May 13, 2008

Italy
European Aerospace & Defense

Finmeccanica (SIFI.MI - EUR 21.36) RS-Rating Suspended

Recommendation Change

Finmeccanica Proposes to Acquire DRS

Investment Conclusion

- Since Lehman Brothers is acting as financial adviser to Finmeccanica in its proposed acquisition of DRS, we are suspending our rating and price target. Facts of the deal released by the companies, along with historical information on DRS as well as financial metrics/valuation multiples are provided below.

Summary

- Deal approved by both boards, but other offers from outside bidders always possible. Break-up fee is $90m.
- Funding of the ~$5.2bn or ~EUR3.4bn transaction initially from a committed bridge loan, but permanent financing is planned to include roughly equal shares of divestitures, equity, and debt to maintain or improve current debt ratings.
- Partial divestiture of Ansaldo Energia via IPO and sale of other assets announced.
- Various approvals still needed in the US, including DRS shareholders and government approvals.
- Italian government 34% stake expected to be diluted.
- DRS management will stay on to run DRS as an independent U.S. subsidiary

FY Dec	2007A	2008E		2009E		2010E	
Currency EUR	Actual	Old	New	Old	New	Old	New
Revenue (m)	13429.0	N/A	N/A	N/A	N/A	N/A	N/A
PTP (m)	847.0	N/A	N/A	N/A	N/A	N/A	N/A
EPS	1.14	N/A	N/A	N/A	N/A	N/A	N/A
EV/CE	N/A	N/A	N/A	N/A	N/A	N/A	N/A
EV/Sales	0.64	N/A	N/A	N/A	N/A	N/A	N/A
EV/OR	N/A	N/A	N/A	N/A	N/A	N/A	N/A
*P/E	18.7	N/A	N/A	N/A	N/A	N/A	N/A

Calendarised Data

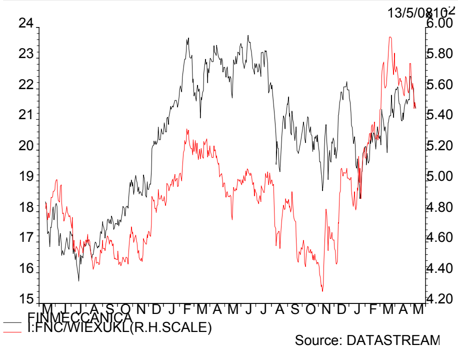
Market Data

Market Cap (m)	N/A
Units Outstanding (m)	N/A
Float (%)	N/A
Net Distribution Yield (%)	N/A
Convertible	N/A
Shares per ADR	N/A

Financial Summary

Five Yr. EPS CAGR (%)	N/A
Return on Equity FY07 (%)	N/A
Current BVPS	N/A
Net Debt (m current)	N/A

Stock Overview



Reuters	SIFI.MI
Bloomberg	FNC IM
ADR	

Performance	1M	3M	12M
Absolute %	N/A	N/A	N/A
Rel. Market %	N/A	N/A	N/A
Rel. Sector %	N/A	N/A	N/A

52 Week Range 23.74 - 18.42

Stock Rating		Target Price	
New:	RS-Rating Suspended	New:	N/A
Old:	-	Old:	N/A

Sector View: 1-Positive

Announcements and Statements Made by the Companies

1. Finmeccanica and DRS announced jointly that they have agreed to an $81 per share offer for Finmeccanica to acquire all the shares of DRS and to assume its outstanding debt. Both boards of directors have approved the transaction and Finmeccanica has firm commitments for 100% of the transaction funding. The companies are planning a joint investor meeting on Tuesday May 13, which will be webcast from both company websites.
2. The transaction would be valued at approximately $5.2 billion in total, or €3.4 billion and would be subject to US Government approvals including the Exon-Florio Presidential CFIUS certification, the Hart-Scott-Rodino anti-trust review, and to Department of Defense security approvals. The companies said various government agencies had already been notified and that they anticipated obtaining the necessary approvals and closing in the 4th quarter of 2008. The Italian government approvals have effectively been granted by the Finmeccanica Board of Directors which is controlled by representatives of the Italian government, which owns 34% of Finmeccanica.

PLEASE SEE ANALYST(S) CERTIFICATION(S) ON PAGE 3 AND IMPORTANT DISCLOSURES BEGINNING ON PAGE 4

3. Finmeccanica has bridge loan commitments from a consortium of banks for the funds required for closing. The bridge loan will be taken out by permanent financing which will be a combination of divestitures, equity, and debt in roughly equal percentages. Divestitures announced in conjunction with the DRS transaction include the sale via IPO of a stake of Ansaldo Energia and sale of shares of STM owned by the company.

4. The equity is planned to be issued in the form of a rights offering which would distribute rights to shareholders as a dividend. These rights would reward shareholders by giving them the right to purchase Finmeccanica shares at a ~25% discount to the trading value which was €21.36 at last night's closing. The company said that it planned to have an Extraordinary General Meeting (EGM) at which shareholders would be asked to approve the proposed rights offering. The rights offering will have the effect of diluting the Italian government's current 34% stake in Finmeccanica. The Italian government can limit its dilution either by setting a ceiling on the size of the rights offering or by participating in the rights offering. It is expected that the Italian government will not fall below a 30% stake in the company.

The Proposed DRS Transaction: Finmeccanica proposes to pay $81 per share to acquire DRS which including $1.2 billion of outstanding debt would bring the total to just over $5 billion. There is a break up fee of $90 million, or ~2% of the transaction consideration, which would be paid to Finmeccanica if their bid is topped by another company. The companies need the following approvals:

- Committee on Foreign Investment in the United States (CFIUS) which is a Presidential finding following the recommendations from several cabinet level departments.
- Hart-Scott-Rodino (HSR) Anti-Trust Review
- Approval for an Special Security Agreement (SSA) for the bulk of the DRS company
- Approval of the shareholders of DRS to close
- Approval of the shareholders of Finmeccanica to issue the equity offering but not to close the transaction

DRS and Valuation of Deal: DRS, which had revenues of $2.8 billion in its fiscal year ended March 2007, is the 21st-largest US defense company, according to DRS management. DRS revenues have grown at a compound annual rate of 42% since 2004; organic growth has been augmented by regular acquisitions. In the first nine months of fiscal 2008, DRS reported that revenues grew organically at an annual rate of 17%. Since 1968, the company has completed more than 20 acquisitions; the most recent significant acquisition was that of Engineered Support Systems, which was completed in January 2006. The company recently reported that the army accounted for more than half of its current revenues. For 2007 and the first nine months of 2008, DRS had EBITDA margins greater than 13%. DRS reports that its revenues are diverse, with no single program larger than 5% of revenues, and that the top 10 contracts amount to approximately 30% of revenues. DRS released an investor alert that it is due to report full fiscal 2008 year results on May 20, 2008. Consensus forecasts (in US dollars and euros) for DRS for the full calendar year 2009 are shown in Figure 1:

Figure 1: DRS Consensus Forecasts for Calendar Year 2009

CY2009 DRS Estimates (billions, except EPS)	U.S. Dollars	Euros*
Revenues	3.4	2.2
EBIT	0.40	0.26
Margin	*11.7%*	
EBITDA	0.49	0.32
Margin	*14.4%*	
EBITA	0.43	0.27
Margin	*12.5%*	
EPS	$4.39	
FCF	0.19	0.12

** Based on $/€ rate of 1.56*
Source: All estimates are calendar year 2009 estimates from First Call

Using these consensus metrics for DRS, the valuation metrics on the proposed DRS acquisition at the $81 per share deal price are TEV to EBIT/A of 11.8x, TEV to EBIT/DA of 10.6x, and a P/E of 18.5x on calendar year 2009 consensus estimates.

Finmeccanica Before and After the Proposed Transaction: Finmeccanica has provided investors with guidance for 2008-2009 and 2010 for revenues, EBIT/A, and cash flows. Should the transaction close in the fourth quarter as anticipated by the companies in the press release, DRS would affect Finmeccanica results slightly for the last quarter of 2008 and for the full year 2009 and 2010. Finmeccanica has said the DRS transaction would not affect its EPS in 2008 or 2009, but that it expected the transaction to be accretive thereafter, according to CFO Alessandro Pansa. Finmeccanica provided the following pro forma Finmeccanica adjustments for 2009 including the acquisition of DRS - using the consensus estimates for DRS's 2009 calendar year:

- Additional Revenues: ~$3.6 billion (~EUR 2.2 billion)
- EBIT/A: ~$440 million (~EUR 280 million)
- EBIT/A margin: ~12%
- EBIT/DA margin ~13.5%
- Additional Interest depending on the amount of additional debt
- Additional shares due to rights offering: ~40 mm shares, depending on size of the equity offering.

Finmeccanica said its rationale for the transaction included increased access to the US defense market, which is the world's largest (97% of DRS sales are to US government agencies and its prime contractors). DRS CEO Mark Newman said the transaction, in addition to providing attractive returns, would enable DRS to be better able to compete and win contracts around the world. Finmeccanica sales in the US were 11% before the transaction and would rise to 24% post the transaction on a pro forma 2007 basis.

Analyst Certification:

We, Joseph F. Campbell and Carter Copeland, hereby certify (1) that the views expressed in this research Company Note accurately reflect our personal views about any or all of the subject securities or issuers referred to in this Company Note and (2) no part of our compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Company Note.

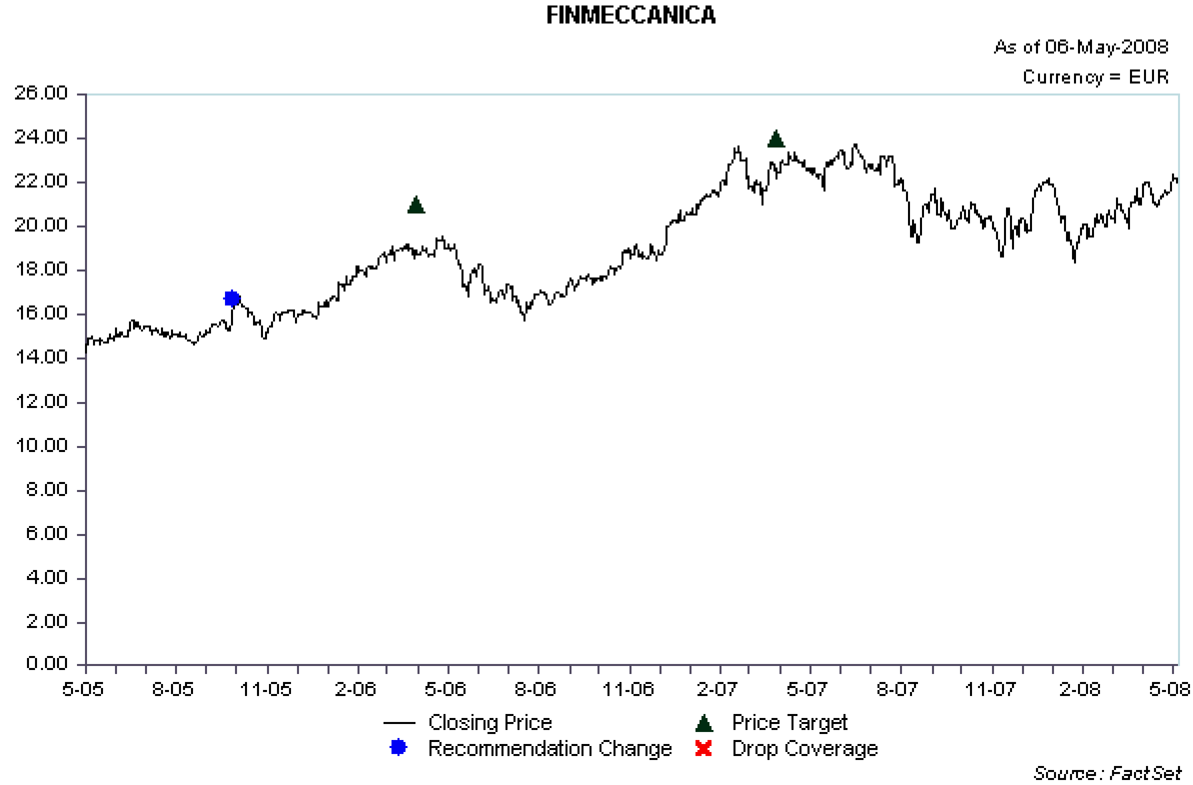
Company Description:

For a complete background on this company, our earnings forecasts and valuation comparables, please refer to our website, located at www.lehmanlive.com/equities/indmanu. If you require access, please contact us on +44 20 7256 4631.

Important Disclosures:

Finmeccanica (SIFI.MI) **EUR 21.36 (12-May-2008)** **RS-Rating Suspended / 1-Positive**

Rating and Price Target Chart:



Currency=EUR

Date	Closing Price	Rating	Price Target
29-Mar-07	22.66		24.00
30-Mar-06	18.94		21.00

Date	Closing Price	Rating	Price Target
28-Sep-05	16.63	1 -Overweight	

FOR EXPLANATIONS OF RATINGS REFER TO THE STOCK RATING KEYS LOCATED ON THE PAGE FOLLOWING THE LAST PRICE CHART.

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Valuation Methodology: Our Price Target and Rating are currently suspended.

Risks Which May Impede the Achievement of the Price Target: Finmeccanica designs and manufactures complex aerospace and defence products. Programmes can experience delays and cost overruns that would negatively affect results. The company is also exposed to the commercial aerospace industry and results could be negatively affected by war, terrorism or airline bancruptcies. Finmeccannica has an exposure to the Italian, UK, US and global defence budgets, which, if they were to decline, could have a meaningful negative effect on company results.

Other Material Conflicts: Lehman Brothers is acting as financial adviser to Finmeccanica SpA with respect to its acquisition of DRS Technologies Inc

Important Disclosures Continued:
The analysts responsible for preparing this report have received compensation based upon various factors including the firm's total revenues, a portion of which is generated by investment banking activities.

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Company Name	Ticker	Price (12-May-2008)	Stock / Sector Rating
Finmeccanica	SIFI.MI	EUR 21.36	RS-Rating Suspended / 1-Positive

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BAE SYSTEMS (BAES.L)
EADS (EAD.PA)
Finmeccanica (SIFI.MI)

In addition to the stock rating, we provide sector views which rate the outlook for the sector coverage universe as 1-Positive, 2-Neutral or 3-Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating
1-Overweight - The stock is expected to outperform the unweighted expected total return of the sector coverage universe over a 12-month investment horizon.
2-Equal weight - The stock is expected to perform in line with the unweighted expected total return of the sector coverage universe over a 12- month investment horizon.
3-Underweight - The stock is expected to underperform the unweighted expected total return of the sector coverage universe over a 12- month investment horizon.
RS-Rating Suspended - The rating and target price have been suspended temporarily to comply with applicable regulations and/or firm policies in certain circumstances including when Lehman Brothers is acting in an advisory capacity in a merger or strategic transaction involving the company.

Sector View
1-Positive - sector coverage universe fundamentals/valuations are improving.
2-Neutral - sector coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.
3-Negative - sector coverage universe fundamentals/valuations are deteriorating.

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