

Price ord. (Eu): 11.0

BCI Index: 1,875

Target Price (Eu) 12 m: 11.0

Previous Target (Eu): 12.5

BULGARI

Sector:

Reuters page:

NEUTRAL

Luxury Goods

BULG.MI

Company Data

No. of shares (mn): 288.1

Market Cap. (Eu mn): 3,169

Market Float (Eu mn): 1,429

EV/Ebitda '99A: 30.8

EV/Ebitda '00E: 20.6

EV/Ebitda '01E: 18.7

EV/Ebitda '02E: 14.1

EV/Ebit '99A: 39.5

EV/Ebit '00E: 24.8

EV/Ebit '01E: 22.8

EV/Ebit '02E: 16.6

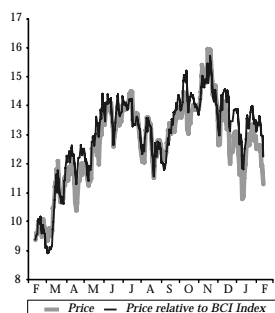
Average Daily Volumes ('000):
1,186

Relative Performance:

	1 m	3 m	12 m
Ord	-2.5%	-20.4%	25.9%

12 Month High/Low:
15.95/9.35

Bulgari - 12 Months



Source: Datastream

Key Figures 1999-2004E*

Year to 31/12	Net Sales (Eu mn)	Operating Profit (Eu mn)	Net Profit (Eu mn)	Restated EPS (Eu)	Stated CEPS (Eu)	P/E Restated	P/CEPS	Dividend (Eu)	Gross Yield
1999	487.5	81.4	59.0	0.212	0.292	51.9	37.7	0.057	0.5%
2000E	697.6	136.0	95.6	0.338	0.440	32.5	25.0	0.077	0.7%
2001E	807.0	146.4	105.7	0.374	0.484	29.4	22.7	0.103	0.9%
2002E	1007.5	198.2	146.6	0.518	0.640	21.2	17.2	0.129	1.2%
2003E	1197.2	250.0	190.9	0.673	0.810	16.3	13.6	0.155	1.4%
2004E	1383.9	302.0	238.6	0.841	0.991	13.1	11.1	0.181	1.6%

* Current estimates do not include JV with Marriott

Joint Venture with Marriott

- **Bulgari diversifies and enters the Leisure sector.** Bulgari has signed a JV agreement with Marriott International (the luxury hotel division of the Marriott group) for the joint management of a worldwide hotel chain (called Bvlgari Hotels & Resorts). Bulgari will be in charge of the design, catering and interior design end of the deal, while Marriott will be in charge of the actual hotel management.
- **Bulgari Hotels & Resorts: the Company.** The JV should invest some \$140mn over the next five years, which will be financed through equity (65% Bulgari and 35% Marriott) and debt (35% Bulgari and 65% Marriott). The investments are relative to a) designing and furnishing the hotels; b) catering structures. Most of the hotels will be leased and the company's portfolio of managed properties should amount to roughly \$800mn.
- **Bulgari Hotels & Resorts: the prospects.** By 2008, the JV should be able to generate some \$300mn of turnover and have an EBITDA margin of 25%, in line with the luxury hotel chains already present on the market (\$75mn EBITDA). Bulgari Hotel & Resorts will probably be loss making until 2003-2004 and earnings positive in 2005, when it should post a net profit of around L5.5bn.
- **Change in estimates.** Bulgari will make money thanks to dividends, royalties and to the cross selling of Bulgari products at the new locations. Management has announced that the deal will be counterdilutive starting from 2004. Without taking into account the cross-selling synergies (conservatively), we calculate a dilution of around 2% on EPS for the next 3 years. This change is not yet in our estimates, as we are waiting to speak with the company.

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■ **Core business growth prospects are limited: NEUTRAL.** Our recommendation on the stock is NEUTRAL and our target price has been lowered to Eu 11 in light of the following:

- a) management's long term indications are for a slowdown in top line growth (+3-4% starting from 2004);
- b) diversification in new and more challenging business areas means that it is becoming increasingly difficult for Bulgari to find attractive investment opportunities in the luxury sector, which is characterized by high returns;
- c) the deal will be dilutive for the first few years and, even if beneficial in the long term, involves execution risks.

Our target price of Eu 11 implies a 2004 P/E (discounted back) of 16x, which is consistent with expected EPS growth of 5-8% for the following years.

Bulgari - Profit & Loss Account 1998-2004E*

(L bn)	1998	1999	2000E	2001E	2002E	2003E	2004E
Net Sales (including the effect of exchanges rates)	707.3	939.8	1,347.9	1,562.5	1,950.8	2,318.2	2,679.7
Other Revenues	3.6	4.1	2.7	0.0	0.0	0.0	0.0
Total Revenues	710.9	943.9	1,350.7	1,562.5	1,950.8	2,318.2	2,679.7
<i>Total Sales Growth Rate (%)</i>	<i>23.7%</i>	<i>32.8%</i>	<i>43.1%</i>	<i>15.7%</i>	<i>24.8%</i>	<i>18.8%</i>	<i>15.6%</i>
Raw Materials	(209.4)	(299.1)	(475.3)	(539.4)	(669.1)	(788.9)	(909.1)
Services	(207.9)	(244.7)	(309.1)	(377.5)	(463.7)	(541.0)	(616.4)
Others	(52.8)	(65.0)	(83.5)	(97.1)	(122.9)	(146.2)	(165.9)
Value Added	240.9	335.2	482.7	548.6	695.1	842.1	988.3
Labour Cost	(107.1)	(132.8)	(164.7)	(197.4)	(239.7)	(276.7)	(314.5)
Ebitda	133.9	202.4	318.0	346.2	453.4	562.4	670.9
<i>Ebitda Margin (%)</i>	<i>18.8%</i>	<i>21.4%</i>	<i>23.5%</i>	<i>22.2%</i>	<i>23.2%</i>	<i>24.3%</i>	<i>25.0%</i>
Depreciations	(29.1)	(42.6)	(52.7)	(60.4)	(66.9)	(74.8)	(82.0)
Provisions	(1.2)	(2.2)	(1.9)	(2.3)	(2.9)	(3.6)	(4.2)
Ebit	103.5	157.6	263.4	283.5	383.7	484.1	584.7
<i>Ros Margin (%)</i>	<i>14.6%</i>	<i>16.7%</i>	<i>19.5%</i>	<i>18.1%</i>	<i>19.7%</i>	<i>20.9%</i>	<i>21.8%</i>
<i>Ebit Growth Rate</i>	<i>6.5%</i>	<i>52.2%</i>	<i>67.1%</i>	<i>7.6%</i>	<i>35.3%</i>	<i>26.2%</i>	<i>20.8%</i>
Financial Income (charges)	(2.3)	(13.6)	(16.2)	(30.3)	(24.3)	(17.6)	(3.0)
Exchange Rate Income (charges)	8.9	(5.9)	(8.0)	7.0	0.0	0.0	0.0
Extraordinary Items	(7.1)	(7.4)	(6.4)	(7.2)	(9.0)	(10.8)	(12.6)
Others	(1.6)	1.8	0.0	0.0	0.0	0.0	0.0
Pre Tax Profit	101.4	132.6	232.9	253.0	350.4	455.7	569.1
Taxes	(13.0)	(14.5)	(41.9)	(45.5)	(63.1)	(82.0)	(102.4)
Minorities	(3.1)	(3.8)	(5.8)	(2.9)	(3.5)	(4.0)	(4.6)
Net Profit	85.3	114.2	185.2	204.6	283.9	369.7	462.0
<i>Net Margin</i>	<i>12.0%</i>	<i>12.1%</i>	<i>13.7%</i>	<i>13.1%</i>	<i>14.6%</i>	<i>15.9%</i>	<i>17.2%</i>
<i>Net Profit Growth Rate</i>	<i>12.2%</i>	<i>33.9%</i>	<i>62.1%</i>	<i>10.5%</i>	<i>38.7%</i>	<i>30.2%</i>	<i>25.0%</i>
Restated Net Profit	89.2	118.3	188.7	208.6	288.8	375.6	469.0

* Current estimates do not take into account the new Marriott/Bulgari JV and slightly lower 4Q00 sales indications

Source: Intermonte Securities estimates

The Operation

The Bvlgari Hotel & Resorts JV will finance its operations through Equity and Debt (we assumed a 50/50 split), and will involve a L290bn total investment over a 5 year period.

The main figures of the deal are:

Bulgari-Marriott JV - Main figures 2001E-2005E

(L bn)	2001E	2002 E	2003E	2004E	2005E
Capex	2.6	3.7	5.6	8.7	13.3
Refurbshment Capex	56.2	55.1	53.2	50.1	45.5
Total Capex	58.8	58.8	58.8	58.8	58.8
Sales	43	61	94	144	222
Sales Target at 2008	615				
Total Project Costs	1680				

Source: Intermonete Securities estimates

In line with company indications, we estimate a total turnover of L615bn by 2008 (20% of total Bulgari group revenues expected by management by 2008).

According to our assumptions (25% EBITDA margin in 2008, royalties at 5% on the JV sales, depreciation at 8% on sales and Capex at 6% on sales) the JV will be operating profit and net result positive in 2004/2005:

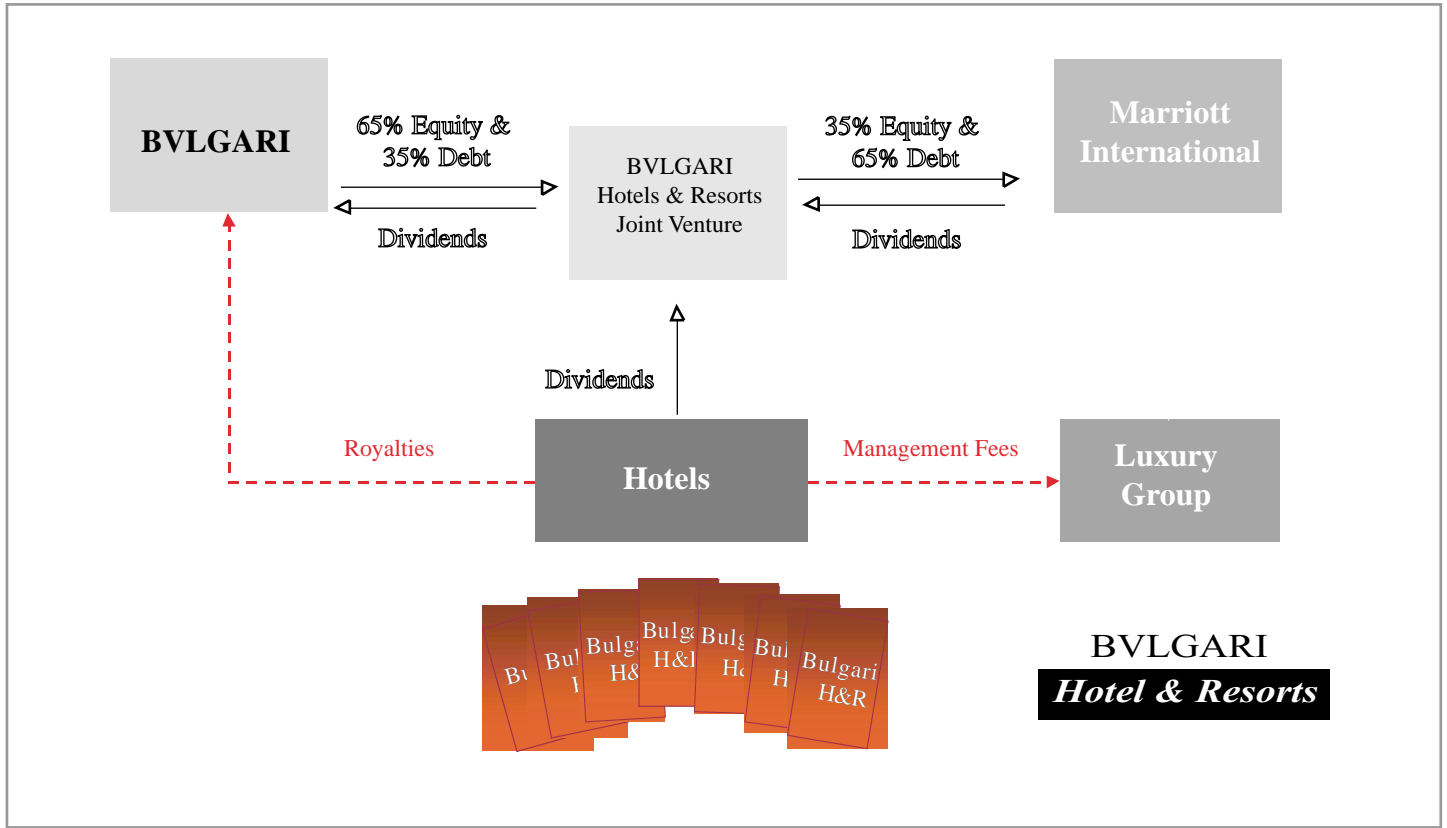
Bulgari-Marriott JV - Profit & Loss Account 2001E-2008E

(L bn)	2001E	2002E	2003E	2004E	2005E	2006E	2007E	2008E
Bulgari Total Turnover	1,609	1,951	2,318	2,680	2,773	2,871	2,971	3,075
<i>Growth Rate</i>		21%	19%	16%	3.5%	3.5%	3.5%	3.5%
Turnover for Bulgari-Marriott JV	43	61	94	144	222	344	535	615
<i>Growth Rate</i>		43%	54%	54%	54%	55%	55%	15%
Ebitda	4	6	11	22	40	62	134	154
<i>Margin</i>	10.0%	10.0%	12.0%	15.0%	18.0%	18.0%	25.0%	25.0%
Royalties	-2.1	-3.0	-4.7	-7.2	-11.1	-17.2	-26.7	-30.8
<i>pertaining to Bvlgari</i>	-1.1	-1.5	-2.3	-3.6	-5.5	-8.6	-13.4	-15.4
<i>pertaining to Marriot</i>	-1.1	-1.5	-2.3	-3.6	-5.5	-8.6	-13.4	-15.4
Depreciation	-3.4	-4.9	-7.5	-11.5	-17.8	-27.6	-42.8	-49.2
Ebit	-1	-2	-1	3	11	17	64	74
<i>ROS</i>	-3.0%	-3.0%	-1.0%	2.0%	5.0%	5.0%	12.0%	12.0%
Interest (Expenses)/Incomes	1	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6
Pre Tax	-0.3	-7.4	-6.5	-2.7	5.5	11.6	58.6	68.2
Taxes	0.0	0.0	0.0	0.0	0.0	0.0	-3.8	-13.6
Net Result	-0.3	-7.4	-6.5	-2.7	5.5	11.6	54.8	54.6

Source: Intermonete Securities estimates

The deal will be structured as follows:

The New Joint Venture Company



Source: Company Presentation

What is really relevant to us at the moment is to establish the impact on Bulgari group revenues.

As regards such, the deal is diluting Bulgari pretax by around 3% in 2001 and will be counterdilutive by 2005:

Bulgari-Marriott JV - Impact on the Bulgari Group 2001E-2005E

(L bn)	2001E	2002 E	2003E	2004E	2005E
Bulgari Group Pre Tax - before	253	350	456	569	706
Financial cost of equity investment	-9.4	-9.4	-9.4	-9.4	-9.4
Royaltees	1.1	1.5	2.3	3.6	5.5
Equity stake consolidation	-0.18	-4.83	-4.25	-1.77	3.57
Bulgari Group Pre Tax - after	244	338	444	561	705
% (Dilution)/Counterdilution	-3.4%	-3.6%	-2.5%	-1.3%	0.0%

Source: Intermonte Securities estimates

Bulgari, in fact, will have to carry the cost of financing the venture (6.5% on L147bn) while it will benefit from the royalties that the JV will pay in order to use the Bulgari brand. On top of that, Bulgari will consolidate 65% of the JV's net result, which will negatively impact the group until 2005.

We are not including this venture in our estimates, as this will be done in a forthcoming note, after speaking with the company.

Diversification or... Diworsification?

The company's 2008 sales target of L3000bn means a 12% 2001-2008 Sales CAGR, but according to our estimates, it means a 3% 2005-2008 Sales CAGR. The message, however, is terrible for a high growth company still rated at 36x 2000.

The risks associated with the deal could be:

- Execution risks (competition is tough and break even may be reached later than expected);
- More capital injection needed to finance the venture.

The rationale of this move is to enter the fastest growing segment of the luxury market: high worth individuals tourism.

The problem is also related to the fact that the market rates the pure luxury stocks differently (Bulgari trades at 34x EPS 2000 and 5x EV/Sales) from the leisure stocks (Marriott trades at 20x EPS 2000 and 1.1x EV/Sales!).

We think the fact that Bulgari will no longer be a pure play on luxury will penalize the stock valuation.

Therefore, on the back of:

- a) The negative impact on Bulgari's EPS:

Bulgari Group - EPS Changes 2001E-2005E

(Eu)	2001E	2002 E	2003E	2004 E	2005E
Stated					
Before	0.367	0.509	0.663	0.828	1.027
After	0.359	0.496	0.653	0.825	1.037
<i>% (Dilution)/Counterdilution</i>	<i>-2.0%</i>	<i>-2.5%</i>	<i>-1.4%</i>	<i>-0.4%</i>	<i>0.9%</i>
Restated					
Before	0.379	0.525	0.682	0.851	1.027
After	0.374	0.518	0.673	0.841	1.043
<i>% (Dilution)/Counterdilution</i>	<i>-1.5%</i>	<i>-1.3%</i>	<i>-1.2%</i>	<i>-1.2%</i>	<i>1.5%</i>

Source: Intermonte Securities estimates

Even if we are assuming a more conservative approach compared to company indications (we are not considering any synergies on the core business);

- b) The negative concept of diversification into lower rated business;
 c) The negative indications on Bulgari's core business long term growth prospects;

We confirm our NEUTRAL stance, with a target of Eu 11 and a trading range Eu 10-12.

Our target reflects Bulgari having a 2004-2008 Sales CAGR of 3% and an EPS CAGR around 7% in 2004. Assigning a P/E of 16x would imply a PEG of 2.3x, which we consider reasonable. This means a fair value of Eu 13.3 (16x an EPS of Eu 0.833) in 2004, which discounted at 6%, means a fair value of Eu 11.