EADS
(EAD)

26 June 2011

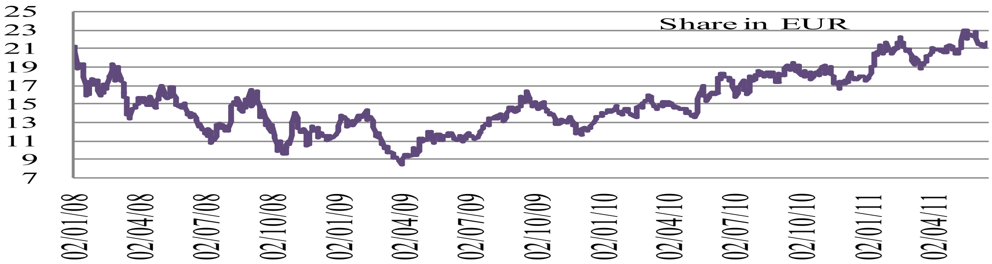
Description

EADS is the result of the combination in 2001 of 3 European aerospace companies (DaimlerChrysler Aerospace, CASA and Aerospatiale-Matra). It owns Airbus (aircraft manufacturer of A320, A380...), Airbus Military (A400), Astrium (space), Eurocopter, Cassidian (defence) and has a share in ATR regional aircraft manufacturer. The group recorded €46 billion of revenue in 2010. Its main competitors are Boeing, Northrop Grumman, Lockheed Martin, General Dynamics, Raytheon (US), Thales (FR) or BAE Systems (UK). Its key markets are Europe (47% of 2010 revenue), Asia-Pacific (25%), Middle-East (13%), North America (8%) and RoW (7%). The company had 121,691 employees at the end of 2010.

Share Price	22.40€
Nb of shares	817.1m
Market Capitalization	**€18,303m**
Net Debt 2011e	-€6,160m
Enterprise Value	**€12,143m**

FAIR @ ~14€
Valuation Range
[15.6€-22.8€]

	2008	2009	2010	2011e	2012e
Revenue	43,265	42,822	45,752	47,089	48,884
Recurring EBIT	2,830	-322	1,231	2,329	2,901
Net Profit	1,572	-763	553	1,225	1,661
EPS	1.95	-0.94	0.68	1.51	2.05
DPS	0.20	0.00	0.22	0.24	0.27
Free Cash Flow	2,597	556	2,791	-247	409



Market profile

High 52 weeks	23.10€
Low 52 weeks	15.80€
Average volume	1,567,062
Free float	49%
Insiders	51%

Shareholders

Sogeade	22.46%
Daimler	22.46%
SEPI	5.47%
French State	0.06%
Treasury shares	0.39%
Free float	49.16%

Valuation ratios

P/E 2011e/2012e	14.8/10.9x
P/CF 2011e/2012e	7.5x/5.8x
P/B 2011e/2012e	1.8x/1.6x
EV/EBIT 2011e/2012e	5.2x/4.1x
Rendement du dvd	1.1%/1.2%
FCF Yield 2011e/2012e	-2.1%/3.5%
Gearing 2011e/2012e	-62%/-56%

5 year-forecast (CAGR)

Revenue	3.4%
EBIT	32.0%
EPS	40.9%
DPS	10.0%

Why hold/buy the share ?

We believe that the share is fairly priced and could hardly suffer any setback (industrial, financial, political) at the current level. After a significant rebound related to the financial recovery of its clients (airlines) and the end of the global recession, EADS now clearly needs to reassure investors on its ability to grow margins. In the medium term, we think that's quiet a challenge as the company will have to finance its A350 program and the industrialization of A400M. Over the long term, the company still needs to rebalance its portfolio towards more defence activities, which will require more M&A.

Bottom-line, the key question is: after all theses challenges are «solved», what about value creation. On our estimates, we don't see how or when EADS will be able to earn a return that covers the cost of its capital. In our opinion, this could be THE trigger for a rerating of the EADS stock in the market.

Catalysts

1) Ability to raise prices at Airbus and fulfill the production planning.
2) Success in the A380 superjumbo market (new B747-8 an admittance Airbus was right ?)
3) Clarification of the leadership in European aerospace defence (highly political decision)
4) Ability to create value, i.e. to earn a return that covers the cost of capital (12%).

Risks

1) Difficulty to reach the break-even point of the A380 and the A400M programs.
2) Uncertainty over the industrialization of the A350 (new cost cuts needed ?)
3) Volatility of Airbus's earnings in the civil aerospace market and the unability to raise the average selling price of the aircrafts (new engine sufficient ?).
4) Political; corporate governance and France-Germany bilateral mgt of the co.

Valuation

We derived the intrinsic value of EADS shares through 4 methods: DCF: €21.4 (WACC 12.2%, g=2%, avg op margin 2011-2018e 6.1%). Sum of the parts: €18 (o/w Airbus is the largest component, accounting for 69% of EV). EVA: €22.8 (most of the value is related to the assets already in place). EPV: €15.6 (high hurdle rate EADS has limited scope to create value). Intrinsic value estimated at €19.4. Cyclicality of the business and uncertainties regarding existing and coming aerospace programs justifies a margin of safety of 30%.