

PRU Global Basics Fund

Company update

European Aeronautic Defence and Space Company (EADS)

Negative short-term news

In the view of Graham French, the market is currently taking too bearish a view of the outlook for EADS. True, the news on the company has been overwhelmingly negative over the past few months, particularly with the recently-won US refuelling tanker deal now being reopened to bids.

This is a major negative as it also puts in jeopardy the company's plans to build up its manufacturing capabilities in the US, a development the company's management had been focusing on as a means of diversifying EADS' euro cost exposure.

Positive factors

In the fund manager's view, however, there remain a number of positive factors that support the investment case for the stock:

- Aircraft orders are not disappearing. People are not going to stop flying; indeed, this remains a long-term growth industry.
- The company's defence business remains strong.
- EADS will continue to extract cost savings from its 'Power 8' restructuring program
- The order backlog remains strong for number of its products including the A380, A320 and A340.

Benefits to come

The A380 will begin use with new customers such as Emirates later this year and Qantas next year. Our view is that when airlines start to see the benefits (particular in terms of cost and fuel efficiency) of the A380 in their fleets, demand for this transformational product will soar. The China story also remains intact with huge air traffic growth predicted in this country and the rest of the Asian region.

Oil price

The oil price and the euro/dollar exchange rate nevertheless remain key drivers for the company. It will be difficult for EADS to turn round its fortunes if the current oil price / dollar weakness continues. In view of this, however, and given that much of the fund is positively exposed to the high oil price (and therefore weak dollar), from a portfolio construction perspective it is beneficial to hold diversifying positions with negative correlation to this theme.

Long-term case

In summary, Graham French believes that, despite its short-term problems, the long-term case for EADS remains intact. As ever, though, he and the Global Equities team at M&G will continue to keep a close eye on the company.

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