

Equities

15 December 2011 | 8 pages

EADS (EAD.PA)

Alert: Investor Forum Takeaways (Day 1 of 2)

The tone of day 1 (of 2) of the EADS investor forum was generally upbeat, with EADS affirming its guidance for FY12 of a significant improvement in EBIT before one-off items, no further charges on A350 (as expected, following a €200m charge in 3Q11) and no change to planned production rate increases (also as expected). EADS did not provide an update on forthcoming management changes due in 2012 (CEO, CFO and Chairman all to change). The financing situation, both for customers and suppliers, remains challenging but is manageable. We retain our Buy rating and €27 Target Price, on account of strong EPS growth, as a beneficiary of € weakness vs. the \$ and on account of an undemanding valuation at <10x 2013E P/E.

At the group level EADS expects EBIT before one-off items to improve significantly in the medium-term (2015/2016), with the first "significant step" in 2012E driven by Airbus Commercial. We forecast Clean EBIT of €2.5bn in 2012E vs. €1.6bn in 2011E.

In Airbus Commercial, EADS expects "high single-digit" pa medium-term sales growth and targets a 10% EBIT margin before-off items and before the (unspecified) dilutive effect of initial A350XWB deliveries, at an FX rate of \$1.30/€. We believe that this is supportive of our 5.7% Airbus Commercial margin assumption in 2013E and suggests potential margin upside thereafter.

EADS was also relatively upbeat on the non-Airbus businesses, expecting rising profitability in both Eurocopter (EBIT recovery starting slowly in 2012E) and Cassidian (earnings recovery starting in 2013) in 2012E. Given investor concerns over the outlook for defence budgets, EADS' optimism on Cassidian is encouraging, albeit driven by expected growth in highly competitive export markets. In the smaller Astrium business, EADS expects some pressure on 2012E profits due to restructuring costs. In all 3 divisions, EADS commented that a high single digit margin is "within reach". In Airbus Military, EADS expects margin improvements (from a very low base) due to efficiency gains and service and export opportunities.

EADS has c€11bn of Net Cash at present. CFO Hans Peter Ring commented that dividends were likely to rise, but EADS is still clearly considering acquisitions with the aim of re-balancing the business more evenly between Airbus and the non-Airbus businesses (Space, Defence, Helicopters), as mentioned in last year's investor day. M&A in 2011 has been relatively limited (Vizada, Vector, Metron, Satair) and we expect further deals in 2012. Other than noting that EADS seeks acquisition targets that offer synergies, commentary on potential acquisitions was fairly limited.

CFO Hans Peter Ring commented that the aircraft financing environment is currently "challenging but manageable". The withdrawal of a number of French banks from the market has been mitigated by increased activities from Middle Eastern and Asian banks. Positively, EADS continues to regard itself as a "lender of last resort", which is a slight contrast to recent comments made by Boeing Capital.

Company Update

Buy	1
Price (15 Dec 11)	€22.76
Target price	€27.00
Expected share price return	18.6%
Expected dividend yield	1.3%
Expected total return	19.9%
Market Cap	€18,668M
	US\$24,234M

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



Jeremy Bragg

+44-20-7986-1089

jeremy.bragg@citi.com

Devang Doshi

+44-20-7986-6108

devang1.doshi@citi.com

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

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The financing situation is similar for EADS' suppliers (manageable), many of whom have been impacted by a combination of reduced liquidity, capex and working capital requirements associated with rising deliveries and programme delays.

We are far from convinced about EADS' ability to (organically) grow the Cassidian defence & security profit, through focusing on export opportunities, services, security, cyber-security, UAVs and cost cutting – essentially a similar strategy to the other listed defence companies. EADS expects Cassidian to recover to a “strong level of profitability after 2012” (referring to margins) and still targets sales growth to 2015, although a specific revenue target was not issued. We forecast flat Defence EBIT to 2013E, rather than growth, and this is not a key part of our Buy case. As a partner in Eurofighter, EADS stands to benefit if the aircraft is successful in India (126 aircraft with a decision expected “soon”).

Day 2 includes potentially more interesting sessions on Airbus (including an update on operations & A350XWB), Eurocopter and an address from CEO Louis Gallois.

EADS

Valuation

Our one-year target price of €27 per share is based on c11x 2013E P/E (a 12x multiple discounted back one year at 10% cost of equity). We choose to value EADS based on 12x 2013E P/E, discounted back, to reflect significant EPS growth expected in 2013E (+41%) as Airbus Commercial margins recover from c1% in 2011E to 6% in 2013E as production rates increase. Our target price implies c15x 2012E P/E, higher than EADS' long-run average of 13.7x consensus 12-month P/E, which we believe is justified given strong EPS growth prospects (+55% CAGR 2011E to 2013E). Our €27 Target Price implies a 2012E EV/Sales ratio of c0.5x vs. EADS' long-term average of c0.7x. Our DCF suggests €26.90 per share, using conservative assumptions including a WACC of 9.8% and long-term growth of 2.4%.

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) cyclical 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.

Appendix A-1

Analyst Certification

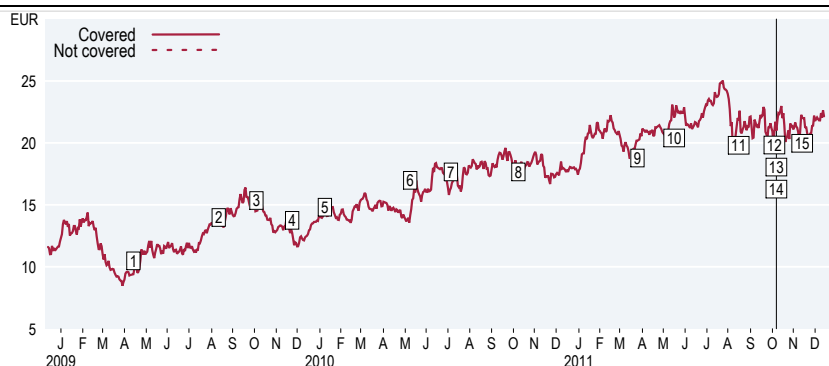
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Ratings and Target Price History Fundamental Research

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

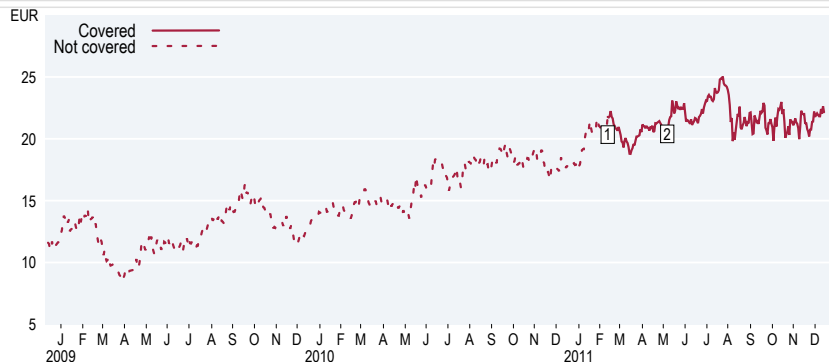
	Date	Rating	Target Price	Closing Price
11	16-Aug-11	2H	*23.00	21.80
12	5-Oct-11	2H	*22.50	20.96
13	7-Oct-11	Stock rating system changed		
14	7-Oct-11	*2	22.50	20.99
15	14-Nov-11	*1	*27.00	22.05

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

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% of companies in each rating category that are investment banking clients

12 Month Rating			Relative Rating		
Buy	Hold	Sell	Buy	Hold	Sell
59%	34%	7%	10%	79%	10%
45%	42%	37%	50%	43%	46%

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