Deutsche Bank

15 BAE Systems – Jaime Rowbotham, BUY, close 574p, 730p tgt, 27% upside

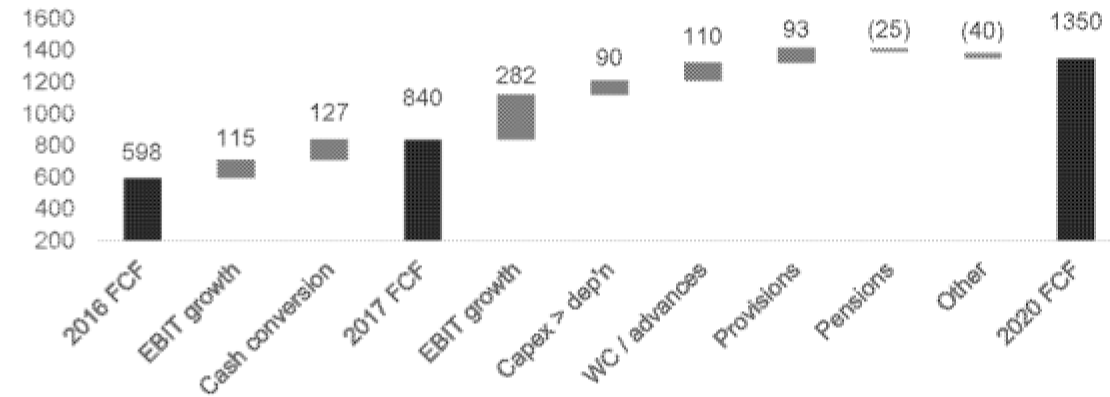
- We see scope for **63% TSR to 2020**. With FCF forecast at £1.35bn in 2020, if the stock were to trade on a 5% yield then those buying now would make 18% TSR per year. Thus now is an attractive entry point into a multi-year defence spending up-cycle.
- **Flat earnings are masking a compelling growth story.** We forecast EBIT growth at 5% at the company level.
- **US strength (9% EBIT CAGR to 2020)** should come from growth in Combat Vehicles & Ship Repair and Electronic Systems, and a profit recovery at Applied Intelligence in Cyber.
- **It should be possible to offset declining Typhoon profit contribution in Air.** The key drivers of this are Missiles (MBDA, in which BAE has a 37.5% stake, is growing at a 12% pa EBIT CAGR), Aftermarket and the stake in the F-35. There is upside potential to this from potential new Typhoon orders, such as from Saudi Arabia.
- **Maritime profitability is well-underpinned** under this UK government, though there is risk from a change in government.
- **Cash conversion is set to improve** from here on lower outflows on working capital, provisions (as most are now non-operational) and pensions (post the triennial review).
- **BAE trades on a discount to EU and US peers** at c13.5x 19E P/E and c9x 19E EV/EBIT, versus 14.5x and 10.5x for EU peers, and 19x and 14x for US peers.
- Catalysts: conversion of contract opportunities

Related DB Research:

BAE: Cashing in: >60% 3-year TSR potential (Rowbotham)

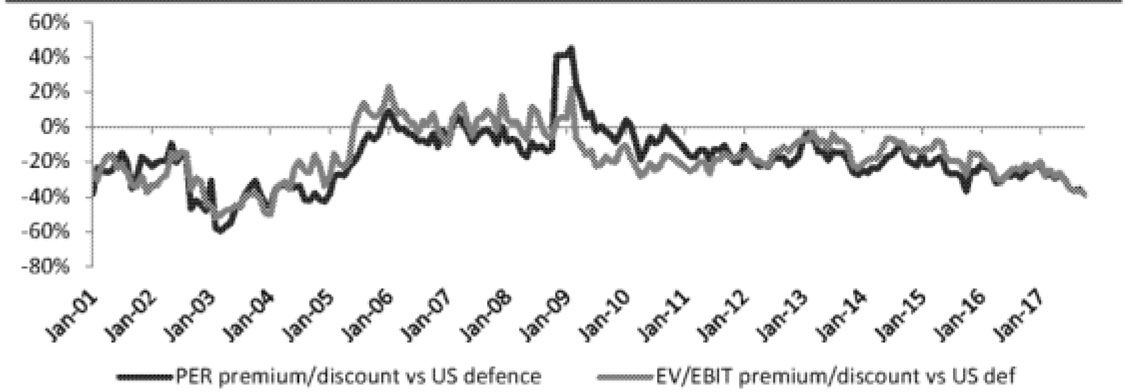
Global Aerospace and Defence: Civil selective; Defence more effective (Kerner)

£1.35bn FCF by 2020, driven by EBIT growth and better cash conversion



Source: Deutsche Bank estimates

BAE trades on a c30% discount relative to its US peers



Source: Deutsche Bank estimates

CONFIDENTIAL - PURSUANT TO FED. R. CRIM. P. 6(e) DB-SDNY-0086807
CONFIDENTIAL SDNY_GM_00232991

EFTA01385521