

RISK FACTORS

1. Financial Market Risks	8
2. Business-Related Risks	10
3. Legal Risks	14
4. Industrial and Environmental Risks	15

EADS is subject to many risks and uncertainties that may affect its financial performance. The business, financial condition or results of operations of EADS could be materially adversely affected by the risks described below. These risks are not the only ones facing EADS. Additional risks not presently known to EADS or that it currently deems immaterial may also impair its business operations.

1. Financial Market Risks

Exposure to Foreign Currencies

A significant portion of EADS' revenues is denominated in U.S. Dollars, while a substantial portion of its costs is incurred in Euro, and to a lesser extent, in Pounds Sterling. Consequently, to the extent that EADS does not use financial instruments to cover its exposure resulting from this foreign currency mismatch, its profits will be affected by market changes in the exchange rate of the U.S. Dollar against these currencies. EADS has therefore implemented an exchange rate strategy in order to manage and minimize such exposure. In order to secure the rates at which U.S. Dollar revenues (arising primarily at Airbus and in the commercial satellite business) are converted into Euro or Pounds Sterling, EADS manages a long-term hedging portfolio. There are complexities inherent in determining whether and when foreign exchange rate exposure of EADS will materialize, in particular given the possibility of unpredictable revenue variations arising from order cancellations and postponements. Furthermore, as a significant portion of EADS' foreign currency exposure is hedged through contractual arrangements with third parties, EADS is exposed to the risk of non-performance by its hedging counterparties. No assurances may be given that EADS' exchange rate hedging strategy will protect it fully from significant changes in the exchange rate of the U.S. Dollar to the Euro and the Pound Sterling and that such changes will not affect its results of operation and financial condition.

EADS' consolidated revenues, costs, assets and liabilities denominated in currencies other than the Euro are translated into the Euro for the purposes of compiling its financial statements. EADS' exchange rate hedging strategy aims to cover its cash flows, and, to a large extent, earnings before interest and taxes, pre-goodwill impairment and exceptionals ("EBIT*"). Changes in the value of these currencies relative to the Euro will have an effect on the Euro value of EADS' reported revenues, costs, assets and liabilities and, to a lesser extent, EBIT*.

Currency exchange rate fluctuations in those currencies other than the U.S. Dollar in which EADS incurs its principal manufacturing expenses (mainly the Euro) may have the effect

of distorting competition between EADS and competitors whose costs are incurred in other currencies. This is particularly true with respect to fluctuations relative to the U.S. Dollar, as many of EADS' products and those of its competitors (e.g., in the defence export market) are priced in U.S. Dollars. EADS' ability to compete with competitors may be eroded to the extent that any of EADS' principal currencies appreciates in value against the principal currencies of such competitors.

See "1.1.4.3 EBIT* Performance by Division — Hedging Impact on EBIT*" for a discussion of EADS' foreign currency hedging policy. See "1.1.3.7 Accounting for Hedged Foreign Exchange Transactions in the Financial Statements" for a summary of EADS' accounting treatment of foreign currency hedging transactions.

Exposure to Sales Financing Risk

In support of sales, EADS (primarily through Airbus and ATR with respect to commercial aircraft) may agree to participate in the financing of customers. As a result, EADS has a significant portfolio of leases and other financing arrangements with airlines. The risks arising from EADS' sales financing activities may be classified into two categories: (i) credit risk, which concerns the customer's ability to perform its obligations under a financing arrangement, and (ii) aircraft value risk, which primarily relates to unexpected decreases in the future value of aircraft. Measures taken by EADS to mitigate these risks include optimised financing and legal structures, diversification over a number of aircraft and customers, credit analysis of financing counterparties, provisioning for the credit and asset value exposure, and transfers of exposure to third parties. No assurances may be given that these measures will protect EADS fully from defaults by its customers or significant decreases in the value of the financed aircraft in the resale market.

EADS' sales financing arrangements expose it to aircraft value risk, because it retains collateral interests in aircraft for the purpose of securing customers' performance of their financial obligations to EADS, and because it guarantees part of the market value of certain aircraft during limited periods after


[Back to Contents](#)


their delivery to customers. Under adverse market conditions, the market for used aircraft could become illiquid and the market value of used aircraft could significantly decrease below projected amounts. In the event of a financing customer default at a time when the market value for a used aircraft has unexpectedly decreased, EADS would be exposed to the difference between the outstanding loan amount and the market value of the aircraft, net of ancillary costs (such as maintenance and remarketing costs, etc.). Similarly, if an unexpected decrease in the market value of a given aircraft coincided with the exercise window of an asset value guarantee (“AVG”) with respect to that aircraft, EADS would be exposed to losing as much as the difference between the market value of such aircraft and the AVG amount. No assurances may be given that the provisions taken by EADS will be sufficient to cover these potential shortfalls.

Through the Airbus Asset Management Division or as a result of past financing transactions, EADS is the owner of used aircraft, exposing it directly to fluctuations in the market value of these used aircraft.

Counterparty Credit Risk

EADS is exposed to credit risk to the extent of non-performance by its financial instrument counterparties. However, the Group has policies in place to avoid concentrations of credit risk and to ensure that credit risk is limited.

Cash transactions and derivative counterparties are limited to high credit quality financial institutions. EADS has set up a credit limit system to actively manage and limit its credit risk exposure. This limit system assigns maximum exposure lines to counterparties of financial transactions, based at a minimum on their credit ratings as published by Standard & Poor’s, Moody’s

and Fitch Ratings. The respective limits are regularly monitored and updated.

As counterparty credit risk also arises in the context of sales financing transactions, EADS’ general policy is to provide financing to customers and through structures with an appropriate credit standing. See “1.1.7.4 Sales Financing”.

Exposure on Equity Investment Portfolio

EADS holds several equity investments for industrial or strategic reasons, the business rationale for which may vary over the life of the investment. Equity investments are either accounted for using the equity method (associated companies), if EADS has the ability to exercise significant influence, or at fair value. If fair value is not readily determinable, the investment is measured at cost.

EADS’ principal investment in associates is Dassault Aviation. The net asset value of this investment was €2.0 billion at 31st December 2006. EADS believes that its exposure to the risk of unexpected material adverse changes in the value of Dassault Aviation and that of other associated companies is limited. For equity investments other than associates, which make up only a fraction of EADS’ total assets, EADS regards the risk of negative changes in fair value or impairments on these investments as non-significant.

Treasury shares held by EADS are not considered to be equity investments. Additionally, treasury shares are not regarded as being exposed to risk, as any change in value of treasury shares is recognised directly in equity only when sold to the market and never affects net income. Treasury shares are held to hedge the dilution risk arising from employee stock ownership plans and the exercise by employees of stock options.

2. Business-Related Risks

Aircraft Market Cyclicity

In 2006, the combined revenues generated from Airbus and ATR represented approximately two-thirds of EADS' consolidated revenues. Historically, the commercial passenger aircraft market has shown cyclical trends, due in part to the sensitivity of passenger demand in the air travel market to growth in gross domestic product (“GDP”). Other factors, however, play an important role, such as (i) the average age and technical obsolescence of the fleet relative to new aircraft, (ii) the number and characteristics of aircraft taken out of service and parked pending potential return into service, (iii) passenger load factors, (iv) airline pricing policies, (v) airline financial health and (vi) deregulation. EADS expects that the market for commercial passenger aircraft will continue to be cyclical, and that future downturns in broad economic trends may have a negative effect on its future results of operation and financial condition.

Impact of Terrorism, Epidemics and Catastrophic Events On Aircraft Market

As the terrorist attacks in New York and Madrid and the spread of the Severe Acute Respiratory Syndrome (“SARS”) virus and avian flu have demonstrated, terrorism and epidemics may negatively affect public perception of air travel safety and comfort, which may in turn reduce demand for air travel and commercial aircraft. The outbreak of war in a given region may also affect the willingness of the public to travel by air. Furthermore, major airplane crashes may have a negative effect on the public's or regulators' perceptions of the safety of a given class of aircraft, form of design, or airline. As a consequence of terrorism, epidemics and other catastrophic events, an airline may be confronted with sudden reduced demand for air travel and be compelled to take costly security and safety measures. In response to such events, and the resulting negative impact on the airline industry or particular airlines, EADS may suffer from a decline in demand for all or certain types of its aircraft, and EADS' customers may postpone delivery of new aircraft or cancel orders.

Dependence on Defence Spending and on Certain Markets

In 2006, approximately 25% of EADS' consolidated revenues was derived from defence spending. In any single market, defence spending depends on a complex mix of geopolitical considerations, budgetary constraints and the ability of the

armed forces to meet specific threats and perform certain missions. Defence spending may be subject to significant fluctuations from year to year and country to country. Adverse economic and political conditions as well as downturns in broad economic trends in EADS' defence or may have a negative effect on EADS' future results of operations and financial condition.

In the case where several countries undertake to enter together into defence procurement contracts, economic, political or budgetary constraints in any one of these countries may have a negative effect on the ability of EADS to enter into or perform such contracts.

Further, a significant portion of EADS (including Airbus) backlog is concentrated in certain regions or countries, including the United States of America, China, India and the United Arab Emirates. Adverse economic and political conditions as well as downturns in broad economic trends in these countries or regions may have a negative effect on EADS' and Airbus future results of operations and financial condition.

Dependence

A significant portion of EADS (including Airbus) backlog is made in certain regions. In 2006, approximately 25% of EADS' consolidated revenues were derived from certain regions as derived from defence spending. In any single market, defence spending depends on a complex mix of geopolitical considerations, budgetary constraints and the ability of the armed forces to meet specific threats and perform certain missions. Defence spending may be subject to significant fluctuations from year to year and country to country. Adverse economic and political conditions as well as downturns in broad economic trends in EADS' defence markets may have a negative effect on EADS' future results of operations and financial condition.

Emergence of Public-Private Partnerships and Private Finance Initiatives

Defence customers, particularly in the U.K., increasingly request proposals and grant contracts under schemes known as public-private partnerships (“PPPs”) or private finance initiatives (“PFIs”). PPPs and PFIs differ substantially from



traditional defence equipment sales, as they often incorporate elements such as:

- the provision of extensive operational services over the life of the equipment;
- continued ownership and financing of the equipment by a party other than the customer, such as the equipment provider;
- mandatory compliance with specific customer requirements pertaining to public accounting or government procurement regulations; and
- provisions allowing for the service provider to seek out additional customers for unused capacity.

EADS is party to PPP and PFI contracts, for example through Paradigm with Skynet 5 and related telecommunications services, and involved in additional PFI proposals, such as the Airtanker (FSTA) project. One of the complexities presented by PFIs lies in the allocation of risks and the timing thereof among different parties over the lifetime of the project.

There can be no assurances of the extent to which EADS will efficiently and effectively (i) compete for future PFI or PPP programmes, (ii) administer the services contemplated under the contracts, (iii) finance the acquisition of the equipment and the ongoing provision of services related thereto, or (iv) access the markets for the commercialisation of excess capacity. EADS may also encounter unexpected political, budgetary, regulatory or competitive risks over the long duration of PPP and PFI programmes.

Competition and Market Access

Most of EADS' businesses are subject to significant competition, and Airbus has been affected by downward price pressure resulting from such competition. EADS believes that some of the underlying causes of such price competition have been mitigated by restructuring in the aerospace and defence industry. Nevertheless, certain customers have had greater leverage to encourage competition in respect of a variety of issues, including price and payment terms. No assurance can be given that competition may not intensify, particularly in the context of a prolonged economic downturn in the future.

In addition, the contracts for many aerospace and defence products are awarded, implicitly or explicitly, on the basis of home country preference. Although EADS constitutes a multinational combination which helps to broaden its domestic market, it may remain at a competitive disadvantage in certain countries, especially outside of Europe, relative to local contractors for certain products. The strategic importance and political sensitivity attached to the aerospace and defence

industries means that political considerations will play a role in the choice of many products for the foreseeable future.

Availability of Government Financing

Since 1992, the E.U. and the U.S. have operated under an agreement that sets the terms and conditions of financial support that governments may provide to civil aircraft manufacturers. In late 2004, however, the U.S. sought to unilaterally withdraw from this agreement, which eventually led to the U.S. and the E.U. making formal claims against each other before the World Trade Organisation ("WTO"). While both sides have expressed a preference for a negotiated settlement that provides for a level playing field when funding future aircraft developments, they have thus far failed to reach agreement on key issues. The terms and conditions of any new agreement, or the outcome of the formal WTO proceedings, may limit access by EADS to risk-sharing-funds for large projects, or may establish an unfavourable balance of access to government funds by EADS as compared to its U.S. competitors.

In prior years, EADS and its principal competitors have each received different types of government financing of product research and development. For example, EADS received repayable financing from certain governments in relation to the A380 commercial aircraft programme, and is in discussions with certain E.U. countries regarding financing for the development of the A350XWB commercial aircraft programme. However, no assurances can be given that government financing will continue to be made available in the future for these and other projects, in part as a result of the proceedings mentioned above.

Technologically Advanced Products and Services

EADS offers its customers products and services that are often technologically advanced, the design and manufacturing of which can be complex and require substantial integration and coordination along the supply chain. In addition, most of EADS' products must function under demanding operating conditions. Even though EADS believes it employs sophisticated design, manufacturing and testing practices, there can be no assurance that EADS' products or services will be successfully developed, manufactured or operated or that they will be developed or will perform as intended.

Certain of EADS' contracts require it to forfeit part of its expected profit, to receive reduced payments, to provide a replacement launch or other product or service, or to reduce the price of subsequent sales to the same customer if its products fail to be delivered on time or to perform adequately. No

assurances can be given that performance penalties or contract cancellations will not be imposed should EADS fail to meet delivery schedules or other measures of contract performance.

For example, following the production difficulties that EADS encountered in 2006 in connection with its A380 programme — which led it to twice revise its delivery schedule for the aircraft — certain customers decided to cancel their A380 orders. In addition, EBIT[®] at Airbus was also negatively affected by €2.5 billion in 2006, in part due to the contractual penalties to be paid to customers as a result of the delivery delays. See “1.1 Management’s Discussion and Analysis of Financial Condition and Results of Operations — Overview — Significant Programme and Restructuring Developments in 2006” for further detail.

There can be no assurances that problems similar to the ones encountered in connection with development of the A380 will not occur in the future. In addition to any costs resulting from product warranties, contract performance or required remedial action, such problems may result in increased costs or loss of revenues — in particular as a result of contract cancellations — which could have a negative effect on EADS’ future results of operation and financial condition. Any future problems may also have a significant adverse effect on the competitive reputation of EADS’ products. See “3. Legal Risks — Product Liability and Warranty Claims”.

Major Research and Development Programmes

The business environment in many of EADS’ principal operating business segments is characterised by extensive research and development costs requiring significant up-front investments. The business plans underlying such investments often contemplate a long payback period before these investments are recouped, and assume a certain level of return over the course of this period in order to justify the initial investment. There can be no assurances that the commercial, technical and market assumptions underlying such business plans will be met, and consequently, the payback period or returns contemplated therein achieved.

EADS expects that its consolidated research and development expenses may increase significantly in future years in connection with the ramp-up of new programmes, in particular development on the A350XWB.

“Power8” Restructuring Programme

EADS has announced the implementation of a significant cost reduction and restructuring programme at Airbus, referred to as “Power 8”. This programme looks at all aspects of the company

to make it leaner, more integrated, more efficient and more productive. As part of Power8, Airbus management will implement cost reduction and cash generating efforts with the goal of achieving EBIT[®] contributions of €2.1 billion from 2010 onwards and an additional €5 billion of cumulative cash flow from 2007 to 2010. A large part of the cost savings is expected to be realised through the reduction of Airbus’ headcount by 10,000 employees (with temporary and on-site subcontractors accounting for approximately 50% of such reduction).

These anticipated cost savings are based on preliminary estimates, however, and actual savings may vary significantly. In particular, EADS’ cost reduction measures are based on current conditions and do not take into account any future cost increases that could result from changes in its industry or operations, including new business developments, wage and price increases or other factors. EADS’ failure to successfully implement these planned cost reduction measures, or the possibility that these efforts may not generate the level of cost savings it expects going forward, could negatively affect its future results of operation and financial condition.

In addition to the risk of not achieving the anticipated level of cost savings from Power 8, EADS may also incur higher than expected costs in seeking to implement Power 8, depending on the outcome of its current negotiations with labour and other representatives. Restructuring, closures, site sales and job reductions may also harm EADS’ labour relations and public relations, and have led and could lead to work stoppages and/or demonstrations. In the event that EADS is unable to negotiate effectively with labour representatives and these work stoppages and/or demonstrations become prolonged, or the costs of implementing Power 8 are otherwise higher than anticipated following such negotiations, EADS’ future results of operation and financial condition may be negatively affected.

Industrial Ramp-up

As a result of the large number of new orders for aircraft recorded in recent years, EADS has accelerated its production rate in order to meet the agreed upon delivery schedules for such new aircraft, in particular at Airbus and Eurocopter. As it nears full capacity, EADS’ ability to further increase its production rate will be dependent upon a variety of factors, including execution of internal performance plans, availability of raw materials and parts (such as aluminum, titanium, and composites), conversion of raw materials into parts and assemblies, and performance by suppliers and subcontractors. The failure of any or all of these factors could lead to missed delivery commitments, and depending on the length of delay in meeting delivery commitments, could lead to additional costs and customers’ rescheduling or terminating their orders.



Programme-Specific Risks

In addition to the risk factors mentioned above, EADS also faces the following programme-specific risks in the future (while this list does not purport to be comprehensive, it highlights the current risks believed to be material by management). The first three items relate to the primary risks faced at Airbus in particular:

- *A380 programme*. In connection with the A380 programme and following the delivery delays announced in 2006, EADS faces the following main challenges: (i) management of stress in the supply chain as a result of the steep ramp-up in production in coming years, (ii) avoidance of production disruptions as a result of the implementation of Power8, in particular with respect to its effect on labour relations, and (iii) introduction of a new digital mock-up for future A380 production. EADS' ability to successfully meet these challenges will be critical in ensuring the smooth production of "wave 2" aircraft, *i.e.*, those beyond the initial 25 aircraft produced;
- *A350XWB programme*. In connection with the A350XWB programme, EADS faces the following main challenges: (i) ensuring — through training or otherwise — the availability of key personnel and other resources, particularly with respect to the industrialisation of certain composites, (ii) conversion on favourable terms of orders for the previous version of the A350 aircraft into orders for the new XWB version, and (iii) engagement of risk-sharing partners for the programme at the level of involvement expected by Airbus;
- *A400M programme*. In connection with the A400M programme, EADS faces the following main challenges: (i) management of technical challenges new to Airbus, particularly the modelling of aircraft behaviour based on use of an extremely powerful turboprop engine mounted on a high wing, and on flight in a tactical operations environment, and (ii) ensuring that the aircraft is both commercially

certified and meets the range of military qualifications required by programme customers in each jurisdiction;

- *NH90 programme*. In connection with the NH90 programme, EADS faces the following main challenges: (i) meeting the development schedule and cost objectives of ongoing development programmes on the various versions, and (ii) managing the steep industrial ramp-up on the programme and the associated strain on the supply chain;
- *Paradigm programme*. In connection with the Paradigm programme, EADS faces the following main challenges: (i) ensuring the on-time completion of Skynet 5 infrastructure development, (ii) build-up of third party revenues, and (iii) completing, launching and ensuring the successful functioning of the Skynet 5A, 5B and 5C satellites, the loss of any of which would result in operational, commercial and accounting consequences.

Pension Commitments

EADS participates in several pension plans for both executive as well as non-executive employees, some of which are underfunded. For further information related to these plans, see "1.1 Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Notes to Consolidated Financial Statements (IFRS) — Note 21b: Provisions for retirement plans". Although EADS has recorded a provision in its balance sheet for its share of the underfunding based on current estimates, there can be no assurance that these estimates will not be revised upward in the future, leading EADS to record additional provisions in respect of such plans. These additional provisions would in turn have a negative effect on EADS' total equity (net of deferred taxes), which could have a negative effect on its future financial condition.

3. Legal Risks

Dependence On Joint Ventures and Minority Holdings

EADS generates a substantial proportion of its revenues through various consortia, joint ventures and equity holdings and believes that its alliances and partnerships are a source of competitive advantage. These arrangements include primarily:

- the Eurofighter and AirTanker consortia;
- three principal joint ventures: MBDA, ATR and Atlas Elektronik;
- majority interest: Dornier GmbH; and
- investment in associates: Dassault Aviation.

The formation of partnerships and alliances with other market players is an integral strategy of EADS and the proportion of sales generated from consortia, joint ventures and equity holdings may rise in future years. This strategy may from time to time lead to changes in the organisational structure, or realignment in the control, of EADS' existing joint ventures.

EADS exercises varying and evolving degrees of control in the consortia, joint ventures and equity holdings in which it participates. While EADS seeks to participate only in ventures in which its interests are aligned with those of its partners, the risk of disagreement or deadlock is inherent in a jointly controlled entity, particularly in those entities that require the unanimous consent of all members with regard to major decisions and specify limited exit rights. The other parties in these entities may also be competitors of EADS, and thus may have interests which differ from those of EADS.

In addition, in those holdings in which EADS is a minority partner or shareholder, EADS' access to the entity's books and records, and as a consequence, EADS' knowledge of the entity's operations and results, is generally limited as compared to entities in which EADS is a majority holder or is involved in the day-to-day management.

Product Liability and Warranty Claims

EADS designs, develops and produces a number of high profile products of large individual value, particularly civil and military aircraft and space equipment. EADS is subject to the risk of product liability and warranty claims in the event that any of its products fail to perform as designed. While EADS believes that its insurance programs are adequate to protect it from such liabilities and that no material claims have been made against it, no assurances can be given that claims will not

arise in the future or that such insurance cover will be adequate.

Intellectual Property

EADS relies upon patent, copyright, trademark and trade secret laws, and agreements with its employees, customers, suppliers and other parties, to establish and maintain its intellectual property rights in technology and products used in its operations. Despite these efforts to protect its intellectual property rights, any of EADS' direct or indirect intellectual property rights could be challenged, invalidated or circumvented. Further, the laws of certain countries do not protect EADS' proprietary rights to the same extent as the laws in Europe and the United States. Therefore, in certain jurisdictions EADS may be unable to protect its proprietary technology adequately against unauthorized third-party copying or use, which could adversely affect its competitive position.

Export Controls and Other Regulations

The export market is a significant market for EADS. In addition, many of the products EADS designs and manufactures for military use are considered to be of national strategic interest. Consequently, the export of such products outside of EADS' domestic markets may be restricted or subject to licensing and export controls, notably by the U.K., France, Germany and Spain, where EADS carries out its principal military activities as well as by other countries where suppliers come from, notably, the U.S. There can be no assurance (i) that the export controls to which EADS is subject will not become more restrictive, (ii) that new generations of EADS products will not also be subject to similar or more stringent controls or (iii) that geopolitical factors will not make it impossible to obtain export licenses for one or more clients or constrain EADS' ability to perform under previously signed contracts. Reduced access to military export markets may have a material adverse effect on EADS' business, financial condition and results of operations.

EADS is also subject to a variety of other governmental regulations that may adversely affect its business and financial condition, including among others, regulations relating to the protection of the environment, the use of its products, labour practices and dealings with foreign officials. In addition, EADS' ability to market new products and enter new markets may be dependent on obtaining government certifications and approvals in a timely manner.

 [Back to Contents](#) 

4. Industrial and Environmental Risks

Together with other companies in the principal industries in which it operates, EADS is subject to numerous E.U., national, regional and local environmental laws and regulations concerning emissions into the environment, discharges to surface and subsurface water and the disposal and treatment of waste materials. EADS believes that it is currently capable of satisfying the stricter environmental standards for the future contemplated by current laws or regulations, including increasingly stringent environmental product quality standards

that will be implemented over the next few years, without incurring significant capital expenditure. However, there can be no assurance that increased capital expenditure and operating costs resulting from future environmental regulations will not adversely affect the results of EADS' operations and its financial condition.

For more information, please see "Part 2/2.3 Environmental Care".