

FINMECCANICA

ACCUMULATE (unchanged)

Target €0.78

August 6th, 2002

n° 294

➤ Price	0.62
➤ BCI Index	1,113
➤ Mkt. Cap. (€mn)	5,239
➤ Free Float	68%
➤ Reuters – Bloomberg	SIFI.MI – FNC IM

The acquisition season has started

REASON FOR REPORT: ACQUISITIONS OF TELESPAZIO (TS) AND MARCONI MOBILE (MM)

CONCLUSION

Finmeccanica (FNC) management – with an outlay of some €0.84 bn (€0.61 bn for MM and €0.23 bn for TS) - **has confirmed its determination to grow in the group's core aerospace and defence business** in order to position itself as a heavyweight partner for new international alliances.

Both the new acquisitions:

- **Are complementary to existing business** – MM contributes military radio communications and TS satellite services
- **Have good initial profitability:** EBITDA margin of 11.6% for MM and of 11.3% for TS, vs. the consolidated average margin of 10%
- **Permit exploitation of synergies (no guidance were provided):** MM offers solutions transversally to FNC businesses and operates in a market featuring 7% CAGR. TS offers the possibility of supplying satellite turnkey projects

MM is reasonably priced: a 2001 EV/EBITDA of 9.3x for MM seems high but is justified by the prospects of market growth and synergies. On the contrary, **6.8x for TS reflects the greater uncertainty of the latter's market of reference.**

These acquisitions will be financed from the €1-bn cash inflow coming from divestiture of 3.3% of STM in December 2001 at €35.75 PS (see our short note no. 356 dated December, 14th 2001). **2002E D/E ratio thus rises to about 0.2x** (considering just bank debt) – a level leaving room for other acquisitions (for example 75% of Aermacchi – air trainers – to be concluded by the end of the year). **There is therefore no necessity to proceed with further divestitures of STM** – something that, at current prices, management in any case excludes.

The new challenge for management is its ability to conclude further disposals of businesses no longer considered strategic (energy and transport). **FNC's NAV of €0.82 PS shows a discount of 24%.** Although the visibility of the main asset – STM (Accumulate), worth 43% of NAV – is not strong, at present prices **we confirm our ACCUMULATE recommendation for FNC with a target price of €0.78 PS (applying a 10% discount to STM).**

THE FIRST TWO ACQUISITIONS OF THE NEW MANAGEMENT TEAM

As anticipated by the Italian press in the last few days, **Finmeccanica has concluded two acquisitions for its core business:**

- 1) **Marconi Mobile:** Italian leader in naval, terrestrial and satellite military radio communications with a presence also in the UK (20% of sales), Turkey, Brazil e Rumania. **It is particularly important for the Defence business**, which did not have these skills (mainly avionic and AMS – 50/50 JV with Alenia Marconi Systems), now being rationalised.

The multiples paid are justified by the good market outlook (7% CAGR) and by the potential for transversal applications within FNC: 2001 EV/Sales = 1.07x and EV/EBITDA = 9.3x. Comparable listed companies (Thales, General Dynamics, Rockwell and L-3 Communication) on avg are trading at a 2002E EV/sales= 1.2x and EV/EBITDA= 9.1x

MARCONI MOBILE DEAL (€mn)			
2001 Value of Production	576	EV	614
2001 EBITDA	66	EV/sales	1.07x
EBITDA margin	11.5%	EV/EBITDA	9.3x

Source: Euromobiliare SIM estimates

COMPARABLES COMPANIES (2002E MULTIPLES)		
	EV/sales	EV/EBITDA
Thales	0.73	7.2
Raytheon	1.19	9.4
General Dynamics	1.31	9.5
Rockwell	1.01	7.7
L-3 Communication	1.61	11.6
AVERAGE	1.17	9.1

Source: IBES

- 2) **Telespazio** (pending Antitrust go-ahead expected within 2-3 months): **satellite services** – including definition, design and installation of satellite systems and management of space missions. It is important for Alenia Spazio (AS – whose business is currently stationary) that adds services to its production skills, thus **becoming able to supply turnkey projects**.

The multiples paid are lower because the business features bigger question marks, pending definition of the Galileo project (first integrated satellite-based navigation system for civilian use) **and of Cosmo-Skyimed** (for Earth observation): EV/sales = 0.76x and EV/EBITDA = 6.8x. Because of this we do not rule out the possibility of longer integration timing plus extraordinary costs. **The main objective is to increase AS' critical mass, setting it up as a heavyweight partner with a view to new international alliances.**

TELESPAZIO DEAL (€mn)			
2002 value of production	301	EV	230
2002 EBITDA	34	EV/sales	0.76x
EBITDA margin	11.3%	EV/EBITDA	6.8x

Source: Euromobiliare SIM estimates

VALUATION

Below we present updated NAV (€0.82 PS) revising downwards the valuation of:

- IT Software using Engineering multiples (2002E EV/EBITDA= 4.4x and EV/sales= 0.6x)
- Energy and Transportation (no more strategic) due to the difficulty to find buyers

and assuming valuation of the new assets:

- the same as purchase price for MM considering both prospects of market growth and synergies (substantially in line with market multiples)
- 20% lower for TS due to the lower visibility of the related business

FINMECCANICA VALUATION: SUM OF THE PARTS

Asset	Sector	Stake %	# shares*	€ PS	€ mn	%	Resulting valuation
Alenia Aeronautica	Aeronautics	100.0%			1,279	19%	2002/03E EV/EBITDA=6,5/5,8x
Alenia Spazio	Space	100.0%			431	6%	2003E EV/Sales=0,86/EV/EBITDA=7x
AgustaWestland	Helicopters	50.0%			1,360	20%	2002/03E EV/EBITDA=9/7,1x
AMS, MBDA & other	Defence	**			1,986	29%	2002/03E EV/Sales=0,96/0,75x
Ansaldo Energia	Energy	100.0%			100	1%	Expected divestiture
Elsag S.p.A.	IT Services	100.0%			214	3%	2002/03E EV/EBITDA=4,3/3,8x
Ansaldo Trasporti + Breda	Transportation	100.0%			274	4%	2002/03E EV/EBITDA=3,5/3,3x
TOTAL UNLISTED SHAREHOLDINGS (1)					5,644	82%	
STMicroelectronics	Semiconductor	18.3%	164.7	18.0	2,965	43%	Mkt price
TOTAL LISTED SHAREHOLDINGS (2)					2,965	43%	
Capitalised holding costs (3)					-390	-6%	
Attributable Net cash (net debt) + Severance indemnity (4)					-1,319	-19%	
Taxes on potential capital gains (5)					-31	0%	
TOTAL (1+2+3+4+5)					6,869	100%	
Tot. Nr. Shares					8,425.9		
NAV per share €					0.82		

*assuming consolidation of MM starting from August 2002 and TS from January 2003
Source: Euromobiliare SIM estimates

and STM's price sensitivity (Accumulate).

SENSITIVITY ANALYSIS - FINMECCANICA TARGET AT DIFFERENT STM HOLDING DISCOUNTS									
PRICE	0%=NAV	5%	10%	15%	20%	25%	30%	35%	
+35%	24.3	0.94	0.91	0.89	0.87	0.84	0.82	0.80	0.77
+30%	23.4	0.92	0.90	0.88	0.85	0.83	0.81	0.78	0.76
+25%	22.5	0.90	0.88	0.86	0.84	0.82	0.79	0.77	0.75
+20%	21.6	0.89	0.86	0.84	0.82	0.80	0.78	0.76	0.74
+15%	20.7	0.87	0.85	0.83	0.81	0.79	0.77	0.75	0.73
+10%	19.8	0.85	0.83	0.81	0.79	0.77	0.75	0.73	0.71
+5%	18.9	0.83	0.81	0.80	0.78	0.76	0.74	0.72	0.70
Last price	18.0	0.82	0.80	0.78	0.76	0.74	0.73	0.71	0.69
-5%	17.1	0.80	0.78	0.76	0.75	0.73	0.71	0.70	0.68
-10%	16.2	0.78	0.76	0.75	0.73	0.72	0.70	0.69	0.67
-15%	15.3	0.76	0.75	0.73	0.72	0.70	0.69	0.67	0.66
-20%	14.4	0.74	0.73	0.72	0.70	0.69	0.67	0.66	0.65
-25%	13.5	0.73	0.71	0.70	0.69	0.67	0.66	0.65	0.63
-30%	12.6	0.71	0.70	0.69	0.67	0.66	0.65	0.64	0.62
-35%	11.7	0.69	0.68	0.67	0.66	0.65	0.63	0.62	0.61

Source: Euromobiliare SIM estimates

P&L AND BALANCE SHEET MAIN FIGURES (€mn)

	2000	%	2001	%	2002E	%	2003E	%	2004E	%
Sales	6,224		6,774		7,567		8,662		9,208	
Incr. %	4		9		12		14		6	
EBITDA	624	10.0	678	10.0	667	8.8	824	9.5	921	10.0
Incr. %	4		9		-2		24		12	
EBIT	366	5.9	411	6.1	384	5.1	510	5.9	587	6.4
Incr. %	17		12		-7		33		15	
STM at equity	341	5.5	53	0.8	76	1.0	142	1.6	222	2.4
Incr. %	n.m.		-85		44		86		57	
Pre Tax Inc.	460	7.4	317	4.7	432	5.7	601	6.9	764	8.3
Incr. %	156		-31		36		39		27	
Net Income	403	6.5	212	3.1	270	3.6	429	5.0	576	6.3
Incr. %	454		-47		27		59		34	
Cash Flow	661	10.6	479	7.1	553	7.3	744	8.6	910	9.9
Cap. Exp.	129		158		156		171		188	
Net Fin. Pos.	-980		149		-731		-565		-403	
D/E	0.3		n.m.		0.2		0.2		0.1	
ROE	14%		7%		8%		12%		15%	
ROCE	6%		9%		7%		8%		9%	

PER-SHARE DATA (€cents)

	2000		2001		2002E		2003E		2004E	
Eps	4.8		2.5		3.2		5.1		6.8	
Incr. %	133		-47		27		58		34	
Eps Adj.	2.6		3.5		2.7		3.2		3.5	
CFPS	7.9		5.7		6.6		8.8		10.8	
BV	37.0		37.9		39.8		43.8		49.4	
Dividend	0.0		1.0		1.1		1.2		1.3	

MARKET RATIOS

	2000		2001		2002E		2003E		2004E	
PE	27.2		39.1		19.3		12.2		9.1	
PE Adj.	50.0		28.5		22.9		19.4		18.0	
PCF	16.6		17.3		9.5		7.0		5.8	
PBV	3.5		2.6		1.6		1.4		1.3	
Yield	0.0%		1.0%		1.8%		1.9%		2.1%	

EV FIGURES

	2000		2001		2002E		2003E		2004E	
EV	11,929		8,135		5,970		5,805		5,642	
EV/Sales	1.92		1.20		0.79		0.67		0.61	
EV/EBITDA	20.3		12.7		9.4		7.3		6.3	
EV/EBIT	32.6		19.8		15.5		11.4		9.6	

* assuming consolidation of MM starting from August 2002 and TS from January 2003

Source: Euromobiliare SIM estimates & company data

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