

## DESK NOTE

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### Rolls Royce PLC (RR/EUR RU) – *Tailwinds And Strong Results Push Stock, But Valuation Remains a Concern*

**Conclusive Summary:** We recommend avoiding Rolls-Royce at current levels, as we see the stock driven primarily by momentum and expect some reversion in the mid-term unless earnings continue to exceed expectations.

While the company has made a strong post-COVID turnaround, with 2024 adjusted operating profit up 55% YoY to £2.46 billion and free cash flow surging 89% to £2.43 billion, its valuation appears demanding, pricing in much of the restructuring-driven improvements. The £1 billion share buyback and 6.0p dividend announcement may provide near-term support, but **we believe sustained upside depends on further margin expansion and consistent earnings beats**. With 2025 guidance for adjusted operating profit (£2.7B–£2.9B) and free cash flow (£2.7B–£2.9B) exceeding consensus estimates, positive surprises remain possible, yet we remain cautious given the stock's recent rally. The stock, however, **can be a solid investment for momentum investors, given the tailwinds in all of its segments** due to AI data center power needs (Power Systems & SMR), increased military spending in the EU (Defense), and improving engine flying hours (Civil Aerospace).

**Competitive Position:** Rolls-Royce holds a leading position in **widebody aircraft engines** but lacks presence in the high-growth **narrowbody market**, dominated by GE-Safran and P&W. Its **Defense** segment benefits from strong positions in **submarine nuclear propulsion** and key military programs like AUKUS and GCAP. In **Power Systems**, its **mtu brand** is a major player in **data center backup power**, competing with Cummins and Caterpillar, while investing in **Battery Energy Storage Systems**. Rolls-Royce is also an early leader in **SMRs**, advancing UK regulatory approval. **The company's competitive edge lies in high-value aftermarket services, technological innovation, and long-term government contracts**, but challenges remain in **narrowbody aerospace, U.S. defense markets, and SMR commercialization**.

**Valuation:** Using a combination of multiple and DCF valuation, **we reach a blended target price (TP) of €7.60, -14% below current levels**. Due to significant fundamental improvements we expect RR to trade at multiples about 1.5 standard deviations above its 2Y historic multiples. The stock is trading at the 2.5-3.5 standard deviations above its 2-year multiples, and although at a premium still reasonable compared to industry averages. **We suggest avoiding RR stock and suggest reconsidering around €6**.

Ticker: RR/EUR EU

Previous day close price: €8.91

Price range (52w.): €4.27 - €9.28

Reason for note: FY24 earnings

Target price: €7.62 (-14% downside)

Recommendation: ***Avoid***

**Description:** Rolls-Royce Holdings plc (LSE: RR, OTC: RYCEY) is a UK-based engineering company specializing in power and propulsion systems for aerospace, defense, and industrial applications. The company operates through three core business segments:

- **Civil Aerospace (51% of Revenue)** – Designs and manufactures jet engines for commercial aircraft, generating revenue primarily through long-term service contracts under the “Power by the Hour” model.
- **Defense (25%)** – Supplies military jet engines and submarine nuclear propulsion systems, providing stable, government-backed revenue.
- **Power Systems (24%)** – Produces high-performance engines for marine, rail, and power generation applications, including the MTU brand.

Additionally, Rolls-Royce is investing in emerging technologies such as **sustainable aviation fuel (SAF), electric propulsion, and small modular nuclear reactors (SMRs)** to position itself for long-term growth in energy transition markets. The company's revenue model is anchored in **recurring service contracts**, benefiting from increasing global air travel and defense spending.

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Multiple Next 12 Months		Financial Metric	Target EV	Net Debt	Target MCap	Shares	Target Price
EV/Rev	3.1	22,920	71,052	980	70,072	8,505	€8.24
EV/EBITDA	17.0	4,259	72,404	980	71,423	8,505	€8.40
P/FCF	20.6	3,236				8,505	€7.84
Avg. Multiple Price							€8.16
Avg. DCF Price							€7.07
Avg. Multiple & DCF Price							<b>€7.62</b>

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