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Industrials - Aerospace & Defense

Thales S.A. (HO FP)

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RATING	PRICE TARGET	PRICE	52-WEEK RANGE
SELL	**€240**	**€262.40**	**€212.60 – €279.30**

The market prices Thales as a Defence pure-play. It is not one, and H1 2026 shows what that costs. Defence delivered a 100bp margin improvement and Aerospace 130bp. However, the group margin only rose by 35bp because Cyber & Digital (CDI), 16% of sales, gave back 360bp. This matters because of what the current price requires.

At €262.40, our reverse DCF implies a terminal adjusted EBIT margin of 15.9% sustained from 2035 to perpetuity, which is above the upper end of management's own 2028 ambition of 13–14%. Thales is owned by both the French State and Dassault Aviation (53.2% of capital, 66.3% of voting rights) which clearly secures a sovereign position only a few peers can match. But the operating leverage the market is paying for is generated in one segment and consumed in another.

Investment Thesis

- **A conglomerate valued close to a pure-play:** Thales trades 77% of the way from the conglomerate value to the pure-play value, when it is structurally closer to Leonardo and Indra than to Rheinmetall or Kongsberg.
- **H1 2026 exposes the dilution mechanism:** Defence & Aerospace added 91bp to the group margin, but the group only retained 35bp. Digital Identity alone (10.2% of sales) removed 57bp for the group.
- **Exail Acquisition:** Even though it is a strong fit strategically, at 24x 2027 EBIT post cost synergies (vs 15.8x for Thales itself), the price already captures the entirety of the value created. From our DCF, the deal is really worth between -€1.9 and -€2.7 per share, depending on the terminal method. This value is obtained by capitalizing the €90m of synergies in perpetuity.
- **The price target does not require a bear case:** Our €240 target is the average of Gordon Growth (€235) and Exit Multiple (€245) approaches, implying 8.5% downside. The base case already assumes that CDI adj EBIT margin recovers from 10.9% in H1 2026 to 13.5%, and that Defence sustains a 14% adj EBIT margin against a 13.2% three-year average.

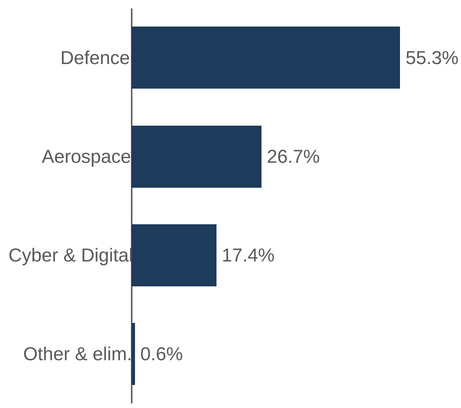
Key Estimates

(EUR)	2026E	2027E
Revenue (€m)	23,938	26,303
Adj. EBIT (€m)	3,064	3,451
Adj. EPS (€)	10.97	12.64
FCF (€m)	2,004	2,533

Model Inputs

WACC	8.41%
Cost of Equity	8.46%
Beta (levered)	1.007
Terminal growth	2%
Exit EV/EBIT	13.9x
Tax rate	21%
Forecast horizon	10Y

Fig 1: FY2025 revenue mix



Source: Thales URD 2025

Market prices a pure-play, Thales is a conglomerate

Thales operates through three segments: Defence (55% of 2025 sales), Aerospace (27%), and Cyber & Digital (17%). Valuing each segment on the multiples of its own pure-play peers gives an estimated value per share of €292, meaning the market is only applying a 10% discount for a conglomerate here. Applying the multiples of Leonardo and Indra Sistemas gives €163.50. This means that the market is valuing Thales 60% above what those multiples imply. Combining those two results gives us the fact that Thales is trading 77% of the way toward a pure standalone play, when it is structurally closer to Leonardo & Indra than to Rheinmetall or Kongsberg.

When combining Defence & Aerospace together, they added 91bp to the group margin in H1 2026. The group delivered only 35bp. The entire difference is Digital Identity: representing only 10.2% of sales, its margin fell from 14.6% to 9.0%, removing 57bp for the group. On the other hand, Cyber was stable at 14.0% and cost the group nothing. This is the conglomerate mechanism in a single half-year.

Valuation signal

Pure-play SOTP	**€292**
Current price	**€262.40**
Leonardo–Indra SOTP	**€163.50**

Our take: spot already gives most of the rerating associated with becoming a defence pure-play, without the group having deconglomerated.

Fig 2: H1 2026 group margin bridge

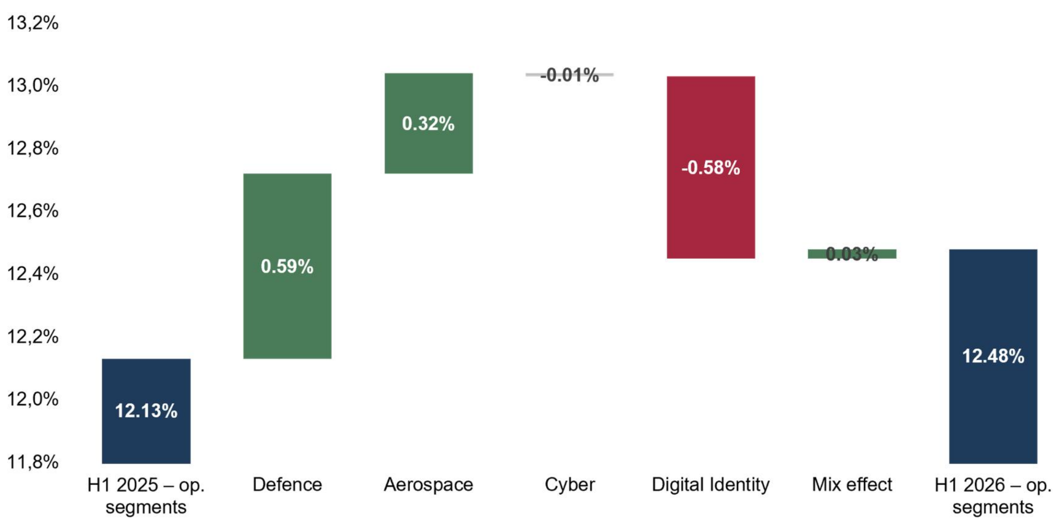
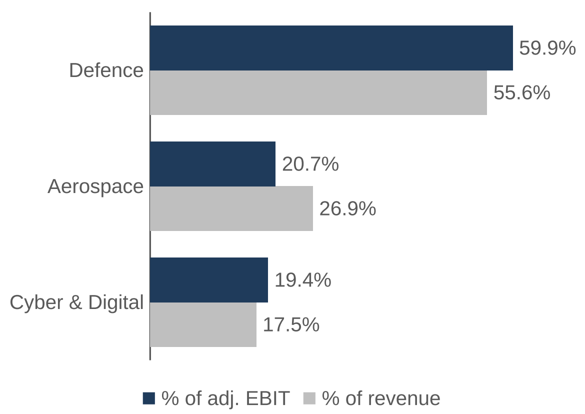


Fig 3: FY2025 revenue vs adjusted EBIT mix



The strategic defence is not visible in the numbers

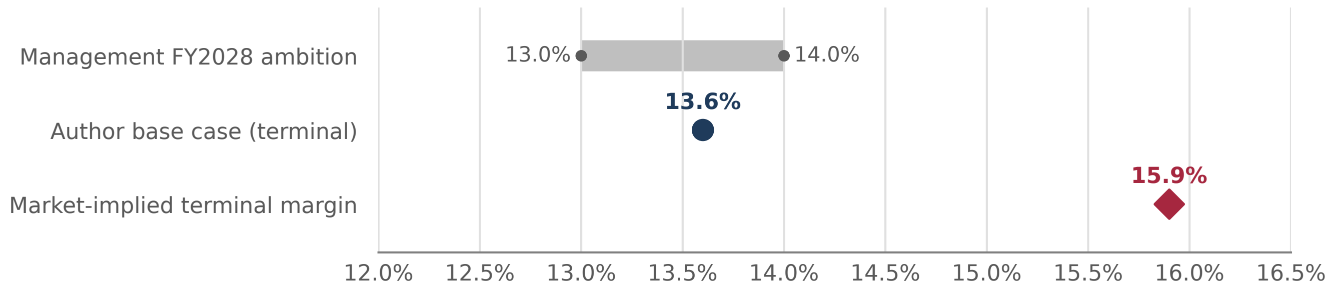
There is one way out of the valuation gap: divesting the underperforming businesses and becoming a pure-play. This was rejected by management during the H1 2026 earnings call. When asked directly whether CDI was a distraction, management rejected the premise, describing it as "a good and profitable business" and defending it on technology grounds (for example cloud capabilities the group did not master before the CDI acquisitions) now feeding Defence and Aerospace, without this showing in the figures.

Our take: The question anyone should ask before buying Thales is whether they believe Digital Identity is about to turn around. We do, and our base case has CDI margin recovering from 10.9% to 13.5% by FY2030. It still is not enough to justify spot.

What €262 implies

The current price can be reached only by making one of three demanding assumptions: a terminal margin above management's ambition, a discount rate near the bottom of our plausible range, or a structurally higher terminal multiple. Our base case uses none of the three.

Fig 4: The market-implied terminal margin sits above both guidance and our base case



a) Terminal EBIT margin

Our reverse DCF implies a 15.9% terminal adjusted EBIT margin from FY2035 into perpetuity, above management's 2028 ambition of 13–14% and above even our bull case. The gap is meaningful because Thales must keep investing to protect its technology position: self-funded R&D represents 6.2% of group revenues and grew 9% organically in H1 2026, ahead of the 7.8% organic growth in sales. This investment is necessary, and of course it limits the operational leverage.

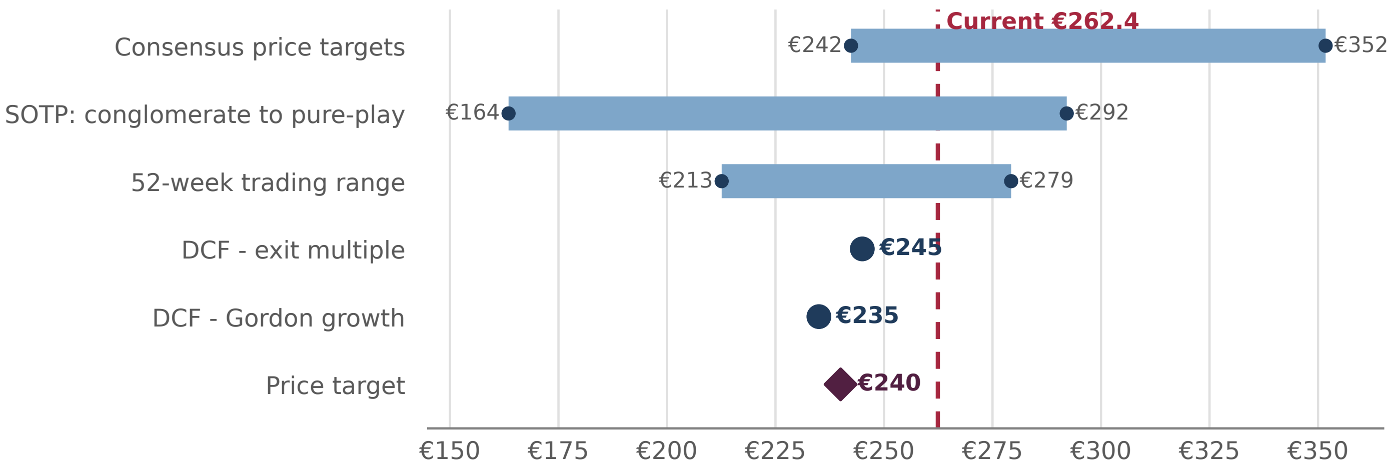
b) Discount rate

Still following our numbers, it would require a 7.79% WACC to reach €262.40. This sits within the range implied by the two beta methods we consider (see Beta methodology, p.4). We come up with a WACC range between 7.61% and 8.41% (the latter being what we retain). Even at the most optimistic end of that range, the implied value per share of our DCF is only 3.6% above the current share price. Again, this supports our thesis of a valuation that is too demanding at the moment.

c) Terminal multiple

Thales currently trades at 17.0x EV/adjusted EBIT NTM. Some re-rating is warranted, as the 2023–24 disposals of Transport and aircraft electrics lifted the Defence weighting. But the two-year window is entirely post-rearmament, and fixing a 2035 terminal multiple on it assumes the re-rating is permanent. Our reverse DCF shows the market itself does not believe that and implies a terminal multiple is 13.7x, already a fifth below the current level. We assume 12.3x, the ten-year median. The valuation gap sits in that 10% difference.

Fig 5: Valuation ranges and price-target construction



The €240 target is coming from the mean between our two methods: €235 under Gordon Growth and €245 under the Exit Multiple method.

Beta methodology

Our Beta is 1.007. Finding a relevant Beta was hard because of the decoupling of Thales from the S&P 500 or the CAC 40, notably after the re-rating of defence companies. Our method is therefore based on Damodaran's figures for Aerospace & Defence companies (67 companies within the same group) and Cyber & Digital (290 companies). Although we acknowledge this method is not perfect, as the firms we are taking into account are not necessarily similar in growth and risk to Thales, this is the best option we have. It yields a 1.007 Beta and a base DCF value of €235.03, a 10.4% discount to the current share price.

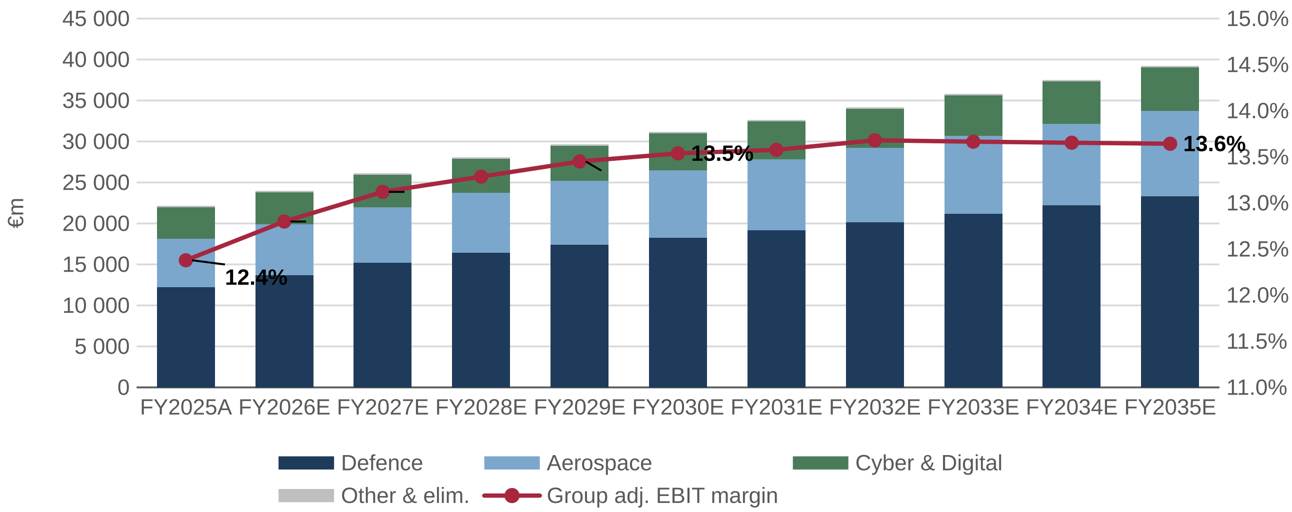
Our second method, which we chose not to retain, was a two-year regression (a window sitting entirely after the Ukraine shock), adjusted using the Blume method, on the rationale that betas converge towards 1 over time.

We ran two regressions on two separate windows, 2 and 5 years. Over 260 weeks it produces a beta of 0.363 with an R^2 of 0.035; over the last 104 weeks, 0.782 with an R^2 of 0.110. An estimate that doubles depending on the window, and where the index explains at best 11% of weekly variance, is not one we can base our valuation on. Our bottom-up estimate of 1.007 also falls inside the 95% confidence interval of the two-year regression, which means that we cannot reject it.

Base case assumptions - Detailed

Our base case does not rely on an economic downturn. Defence order intake remains strong, and Aerospace has visible structural support. We also assume a recovery in Digital Identity. But we do assume that these are not enough to convert those tailwinds into the margins and cash implied by the current price.

Fig 6: Base-case revenue by segment and group adjusted EBIT margin



Defence

We assume low double-digit growth for the next two years up to 2027, followed by a slow decline from 8% to 5% by 2030 and continuing thereafter. The order book is strong, with structural tailwinds for the Defence sector (rising geopolitical tensions, NATO members committing to 3.5% of GDP on core defence plus 1.5% on defence-related infrastructure by 2035). The real deciding factor is therefore Thales' capacity to absorb that growth. The Group did invest heavily in capacity in 2025 (net operating investments up 21% year-on-year, at 3.4% of sales), so we are confident it can continue to deliver in the coming years.

On margins, we believe they are already fairly elevated and that there is not much left to improve. This is mostly because the clients are mainly States: governmental customers account for around 60% of group sales, and defence pricing is negotiated and audited, which caps margin by construction rather than by execution.[a] We therefore hold the margin at 14.0% from 2027 to 2035.

[a]Thales 2025 URD, section 3.3.1 c) — Customer credit, p.75.

Aerospace

Avionics represents a fairly solid market, with forecast growth of 3.9% a year in passenger traffic and 3.4% in fleet size through 2045.[a] Space reached breakeven in 2025, with further improvement in H1 2026. However, some of the space growth is currently disturbed by the pressure in GEO (notably with a cancellation for €150m), and a market coming from 20 satellites a year to 10.[b] Thus, we assume (for the aggregate) a high single digit from 2027, decreasing slightly to 6% in 2030, and 4.5% in 2035 in perpetuity.

In terms of margin, they are solid, and could continue growing slightly in the years to come. We project 10.5% in FY2026, to 12% in 2029 and at perpetuity.

[a]Airbus Global Market Forecast 2026–2045, published 8 July 2026.

[b]Thales 2025 URD, section 2.1.1.3.2, Space — Competitive position.

Cyber & Digital

There was a return to organic growth in Q4 25 for Cyber Products, but Cyber Premium Services was still down double digits.[a] We can expect a recovery from Cyber, as the market is nowadays supported by the needs in AI. On Digital Identity, the picture is less attractive, and we don't forecast a lot of growth in this sector. As we mentioned, the management concedes that DI does not show in the figures for now, but is useful to the group. Still, we forecast 1% of growth for FY 2026, to 4% in 2028, then 3.5% in perpetuity. In terms of margin, both activities have fairly high and resilient margins. However, the sharp drop we saw in H1 2026 is a red flag (with DI adjusted EBIT down 39.5% organically, on virtually flat sales), meaning that Thales may not be able to support those margins indefinitely. For our base case, we try not to be too pessimistic and still forecast 13.5% of adjusted EBIT margin from 2030 and to perpetuity.

[a]Thales 2025 URD, section 2.3.4 — Sales, p.48.

Our take: Our assumptions sit within management's own 2028 ambition, and we assume Digital Identity recovers. Our disagreement comes from the current price and what it asks Thales to deliver, rather than from what Thales will be able to deliver.

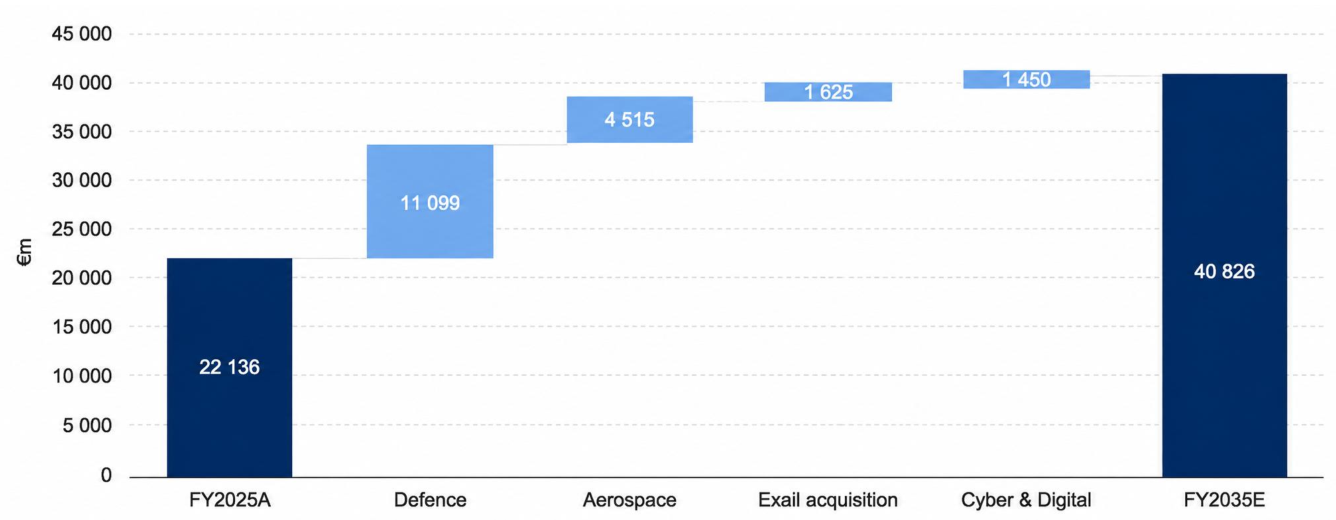
FY2026 group margin	**12.8%**	**FY2027 group margin**	**13.1%**	**Terminal margin**	**13.6%**
FY2025–35 sales CAGR	**6.3%**	**CAGR ex Exail**	**5.9%**	**FY2028 ambition**	**13–14%**

Exail: a strategic fit, but fully priced

The Exail acquisition is a strong strategic fit, but the price already captures the entirety of the value created.

24.0x **FY2027 EBIT paid, post cost synergies**	**15.8x** **Thales' current multiple**	**2032** **Earliest year adjusted ROCE is guided above WACC - Management Guidance**

Fig 7: FY2025–35 revenue growth bridge



Deal economics

At 24.0x FY2027 EBIT after cost synergies, Exail is priced well above Thales itself. From our DCF, the deal is really worth between -€1.9 and -€2.7 per share, depending on the terminal method. This value is obtained by capitalizing the €90m of synergies in perpetuity.

Terminal method	Impact / Thales share
Exit Multiple	**-€1.9**
Gordon Growth	**-€2.7**

Yes, the negative value is modest relative to the group, but it does matter because M&A is being used to reinforce the pure-play narrative that we mentioned.

Return profile and methodology

Management clearly concedes that the value creation takes time, guiding the adjusted ROCE to be above WACC 5 years post-closing, so in 2032 at the earliest, which is a long payback period for a transaction this expensive.

The method we used was to forecast revenues, EBIT after synergies to incorporate those in the DCF. On the other hand, we included the €3.9bn used for the acquisition in the EV -> EqV bridge (discounted in the different periods Thales has to put out cash).

Our take: a good asset can still be a poor transaction. Exail adds strategic strength and €1.6bn to our FY2035 revenue bridge, but the purchase price already captures the synergy case.

Risks & Catalysts

The key asymmetry is that our Sell rating already assumes a meaningful recovery in the weaker businesses. The principal risk is therefore that Defence, Space or Digital Identity delivers materially more than our base case, rather than simply meeting management's existing ambition.

What would make us wrong

- **Defence margins continue to expand:** H1 2026 was already at 13.8%, up 100bp YoY, when we hold 14.0% flat to 2035. Our own bull case has it at 14.5%.
- **Digital Identity turns around:** A genuine recovery in volumes and mix, or clear evidence that CDI capabilities lift Defence and Aerospace economics, would weaken our thesis.
- **Space exceeds the turnaround plan:** A margin above management's 7% objective, with less GEO pressure and stronger LEO exposure, would add upside to Aerospace.
- **Exail delivers more than cost synergies:** Revenue synergies, faster integration or a quicker ROCE ramp could turn this acquisition into a value-creating one.
- **Our terminal multiple is too conservative:** We take the ten-year median at 12.3x, when the market implies 13.7x and the stock trades at 17.0x today. On 13.7x we land at the current share price.

Potential catalysts

- **Q3 2026 sales and order intake:** The release (22 October 2026) provides the next check on Digital Identity profitability and Defence production conversion.
- **Airbus–Leonardo–Thales space combination:** If antitrust allows this operation, it is a partial de-conglomeration, so exactly what would close the discount we are pointing at.
- **PNF and SFO investigations:** The matters disclosed in Note 11 remain unprovisioned and unquantified. Any update could affect both earnings and the risk premium.

Conclusion

Thales is well positioned in important subjects like Defence, Space & Cyber Security, but the valuation is too demanding at present. The group is a well managed conglomerate, but the market seems to value it as a pure-play player. Thus, we forecast some kind of de-rating, lowering the share price to €240 (mean of our DCFs with Gordon Growth and Exit multiples), meaning an 8.5% downside from current market price.