

Pest analysis of the bae company finance essay



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This article want to analysis the five-year of financial data which from 2004 to 2008 of BAE , in order to understand the company's business profitability and development capacity and found the further possibility to enhance the utilization efficiency of it , so that to promote the investment activities of the enterprise's business goal of maximizing value in accordance with a benign operation.

Instruction

BAE Systems is the merger of British Aerospace (BAE) and Marconi Electronic Systems (Marconi Electronic Systems) which was established in November 1999. In September 2004 BAE Systems acquired Alvis Vickers and merged it with its RO Defence ordnance division to form BAE Systems Land Systems. In June 2005 BAE Systems acquired United Defense and reorganised its land systems businesses into BAE Systems Land and Armaments, with Land Systems and Land Systems Hägglunds as subsidiaries of this U. S. based operating group.

It is an international company engaged in the development, delivery and support of advanced defence and aerospace systems in the air, on land, at sea and in space. In 1999 the net sales of the company was 89. 29 billion pounds (14. 449 billion U. S. dollars)of which military sales was 5. 837billion pounds. In 2000, it becamed the third of the world's 100 largest military companies. Now, the company employed more than 100, 000, and annual turnover of the company is 12. 3 billion pounds and orders amounted to 37. 5 billion pounds.

PEST analysis of the BAE company

1. Politics.

BAE Systems is a global company which conducts business in a number of regions, including the Middle East. Sales market over more than 130 countries, this brought great opportunities to the company. However, Government regulations and administrative policies of some countries could change quickly and restraints on the movement of capital could be imposed; governments could expropriate the Group's assets; burdensome taxes or tariffs could be introduced; political changes could lead to changes in the business environment in which the Group operates; and economic downturns, political instability and civil disturbances could disrupt the Group's business activities.

New threats and conflict arenas are placing unprecedented demands on military forces and presenting BAE Systems with new challenges and opportunities to assist those forces in meeting changing defence and security needs.(Susana Callao, 2007)

2. Economic and Society

Global passenger traffic is forecast to increase by approximately 5% per year. Strong growth is expected in Asia and the Middle East and lower growth in the more mature North American and European markets. The market for large commercial jets is forecast to continue to grow on the back of rising passenger travel. Annual revenue passenger kilometres (RPKs) are forecast to grow by approximately 5% through to 2023 creating an expected average demand of some 830 aircraft deliveries a year. The US represents over 45% of the total forecast global defence spend (including equipment, <https://assignbuster.com/pest-analysis-of-the-bae-company-finance-essay/>

personnel and operating costs) to 2010. Defense and transport development brings a huge market demand for the BAE.

3. Technology

BAE Systems has played an important role in transatlantic, most notably has advanced technology in the M777 howitzer and F-35 Joint Strike Fighter programmes. The US and the UK have a long history of defence industrial cooperation that has provided significant benefits to both countries. In today's environment of coalition operations it would be the advantage of both governments and defence industries to allow and, indeed, to encourage freer technology sharing between the UK and the US. For BAE Systems an improved technology sharing environment would enable its engineers and scientists in the US and the UK to collaborate more effectively, and bring together their collective skills and expertise to the benefit of its two major customers, the UK and US governments, as well as to its shareholders.

Review and analysis of company strategy

1. Pricing policies. BAE company's major pricing policy is before business sales occur sign fixed price contracts with clients. Large part of the company's sales come from fixed-price contract. Because the company's largest partner is the United States, the U. S. team a great need for defense products, so the business mainly occur in sectors such as government troops, using a fixed-price sales contracts to ensure fixed sales and also to simplify transactions.

2. Market position. BAE Systems has major operations across five continents and customers in some 130 countries. Global business of the company is

based around six home markets in US, Saudi Arabia Australia, Sweden , South Africa, and the UK. It is the world's second-largest defense company and the third-largest Airline's defense and also the third-largest electronics Airlines.

3. Comparison with that of its competitors. The Group's business is subject to Significant competition. Most of the Group's businesses are focused on the defence industry and subject to competition from national and multi-national arms with substantial resources and capital, and many contracts are obtained through a competitive bidding process.(Tim Sutton, 2004)The Group's ability to compete for contracts depends to a large extent on the effectiveness and innovation of its research and development programmes, its ability to offer better programme performance than its competitors at a lower cost to its customers, and the readiness of its facilities, equipment and personnel to undertake the programmes for which it competes.

4. Development Strategy of BAE Systems

BAE Systems is a large international companies who has the responsibilities to its clients shareholders, employees and partners. Its strategy goal is to maximize the interests of shareholders. In order to achieve the company's strategic goals, the Board promotes to enhance the company's culture atmosphere and establish Operational Framework. . That is based on principles of good governance, aset of definitions, values, policies and processes that guide the company's work and behaviour, and a uesful system of delegated authority(David Tyrrall, 2007). In order to realise the management of the company's business and deliver their strategy, the Operational Framework covers all wholly andmajority-owned businesses and <https://assignbuster.com/pest-analysis-of-the-bae-company-finance-essay/>

describes the Group's methods to its organisation, culture which including ethical principles of business conduct, values and governance framework vision, delegated authorities, and core business processes.

Financial Analysis for BAE Systems

Industry Analysis

In the global aerospace and defense industries Europe accounts for 19.6% of the global market's value. In 2004 the European aerospace and defense market grew by 0.9% which reached a value of \$249.9 billion. The civil aerospace sector generated the second largest revenues in 2004, reaching a value of \$62.3 billion, equivalent to 24.9% of the market's value. In the next five years, it is expected to be greatly growth. By 2009, the market is forecast to reach a value of \$278.2 billion, which equates to a CAGR of 2.2% in the 2004-2009 period, higher than the global market as a whole. However, Asia-Pacific will see spending rise by 4% per annum while the US market is predicted to decline with a 0.6% rate over the same period. During this time the third biggest aerospace and defense company it will also play an increasingly important role in operation and management in the future.

BAE Systems recorded revenues of \$20 billion during the fiscal year 2005, an increase of 25% over 2004. The operating profit of the company was \$1.6 billion during fiscal year 2005, an increase of 16.3% over 2004. The net profit was \$1 billion in fiscal year 2005, compared to a net profit of \$550 million in fiscal 2004. Rolls Royce is the leading player in the global civil aerospace, defense aerospace, marine and energy markets. Compared to BAE systems's business performance, Rolls Royce company recorded revenues of \$7.4 billion during the fiscal year 2005, an increase of 5.2%
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over 2004. The increase was primarily attributable to an increase in revenues from the company's civil aerospace division. The operating profit of the company during fiscal 2005 was \$397.5 million, an increase of 43.5% over fiscal 2004.

The European aerospace and defense market generated total revenues of \$234.9 billion in 2005, this representing a compound annual growth rate (CAGR) of 1.3% for the five-year period spanning 2002-2006. The US and Asia-Pacific markets grew over the same period with CAGRs of 6.7% and 3.4% respectively, to reach the values of \$502.6 billion and \$157.2 billion in 2006.

BAE systems occupies an important position in the industry. In the whole industry it can realized its business very well. The following financial analysis is to analyze 2004 to 2008, the specific circumstances of these years.

Here collect the relevant data of the BAE for five years. These data which is important can best reflects the company's operation. The preparation of data sheets is as follow. The following analysis mairly use dynamic ratio of fixed base method and ues the data of 2004 as a fixed base period to analyze the indicators.

FINANCIAL STATEMENTS

Five-year summary

Income statement $\hat{1}^{-3}$ $\hat{1}^{-3}$ $\hat{1}^{-3}$ $\hat{1}^{-3}$ $\hat{1}^{-3}$ 2008 2007 2006 2005 2004

Sales including Group's share

of equity accounted investments 4, 459 3, 916 4, 007 3, 697 3, 063

Electronics, Intelligence&Suppo

rLand&Armaments 6, 407 3, 538 2, 115 1, 270 482

Programmes & Support 4, 638 5, 327 4, 615 4, 660 -

International 3, 333 3, 359 3, 428 3, 138 -

Programmes - - - - 2219

Customer Solutions & Support - - - - 2, 856

Integrated Systems & Partnerships - - - - 2, 022

HQ & Other Businesses 235 243 295 471 464

Intra-operating group sales (529) (673) (695) (655) (417)

18, 543 15, 710 13, 765 12, 581 10, 689

Underlying EBITA6 (restated)

Electronics, Intelligence & Support 506 437 429 324 256

Land & Armaments 566 324 168 86 (8)

Programmes & Support 491 456 331 261 -

International 35 435 412 403 -

Programmes - - - - 10

Customer Solutions & Support - - - - 497

Integrated Systems & Partnerships - - - - 95

HQ & Other Businesses (101) (203) (146) (117) (50)

1, 897 1, 449 1, 194 957 800

Profit/(loss) on disposal of businesses 238 40 13 (4) -

Uplift on acquired inventories - (12) - (44) -

EBITA5 2, 135 1, 477 1, 207 909 800

Amortisation and impairment

of intangible assets (424) (297) (139) (122) (110)

Finance costs including

share of equity accounted investments 697 93 (174) (196) (132)

Profit before taxation 2, 408 1, 273 894 591 558

Taxation expense including shar

e of equity accounted investments (640) (373) (248) (147) (219)

Profit for the year from

continuing operations 1, 768 900 646 444 339

Profit/(loss) for the year

from discontinued operations – 22 993 111 (336)

Profit for the year 1, 768 922 1, 639 555 3

Balance sheet

Intangible assets 12, 306 9, 559 7, 595 8, 217 6, 115

Property, plant and

equipment, and investment property 2, 558 1, 887 1, 869 1, 922 1, 901

Non-current investments 1, 040 787 678 1, 730 1, 535

Inventories 926 701 395 485 498

Payables (excluding cash

on customers' account) less receivables (5, 866) (5, 373) (4, 298) (4, 596) (3, 891)

Other financial assets and liabilities 240 52 6 (7) –

Retirement benefit obligations (3, 365) (1, 629) (2, 499) (4, 101) (3, 210)

Provisions (845) (809) (695) (718) (491)

Net tax 256 63 648 1, 012 876

Net cash/(debt) 39 700 435 (1, 277) (668)

Disposal groups held for sale – 64 – 137 –

Minority interests (55) (36) (17) (16) (10)

Total equity attributable

to equity holders of the parent 7, 234 5, 966 4, 117 2, 788 2, 655

Financial statement and cash flow analysis,

After the 2003 recession, Europe's aerospace industry will experience a steady growth phase. As prediction, there will be a 3.9% annually growth, which is also reflected in BAE System's financial report after 2004.

Profitability Analysis

Profitability mainly in Revenues, Sales, Operating profit, Order book, Return on sales, Net cash, and Cash inflow from operating activities.

The company recorded revenues of \$20 billion during the fiscal year ended December 2005, an increase of 25% over 2004. The operating profit of the company was \$1.6 billion during fiscal year 2005, an increase of 16.3% over 2004. The net profit was \$1 billion in fiscal year 2005, compared to a net profit of \$5.5 million in fiscal 2004. And for the company Europe - Aerospace & Defense in 2005 it generated revenues of \$42.5 billion, an increase of 7.7% on the previous year. The European aerospace & defense market generated total revenues of \$184.3 billion in 2008, representing a compound annual growth rate (CAGR) of 9% for the period spanning 2004-2008. However the BAE system has higher the average.

Sales represents the amounts derived from the provision of goods and services, and includes the Group's share of sales of its equity accounted investments. Compared with 2004, the sales of BAE increased by 14.2% in 2005, 2.1% in 2006, 16.4% in 2007 and 37.6% in 2008. Overall, BAE's sales

revenue is in an increase trend. Starting in 2006, a significant increase had been shown and compared with 2007 the sales of 2008 increased by 18%. The significant increase in sales in 2008 has primarily been caused by the Land & Armaments operating group due to high armoured wheeled vehicle volumes in the US and full-year impact of the Armor acquisition. This shows that BAE's products have strong market potential.

Operating profit. Operating profit is an indicator to measure of business efficiency. BAE Systems recorded revenues of 16,671 million in the financial year 2008 which is an increase of 16.5% over 2007. For the 2008, the US which is the company's largest geographic market, accounted for 56.4% of the total revenues. Operating profit in 2008 is 2.2 times of 2004, in 2007 it increased 52.1%, from £774m in 2004 to £1177m. Operating profit is showing the trend of rising year by year reflects a good profitability of BAE's business. There is a very good market prospects of the enterprise.

Inventory turnover. Decline in inventory turnover. However, when compared with the same industry Boeing it is still very high. Accounts receivable turnover in 2005 and 2006 was lower than that in the other early years. However, in 2007 and 2008, BAE's accounts receivable turnover increased substantially. Total asset turnover ratio is relatively stable, but slightly higher than the industry standard.

Order book. Order book reflects the popularity of the product, it also shows the potential of products in the market. However, the number of orders can not be a comprehensive response to the operating performance of companies. Between 2005 and 2004, the order book was increasing, while in

2006 the book order was only 31.7 bn, reduced almost by 37%. Then there was a recover and in 2008 the order book was 46.5bn although it was still less than 2004. Reduction in order book illustrates the business sales market in the shrinking. Reduction in main business volume, indicating that the development of enterprises might have gone wrong strategy.

Return on sales. From the table it can be seen that the return on sales is increasing year by year, but the order is indeed in reduction. The Profit for the year in 2006 is very high however the cash inflow from operating activities in this year was the least. It may be there is something that cannot be reflected in the financial report, the other businesses increasing cause income to increase, so it is not reflected in the financial report which is about the return on sales.

Cash inflow from operating activities. Cash inflow from operating activities is used to determine the actual gap between company's operating cash flow and financial reporting operating income or net income. (Hans, 2007). From the table that the operating business cash flow shows a downward trend during the five years. That is to say compared with 2004 the cash inflow from operating activities reduced by 10.7% in 2005, 61.1% in 2006, 8% in 2007, 14.5% in 2008. The 2008 reduction in operating business cash flow largely reflects utilisation of Saudi Typhoon advances received in 2007 and an agreed repayment to the UK Ministry of Defence in respect of the Astute programme. However, it reflected there is something wrong with the company's cash flow.

Net cash. The cash flow was £700m in 2006, however, in 2007 it reduced by 28% and became £435m, even worse in 2008, it is only £39m. In 2008, 43% of the cash flow ratio is too high compared to the same industry. Capital utilization rate is low, so a decline in cash flow to investors is a positive message. And in 2008 29.65 percent of the cash-flow ratio compared to the industry is relatively high. The company Europe – Aerospace & Defense recorded a net cash of \$2.1 billion up 40% in an average.

The reduction of the net cash flow shows that there is some problem in the cash inflow of the company, it may have a bad effect on the operating and development of BAE. However overall level still very high for the company.

Solvency analysis.

Overall there is a very strong solvency. In particular, in year 2005 and 2006, current ratio were more than 2¼. Quick ratio exceeds 1. But it is also the performance of the low efficiency of fund utilization. Although the 2007 and 2008, the flow rate and the liquid have declined more. But does not affect the solvency. And the increased utilization of funds. Assets is responsible for rising rates, leading to long-term solvency has been reduced low. But the asset-liability ratio does not exceed 50%, the long-term solvency remains strong.

Analysis of share price performance

Comments on company management/board of directors and the stock market

The Board promotes a common culture and identity through the Operational Framework. It sets out the way we do business and what it means to be part of the Group. It is the Group's framework for a sound system of internal controls. All employees are required to comply with the Operational Framework in their business conduct.

The BAE Company's TSR (share price growth plus dividends) ranking relative to a comparator group of 18 other international defence and aerospace companies such as Boein, General Dynamics, Raytheon , Cobham, Dassault Aviation, EADS, Embraer PN, Finmeccanica and so on.. None of the shares vest if the Company's TSR is outside the top 50% of TSRs achieved by the sectoral comparator group and 100% vest if it is in the top quintile (ie top 20%) as set out below(Herve, 2006) Rationale for performance measures: importance to major investors as an indication of both earnings and capital growth relative to other major companies in the same sector and to ensure that awards only vest if there has been a clear improvement in the Company's performance over the relevant period.

EBITA .

EBITA refers to a company's income before the deduction of interest, tax and amortization expenses. It is also consistent with the profit measure which is used by BAE to analysis internal performance and as a measure of operating profitability that is comparable over time. ¤€, Underlying EBITA increased 86.7% in 2008 which reaches to ;i1, 897m compared with 2004, and 31%

compared with 2007. according to the calculation , compared with 2004, EBITA increased 45. 4% in 2007, 18. 8% in 2006 and 16. 3% in 2005. Underlying EBITA during the five years is increasing growth all the time . View of the circumstances from the BAE, there is a very good return on investment . That is very likely to achieve value and hedging to buy its stock.

Underlying earnings per share.

From the table it can be seen that Underlying EPS is 37. 1p in 2008 which increases 23% compared with last year. And there is a 28. 1% increase in 2007, 30. 6% in 2006, 29. 3% in 2005. All these increase are compared with the year before. Companies and the stock market do not like fluctuating EPS's. In the past BAE EPS growth rate 35. 25%¼Egrowth potential is still very good and EPS Stability is very good too. Companies operate is stable and reasonable.

The Underlying earnings per share of BAE does not fluctuate badly, so it is good for its shareholders. And Underlying EPS continue to rise mainly reflecting higher underlying EBITA of the BAE.

BAE as an aviation industry leader¼Ein the 2004-2008 years, the company's revenue and profit growth. From 2006 to 2008 BAE's profitability continued to rise. In particular, rising faster in 2008.

Recommendation to investors

Based on the above analysis, it can be seen the company's operating capacity is very light, and development prospects is very good, its position in the industry is also high. The company will continue to develop, and will continue to grow. With the recovery in economic development, the

company's operations development will gradually resume, which will cause the Company's stock price rebound. Therefore, the long-term investors can look up a little, and continue to hold its shares, to realise the purpose of increasing the value of their money. For short-term investors they will have to stage development according to the company, select the appropriate strategy to achieve their own purposes.

SWOT ANALYSIS

Strengths

Weaknesses

BAE achieved with many business acquisitions, and establish friendly and long-term relationship with the United Kingdom and other countries, through the merger, the company's growth has been greatly improved.

Diversified business

The company has advanced technical level.

Strong growth in revenue and profits

Relatively low employee productivity

Unfunded employee post retirement benefits

Sluggish performance in key segments

Fixed-price contracts risk

The Group is exposed to risks inherent in operating in a global market.

The Group is involved in consortia, joint ventures and equity holdings where it does not have control.

Opportunities

Threats

With the intensification of regional conflicts more demand for defense products is also increasing, thus creating a large demand for the company's products, especially the United States, defense products demand is very huge.

Huge international market and the demand for defense products offers great opportunities for BAE's development.

Growth in global aerospace and defense

Intense competition

High dependence on government contracts

Recommendations

Minimize the fixed-price contract and control the initiative rests in its own hands. At the same time to manage contract-related risks and uncertainties, contracts are managed through the application of the Lifecycle Management (LCM) business process mandated by the Group's Operational Framework at the operational level (Flower, 1998)

The Group has formal systems and policies in place which are mandated under the Group's Operational Framework to ensure adherence to regulatory

requirements and to identify any restrictions that could adversely impact the Group's future activities.

The Group has formal systems and procedures in place to monitor the performance of such business arrangements and identify and manage any adverse scenario arising.

In order to protect itself against currency fluctuations, the Group's policy is to hedge all material transactional exposures, unless otherwise approved as an exception by the Treasury Review Management Committee, as well as to manage anticipated economic cash flow exposures over the medium term.

Conclusion

BAE is in a leading position in the aviation industry. Both operating profit margin or asset turnover ratio is higher than the level of the same industry. However, compared with other companies in the industry, the use of financial leverage is not very good, capital utilization rate is not high. From the above there is still great room for BAE development. The future development considerations from the following two: One is to raise operating margin. Second, make full use of financial leverage effect, because of its financial leverage below the level of the same industry.

The most important thing for the company is upgrading in innovation and technological. Encourage the development of a new ideology. New technologies and new ways of working and bring them with a lasting competitive edge.

And for the investors, because in the past BAE EPS growth rate 35.25% growth potential is still very good and EPS Stability is very good too, so they can buy stocks of the company at present time. (David Tyrrell, 2007) Under the financial Crisis, government purchases declined, but as the recovery of the financial environment the company's business will increase, operating profits will increase substantially. Therefore, with the improvement of operating conditions the stock price will be in a good direction.