	364	429	478	529	581
EBIT Margin (Adj) (%)	26.1	24.7	24.5	24.8	25.6	Working capital	-10	-7	-49	-17	-19
Net interest	-48	-37	-37	-34	-30	Other	-102	-117	-127	-145	-147
Associates	0	0	0	0	0	Operating cashflow	252	305	302	367	415
Non-op/Except	-84	-97	-82	-83	-75	Capex	-89	-119	-170	-171	-183
Pre-tax profit	173	226	281	317	375	Net acq/disposals	0	-418	-10	0	0
Tax	-34	-41	-67	-76	-90	Other	0	0	0	0	0
Extraord./Min.Int./Pref.div.	0	0	0	0	0	Investing cashflow	-89	-537	-180	-171	-183
Reported net profit	139	185	214	241	285	Dividends paid	-30	-48	-85	-92	-103
Net Margin (%)	11.9	12.7	13.1	13.8	15.2	Financing cashflow	-137	284	-170	-196	-232
Core NPAT	192	246	276	304	342	Net change in cash	-11	43	-33	0	0
Per share data	2010	2011	2012E	2013E	2014E	Free cashflow to s/holders	163	186	132	196	232
Reported EPS (p)	19.8	23.8	27.1	30.4	35.9	Segment sales (£m)	2010	2011	2012E	2013E	2014E
Core EPS (p)	27.5	31.6	35.0	38.4	43.0	Aircraft Braking Systems	309.7	320.5	336.5	356.7	378.1
DPS (p)	9.2	10.5	11.6	12.7	14.0	Control Systems	182.8	201.6	221.8	235.1	249.2
CFPS (p)	36.0	39.4	38.3	46.2	52.3	Polymers & Composites	156.0	171.2	196.9	210.7	225.4
FCFPS (p)	23.2	24.0	16.7	24.7	29.2	Sensing Systems	208.4	233.9	80.6	88.7	97.5
BVPS (p)	208.0	233.0	248.1	265.6	288.2	Equipment Group	305.1	528.1	797.6	858.7	926.6
Wtd avg ord shares (m)	692	770	782	787	788	PSA	na	na	na	na	na
Wtd avg diluted shares (m)	699	776	788	793	795	Sales - total segments	1,162	1,455	1,633	1,750	1,877
Growth rates	2010	2011	2012E	2013E	2014E	Segment EBIT (£m)	2010	2011	2012E	2013E	2014E
Sales revenue (%)	1.0	25.2	12.2	7.1	7.3	Aircraft Braking Systems	120.7	119.9	122.0	132.9	152.7
EBIT (Adj) (%)	6.1	18.4	11.3	8.6	10.4	Control Systems	44.7	47.9	56.5	59.9	63.5
Core NPAT (%)	12.3	27.8	12.4	10.3	12.3	Polymers & Composites	28.4	31.7	38.0	40.7	43.5
Core EPS (%)	8.7	15.2	10.7	9.7	12.1	Sensing Systems	39.5	43.2	13.0	14.3	15.7
Balance Sheet (£m)	2010	2011	2012E	2013E	2014E	Equipment Group	70.4	116.8	170.7	186.9	204.5
Cash & cash equiv.	52	95	62	62	62	PSA	na	na	na	na	na
Accounts receivables	238	317	356	382	409	EBIT - total segments	303.7	359.5	400.2	434.6	479.9
Inventory	239	278	311	334	358	Segment Margin (%)	2010	2011	2012E	2013E	2014E
Net fixed & other tangibles	413	497	523	551	581	Aircraft Braking Systems	39.0	37.4	36.2	37.2	40.4
Goodwill & intangibles	2,353	2,793	2,769	2,742	2,718	Control Systems	24.5	23.8	25.5	25.5	25.5
Financial & other assets	7	7	7	7	7	Polymers & Composites	18.2	18.5	19.3	19.3	19.3
Total assets	3,302	3,986	4,027	4,076	4,135	Sensing Systems	19.0	18.5	16.1	16.1	16.1
Accounts payable	250	349	353	394	429	Equipment Group	23.1	22.1	21.4	21.8	22.1
Short-term debt	13	7	129	129	129	PSA	na	na	na	na	na
Long-term debt	756	867	660	557	427	Margin - total segments	26.1	24.7	24.5	24.8	25.6
Provisions & other liab	845	969	946	908	878	Leverage & valuation	2010	2011	2012E	2013E	2014E
Total liabilities	1,864	2,193	2,088	1,987	1,864	Adj. net debt (cash)/(£m)	721.4	788.4	735.7	632.3	503.2
Shareholders' equity	1,438	1,793	1,940	2,089	2,272	Pension deficit (surplus)(£m)	265.1	319.9	290.9	250.9	210.9
Minority interests	0	0	0	0	0	Adj. ND to EBITDA (x)	1.98	1.84	1.54	1.19	0.87
Total equity	1,438	1,793	1,940	2,089	2,272	Adj. EV/EBITDA (x)	8.5	9.0	8.6	7.5	6.6
Net debt	717	780	727	623	494	Adj. EV/EBIT (x)	10.2	10.7	10.3	9.2	8.0
Net debt to equity (%)	49.8	43.5	37.5	29.8	21.8	FCF Yield	7.8	6.8	4.3	6.3	7.4

For further data queries on Citi's full coverage universe please contact Citi Research Data Services at CitiRsch.DataServices.Global@citi.com  
For definitions of the items in this table, please click [here](#).

# Contents

<b>Good Organic Growth Prospects</b>	<b>4</b>
Civil Aero OE (18% of Sales)	4
Civil Aero Aftermarket (27% of Sales)	5
Military (40% of Sales)	7
Energy & Others (15% of Sales)	8
<b>Margin Upside</b>	<b>9</b>
<b>M&amp;A: Predator AND Prey?</b>	<b>11</b>
<b>Target Price Raised to 500p</b>	<b>13</b>
<b>Financial Statements</b>	<b>15</b>

## Good Organic Growth Prospects

**Meggitt's medium-term target for 6-7% pa organic growth well underpinned by good prospects in Civil Aero and Energy**

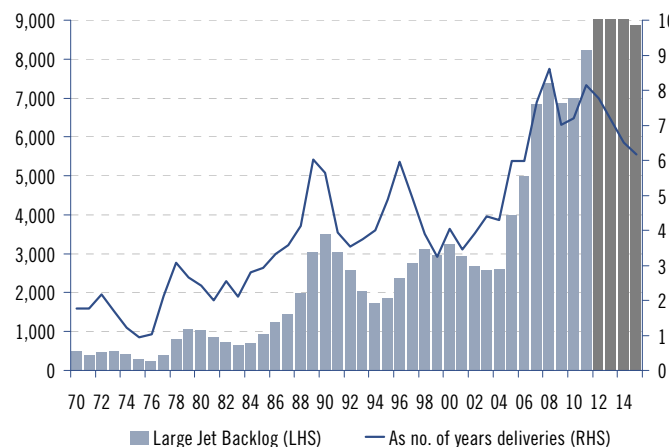
Meggitt targets 6-7% organic sales CAGR 2010-2015 and our forecasts are broadly in line with this guidance. However, in 1H12 Meggitt reported 8% organic growth, despite relatively soft growth in Civil Aero aftermarket (in keeping with its US peers), with encouraging performance from its Energy and Military businesses. Not only do we like the fact that in 1H12 Meggitt exceeded its medium-term growth guidance, but we also approve of the fact that the company met its group guidance despite softness in the core Civil Aero aftermarket business, which reflects the diversity of the group. We see some similarities to Rolls Royce 2-3 years ago when the main profit driver for the business was not Civil Aerospace, but Marine and Defence.

We acknowledge that there is some downside risk to our Military growth forecasts from 2013E in the event of sequestration in the US. However, this is the case for the whole sector and not just Meggitt. Furthermore, Meggitt's military business has thus far proven to be very resilient in comparison to that of its peers, which we believe reflects a focus on more "defensive" areas of the market including defence aerospace (predominantly an aftermarket business), training and vehicle retrofits.

In aggregate we are bullish on Meggitt's organic growth prospects from now, particularly in its Energy business, which delivered 30% organic growth in 1H12 and is an area that management has been particularly optimistic about in recent meetings. We believe that strong growth prospects in Civil Aerospace (particularly OE but also aftermarket) and Energy should offset any softness in the military business. A brief review of the prospects by end market follows:

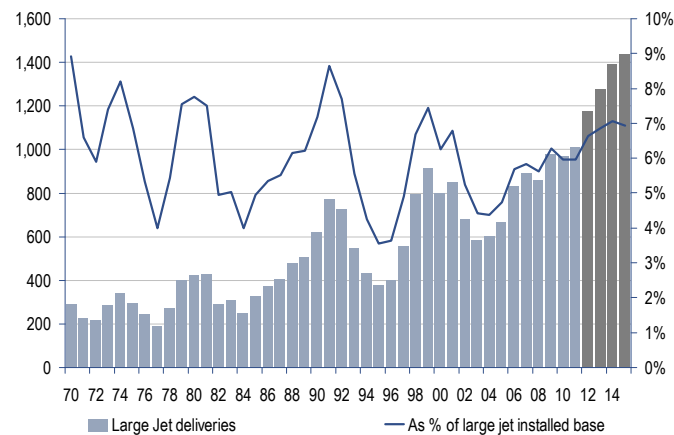
### Civil Aero OE (18% of Sales)

Figure 1. Airbus and Boeing Backlog: 1970-2015E



Source: Ascend, Citi Research

Figure 2. Airbus and Boeing Aircraft Deliveries: 1970-2015E



Source: Ascend, Citi Research

**We forecast 8% organic CAGR in MGGT's Civil OE revenues over 12E-16E**

In 1H12, Meggitt reported 9% organic growth in Civil OE. We expect 9% organic growth in FY12E and 8% organic CAGR 2012E-16E, which is in line with MGGT's medium-term revenue growth target of 7-8%. We remain positive on the outlook for the civil OE cycle, despite recent investor concerns over cancellations following the 787 cancellations from Qantas, and continue to predict a c9% CAGR in Airbus and Boeing deliveries through 2015E. We believe that the delivery outlook for this business is underpinned by a large order backlog for large commercial aircraft (6-7 years of production) and continued demand from both the developed markets to replace older fuel inefficient aircraft, and from the emerging markets. In the near

term, delivery growth for Meggitt should be driven by the 787 ramp-up and the medium-term outlook remains underpinned by the entry into service of a number of aircraft platforms with significant MGGT content including the A350 and the Airbus and Boeing re-engined narrow bodied aircraft (where MGGT continues to win significant work shares on both the GTF and the Leap-X engines).

### Civil Aero Aftermarket (27% of Sales)

Civil aftermarket revenues in 1H12 were held back by Hawker bankruptcy and airline de-stocking, the effects of which are expected to reverse in 2H12E

1H12's aftermarket growth was relatively soft at +1% organic, mainly due to the bankruptcy of the business jet manufacturer Hawker Beechcraft and greater than expected destocking of spares by airlines. Although Meggitt did not disclose the quarterly aftermarket trends, we believe 2Q to be the softer quarter in 1H12 as it was for Meggitt's aftermarket exposed US and Europe peers.

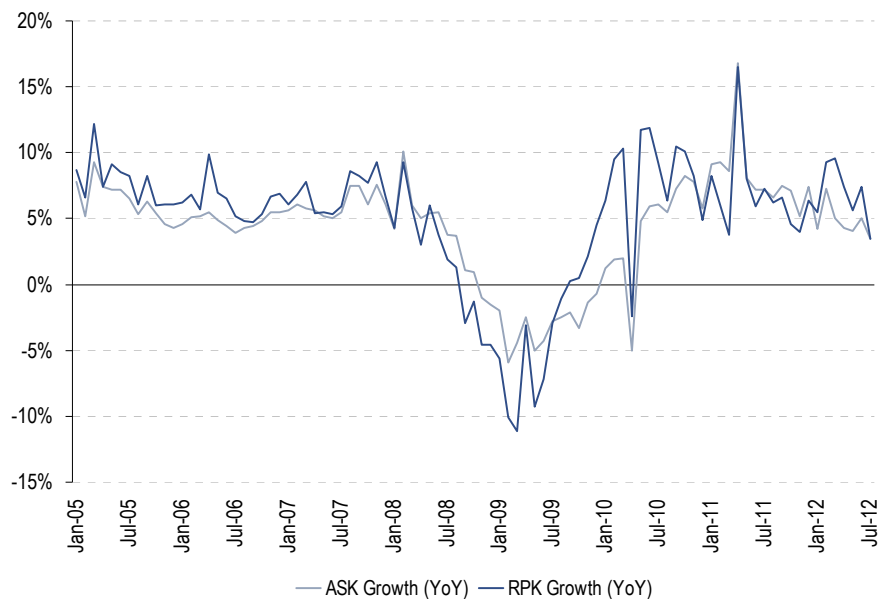
Figure 3. Civil Aero Aftermarket: Organic Revenue Growth (% YoY)

	Dec-10 Year Actual	Dec-11 Year Actual	Mar-12 Quarter Actual	Jun-12 Quarter Actual	Dec-12 Year Guidance	Comments
<b>Goodrich</b>						
All aircraft types	Flat	13%	5%	n/a	n/a	United Technologies closed GR acquisition on 26/7/12
<b>Hamilton Sundstrand</b>						
All aircraft types	n/a	17%	HSD	Flattish	n/a	HSD = High Single Digit
<b>Honeywell</b>						
Large & Regional Jets	1%	16%	11%	4%	n/a	
Business Jets & General Aviation	8%	24%	30%	19%	n/a	ATR/BGA Re coupling To Utilisation
Total Civil Aero	3%	18%	16%	9%	n/a	Commercial Aftermarket to moderate in 2H
o/w Spares	14%	28%	23%	9%	n/a	
o/w MRO	n/a	12%	12%	9%	n/a	
<b>Meggitt</b>						
Total Civil Aero	6%	12%	n/a	1% (1H12)	n/a	Medium-Term Guidance 8-9% CAGR
<b>MTU Aero Engines</b>						
Commercial spares	2%	14%	0%	-5%	"Stable"	12E guidance was downgraded at 1H12 from +5-10% to "stable"
MRO	-4%	9%	12%	16%	+5-10%	
<b>Pratt &amp; Whitney (UTX)</b>						
Comm. Spares (Large Engines)	10%	15%	-4%	-13%	-10%	FY12 guidance cut to -10% from +5% prev.
<b>Rockwell Collins</b>						
Large & Regional Jets	-5%	13%	13%	0%		FY ending September
Business Jets & General Aviation	4%	14%	5%	-1%		
Total Civil Aero	-2%	14%	9%	0%		
<b>Rolls Royce</b>						
Civil Aero Aftermarket	10%	5%	n/a	10% (1H12)	n/a	12E guidance is for good growth in Civil Aero sales (OE+AM)
<b>Safran</b>						
CFM56 Spares	-17%	8%	24%	12% (1H12)	n/a	
High Thrust Engine Spares	2-Digit	2-Digit	Flat	Flat (1H12)	n/a	
Total Civil Aerospace	n/a	8%	15%	8% (1H12)	Up high 1-digit	
<b>GE Aviation (Orders not Sales)</b>						
Avg. Daily Services Order Rate	25%	13%	-10%	-14%	n/a	Partial recovery expected in spares orders in 2H12

Source: Company Reports

Stocking trends for spares are difficult to predict but the absence of a one-time shock (Hawker Beechcraft) in 2H and some indications from the company of improved order activity gives us some confidence that 2H12E will be better than 1H12 and we expect c6% aftermarket growth in 2H and 4% organic growth for the full year.

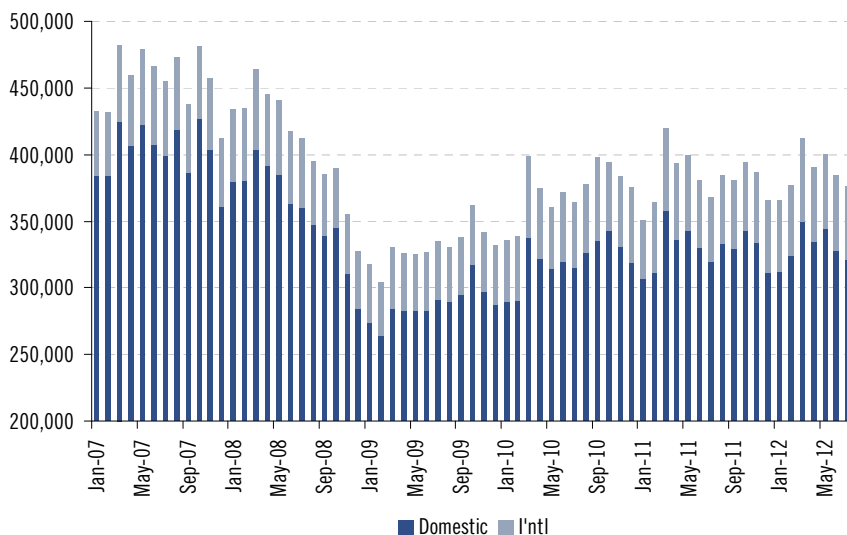
Figure 4. Global International Passenger Traffic & Capacity Growth: Jan 2005 - July 2012



Source: IATA

We expect aftermarket growth to accelerate from 2013E, following a soft 2012E, and predict 9% organic growth from 2013E driven by c5% trend growth in airline capacity boosted further by significant initial provisioning of spares on new aircraft platforms. This is in line with Meggitt's medium-term guidance of 8-9% CAGR 2010A-2015E, split by sector as follows: high single-digit growth in large commercial aircraft, mid single-digit growth in regional jets and mid teens growth in business jets. As noted later, despite softer aftermarket growth in 1H12, Meggitt's EBIT margin remained resilient.

Figure 5. US Business Jet Operations: Jan 2007 – July 2012



Source: US FAA; Operations represent landings and take-offs of business jets

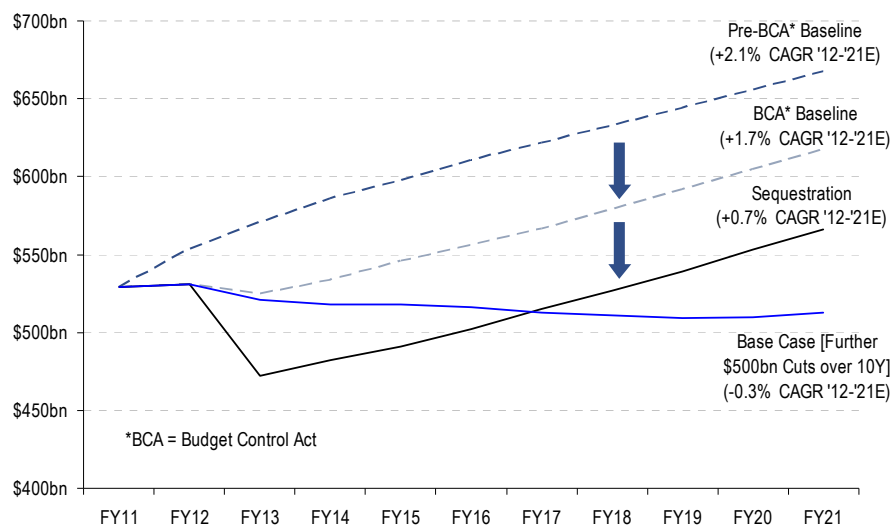
Business jets represent 11% of Meggitt's group sales (o/w OE 5% and aftermarket 6%), but probably a greater percentage of group profits given Meggitt's sole-source wheels and brakes positions on a number of business jets (e.g. every Gulfstream jet takes off and lands on Meggitt landing gear). Meggitt focuses on medium and large cabin jets, where the outlook is more favourable than for the smaller cabin jets.

US business jet operations<sup>1</sup> have been flat YTD (Domestic -1%, International +5%) (Figure 5). Although Meggitt did not disclose organic growth in 1H12 for business jet aftermarket, in total this segment reported c30% growth in 1H12 (based on it representing 6% of total revenues in 1H12A vs. 5% in 1H11A) due to the acquisition of PSA and its exposure to medium and large cabin jets, where the demand environment continues to be relatively benign compared to smaller business jets. MGGT expects to continue taking market share in the medium to large cabin jet segment and projects c70% market share by 2020, up from a little over 50% currently.

We believe that the nascent Chinese business jet market could offer a source of significant growth for Meggitt in the long term. At present there are approximately 17,500<sup>2</sup> business jets in the global fleet, of which 63% are in the US and less than 1% of them are in China. So in the long run this could be an extremely attractive market for Meggitt.

## Military (40% of Sales)

Figure 6. Sequestration Scenarios – US DoD Base Defence Spending, FY11A-FY21E (\$ bn)



Source: DoD, Citi Research

**We see some downside risks to MGGT's military business if sequestration is enforced in the US from 13E**

Our forecasts show 2% pa organic military revenue growth from 2H12E onwards, which is in line with Meggitt's guidance of 2% CAGR 2010A-2015E. However, as is the case with other US defence exposed stocks in the sector, there is downside risk to our forecasts in the event that sequestration occurs in the US from January 2013. For more details on sequestration and the general outlook for US defence spending, please see our note entitled "[Staying Selective on Defence as US Budget Risks Rise](#)". We next hear details on sequestration in early September – see US A&D analyst Jason Gursky's note "[Making a List and Checking it Twice](#)" for more details.

<sup>1</sup> Operations include take-offs and landings

<sup>2</sup> Source: Ascend

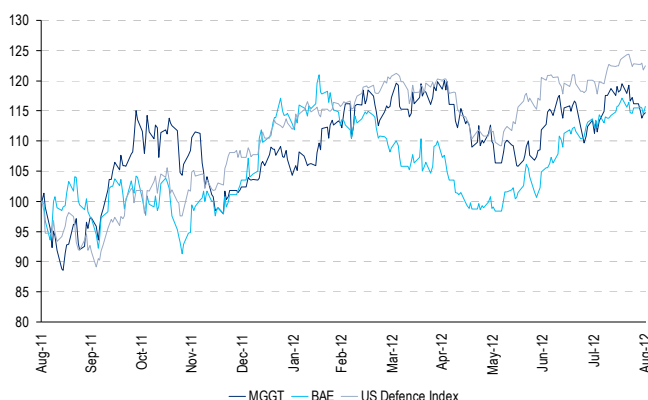
### Sequestration is not our Base Case

Our base case forecast for US defence is that sequestration is circumvented and that nominal defence spending remains flat over the next decade but we highlight increasing headline risk into 2H around US Presidential elections and as the January sequestration deadline approaches.

### MGGT's Military revenues have been relatively more resilient than peers with good near- and medium-term visibility

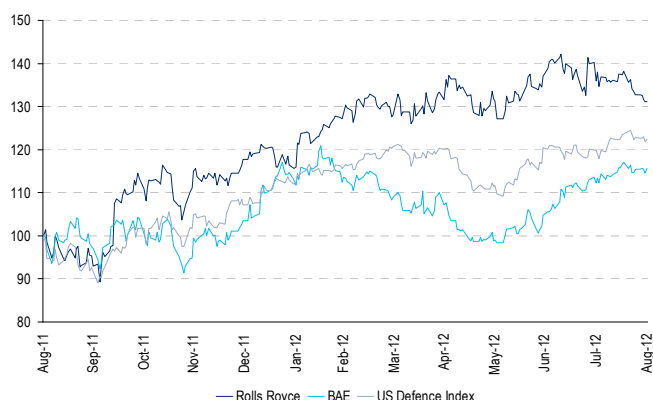
MGGT's military revenues have been surprisingly strong so far (+10% YoY in 1H12 vs. Citi +2%) driven by retrofit work on Bradley infantry fighting vehicles and robust spares demand for its rotary and fixed wing spares. MGGT notes that about two-thirds of the Bradley retrofit revenues still remain to be traded, underpinning the near-term growth outlook, while a number of new aircraft platforms (such as KC390 and JSF) should help sustain revenues over the medium term. Given its niche defence exposure, we see scope for Meggitt to continue to outgrow the overall defence market.

Figure 7. MGGT 1-Yr Share Price Performance vs. BAE Systems & US Defence Companies (Indexed, 31/8/11 = 100)



Source: DataStream, Citi Research; US Defence Index includes GD, HII, LMT, NOC and RTN (equal weights)

Figure 8. RR 1-Yr Share Price Performance vs. BAE Systems & US Defence Companies (Indexed, 31/8/11 = 100)



Source: DataStream, Citi Research; US Defence Index includes GD, HII, LMT, NOC and RTN (equal weights)

Finally we would also note that the other listed defence stocks, e.g. BAE Systems and the US defence primes, have enjoyed a re-rating of late, despite the overhang of sequestration.

## Energy & Others (15% of Sales)

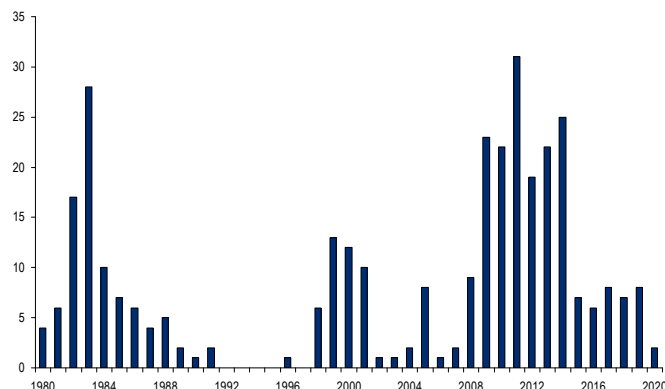
### Strong organic growth prospects in MGGT's Energy business

Whilst small, Meggitt's Energy & Other business is an area that has been growing very quickly. In 1H12A Meggitt reported 30% organic growth in Energy, driven by a combination of very strong growth in the Printed Circuit Heat Exchanger (PCHE) sales and good growth in Meggitt's condition monitoring businesses. We expect 20% organic growth in 2H12E and 15% growth pa thereafter, which could prove to be conservative given the company's guidance of >15% organic sales growth 2010A-2015E and a strong 1H12A. In summary, we see scope for Energy & Other to continue to grow rapidly from a small base and believe that further order flow in this area will be well received by the market.

Energy specifically accounts for around 9% of group sales. Meggitt sells aerospace derived products to Energy customers including sensors, pumps, valves and condition monitoring equipment as well as heat transfer equipment. PCHEs represent between a third and half of Meggitt's Energy business. These compact devices are used in the upstream hydrocarbon processing, petrochemical and refining industries and have been particularly successful in their core offshore markets, but also in the floating liquid natural gas applications.

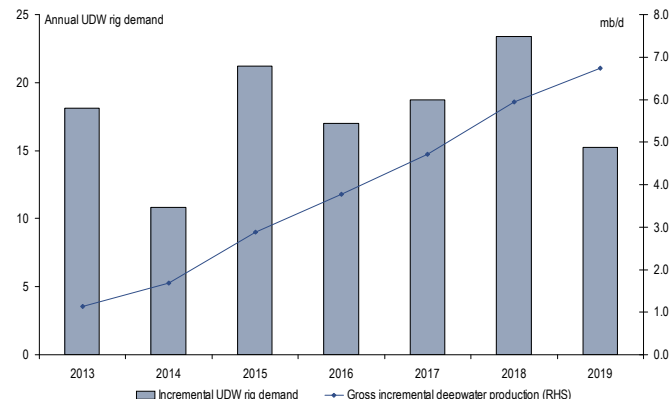


Figure 9. Number of Deepwater Oil Rigs coming On-stream: 1980-2020E



Source: ODS, Citi Research

Figure 10. Projected Demand for Deepwater Oil Rigs: 2013E-2019E



Source: ODS, Citi Research

The outlook for MGGT's Energy business, particularly its PCHEs, remains robust driven by strong demand from the offshore oil and gas industry. As shown in Figure 9, 22 new oil rigs (semisubmersible and drill ships) are expected to come on-stream in 2013, followed by 25 in 2014, representing a 14-15% pa increase. Moreover, our Oil & Gas team's deepwater drilling demand-supply model suggests that approximately 20 new rigs will be required each year through to 2020 to meet their forecast deepwater oil production. This compares to a projected supply of only about 7-8 rigs pa between 2015 and 2020 (Figure 10), highlighting significant under ordering of rigs during this period.

**MGGT targets to grow its Energy business from c9% of group sales currently to 15% within 5 years and 25% within 10 years**

Meggitt is extremely bullish on the prospects for its Energy business. When we met the company at the Farnborough air show, CFO Stephen Young commented that he expected Energy to represent c15% of Meggitt's group sales within 5 years and 25% within 10 years, through a combination of organic growth and (potentially) some acquisitions. Meggitt has won a number of large contracts including those from Petrobras and Shell with potential for significant follow-on orders. The recent \$100m-plus Petrobras order (announced 7/8/12) is the largest contract for Meggitt's Energy business to date, covering equipment supply for 8 vessels, which over time may potentially expand to cover a further 19 vessels. The size of the Shell order has not been disclosed. To put the size of this Petrobras order into perspective, Meggitt's entire Energy business generates just over £60m of sales per annum.

## Margin Upside

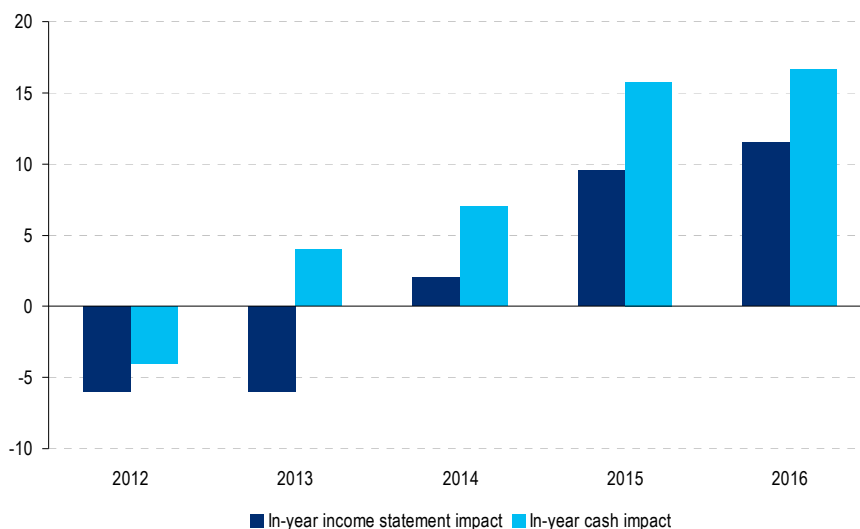
**We expect margin upside to be driven by recovery in civil aftermarket sales, further cost savings and merger synergies from PSA**

Meggitt expects broadly flat margins in FY12E (Citi 24.5%) vs. the 24.7% achieved in FY11A. Given a 23.9% margin in 1H12 (vs. 25.2% in 1H11A) this does imply a strong margin in 2H12E, which should be achievable if Civil Aero aftermarket revenues recover in 2H12 vs. 1H12, as we expect that they will. We find Meggitt's flat margin guidance for FY12 encouraging given that this year includes a full-year contribution from the PacSci acquisition (vs. 9 months in 2011A), which has a lower margin than "old Meggitt", and an expected c£10m headwind from the appreciation of the Swiss Franc.

We see further margin upside in 3 areas, which we believe could potentially add over 100bps to Meggitt's 2012E Underlying EBIT margin of 24.5%:

- **Recovery in high-margin civil aero aftermarket sales** – We believe that 1H12's margins were impressive given softness in Civil Aero aftermarket in the period. We expect some aftermarket recovery in 2H12E and FY13E, which should help group margins. Based on the other stocks under coverage, we estimate that incremental margins on aftermarket spares could be >50%, although this has never been verified by the company.

Figure 11. MGGT P&L and Cash Impact from the New Cost Saving Initiative (£m)



Source: Company Data, Citi Research

- **Raising the Bar** – Following the Transformation plan in 2008, at the 1H12 results Meggitt announced that it intends to extend its cost cutting efforts through a continuous improvement programme through 2016E. The new initiative aims to deliver c£12m of annualised EBIT by the end of 2016E, which equates to c70bps of margin improvement at the group level. When talking to the company in the past, it has been our impression that the Transformation plan was thoroughly endorsed by divisional management and the results exceeded expectations. The initiative aims to improve MGGT's programme management capabilities and bring them within the top decile of the peer group. The programme also appears very attractive from cash flow perspective. Meggitt guides that the programme will be net cash positive in its first full year (2013) and generate >£15m net cash benefit by 2015 (mainly through lower non-recurring costs and lower working capital requirements).
- **Merger synergies from PacSci** – At 1H12 results, management commented that they were “comfortably” on course to achieve the \$22.5m targeted run-rate of cost synergies from PSA, which to us suggests potential upside given management's impressive track record in integrating previous acquisitions (e.g. K+F). We estimate the identified merger synergies (of \$22.5m) could benefit margins by a further 30bps from now.

Historically, Meggitt has guided that it aims to achieve a 30-40bps pa margin improvement on average. Given that Meggitt has already achieved a 24.7% EBIT margin in FY11A, which is significantly higher than that achieved by its peers, we believe that further improvements are a testament to the underlying quality of the business, with sole-source positions on a number of programmes, strong execution and good pricing power (on parts that are mission critical but are of a relatively low value in relation to total cost of the aircraft).

However, it is also worth noting that because margins are already so high, further improvements have only a moderate impact on EPS (e.g. a 100bps margin improvement will only raise EPS by c4%), so EPS growth from now is likely to broadly track underlying sales growth.

## Potential for Further M&A

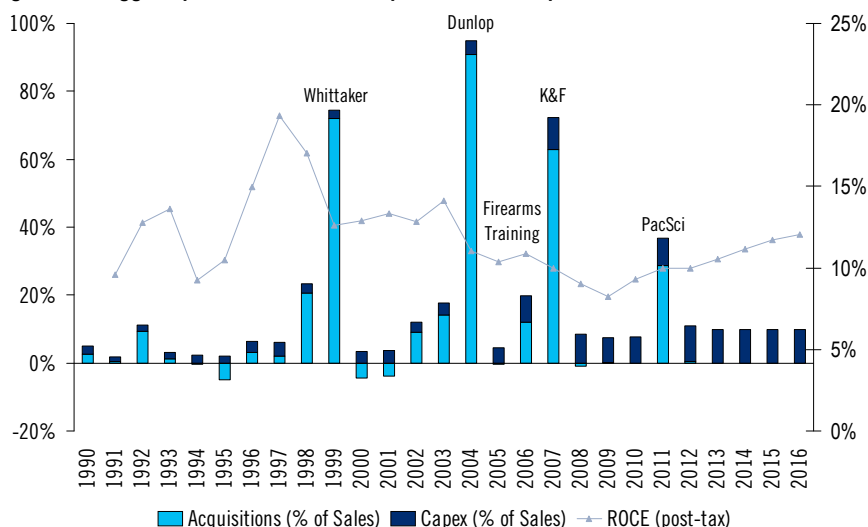
### Meggitt could supplement organic growth with acquisitions

Whilst Meggitt has not explicitly stated that it is looking to make acquisitions, historically, it has made a large acquisition every 3-4 years, the last being Pacific Scientific Aerospace (PacSci) for \$685m (from industrial conglomerate Danaher) announced January 2011 and before that K+F in 2007 (larger at £930m) and Dunlop Standard Aerospace Group in 2004 (c£700m).

Based on ND/EBITDA of 2.5x (vs. a projected 1.5x at 31 Dec 2012E), we estimate that Meggitt has c£460m of firepower for acquisitions, without issuing equity (as it did when it bought PacSci). Meggitt's current loan covenants stipulate  $\leq 3.5x$  ND/EBITDA and  $\geq 3.0x$  Interest Cover. We calculate that based on assumed acquisition multiples of 10-12x EV/EBIT (in line with MGGT's previous acquisition multiples and also in-line with the current average EV/EBIT rating for the civil aero sector) and a cost of debt of 6% (which is probably a conservative estimate), a £100m acquisition would be broadly c1% EPS accretive and that a £500m acquisition would be 4-7% EPS accretive.

We believe that Meggitt's acquisition track record has generally been good. For example the PacSci deal had both a good strategic rationale, with good product overlap (particularly in the smoke detection and fire prevention areas) and exposure to new growth programmes (e.g. 787), as well as a reasonable valuation at c8x current year EV/EBITDA and 8.4x forward EV/EBIT (vs. Meggitt's historical rating of c9x).

Figure 12. Meggitt's post-tax ROCE vs. Acquisitions and Capex as a % of Sales:1990-16E



Source: Company Reports and Citi Research Estimates

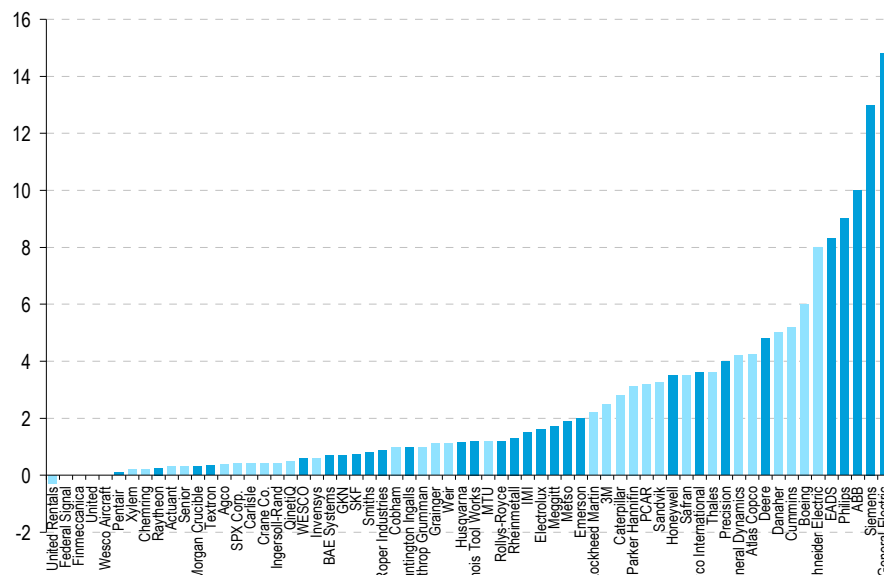
Figure 12 tracks Meggitt's post-tax ROCE, defined as NOPAT/Average Capital Employed (=Total Assets less Interest Bearing Liabilities) from 1990 vs. Capex and Acquisitions as a % of Sales. Although RoCE has been relatively volatile, we believe that this is more due to the broader economic cycle rather than due to impact of doing acquisitions, although it is clearly difficult to disaggregate the performance of a business once it has been acquired from that of the existing group. Despite its high EBIT margins (c25%), ROCE is relatively modest for Meggitt at c11% post-tax and 14% pre-tax, which reflects the company's significant investment requirements (capex and R&D total c10% of sales).

**Meggitt could itself be an attractive acquisition candidate**

Meggitt has long been the subject of M&A speculation<sup>3</sup>, and in our opinion strong free cash flow, a large installed base of aircraft, its position as sole source supplier of aircraft equipment on a large number of platforms and an attractive valuation could make MGGT a potential M&A target. However, buyers of Meggitt have been making this argument for almost a decade and the company has not been acquired...

...So why has Meggitt not been acquired already? We would note the following: 1) Meggitt's already very high margins leave limited scope for improvements or cost synergies for a potential acquirer unless that buyer simply wanted to expand their existing aerospace portfolio (e.g. the acquisition of Volvo Aerospace by GKN); 2) since 2008 there has been significant uncertainty over the outlook for US defence spending but visibility should improve in early 2013 after the sequestration deadline is passed (one way or the other); and 3) with a market capitalisation of £3.1bn and net debt of £788.4bn at 31 Dec 2011, Meggitt would be a relatively large acquisition to all but the largest companies.

**Figure 13. Funds potentially available for M&A at select European and US Capital Goods Companies (\$bn)**



Source: Company data and Citi Research

We have seen some signs of increased M&A activity across the sector. For example, Chemring announced that it had received an early stage bid approach in August this year by Carlyle, a private equity fund that has significant experience buying in the A&D space.

In September 2011, United Technologies acquired US-listed Goodrich for \$18.4bn enterprise value<sup>4</sup>. Goodrich was a competitor of Meggitt in a number of areas, including MGGT's core wheels and brakes business. UTX paid an exit multiple of 10.6x forward EV/EBITDA for Goodrich, which compares to Meggitt's current 2013E EV/EBITDA ratio of 7.5x. Applying Goodrich's takeout multiple to Meggitt would suggest a valuation of 600p per share. Historically, M&A deals in the sector have averaged c13x EV/EBIT (minimum 6.5x, maximum 15x), which would suggest a 50% premium to Meggitt's current share price.

<sup>3</sup> E.g. "M&A hopes fuel Meggitt as market retreats", The Telegraph, 19 September 2011.

<sup>4</sup> Source: United Technologies Investor Presentation, 22/9/11

**Target raised to 500p based on DCF;  
implies 13x P/E and 11.5x EV/EBIT on  
Citi's 13E forecasts**

## Target Price Raised to 500p

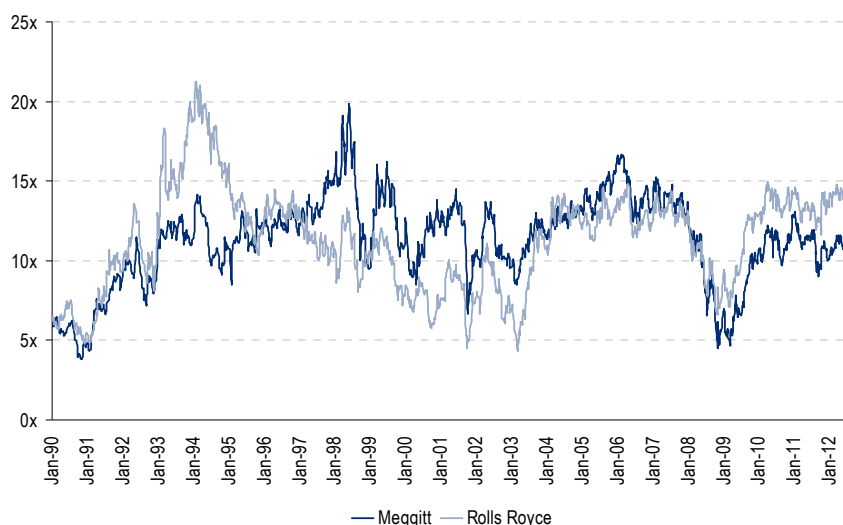
Whilst our 2012 and 2013 EPS forecasts are broadly unchanged, our 2014E EPS is up 4% vs. previously on account of higher sales and lower interest forecast than previously. Our 2012E-14E EPS forecasts are 3-7% ahead of consensus<sup>5</sup>. We have also introduced first time forecasts for 2015E and 2016E to reflect Meggitt's medium term organic sales growth targets and our margin improvement forecasts.

We view the recent pullback from Meggitt's recent share price high of 414p (1 May 2012) as an attractive buying opportunity for this high-quality civil aerospace name and raise our rating from Neutral to Buy with an updated one-year Target Price of 500p per share (=12.9x 2013E P/E and 11.5x 2013E EV/EBIT), which offers a 29% ETR based on yesterday's closing share price of 396p.

We now value Meggitt using a DCF, which is the same method that we use to value its civil aerospace peers, including MTU, Safran and Rolls Royce. We employ consistent assumptions across the sector – we believe that this approach better captures the different long-term capex and R&D assumptions. Our previous target price was based on 9x 2013E EV/EBIT, but since then Meggitt's civil aerospace peers have re-rated making its relative valuation look more attractive.

We believe that Meggitt looks attractive based on a range of valuation metrics.

**Figure 14. Meggitt vs. RR 12-month Forward Consensus P/E: 1990 - date**



Source: DataStream

Meggitt is currently trading on 10.2x 2013E P/E (on Citi forecasts), which is a 9-11% discount vs. its own historical average of 11.3x and the current average P/E rating of 11.7x of its European civil aerospace peers. Our Target Price for Meggitt implies P/E of c13x 2013E, reflecting strong EPS growth prospects from now (11% CAGR 2011A-2016E) due to a combination of good organic sales growth and margin expansion.

<sup>5</sup> Consensus source: I/B/E/S

Meggitt's P/E also compares favourably with that of Buy-rated UK peer Rolls Royce, which is arguably the most relevant comparator. Meggitt is currently trading on 10.2x 2013E P/E vs. 12.1x for Rolls Royce (a 16% discount) and our Target Prices imply 12.9x and 14.4x 2013E P/E, respectively (a 10% discount). Rolls Royce offers marginally higher EPS growth (13% CAGR 2011A-2016E vs. 11% for Meggitt) driven by margin expansion in its Civil Aerospace business and a stronger balance sheet. However, we would argue that Meggitt warrants some P/E premium over Rolls Royce on account of being a more likely M&A candidate. Although Rolls Royce's balance sheet is stronger (and it is therefore cheaper on an EV/EBIT basis than Meggitt), we believe that Rolls Royce is likely to maintain an inefficient net cash balance sheet to meet future investment requirements and to attract customers to long-term service agreements. Meggitt also has more defence exposure than Rolls Royce.

Figure 15. Meggitt – Discounted Cash Flow (£ millions)

	2012E	2013E	2014E	2015E	2016E	2017E	TV
Sales	1,633	1,750	1,877	2,017	2,171	2,342	2,391
Growth		7.1%	7.3%	7.5%	7.7%	7.9%	2.1%
o/w Organic	7.3%	7.1%	7.3%	7.5%	7.7%	7.9%	2.1%
Civil OE	8.5%	8.0%	8.0%	8.0%	8.0%	8.0%	3.0%
Civil Aftermarket	3.5%	9.0%	9.0%	9.0%	9.0%	9.0%	3.0%
Military	6.0%	2.0%	2.0%	2.0%	2.0%	2.0%	0.0%
Energy & Other	25.0%	15.0%	15.0%	15.0%	15.0%	15.0%	3.0%
Organic growth*	7.3%	7.1%	7.3%	7.5%	7.7%	7.9%	2.1%
EBITA	400	435	480	526	570	614	598
Margin	24.5%	24.8%	25.6%	26.1%	26.2%	26.2%	25.0%
Incremental margin		30%	36%	33%	28%	26%	
Taxation	-96	-104	-115	-126	-137	-147	-143
<b>NOPAT</b>	<b>304</b>	<b>330</b>	<b>365</b>	<b>400</b>	<b>433</b>	<b>466</b>	<b>454</b>
Capex	-170	-171	-183	-197	-212	-229	-128
% of Sales	-10.4%	-9.8%	-9.8%	-9.8%	-9.8%	-9.8%	-5.4%
Depreciation & Amortisation	78	95	101	108	116	126	128
% of Sales	4.8%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%
Capex/Depreciation	2.2x	1.8x	1.8x	1.8x	1.8x	1.8x	1.0x
Working Capital	-49	-17	-19	-20	-22	-70	0
% of Sales	-3.0%	-3.0%	-3.0%	-3.0%	-3.0%	-3.0%	0.0%
<b>Free Cash Flow</b>	<b>163</b>	<b>237</b>	<b>264</b>	<b>291</b>	<b>316</b>	<b>293</b>	<b>454</b>
Enterprise Value	5,014	640p					
Net Debt	-788	-100p					
Pension Deficit	-317	-40p					
<b>Equity Value</b>	<b>3,909</b>	<b>500p</b>					

Source: Citi Research

Our DCF valuation is based on a set of conservative assumptions including an 8.7% WACC, 2.1% terminal growth and a 25% terminal margin (vs. 24.7% achieved in 2011A). Our detailed DCF model is shown above. A 50 bps change in our WACC assumption impacts Meggitt's DCF value by 10-12% while a 50 bps change in the terminal growth assumption has a c8% impact.

## Financial Statements

Figure 16. Meggitt - Profit & Loss Account, 2005A-2016E (£ millions)

	2005A	2006A	2007A	2008A	2009A	2010A	2011A	2012E	2013E	2014E	2015E	2016E
Aircraft Braking Systems	na	na	na	na	319	310	321	337	357	378	401	425
Control Systems	na	na	na	na	182	183	202	222	235	249	264	280
Polymers & Composites	na	na	na	na	148	156	171	197	211	225	241	258
Sensing Systems	na	na	na	na	193	208	234	81	89	98	107	118
Equipment Group	na	na	na	na	309	305	528	798	859	927	1,004	1,091
<b>Sales</b>	<b>616</b>	<b>670</b>	<b>878</b>	<b>1,163</b>	<b>1,151</b>	<b>1,162</b>	<b>1,455</b>	<b>1,633</b>	<b>1,750</b>	<b>1,877</b>	<b>2,017</b>	<b>2,171</b>
Growth	29%	9%	31%	32%	-1%	1%	25%	12%	7%	7%	7%	8%
Organic Growth	7%	10%	11%	10%	-13%	-1%	12%	7%	7%	7%	7%	8%
Aircraft Braking Systems	na	na	na	na	116	121	120	122	133	153	173	189
Control Systems	na	na	na	na	43	45	48	57	60	64	67	71
Polymers & Controls	na	na	na	na	30	28	32	38	41	44	47	50
Sensing Systems	na	na	na	na	33	40	43	13	14	16	17	19
Equipment Group	na	na	na	na	64	70	116.8	171	187	205	221	241
<b>Clean EBITA</b>	<b>131</b>	<b>149</b>	<b>216</b>	<b>296</b>	<b>286</b>	<b>304</b>	<b>360</b>	<b>400</b>	<b>435</b>	<b>480</b>	<b>526</b>	<b>570</b>
growth	28%	14%	45%	37%	-3%	6%	18%	11%	9%	10%	10%	8%
Aircraft Braking Systems	na	na	na	na	36.4%	39.0%	37.4%	36.2%	37.2%	40.4%	43.2%	44.5%
Control Systems	na	na	na	na	23.9%	24.5%	23.8%	25.5%	25.5%	25.5%	25.5%	25.5%
Polymers & Controls	na	na	na	na	20.3%	18.2%	18.5%	19.3%	19.3%	19.3%	19.3%	19.3%
Sensing Systems	na	na	na	na	16.9%	19.0%	18.5%	16.1%	16.1%	16.1%	16.1%	16.1%
Equipment Group	na	na	na	na	20.7%	23.1%	22.1%	21.4%	21.8%	22.1%	22.1%	22.1%
<b>margin</b>	<b>21.2%</b>	<b>22.3%</b>	<b>24.6%</b>	<b>25.5%</b>	<b>24.9%</b>	<b>26.1%</b>	<b>24.7%</b>	<b>24.5%</b>	<b>24.8%</b>	<b>25.6%</b>	<b>26.1%</b>	<b>26.2%</b>
Amortisation/Exceptionals	-29	-6	-74	-124	-53	-84	-97	-82	-83	-75	-75	-75
<b>EBIT</b>	<b>101</b>	<b>143</b>	<b>143</b>	<b>172</b>	<b>233</b>	<b>220</b>	<b>263</b>	<b>318</b>	<b>351</b>	<b>405</b>	<b>451</b>	<b>495</b>
Net Interest	-14	-17	-37	-53	-52	-48	-37	-37	-34	-30	-25	-19
Associates	0	0	0	0	0	0	0	0	0	0	0	0
Discontinued operations	0	0	0	0	0	0	0	0	0	0	0	0
<b>PBT</b>	<b>87</b>	<b>127</b>	<b>105</b>	<b>119</b>	<b>181</b>	<b>173</b>	<b>226</b>	<b>281</b>	<b>317</b>	<b>375</b>	<b>426</b>	<b>476</b>
<b>Clean PBT</b>	<b>116</b>	<b>133</b>	<b>179</b>	<b>243</b>	<b>234</b>	<b>256</b>	<b>323</b>	<b>363</b>	<b>401</b>	<b>450</b>	<b>501</b>	<b>551</b>
Taxation	-22	-32	-16	-20	-42	-34	-41	-67	-76	-90	-102	-114
Effective Tax Rate	25%	26%	15%	17%	23%	20%	18%	24%	24%	24%	24%	24%
Underlying Taxation	-30	-36	-49	-68	-63	-64	-78	-87	-96	-108	-120	-132
Underlying Tax Rate	26%	27%	27%	28%	27%	25%	24%	24%	24%	24%	24%	24%
Minority interests	0	0	0	0	0	0	0	0	0	0	0	0
<b>Net Income</b>	<b>66</b>	<b>94</b>	<b>89</b>	<b>99</b>	<b>139</b>	<b>139</b>	<b>185</b>	<b>214</b>	<b>241</b>	<b>285</b>	<b>324</b>	<b>362</b>
<b>Clean Net Income</b>	<b>86</b>	<b>97</b>	<b>130</b>	<b>175</b>	<b>171</b>	<b>192</b>	<b>246</b>	<b>276</b>	<b>304</b>	<b>342</b>	<b>381</b>	<b>419</b>
Average Ordinary Shares	431	507	587	662	676	692	770	782	787	788	788	788
Average Diluted Shares	433	511	590	663	677	699	776	788	793	795	795	795
Basic EPS	15.2p	18.6p	15.2p	15.0p	20.5p	20.1p	24.0p	27.3p	30.7p	36.1p	41.1p	45.9p
Diluted EPS	15.1p	18.5p	15.1p	14.9p	20.5p	19.8p	23.8p	27.1p	30.4p	35.9p	40.7p	45.5p
<b>Clean EPS - basic</b>	<b>20.0p</b>	<b>19.1p</b>	<b>22.1p</b>	<b>26.5p</b>	<b>25.3p</b>	<b>27.8p</b>	<b>31.9p</b>	<b>35.3p</b>	<b>38.7p</b>	<b>43.4p</b>	<b>48.3p</b>	<b>53.1p</b>
growth	15%	-4%	16%	20%	-4%	10%	15%	11%	10%	12%	11%	10%
<b>DPS</b>	<b>6.60p</b>	<b>7.40p</b>	<b>8.20p</b>	<b>8.45p</b>	<b>8.45p</b>	<b>9.20p</b>	<b>10.50p</b>	<b>11.55p</b>	<b>12.71p</b>	<b>13.98p</b>	<b>15.37p</b>	<b>16.91p</b>

Source: Company Reports and Citi Research Estimates

Figure 17. Meggitt - Cash Flow Statement, 2005A-2016E (£ millions)

	2005A	2006A	2007A	2008A	2009A	2010A	2011A	2012E	2013E	2014E	2015E	2016E
EBITA	130.6	149.2	216.3	296.4	286.2	303.7	359.5	400.2	434.6	479.9	525.9	569.8
Depreciation & Amortisation	17.9	24.1	33.4	47.0	57.2	60.7	69.0	78.2	94.7	101.2	108.4	116.4
<b>EBITDA</b>	<b>148.5</b>	<b>173.3</b>	<b>249.7</b>	<b>343.4</b>	<b>343.4</b>	<b>364.4</b>	<b>428.5</b>	<b>478.4</b>	<b>529.3</b>	<b>581.2</b>	<b>634.4</b>	<b>686.2</b>
margin	24.1%	25.9%	28.4%	29.5%	29.8%	31.4%	29.4%	29.3%	30.3%	31.0%	31.5%	31.6%
Tax Paid	-21.2	-19.5	-23.4	-30.3	-38.9	-25.7	-42.6	-62.4	-71.1	-84.9	-97.2	-109.1
Interest Paid	-13.8	-16.5	-29.8	-46.2	-42.0	-38.1	-30.7	-29.0	-26.0	-22.0	-17.0	-11.0
Working Capital	-4.1	-11.8	-34.9	-25.5	20.1	-10.0	-6.5	-49.0	-17.5	-18.8	-20.2	-21.7
Other	-17.1	-23.0	-4.7	-39.0	-43.7	-38.6	-43.3	-35.9	-48.2	-40.0	-40.0	-40.0
<b>Operating Cash Flow</b>	<b>92.3</b>	<b>102.5</b>	<b>156.9</b>	<b>202.4</b>	<b>238.9</b>	<b>252.0</b>	<b>305.4</b>	<b>302.0</b>	<b>366.5</b>	<b>415.5</b>	<b>460.0</b>	<b>504.3</b>
Capex	-27.2	-52.5	-83.7	-99.9	-83.9	-89.4	-119.0	-170.2	-170.9	-183.3	-197.0	-212.1
Capex/Depreciation	1.5x	2.2x	2.5x	2.1x	1.5x	1.5x	1.7x	2.2x	1.8x	1.8x	1.8x	1.8x
<b>Free Cash Flow</b>	<b>65.1</b>	<b>50.0</b>	<b>73.2</b>	<b>102.5</b>	<b>155.0</b>	<b>162.6</b>	<b>186.4</b>	<b>131.8</b>	<b>195.6</b>	<b>232.1</b>	<b>263.0</b>	<b>292.2</b>
Per Share	15.1p	9.9p	12.5p	15.5p	22.9p	23.5p	24.2p	16.9p	24.9p	29.4p	33.4p	37.1p
Conversion	50%	34%	34%	35%	54%	54%	52%	33%	45%	48%	50%	51%
Net Acquisitions/Disposals	1.4	-80.8	-552.1	10.7	-0.7	0.0	-417.6	-9.5	0.0	0.0	0.0	0.0
Equity Issued	2.8	3.7	430.0	2.1	1.3	4.2	249.5	0.0	0.0	0.0	0.0	0.0
Dividends Paid	-26.0	-32.0	-35.6	-35.8	-29.6	-29.7	-48.4	-84.5	-92.2	-103.0	-113.5	-124.8
Exchange differences	3.3	-3.3	-5.3	-312.0	115.5	-36.3	-13.9	14.9	0.0	0.0	0.0	0.0
Other	-31.5	23.0	-371.9	0.0	-2.2	-13.6	-23.0	0.0	0.0	0.0	0.0	0.0
<b>Change in Net Debt</b>	<b>15.1</b>	<b>-39.4</b>	<b>-461.7</b>	<b>-232.5</b>	<b>239.3</b>	<b>87.2</b>	<b>-67.0</b>	<b>52.7</b>	<b>103.4</b>	<b>129.1</b>	<b>149.5</b>	<b>167.4</b>
Opening Net Debt/(Cash)	329.4	314.3	353.7	815.4	1,047.9	808.6	721.4	788.4	735.7	632.3	503.2	353.7
<b>Closing Net Debt/(Cash)</b>	<b>314.3</b>	<b>353.7</b>	<b>815.4</b>	<b>1,047.9</b>	<b>808.6</b>	<b>721.4</b>	<b>788.4</b>	<b>735.7</b>	<b>632.3</b>	<b>503.2</b>	<b>353.7</b>	<b>186.3</b>

Source: Company Reports and Citi Research Estimates



## Meggitt Plc

### Company description

MGGT is a UK-based engineering company which designs and manufactures components and systems, predominantly for Aerospace & Defence end markets (86% of group revenue). Key products include aircraft wheels & brakes. The company also has leading positions on environment control and fire detection systems within aircraft, sophisticated sensors, fire arms training systems and combat support equipment. Some of Meggitt's key customers include the US DoD, the UK MoD, defence prime contractors, commercial & business aircraft manufacturers and aero-engine makers.

### Investment strategy

We rate Meggitt Buy. Meggitt offers a number of investment attractions including a significant civil aerospace aftermarket exposure, high entry barriers both in civil and military aircraft equipment markets, sole-source positions on a number of aircraft platforms and last, but not least, a fast growing Energy business. We are bullish on Meggitt's earnings growth prospects driven by strong organic growth and potential margin improvement. We see further upside to Meggitt's already high c25% margins driven by a recovery in high-margin civil aftermarket revenues, further cost savings and merger synergies from the PSA acquisition. At 1H12 results, Meggitt announced a new cost saving initiative aimed at generating £12m of annualised EBIT by 2016E (c70 bps margin improvement), which we believe will be successfully achieved given Meggitt's impressive track record in cost control and merger synergies.

### Valuation

Our 12-month target price of 500p is based DCF in which we apply a set of conservative assumptions including an 8.7% WACC, 2.1% terminal growth and a 25% terminal margin (vs. 24.7% achieved in 2011A). Our target price implies a 2013E P/E of c13x vs. its long-term average of c11x reflecting Meggitt's strong earnings growth prospects. The implied 2013E EV/EBIT at our target is 11.5x, which is above its long-term historical average of 9x reflecting strong growth prospects in civil aerospace and energy end markets.

### Risks

The key risks to our investment thesis on Meggitt are: (1) Pace / timing of Civil Aerospace recovery could disappoint, particularly in the business jet market where the outlook is the most uncertain. (2) Approximately 40% of group revenue comes from defence end markets where long-term spending outlook is clouded by rising fiscal deficits. (3) Meggitt has significantly higher financial gearing than its A&D peers. However, there is substantial covenant headroom and no refinancing requirements until at least 2016E. (4) Meggitt has relied heavily on acquisitions to drive growth. This strategy carries with it the risks of overpaying for acquisitions or failing to integrate acquired companies which could destroy shareholder value. (5) With 75% of its revenue denominated in US\$, Meggitt carries a significant FX translational exposure. If the UK£ were to strengthen against the US\$ it could adversely impact Meggitt's reported earnings. We estimate that every 5 \$ cents movement in the spot rate impacts underlying PBT by £9m.

## Rolls Royce

(RR.L; £8.32; 1)

### Valuation

Our 980p target price is based on DCF, which includes a 9.7% WACC, a 2.6% terminal growth and a 13.5% long term margin assumption. Our target implies 10.6x 2013E EV/EBIT and 14.4x 2013E P/E, vs. RR's historical averages of 10.6x and 11.4x, respectively, reflecting strong earnings growth prospects driven by margin improvements, higher returns, reduced cyclicalities and a much stronger balance sheet than in the past. The implied EV/Sales at our target price is 1.32x 2013E (vs. our long-run margin assumption of 13.5%).

### Risks

The key risks to our investment thesis on Rolls Royce are: (1) exposure to the civil aerospace downturn, particularly potential deferrals/cancellation of existing orders and retirement of engines in the current fleet as airlines cut capacity, (2) if the market fails to recognise improvements in RR's business model further multiple compression may occur, as has been the case in previous cycles, (3) vendor financing may increase in a downturn, lowering cash flows, (4) transactional foreign exchange risk, (5) exposure to programme delays on new aircraft (e.g. A400M, Boeing 787, A350), (6) non civil-aero businesses may also prove cyclical, particularly the Marine division; energy may continue to be a drag on group results, and (7) medium-term R&D expenditure may increase due to the development of the A350 XWB engine and in the longer term the next generation narrow body aircraft.

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.

## Appendix A-1

### Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

### IMPORTANT DISCLOSURES

#### Meggitt Plc (MGGT.L)

##### Ratings and Target Price History Fundamental Research

Analyst: Jeremy Bragg

Covered since June 25 2010



	Date	Rating	Target Price	Closing Price
1	25-Jun-10	*1M	*4.00	3.10
2	19-Jan-11	1M	*4.25	3.57
3	3-Aug-11	1M	*4.45	3.80

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	7-Sep-11	1M	*4.05	3.28
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	4.05	3.40

	Date	Rating	Target Price	Closing Price
7	10-Nov-11	*2	4.05	3.70
8	20-Dec-11	2	*3.70	3.50
9	8-Mar-12	2	*4.00	3.99

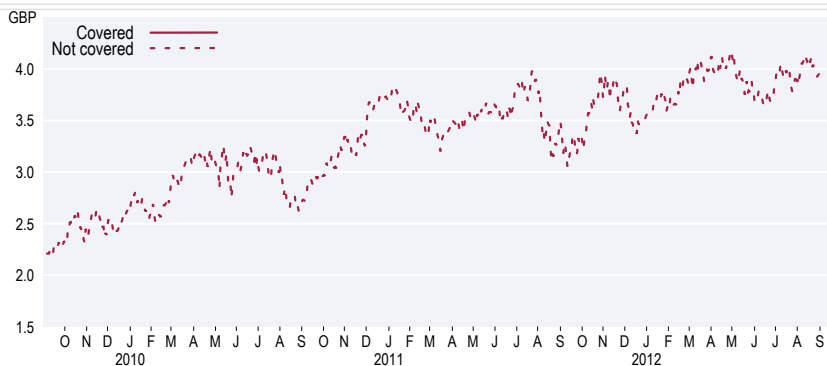
Rating/target price changes above reflect Eastern Standard Time

#### Meggitt Plc (MGGT.L)

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

Analyst: Jeremy Bragg

Covered since June 25 2010



\* Indicates change

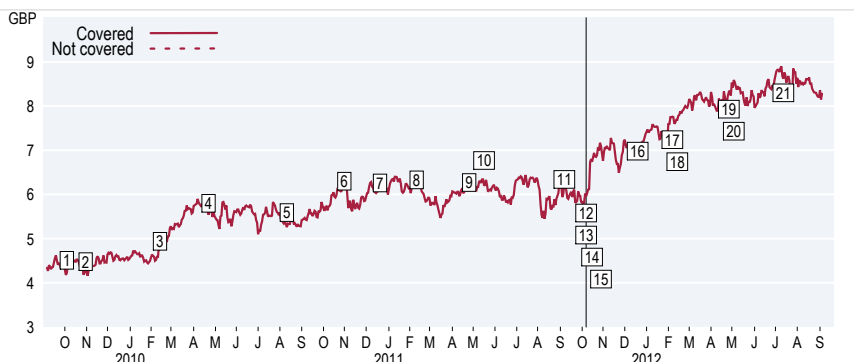
Rating/target price changes above reflect Eastern Standard Time

## Rolls Royce (RR.L)

### Ratings and Target Price History

### Fundamental Research

Analyst: Jeremy Bragg



	Date	Rating	Target Price	Closing Price
1	5-Oct-09	*1M	*5.10	4.22
2	30-Oct-09	1M	*5.16	4.24
3	12-Feb-10	*2M	5.16	4.76
4	22-Apr-10	2M	*5.24	5.54
5	11-Aug-10	2M	*5.81	5.26
6	1-Nov-10	2M	*5.87	6.30
7	21-Dec-10	*1M	*7.32	6.26

\* Indicates change

	Date	Rating	Target Price	Closing Price
8	10-Feb-11	1M	*7.41	6.26
9	26-Apr-11	1M	*7.53	6.23
10	17-May-11	1M	*7.23	6.20
11	7-Sep-11	1M	*7.14	6.25
12	7-Oct-11	Stock rating system changed		
13	7-Oct-11	*1	7.14	5.96
14	17-Oct-11	1	*7.82	6.74

	Date	Rating	Target Price	Closing Price
15	28-Oct-11	1	*7.90	7.09
16	20-Dec-11	1	*8.09	7.10
17	7-Feb-12	1	*8.29	7.76
18	14-Feb-12	1	*8.59	7.69
19	26-Apr-12	1	*8.70	8.32
20	3-May-12	1	*9.70	8.59
21	12-Jul-12	1	*9.80	8.62

Rating/target price changes above reflect Eastern Standard Time

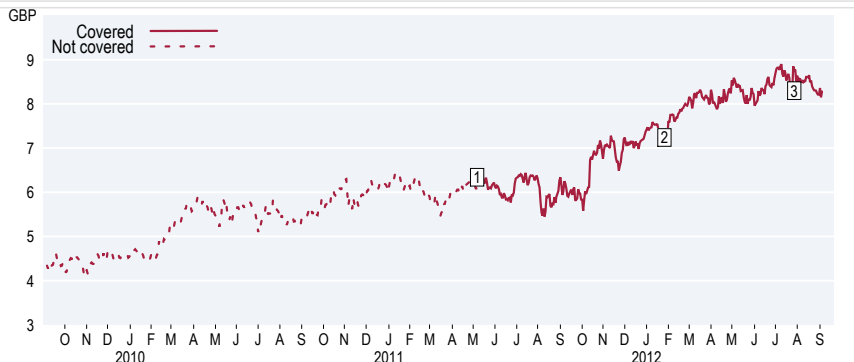
## Rolls Royce (RR.L)

### 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 MP	-	6.17

\* Indicates change

	Date	Rating	Target Price	Closing Price
2	26-Jan-12	*REM MP	-	7.42

	Date	Rating	Target Price	Closing Price
3	27-Jul-12	*ADD MP	-	8.76

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Inc. or its affiliates has received compensation for investment banking services provided within the past 12 months from Rolls Royce.

Citigroup Global Markets Inc. or its affiliates expects to receive or intends to seek, within the next three months, compensation for investment banking services from Rolls Royce.

Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from Rolls Royce in the past 12 months.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as investment banking client(s): Rolls Royce.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: Rolls Royce.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, non-securities-related: Rolls Royce.

Analysts' compensation is determined based upon activities and services intended to benefit the investor clients of Citigroup Global Markets Inc. and its affiliates ("the Firm"). Like all Firm employees, analysts receive compensation that is impacted by overall firm profitability which includes investment banking revenues.

The Firm is a market maker in the publicly traded equity securities of Rolls Royce.

For important disclosures (including copies of historical disclosures) regarding the companies that are the subject of this Citi Research product ("the Product"), please contact Citi Research, 388 Greenwich Street, 28th Floor, New York, NY, 10013, Attention: Legal/Compliance [E6WYB6412478]. In addition, the same important disclosures, with the exception of the Valuation and Risk assessments and historical disclosures, are contained on the Firm's disclosure website at [https://www.citivelocity.com/cvr/eppublic/citi\\_research\\_disclosures](https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures). Valuation and Risk assessments can be found in the text of the most recent research note/report regarding the subject company. Historical disclosures (for up to the past three years) will be provided upon request.

### Citi Research Ratings Distribution

<i>Data current as of 30 Jun 2012</i>	<b>12 Month Rating</b>			<b>Relative Rating</b>		
	<b>Buy</b>	<b>Hold</b>	<b>Sell</b>	<b>Buy</b>	<b>Hold</b>	<b>Sell</b>
Citi Research Global Fundamental Coverage	53%	37%	10%	10%	80%	10%
% of companies in each rating category that are investment banking clients	44%	43%	40%	48%	43%	45%

#### Guide to Citi Research Fundamental Research Investment Ratings:

Citi Research stock recommendations include an investment rating and an optional risk rating to highlight high risk stocks.

**Risk rating** takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned.

**Investment Ratings:** Citi Research investment ratings are Buy, Neutral and Sell. Our ratings are a function of analyst expectations of expected total return ("ETR") and risk. ETR is the sum of the forecast price appreciation (or depreciation) plus the dividend yield for a stock within the next 12 months. The Investment rating definitions are: Buy (1) ETR of 15% or more or 25% or more for High risk stocks; and Sell (3) for negative ETR. Any covered stock not assigned a Buy or a Sell is a Neutral (2). For stocks rated Neutral (2), if an analyst believes that there are insufficient valuation drivers and/or investment catalysts to derive a positive or negative investment view, they may elect with the approval of Citi Research management not to assign a target price and, thus, not derive an ETR. Analysts may place covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and / or trading in the company's securities (e.g. trading suspension). As soon as practically possible, the analyst will publish a note re-establishing a rating and investment thesis. To satisfy regulatory requirements, we correspond Under Review and Neutral to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.

**Relative three-month ratings:** Citi Research may also assign a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the geographic and industry sector over a 3 month period. The relative call may highlight a specific near-term catalyst or event impacting the company or the market that is anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) will indicate the most and least preferred stocks in the universe of stocks under consideration, explaining the basis for this short-term view. This three-month view may be different from and does not affect a stock's fundamental equity rating, which reflects a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most preferred calls correspond to a buy recommendation and least preferred calls correspond to a sell recommendation. Any stock not assigned to a most preferred or least preferred call is considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we correspond NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we do not consider NRR to be a recommendation.

Prior to October 8, 2011, the firm's stock recommendation system included a risk rating and an investment rating. **Risk ratings**, which took into account both price volatility and fundamental criteria, were: Low (L), Medium (M), High (H), and Speculative (S). **Investment Ratings** of Buy, Hold and Sell were a function of the Citi Research expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating. Additionally, analysts could have placed covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and/or trading in the company's securities (e.g. trading suspension). Stocks placed "Under Review" were monitored daily by management and as practically possible, the analyst published a note re-establishing a rating and investment thesis. For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings were: Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return). For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings were: Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

#### NON-US RESEARCH ANALYST DISCLOSURES

Non-US research analysts who have prepared this report (i.e., all research analysts listed below other than those identified as employed by Citigroup Global Markets Inc.) are not registered/qualified as research analysts with FINRA. Such research analysts may not be associated persons of the member organization and therefore may not be subject to the NYSE Rule 472 and NASD Rule 2711 restrictions on communications with a subject company, public appearances and trading securities held by a research analyst account. The legal entities employing the authors of this report are listed below:

Citigroup Global Markets Ltd	Jeremy Bragg
Citigroup Global Markets India Private Limited	Devang Doshi

#### OTHER DISCLOSURES

The subject company's share price set out on the front page of this Product is quoted as at 06 September 2012 08:24 AM on the issuer's primary market.

Citigroup Global Markets Inc. and/or its affiliates has a significant financial interest in relation to Rolls Royce. (For an explanation of the determination of significant financial interest, please refer to the policy for managing conflicts of interest which can be found at [www.citiVelocity.com](http://www.citiVelocity.com).)

For securities recommended in the Product in which the Firm is not a market maker, the Firm is a liquidity provider in the issuers' financial instruments and may act as principal in connection with such transactions. The Firm is a regular issuer of traded financial instruments linked to securities that may have been recommended in the Product. The Firm regularly trades in the securities of the issuer(s) discussed in the Product. The Firm may engage in securities transactions in a manner inconsistent with the Product and, with respect to securities covered by the Product, will buy or sell from customers on a principal basis.

Securities recommended, offered, or sold by the Firm: (i) are not insured by the Federal Deposit Insurance Corporation; (ii) are not deposits or other obligations of any insured depository institution (including Citibank); and (iii) are subject to investment risks, including the possible loss of the principal amount invested. Although information has been obtained from and is based upon sources that the Firm believes to be reliable, we do not guarantee its accuracy and it may be incomplete and condensed. Note, however, that the Firm has taken all reasonable steps to determine the accuracy and completeness of the disclosures made in the Important Disclosures section of the Product. The Firm's research department has received assistance from the subject company(ies) referred to in this Product including, but not limited to, discussions with management of the subject company(ies). Firm policy prohibits research analysts from sending draft research to subject companies. However, it should be presumed that the author of the Product has had discussions with the subject company to ensure factual accuracy prior to publication. All opinions, projections and estimates constitute the judgment of the author as of the date of the Product and these, plus any other information contained in the Product, are subject to change without notice. Prices and availability of financial instruments also are subject to change without notice. Notwithstanding other departments within the Firm advising the companies discussed in this Product, information obtained in such role is not used in the preparation of the Product. Although Citi Research does not set a predetermined frequency for publication, if the Product is a fundamental research report, it is the intention of Citi Research to provide research coverage of the/those issuer(s) mentioned therein, including in response to news affecting this issuer, subject to applicable quiet periods and capacity constraints. The Product is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in the Product must take into account existing public information on such security or any registered prospectus.

Investing in non-U.S. securities, including ADRs, may entail certain risks. The securities of non-U.S. issuers may not be registered with, nor be subject to the reporting requirements of the U.S. Securities and Exchange Commission. There may be limited information available on foreign securities. Foreign companies are generally not subject to uniform audit and reporting standards, practices and requirements comparable to those in the U.S. Securities of some foreign companies may be less liquid and their prices more volatile than securities of comparable U.S. companies. In addition, exchange rate movements may have an adverse effect on the value of an investment in a foreign stock and its corresponding dividend payment for U.S. investors. Net dividends to ADR investors are estimated, using withholding tax rates conventions, deemed accurate, but investors are urged to consult their tax advisor for exact dividend computations. Investors who have received the Product from the Firm may be prohibited in certain states or other jurisdictions from purchasing securities mentioned in the Product from the Firm. Please ask your Financial Consultant for additional details. Citigroup Global Markets Inc. takes responsibility for the Product in the United States. Any orders by US investors resulting from the information contained in the Product may be placed only through Citigroup Global Markets Inc.

**Important Disclosures for Morgan Stanley Smith Barney LLC Customers:** Morgan Stanley & Co. LLC (Morgan Stanley) research reports may be available about the companies that are the subject of this Citi Research research report. Ask your Financial Advisor or use [smithbarney.com](http://smithbarney.com) to view any available Morgan Stanley research reports in addition to Citi Research research reports.

Important disclosure regarding the relationship between the companies that are the subject of this Citi Research research report and Morgan Stanley Smith Barney LLC and its affiliates are available at the Morgan Stanley Smith Barney disclosure website at [www.morganstanleysmithbarney.com/researchdisclosures](http://www.morganstanleysmithbarney.com/researchdisclosures).

For Morgan Stanley and Citigroup Global Markets, Inc. specific disclosures, you may refer to [www.morganstanley.com/researchdisclosures](http://www.morganstanley.com/researchdisclosures) and [https://www.citivelocity.com/cvr/eppublic/citi\\_research\\_disclosures](https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures).

This Citi Research research report has been reviewed and approved on behalf of Morgan Stanley Smith Barney LLC. This review and approval was conducted by the same person who reviewed this research report on behalf of Citi Research. This could create a conflict of interest.

**The Citigroup legal entity that takes responsibility for the production of the Product is the legal entity which the first named author is employed by.** The Product is made available in **Australia** through Citi Global Markets Australia Pty Ltd. (ABN 64 003 114 832 and AFSL No. 240992), participant of the ASX group and regulated by the Australian Securities & Investments Commission. Citigroup Centre, 2 Park Street, Sydney, NSW 2000. The Product is made available in Australia to Private Banking wholesale clients through Citigroup Pty Limited (ABN 88 004 325 080 and AFSL 238098). Citigroup Pty Limited provides all financial product advice to Australian Private Banking wholesale clients through bankers and relationship managers. If there is any doubt about the suitability of investments held in Citigroup Private Bank accounts, investors should contact the Citigroup Private Bank in Australia. Citigroup companies may compensate affiliates and their representatives for providing products and services to clients. The Product is made available in **Brazil** by Citigroup Global Markets Brasil - CCTVM SA, which is regulated by CVM - Comissão de Valores Mobiliários, BACEN - Brazilian Central Bank, APIMEC - Associação dos Analistas e Profissionais de Investimento do Mercado de Capitais and ANBID - Associação Nacional dos Bancos de Investimento. Av. Paulista, 1111 - 11º andar - CEP. 01311920 - São Paulo - SP. If the Product is being made available in certain provinces of **Canada** by Citigroup Global Markets (Canada) Inc. ("CGM Canada"), CGM Canada has approved the Product. Citigroup Place, 123 Front Street West, Suite 1100, Toronto, Ontario M5J 2M3. This product is available in **Chile** through Banchile Corredores de Bolsa S.A., an indirect subsidiary of Citigroup Inc., which is regulated by the Superintendencia de Valores y Seguros. Agustinas 975, piso 2, Santiago, Chile. The Product is made available in **France** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. 1-5 Rue Paul Cézanne, 8ème, Paris, France. The Product is distributed in **Germany** by Citigroup Global Markets Deutschland AG ("CGMD"), which is regulated by Bundesanstalt fuer Finanzdienstleistungsaufsicht (BaFin). CGMD, Reuterweg 16, 60323 Frankfurt am Main. Research which relates to "securities" (as defined in the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong)) is issued in **Hong Kong** by, or on behalf of, Citigroup Global Markets Asia Limited which takes full responsibility for its content. Citigroup Global Markets Asia Ltd. is regulated by Hong Kong Securities and Futures Commission. If the Research is made available through Citibank, N.A., Hong Kong Branch, for its clients in Citi Private Bank, it is made available by Citibank N.A., Citibank Tower, Citibank Plaza, 3 Garden Road, Hong Kong. Citibank N.A. is regulated by the Hong Kong Monetary Authority. Please contact your Private Banker in Citibank N.A., Hong Kong, Branch if you have any queries on or any matters arising from or in connection with this document. The Product is made available in **India** by Citigroup Global Markets India Private Limited, which is regulated by Securities and Exchange Board of India. Bakhtawar, Nariman Point, Mumbai 400-021. The Product is made available in **Indonesia** through PT Citigroup Securities Indonesia. 5/F, Citibank Tower, Bapindo Plaza, Jl. Jend. Sudirman Kav. 54-55, Jakarta 12190. Neither this Product nor any copy hereof may be distributed in Indonesia or to any Indonesian citizens wherever they are domiciled or to Indonesian residents except in compliance with applicable capital market laws and regulations. This Product is not an offer of securities in Indonesia. The securities referred to in this Product have not been registered with the Capital Market and Financial Institutions Supervisory Agency (BAPEPAM-LK) pursuant to relevant capital market laws and regulations, and may not be offered or sold within the territory of the Republic of Indonesia or to Indonesian citizens through a public offering or in circumstances which constitute an offer within the meaning of the Indonesian capital market laws and regulations. The Product is made available in **Israel** through Citibank NA,



regulated by the Bank of Israel and the Israeli Securities Authority. Citibank, N.A. Platinum Building, 21 Ha'arba'ah St, Tel Aviv, Israel. The Product is made available in **Italy** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. Via dei Mercanti, 12, Milan, 20121, Italy. The Product is made available in **Japan** by Citigroup Global Markets Japan Inc. ("CGMJ"), which is regulated by Financial Services Agency, Securities and Exchange Surveillance Commission, Japan Securities Dealers Association, Tokyo Stock Exchange and Osaka Securities Exchange. Shin-Marunouchi Building, 1-5-1 Marunouchi, Chiyoda-ku, Tokyo 100-6520 Japan. If the Product was distributed by SMBC Nikko Securities Inc. it is being so distributed under license. In the event that an error is found in an CGMJ research report, a revised version will be posted on the Firm's Citi Velocity website. If you have questions regarding Citi Velocity, please call (81 3) 6270-3019 for help. The Product is made available in **Korea** by Citigroup Global Markets Korea Securities Ltd., which is regulated by the Financial Services Commission, the Financial Supervisory Service and the Korea Financial Investment Association (KOFIA). Citibank Building, 39 Da-dong, Jung-gu, Seoul 100-180, Korea. KOFIA makes available registration information of research analysts on its website. Please visit the following website if you wish to find KOFIA registration information on research analysts of Citigroup Global Markets Korea Securities Ltd. <http://dis.kofia.or.kr/fs/dis2/fundMgr/DISFundMgrAnalystPop.jsp?companyCd2=A03030&pageDiv=02>. The Product is made available in Korea by Citibank Korea Inc., which is regulated by the Financial Services Commission and the Financial Supervisory Service. Address is Citibank Building, 39 Da-dong, Jung-gu, Seoul 100-180, Korea. The Product is made available in **Malaysia** by Citigroup Global Markets Malaysia Sdn Bhd (Company No. 460819-D) ("CGMM") to its clients and CGMM takes responsibility for its contents. CGMM is regulated by the Securities Commission of Malaysia. Please contact CGMM at Level 43 Menara Citibank, 165 Jalan Ampang, 50450 Kuala Lumpur, Malaysia in respect of any matters arising from, or in connection with, the Product. The Product is made available in **Mexico** by Acciones y Valores Banamex, S.A. De C. V., Casa de Bolsa, Integrante del Grupo Financiero Banamex ("Accival") which is a wholly owned subsidiary of Citigroup Inc. and is regulated by Comision Nacional Bancaria y de Valores. Reforma 398, Col. Juarez, 06600 Mexico, D.F. In **New Zealand** the Product is made available to 'wholesale clients' only as defined by s5C(1) of the Financial Advisers Act 2008 ('FAA') through Citigroup Global Markets Australia Pty Ltd (ABN 64 003 114 832 and AFSL No. 240992), an overseas financial adviser as defined by the FAA, participant of the ASX Group and regulated by the Australian Securities & Investments Commission. Citigroup Centre, 2 Park Street, Sydney, NSW 2000. The Product is made available in **Pakistan** by Citibank N.A. Pakistan branch, which is regulated by the State Bank of Pakistan and Securities Exchange Commission, Pakistan. AWT Plaza, 1.1. Chundrigar Road, P.O. Box 4889, Karachi-74200. The Product is made available in the **Philippines** through Citicorp Financial Services and Insurance Brokerage Philippines, Inc., which is regulated by the Philippines Securities and Exchange Commission. 20th Floor Citibank Square Bldg. The Product is made available in the Philippines through Citibank NA Philippines branch, Citibank Tower, 8741 Paseo De Roxas, Makati City, Manila. Citibank NA Philippines NA is regulated by The Bangko Sentral ng Pilipinas. The Product is made available in **Poland** by Dom Maklerski Banku Handlowego SA an indirect subsidiary of Citigroup Inc., which is regulated by Komisja Nadzoru Finansowego. Dom Maklerski Banku Handlowego S.A. ul.Senatorska 16, 00-923 Warszawa. The Product is made available in the **Russian Federation** through ZAO Citibank, which is licensed to carry out banking activities in the Russian Federation in accordance with the general banking license issued by the Central Bank of the Russian Federation and brokerage activities in accordance with the license issued by the Federal Service for Financial Markets. Neither the Product nor any information contained in the Product shall be considered as advertising the securities mentioned in this report within the territory of the Russian Federation or outside the Russian Federation. The Product does not constitute an appraisal within the meaning of the Federal Law of the Russian Federation of 29 July 1998 No. 135-FZ (as amended) On Appraisal Activities in the Russian Federation. 8-10 Gasheka Street, 125047 Moscow. The Product is made available in **Singapore** through Citigroup Global Markets Singapore Pte. Ltd. ("CGMSPL"), a capital markets services license holder, and regulated by Monetary Authority of Singapore. Please contact CGMSPL at 8 Marina View, 21st Floor Asia Square Tower 1, Singapore 018960, in respect of any matters arising from, or in connection with, the analysis of this document. This report is intended for recipients who are accredited, expert and institutional investors as defined under the Securities and Futures Act (Cap. 289). The Product is made available by The Citigroup Private Bank in Singapore through Citibank, N.A., Singapore Branch, a licensed bank in Singapore that is regulated by Monetary Authority of Singapore. Please contact your Private Banker in Citibank N.A., Singapore Branch if you have any queries on or any matters arising from or in connection with this document. This report is intended for recipients who are accredited, expert and institutional investors as defined under the Securities and Futures Act (Cap. 289). This report is distributed in Singapore by Citibank Singapore Ltd ("CSL") to selected Citigold/Citigold Private Clients. CSL provides no independent research or analysis of the substance or in preparation of this report. Please contact your Citigold/Citigold Private Client Relationship Manager in CSL if you have any queries on or any matters arising from or in connection with this report. This report is intended for recipients who are accredited investors as defined under the Securities and Futures Act (Cap. 289). Citigroup Global Markets (Pty) Ltd. is incorporated in the **Republic of South Africa** (company registration number 2000/025866/07) and its registered office is at 145 West Street, Sandton, 2196, Saxonwold. Citigroup Global Markets (Pty) Ltd. is regulated by JSE Securities Exchange South Africa, South African Reserve Bank and the Financial Services Board. The investments and services contained herein are not available to private customers in South Africa. The Product is made available in **Spain** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. 29 Jose Ortega Y Gasset, 4th Floor, Madrid, 28006, Spain. The Product is made available in the **Republic of China** through Citigroup Global Markets Taiwan Securities Company Ltd. ("CGMTS"), 14 and 15F, No. 1, Songzhi Road, Taipei 110, Taiwan and/or through Citibank Securities (Taiwan) Company Limited ("CSTL"), 14 and 15F, No. 1, Songzhi Road, Taipei 110, Taiwan, subject to the respective license scope of each entity and the applicable laws and regulations in the Republic of China. CGMTS and CSTL are both regulated by the Securities and Futures Bureau of the Financial Supervisory Commission of Taiwan, the Republic of China. No portion of the Product may be reproduced or quoted in the Republic of China by the press or any third parties [without the written authorization of CGMTS and CSTL]. If the Product covers securities which are not allowed to be offered or traded in the Republic of China, neither the Product nor any information contained in the Product shall be considered as advertising the securities or making recommendation of the securities in the Republic of China. The Product is for informational purposes only and is not intended as an offer or solicitation for the purchase or sale of a security or financial products. Any decision to purchase securities or financial products mentioned in the Product must take into account existing public information on such security or the financial products or any registered prospectus. The Product is made available in **Thailand** through Citicorp Securities (Thailand) Ltd., which is regulated by the Securities and Exchange Commission of Thailand. 18/F, 22/F and 29/F, 82 North Sathorn Road, Silom, Bangrak, Bangkok 10500, Thailand. The Product is made available in **Turkey** through Citibank AS which is regulated by Capital Markets Board. Tekfen Tower, Eski Buyukdere Caddesi # 209 Kat 2B, 23294 Levent, Istanbul, Turkey. In the **U.A.E.**, these materials (the "Materials") are communicated by Citigroup Global Markets Limited, DIFC branch ("CGML"), an entity registered in the Dubai International Financial Center ("DIFC") and licensed and regulated by the Dubai Financial Services Authority ("DFS") to Professional Clients and Market Counterparties only and should not be relied upon or distributed to Retail Clients. A distribution of the different Citi Research ratings distribution, in percentage terms for Investments in each sector covered is made available on request. Financial products and/or services to which the Materials relate will only be made available to Professional Clients and Market Counterparties. The Product is made available in **United Kingdom** by Citigroup Global Markets Limited, which is authorised and regulated by Financial Services Authority. This

material may relate to investments or services of a person outside of the UK or to other matters which are not regulated by the FSA and further details as to where this may be the case are available upon request in respect of this material. Citigroup Centre, Canada Square, Canary Wharf, London, E14 5LB. The Product is made available in **United States** by Citigroup Global Markets Inc, which is a member of FINRA and registered with the US Securities and Exchange Commission. 388 Greenwich Street, New York, NY 10013. Unless specified to the contrary, within EU Member States, the Product is made available by Citigroup Global Markets Limited, which is regulated by Financial Services Authority.

Pursuant to Comissão de Valores Mobiliários Rule 483, Citi is required to disclose whether a Citi related company or business has a commercial relationship with the subject company. Considering that Citi operates multiple businesses in more than 100 countries around the world, it is likely that Citi has a commercial relationship with the subject company.

Many European regulators require that a firm must establish, implement and make available a policy for managing conflicts of interest arising as a result of publication or distribution of investment research. The policy applicable to Citi Research's Products can be found at [https://www.citivelocity.com/cvr/eppublic/citi\\_research\\_disclosures](https://www.citivelocity.com/cvr/eppublic/citi_research_disclosures).

Compensation of equity research analysts is determined by equity research management and Citigroup's senior management and is not linked to specific transactions or recommendations.

The Product may have been distributed simultaneously, in multiple formats, to the Firm's worldwide institutional and retail customers. The Product is not to be construed as providing investment services in any jurisdiction where the provision of such services would not be permitted.

Subject to the nature and contents of the Product, the investments described therein are subject to fluctuations in price and/or value and investors may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Certain investments contained in the Product may have tax implications for private customers whereby levels and basis of taxation may be subject to change. If in doubt, investors should seek advice from a tax adviser. The Product does not purport to identify the nature of the specific market or other risks associated with a particular transaction. Advice in the Product is general and should not be construed as personal advice given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. Prior to acquiring any financial product, it is the client's responsibility to obtain the relevant offer document for the product and consider it before making a decision as to whether to purchase the product. With the exception of our product that is made available only to Qualified Institutional Buyers (QIBs) and other product that is made available through other distribution channels only to certain categories of clients to satisfy legal or regulatory requirements, Citi Research concurrently disseminates its research via proprietary and non-proprietary electronic distribution platforms. Periodically, individual Citi Research analysts may also opt to circulate research posted on such platforms to one or more clients by email. Such email distribution is discretionary and is done only after the research has been disseminated via the aforementioned distribution channels. Citi Research simultaneously distributes product that is limited to QIBs only through email distribution.

The level and types of services provided by Citi Research analysts to clients may vary depending on various factors such as the client's individual preferences as to the frequency and manner of receiving communications from analysts, the client's risk profile and investment focus and perspective (e.g. market-wide, sector specific, long term, short-term etc.), the size and scope of the overall client relationship with Citi and legal and regulatory constraints. Citi Research product may source data from dataCentral. dataCentral is a Citi Research proprietary database, which includes Citi estimates, data from company reports and feeds from Reuters and Datastream.

---

© 2012 Citigroup Global Markets Inc. Citi Research is a division of Citigroup Global Markets Inc. Citi and Citi with Arc Design are trademarks and service marks of Citigroup Inc. and its affiliates and are used and registered throughout the world. All rights reserved. Any unauthorized use, duplication, redistribution or disclosure of this report (the "Product"), including, but not limited to, redistribution of the Product by electronic mail, posting of the Product on a website or page, and/or providing to a third party a link to the Product, is prohibited by law and will result in prosecution. The information contained in the Product is intended solely for the recipient and may not be further distributed by the recipient to any third party. Where included in this report, MSCI sourced information is the exclusive property of Morgan Stanley Capital International Inc. (MSCI). Without prior written permission of MSCI, this information and any other MSCI intellectual property may not be reproduced, redisseminated or used to create any financial products, including any indices. This information is provided on an "as is" basis. The user assumes the entire risk of any use made of this information. MSCI, its affiliates and any third party involved in, or related to, computing or compiling the information hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability or fitness for a particular purpose with respect to any of this information. Without limiting any of the foregoing, in no event shall MSCI, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind. MSCI, Morgan Stanley Capital International and the MSCI indexes are services marks of MSCI and its affiliates. The Firm accepts no liability whatsoever for the actions of third parties. The Product may provide the addresses of, or contain hyperlinks to, websites. Except to the extent to which the Product refers to website material of the Firm, the Firm has not reviewed the linked site. Equally, except to the extent to which the Product refers to website material of the Firm, the Firm takes no responsibility for, and makes no representations or warranties whatsoever as to, the data and information contained therein. Such address or hyperlink (including addresses or hyperlinks to website material of the Firm) is provided solely for your convenience and information and the content of the linked site does not in anyway form part of this document. Accessing such website or following such link through the Product or the website of the Firm shall be at your own risk and the Firm shall have no liability arising out of, or in connection with, any such referenced website.

---

ADDITIONAL INFORMATION IS AVAILABLE UPON REQUEST

---