Rockwell Collins, Inc.

NYSE:COL

Analyst: Pierre Riffard
Sector: Industrials

BUY

Price Target: $108

Key Statistics as of 04/22/2016

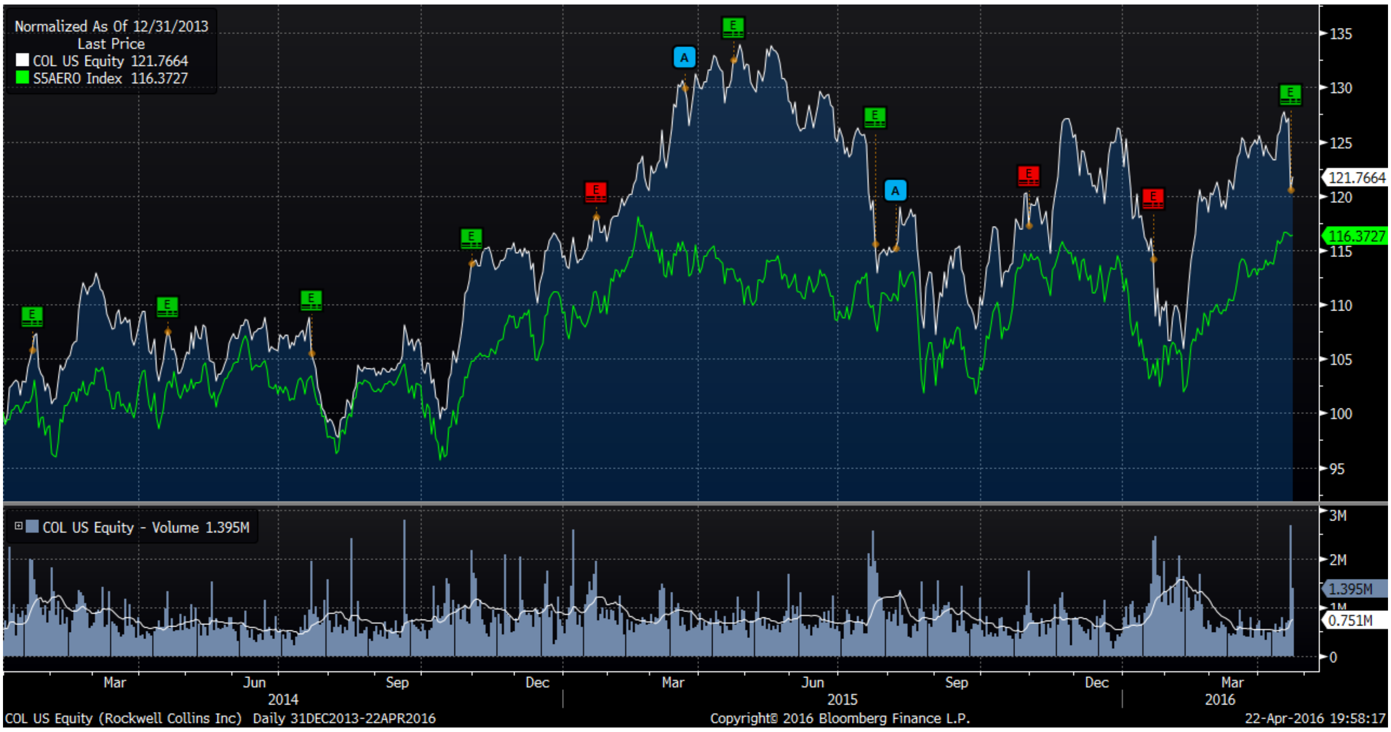
Market Price:	$90.01
Industry:	Aerospace & Defense
Market Cap:	$11.719B
52-Week Range:	$76.03 - $99.37
Beta:	0.63

Thesis Points:

- Strong outlook will provide opportunities to the future growth of the company.
- The top performer of the industry in terms of profitability.
- Several growth investments to maintain future growth above the industry average.

Company Description:

Rockwell Collins, Inc. (NYSE:COL) is a global Aerospace & Defense company, headquartered in Cedar Rapids, Iowa. The company designs, produces and supports communication and aviation systems for commercial and military customers and provides information management services through voice and data communication networks and solutions worldwide. COL is one of the largest supplier to governments, aircraft & defense companies, and airports. The company employed an average of 19,500 during FY2015. The company has offices worldwide including Canada, Mexico, Brazil, France, Germany, UK, Russia, Saudi Arabia, UAE, Australia, China, India, and Singapore. Through large R&D investments and some key acquisitions, the company has succeeded to develop its product portfolio to one of the broader currently available on the market, allowing the company to better respond to customers, and to better react to industry and technological changes.

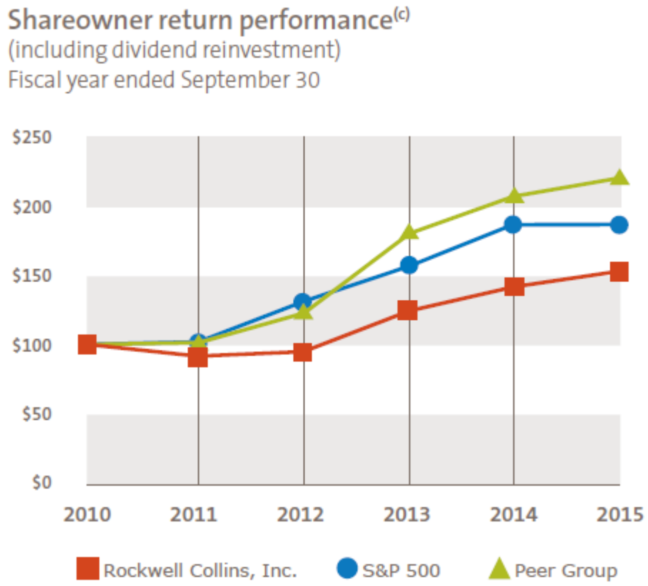


Thesis

Rockwell Collins' fundamentals are in the top range of its industry. The company is showing strong and improving margins over the years with strong expectations over the next ten years, especially regarding the growth rate. While competitors are expected to grow at 3% over the next years, COL is expected to grow between 3% and 5%. The very large portfolio of the company is offering a great diversification of customers and risks, and give the company more potential for growth in the long run. The outlook for the overall industry is offering better growth rates than the forecast global GDP growth rate, which is going to improve the top-line growth of the company.

On 4/21/16, the company reported mixed quarterly results. Revenue missed estimates by 1.38%, Net Income beat by 0.77%, and EPS beat by 1.90%. The stock went down by 5%, which seems to me like an overreaction from investors who were having some doubts about growth forecast for the company, even if the CEO stated he left its full-year outlook unchanged. Based on its excellent fundamentals, plus its large portfolio and R&D investments, the company is still better prepared than competitors for future growth, and better margins.

Based on the stock chart analysis, the company is also offering a positive alpha compared to the aerospace & defense industry. The 5% drop will soon be erased as it offers an opportunity to buy the stock at a cheap price, and may be able to pass the $100 barrier over the next months.



Product Portfolio

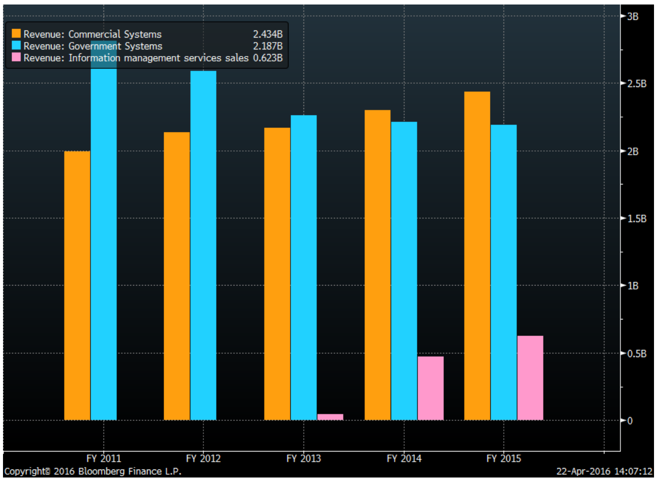
The activity of COL is divided into three segments and serves a worldwide customer base including the US Department of Defense, US Coast Guard, civil agencies, civil airports, defense contractors, foreign ministries of defense, manufacturers of commercial air transport, business and regional aircraft, commercial airlines, business jet operators, the FAA (Federal Aviation Administration), critical infrastructure operators and major passenger and freight railroads.

The first segment of COL is *Commercial Systems*. It accounted for 46.4% of FY2015 total sales. This segment supplies aviation electronics systems, products and services. This segment has the highest operating margin of the three segments at 22.8% in 2015.

The second most important segment is *Government Systems*. It accounted for 41.7% of FY2015 total sales. It provides a large range of electronic products, systems, and services to the US government, federal agencies, foreign ministries of defense, and defense contractors. It supplies defense-related products such as communication systems, navigation products and systems, avionics sub-systems, precision targeting, electronic warfare and range and training systems, simulation systems, and maintenance and repair services. The operating margin of the segment was 20.9% in 2015.

The last segment is *Information Management Services*. It accounted for 11.9% of FY2015 sales. It provides communications services, systems integration and security solutions across the aviation, airport, rail, transit and nuclear security markets. This segment was created in December 2013, following the acquisition of ARINC Inc., which was a leader in communications and information processing solutions for the commercial aviation industry. The operating income of that segment is the lowest at 15.2%, but is in line with the industry ratio of 15.9%. The Monte Carlo simulation of the pro-forma shows that the price is more sensitive to the revenue than to the operating costs and that segment is showing very strong growth rates with a YoY growth rate at 32%.

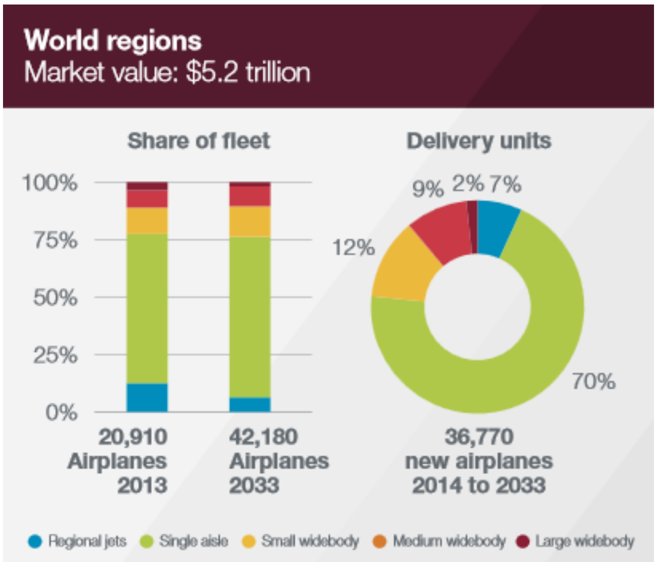
Government Systems sales stayed flat over the last three years due to the defense budget restriction. The growth of the defense industry is now expected to return to a 3% growth in 2016 following several global challenges like the rise in defense expenditures from non-ally states, and the recent resurgence of global threats. Even if the next American president is not willing to boost the defense budget, he or she will not be able to reduce it. Even if that particular segment will not have strong growth rates in the near future, it guarantees a certain level of sales over the next years, and cannot be impacted by recession or financial crisis.



Industry Outlook

The core activity of COL is dependent on the defense industry and the commercial airplanes industry. As explained earlier, the defense outlook is looking strong as it will provide safe sales over the long-run, the US defense budget is likely to increase, and it is not vulnerable in case of economic downturn.

According to Boeing [1] (NYSE:BA), The long-term demand (2013-2033) for new airplanes comprises 36,770 aircrafts valued at $5.2 trillion. Around 42% of the new airplanes will replace older and less efficient airplanes. The 3% forecast global GDP growth will be a key contributor to the aviation industry growth that is expected to grow at 5%, and to the cargo traffic industry to grow at 4.7%. The growing middle-class worldwide will also support that growth. Fast-growing low-cost carriers will be in need to replace aging airplanes. The demand will also be strong in emerging countries, especially China where the company has offices.



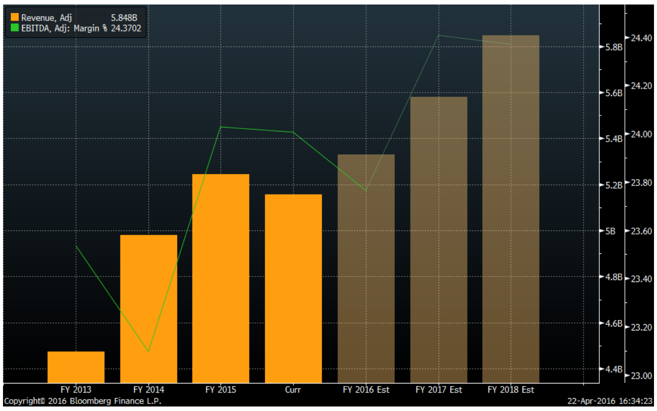
The defense and aviation industry are driven by technological improvements, and key developments will continue to be essential for growth. Security and communication are also extremely important and highly regulated. The company is one of the leader in developing sophisticated electronic systems for aircrafts and airports to improve communication, data management and safety. The FY2015 Research & Development accounted for $850 million or 16.2% of total sales. 32% of R&D are company-funded, and total R&D went up by 10% YoY. Such expenses are making the company ahead of the competition in terms of technological improvements.

Since one year, lots of small and large companies announced they are working on new designs for commercial supersonic, and military supersonic/hypersonic aircrafts, which will required brand-new and high-end electronic systems. This new market will create an opportunity for the company by securing key contracts with manufacturers.

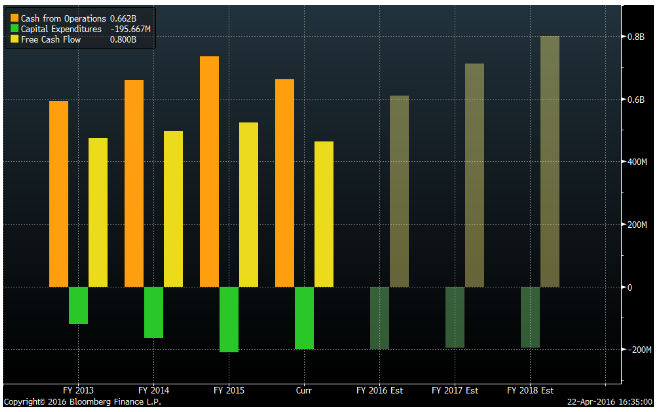
[1] http://www.boeing.com/assets/pdf/commercial/cmo/pdf/Boeing_Current_Market_Outlook_2014.pdf

Fundamentals & Competitors

In 2015, the company reached a record sales at $5.244 billion which represents a 5% YoY growth. *Commercial Systems* sales grew by 6%, *Information Management Services* went up by 32%, and *Government Systems* went down by 1% primarily due to a negative currency impact related to the strong USD. The operating-costs-to-revenue ratio were 77.2%, which is in line with its historic ratio of 77.3%, and well above the peers' at 84.9%. The operating-costs-to-revenue ratio is expected to decline to 74% in 2019. The revenue are expected to reach $6.331 billion in 2020, which corresponds to a CAGR of 4% over five years. The EBITDA margin, currently at 24% is expected to gradually improve to reach 25% in 2019. The profit margin is expected to gain 1% to 14% in 2019. Free Cash Flow is also expected to increase by 66.5% over the next five years.



When compared to the overall industry and to competitors, we can see COL is outperforming every competitors. The EBITDA margin is 8% higher than the industry average, and the profit margin is 5.4% higher at 12.5%. The sales per employees at $269k is above the industry average and among the best of the industry. The EV/EBITDA is lower than peers' at 10.06. The Free Cash Flow margin is 2.5% higher than the industry. Capital expenditures are expected to stay around 2015 level at $200 million.



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Name (BI Peers)	EBITDA to Net Sales:Y	Sl/Empl:Y	PM:Y	EV / EBITDA Adj:Y	EV/Sales T12M:D-1	Dvd Yld:Y	FCF Margin
Average	15.91%	239.09k	7.10%	11.13	2.04	1.40%	7.55%
100) ROCKWELL COLLINS INC	24.03%	268.92k	12.51%	10.06	2.68	1.54%	10.01%
101) CAE INC	23.23%	--	8.27%	9.87	2.02	1.83%	5.54%
102) ULTRA ELECTRONICS HL...	16.04%	229.20k	8.62%	12.15	2.14	2.33%	6.71%
103) THALES SA	10.74%	252.40k	5.69%	8.23	1.02	1.64%	7.07%
104) L-3 COMMUNICATIONS ...	6.55%	275.42k	5.66%	11.32	1.16	2.18%	8.61%
105) MEGGITT PLC	23.59%	211.09k	12.37%	9.53	2.60	3.84%	20.01%
106) HEICO CORP	23.35%	258.40k	11.22%	13.99	3.52	0.28%	13.01%
107) SAFRAN SA	16.32%	289.88k	0.44%	7.41	1.53	2.18%	11.02%
108) ESTERLINE TECHNOLOGI...	17.54%	159.33k	8.85%	10.85	--	0.00%	8.32%
109) ZODIAC AEROSPACE	10.36%	183.99k	3.77%	17.74	1.40	1.18%	0.69%

(Accounting adjustments: Adjusted for abnormal items, when applicable) 10) Analyze List

Growth Investments

The company has developed several new products, and had been awarded several contracts that are going to bring important revenue streams in the future.

Boeing (NYSE:BA) selected Rockwell Collins to provide avionics for the 777X, which makes the company the supplier of flight decks for Boeing's entire fleet of next-generation airplanes. The Pro Line Fusion integrated flight deck is a segment leader gaining lots of interests by defense contractors and airplane manufacturers like Airbus, Textron, Sikorsky, Embraer and Dassault.

The key partnership with Boeing is becoming more and more important. The development of the 787 Dreamliner made COL to develop the most advanced systems ever deployed. The company is a key supplier for the development of the 737MAX and the 777X that will enter service in 2017 and 2020 respectively. COL is anticipating significant revenue into the next decade from its partnership with Boeing.

In 2015, the company secured three important long-term contracts to provide advanced airborne software-defined radios to Naval Air Systems Command, avionics and mission equipment to Sikorsky, and oceanic data link services to the FAA.

The company introduced in 2015 TruNet, a brand new communication system for military customers ensuring secure connectivity between ground and airborne elements. This system gives armed forces a complete control of communications across the battlefields. It also introduced FireStorm, which is an integrated targeting system with digital connectivity to the battlespace.

The R&D expenses were close to $1 billion in FY2015 and are expected to be close to $1 billion in FY2016. The company employs around 6,100 engineers. Such investment is essential for the firm to stand out within the industry, to continue to develop the best products, systems and services for the defense and aviation industry, especially when precision, communication, and safety are more important than ever.

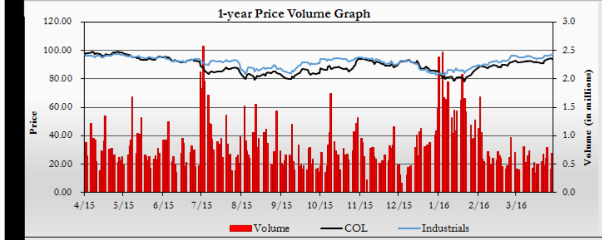
Conclusion

Rockwell Collins is a well-established company serving worldwide customers with reliable products and services. The company is not entirely dependent on defense contracts or on the American government to grow, and its very large and complete portfolio is opening lots of doors for further improvements in top- and bottom-line growth. Its focus on R&D is a competitive advantage compared to competitors as the company is in good position to always develop the most advanced products. Based on fundamentals, the company succeeded to have much better margins, and better growths than competitors. It secured many contracts and key partnerships that will bring important revenues over the next years. Expectations in revenue growth, EBITDA, and Free Cash Flow are better than competitors, and can even be better due to the industry outlook, and the R&D investments. Currently the stock is not performing as well as its peers or as the market. The last mixed earnings call made investors to doubt about the strong expectations of the company, and the stock dropped by 5%. Due to the market position of the company, and as its full-year outlook remained unchanged, I think investors overreacted, which created this temporary but good opportunity to buy the stock near $90. I am expecting to see the stock to catch up with the industry and to pass the $100 barrier over the next three to nine months.

Rockwell Collins Inc. (COL) — CENTER FOR GLOBAL FINANCIAL STUDIES — BULLISH

Analysis by Pierre Riffard	Current Price:	$90.01	Intrinsic Value	$92.59
4/22/2016	Divident Yield:	1.5%	Target Price	$108.96

Target 1 year Return: 22.53%
Probability of Price Increase: 98.5%



Description

Rockwell Collins, Inc. designs, produces, and supports communications and aviation systems worldwide.

General Information

Sector	Industrials
Industry	Aerospace and Defense
Last Guidance	November 3, 2015
Next earnings date	July 21, 2016
Estimated Country Risk Premium	7.53%
Effective Tax rate	27%
Effective Operating Tax rate	18%

Market Data

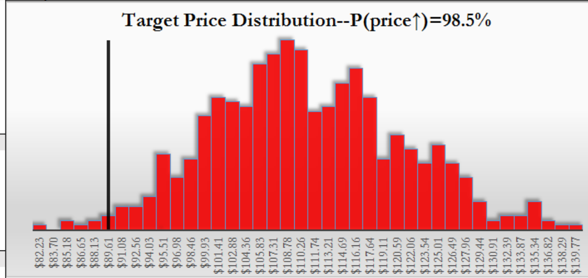
Market Capitalization	$11,718.78
Daily volume (mil)	1.35
Shares outstanding (mil)	130.19
Diluted shares outstanding (mil)	133.00
% shares held by institutions	80%
% shares held by investments Managers	72%
% shares held by hedge funds	2%
% shares held by insiders	0.30%
Short interest	4.05%
Days to cover short interest	5.85
52 week high	$99.37
52-week low	$76.03
Levered Beta	0.69
Volatility	20.32%

Past Earning Surprises

Quarter ending	Revenue	EBITDA
3/31/2015	1.24%	-3.38%
6/30/2015	-4.93%	-7.48%
9/30/2015	-3.42%	-12.36%
12/31/2015	-6.26%	-11.93%
3/31/2016	-4.40%	-8.28%
Mean	-3.55%	-8.68%
Standard error	1.3%	1.6%

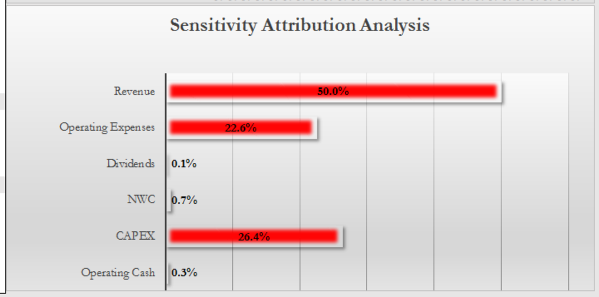
Peers

Spirit AeroSystems Holdings, Inc.
Triumph Group, Inc.
Raytheon Company
General Dynamics Corporation
L-3 Communications Holdings Inc.
B/E Aerospace Inc.
Huntington Ingalls Industries, Inc.
TransDigm Group Incorporated

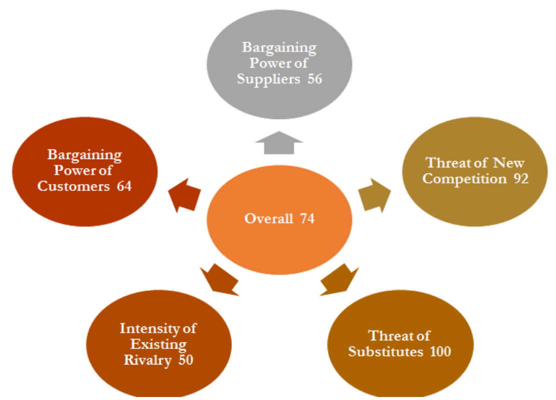


Management	Position	Total compensations growth	Total return to shareholders
Ortberg, Robert	Chairman, President and Chai	29.14% per annum over 5y	-0.82% per annum over 5y
Allen, Patrick	Chief Financial Officer and	6.19% per annum over 5y	-0.82% per annum over 5y
MacLauchlan, Jeffrey	Senior Vice President of Cor	N/M	0% per annum over 0y
Statler, Kent	Chief Operating Officer of C	9.81% per annum over 5y	-0.82% per annum over 5y
Jasper, Philip	Chief Operating Officer of G	6.36% per annum over 2y	11.54% per annum over 2y
King, Bruce	Senior Vice President of Ope	N/M	N/M

Profitability	COL (LTM)	COL (5 years historical average)	Industry (LTM)
ROIC	20.5%	48.60%	16.98%
NOPAT Margin	28%	28.69%	9.7%
Revenue/Invested Capital	0.74	1.69	1.76
ROE	25.0%	47.18%	19.92%
Adjusted net margin	26%	27.94%	8.9%
Revenue/Adjusted Book Value	0.94	1.69	2.24
Invested Funds	**COL (LTM)**	**COL (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	3.7%	5.4%	19%
Estimated Operating Cash/Total Capital	3.7%	5.2%	N/A
Non-cash working Capital/Total Capital	21.2%	21.5%	13%
Invested Capital/Total Capital	99.5%	99.3%	80%
Capital Structure	**COL (LTM)**	**COL (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.16	0.11	0.21
Cost of Existing Debt	4.71%	-16.78%	4.20%
Estimated Cost of new Borrowing	3.76%	2.69%	4.20%
CGFS Risk Rating	BB	A	BBB
Unlevered Beta (LTM)	0.63	0.93	0.84
WACC	8.63%	11.63%	9.90%



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	-1.5%	27.6%	2.37
3/31/2017	1.9%	23.9%	1.77
3/31/2018	3.3%	23.5%	1.67
3/31/2019	5.5%	23.5%	1.65
3/31/2020	5.7%	23.7%	1.65
3/31/2021	5.3%	22.7%	1.56
3/31/2022	5.0%	22.6%	1.55
3/31/2023	4.6%	22.4%	1.53
3/31/2024	4.2%	22.1%	1.50
3/31/2025	3.8%	21.8%	1.45
3/31/2026	3.4%	21.4%	1.41
Continuing Period	3.0%	21.0%	1.38

Period	Invested Capital	Net Claims	Price per share
Base Year	$1,887.94	$2,054.71	$92.68
3/31/2017	$2,831.91	$489.84	$108.75
3/31/2018	$4,681.45	-$1,153.80	$124.68
3/31/2019	$6,844.21	-$2,762.15	$140.60
3/31/2020	$6,970.85	-$4,409.20	$156.48
3/31/2021	$8,158.13	-$6,051.95	$172.23
3/31/2022	$8,737.77	-$7,857.58	$189.13
3/31/2023	$9,180.00	-$9,575.02	$205.53
3/31/2024	$9,664.95	-$11,304.76	$222.09
3/31/2025	$10,128.65	-$13,030.50	$238.70