

## Thales

31 October 2014

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### £1.5bn UK Project Marshall win

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HO FP

Price: €38.60

Mkt cap: €8.00bn

Analyst: Sash Tusa

#### Our view: Not as “jumbo” as it looks

Thales and its partner NATS (the UK’s National Air Traffic Systems) have won the £1.5bn Project Marshall, to upgrade and support the UK military air traffic control system for the next 22 years. The order looks huge, and is, we believe, one of those large upcoming orders about which Thales spoke with such confidence on the Q3 results call, forecasting a strong Q414 book to bill.

However, this is not what we believe investors usually consider as what Thales terms a “jumbo” order (ie a c €1bn order; the average size of Thales’ orders is probably closer to €10m).

Specifically:

- The order is spread over 22 years (so £68m pa),
- It is shared equally with NATS (so £34m pa for Thales), and
- It will involve around £400m of upfront investment in terms of equipment renovation.

The contract would, if evenly spread, therefore add around €43mn to Thales’ annual revenues, an uplift on 2013 of 0.3%. We also note that, given the investment requirements of the project, the contract is unlikely to be earnings accretive for Thales out through 2016. We therefore think this order alone is highly unlikely to drive any sort of uplift in Thales’ 2015 guidance, which we still believe could disappoint when it is disclosed with the 2014 annual results on 26 February 2015.

#### “Real jumbos” move the needle of sales and earnings

Thales typically refers to “jumbo” orders not just by reference to their size, but also an implication that, over the period of their delivery (typically three to five years for a large defence export programme such as the ongoing €1bn+ Indian Mirage 2000-5 upgrade programme), they will “move the needle” in terms of both revenues and earnings. We think that, were Thales to win a significant portfolio of long-term service and support contracts such as Project Marshall, it might trend towards a higher rating. But a single contract like this simply cannot deliver such an uplift, and we think it more likely that there could be an emerging mismatch between investor expectations for 2015-16 (based upon an apparently buoyant order intake in Q414) and a weak underlying (ex-jumbos) book to bill, and hence revenue outlook.

#### Read-across to other companies

There is currently a bit of an orders splurge in the UK ahead of the 2015 general election. Defence Secretary Michal Fallon said at the Conservative Party Conference in early October that, with the defence budget now in balance, he would be able to release more orders following the £3.5bn FRES Scout armoured vehicle contract awarded to General Dynamics.

We see the following read-through to other companies in the sector:

- Based upon Mr Fallon’s other comments, we believe the most likely outstanding contract to be for the development and first of class Type 26 Frigate, to be placed with BAE Systems.



- But we think that there is also the possibility of a major attack helicopter order (either an upgrade programme for Finmeccanica's AgustaWestland, or new Apache helicopters from Boeing).
- We think that a "lease" (in effect delayed purchase) of Boeing P-8 maritime patrol aircraft is rapidly decreasing in likelihood due to the cost and lack of UK workshare, which makes such an order politically less attractive.

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