UBS

Global Equity Research

Italy

Clothing & Fabrics

Rating	Neutral 1
	Prior: Not Rated
Price target	€20.20/US$24.62
	Prior:Not Rated
Price	€18.50/US$23.28

RIC: V.MI BBG: V IM

2 August 2005

UBS Investment Research

Valentino Fashion Group

Managing a portfolio of attractive brands

- **Positive momentum, but further upward revision unlikely**

We are initiating coverage on Valentino Fashion Group, floated on 1 July 2005, with a Neutral 1 rating. Our caution reflects the already optimistic expectations for its growth strategy (+18% 2004-07E EPS CAGR), thus leaving little room for potential earnings upgrades in the medium term.

- **Scope for business expansion**

Formerly the fashion division of Marzotto group, Valentino was recently spun off. Increased management focus generates potential for corporate restructuring and incremental growth opportunities, in our view. Its current debt capacity (1.4x net debt/EBITDA and 0.9x financial gearing in 2006E) and 5% average 2005-07E FCF yield could sustain a more aggressive corporate strategy. Its quarterly results release in September - the first financial event since floatation - could provide greater visibility on its medium-term strategy.

- **Downside protection in the short term: positive newsflow**

While the current high single-digit growth rate of its order backlog limits the risks to our earnings in 2005, sharper competition in the fashion/apparel industry and any weakening of consumer demand could make delivery on its earnings targets more challenging in the medium term, in our view. Although we see its brand growth as attractive (HUGO, BOSS, Valentino, Marlboro Classics), the current share price seems to discount most of its potential.

- **Valuation: A fair risk reward profile, in our view**

We rate the stock Neutral 1 with a price target of €20.2 - a 10% premium to the value of its brands (our DCF yields €18.4 a share). The stock currently trades on 10.5-11.2x EV/EBITDA and 22.3-17.7x PE in 2005-06E. In our view, its growth prospects (1.3x 2005E PEG and 1.1x 2005E EV/EBITDAG) support these valuation multiples.

Highlights (€m)	12/03	12/04	12/05E	12/06E	12/07E
Revenues	1,470	1,551	1,676	1,788	1,898
EBIT	139	163	185	210	235
Net income (UBS)	32	56	62	77	93
EPS (UBS, €)	0.44	0.75	0.83	1.05	1.25
Net DPS (UBS, €)	0.00	0.00	0.39	0.40	0.42

Profitability & Valuation	5-yr hist. av.	12/04	12/05E	12/06E	12/07E
EBIT margin %	-	10.5	11.0	11.7	12.4
ROIC (EBIT) %	-	17.5	19.1	20.7	22.4
EV/EBITDA x	-	-	11.5	10.2	9.1
PE (UBS) x	-	-	22.3	17.7	14.8
Net dividend yield %	-	-	2.1	2.2	2.3

Source: Company accounts, Thomson Financial, UBS estimates. UBS EPS is stated before goodwill, exceptionals and other special items.
Valuations: based on an average share price that year, (E): based on a share price of €18.50 on 02 Aug 2005 17:01 BST

Laura Leonardelli
Analyst
laura.leonardelli@ubs.com
+39-02-7210 0254

Italian specialist sales
-
-
+39 02 72100 493

Trading data (local/US$)	
52-wk. range	€20.95-18.40/US$25.32-22.42
Market cap.	€1.37bn/US$1.72bn
Shares o/s	68.3m (ORD)
Free float	43%
Avg. daily volume ('000)	79
Avg. daily value (€m)	1.5

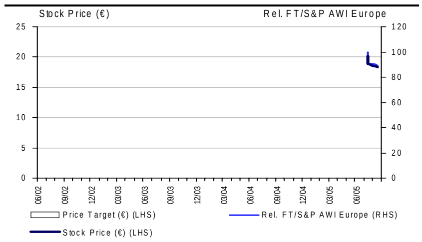
Balance sheet data 12/05E	
Shareholders' equity	€0.35bn
P/BV (UBS)	3.7x
Net cash (debt)	(€0.41bn)

Forecast returns	
Forecast price appreciation	+9.2%
Forecast dividend yield	2.1%
Forecast stock return	+11.3%
Market return assumption	7.2%
Forecast excess return	+4.1%

EPS (UBS, €)

	12/05E			12/04
	From	To	Cons.	Actual
Q1E	-	0.39	-	-
Q2E	-	(0.28)	-	-
Q3E	-	0.51	-	-
Q4E	-	0.20	-	-
12/05E	-	0.83	-	
12/06E	-	1.05	-	

Performance (€)



Source: UBS

www.ubs.com/investmentresearch

This report has been prepared by UBS Limited

Contents

page

Laura Leonardelli
Analyst
laura.leonardelli@ubs.com
+39-02-7210 0254

Italian specialist sales
-
-
+39 02 72100 493

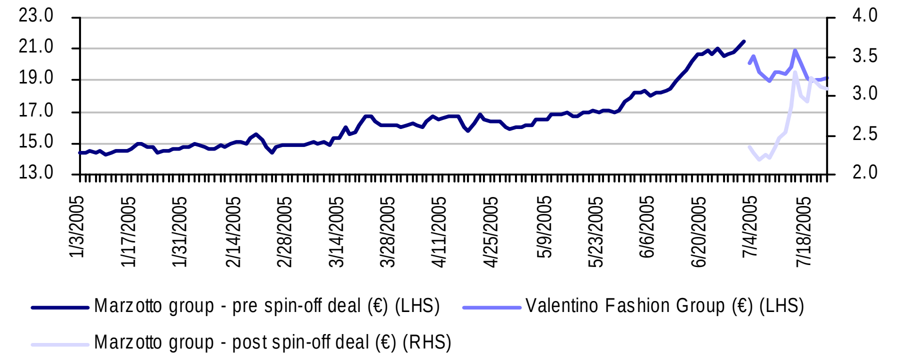
Investment summary

Neutral 1 rating; €20.2 price target

We are initiating coverage on Valentino Fashion Group – a leading player in men's classic clothing, women's apparel/luxury goods, sportswear and fashion accessories – with a Neutral 1 rating and 12-month share price target of €20.2, reflecting 9% potential upside from current prices. Valentino Fashion Group shares – ordinary, convertible saving and saving shares – were floated on 1 July 2005, following the spin-off deal announced by parent company Marzotto SpA (€3.2, not rated). The flotation did not bring about a change in ownership, and did not involve cash considerations or the raising of capital, but it did increase visibility on the value of the different brands, in our view. The company holds 51% of the total number of outstanding shares of Hugo Boss (€27.1, not rated) or 79% of Hugo Boss voting shares, and fully consolidates Hugo Boss financials.

Valentino Fashion is the fashion division of the Marzotto group, and was recently spun-off and listed

Chart 1: Marzotto and Valentino Fashion – ordinary share price (pre and post spin-off)



Source: UBS; prices as of 1 August 2005

- **The main sales drivers are higher brand awareness and expansion of the product range:** Valentino Fashion Group operates in the fashion/ apparel industry, mostly through its owned brands, BOSS and Valentino (68% and 12% of 2005E group sales, respectively), and licensed brand Marlboro Classics (8% of sales). We forecast 8.1% y/y sales growth in 2005 and 6.4% y/y annual average sales growth in the period 2006-07, supported by the increasing penetration of its brands in all apparel/fashion categories, and its planned geographical expansion in both wholesale and retail activities.

Table 1: Valentino Fashion – sales

2005E	Sales (€ m)	Y/y (%)
Hugo Boss	1,266	8%
Valentino	207	22%
Marlboro & others	258	-1%
Intra-group	(54)	12%
Total sales	1,676	8%

Source: UBS estimates

- **Expected positive sales momentum and operating margin expansion should sustain double-digit earnings growth prospects:** We expect group earnings momentum to be strong in the next few years (+10% y/y EPS growth in 2005E to €0.83, +26% y/y in 2006E to €1.05 and +20% y/y in 2007E to €1.25). We assume low double-digit earnings growth for Hugo Boss for the period 2005-07E and strong profit growth from Valentino brand expansion (from net profit of €16 million in 2004 to €36 million in 2007E). The year-to-date 2005 positive earnings momentum of Hugo Boss (+16% y/y profit growth in first half 2005) and the profit turnaround to date by Valentino should limit the risk of short-term earnings disappointment, in our opinion.

Hugo Boss operations and the brand potential of Valentino should drive 18% 2004-07E EPS CAGR, in our view

- **Our valuation approach is mostly focused on the extrapolation of the company's brand values and the analysis of its medium-term financial opportunities:** Our €20.2 price target is based on a 10% premium to our DCF valuation by brand, which yields €18.4 a share, and is supported by the potential benefits afforded by various medium-term financial opportunities. While the company has not disclosed plans to undertake a more aggressive corporate strategy, we believe its increased management focus on the spun-off operations, and the group's debt capacity (1.4x net debt/EBITDA and 0.9x financial gearing in 2006E) and cash flows (5% average FCF yield in 2005-07E) could sustain further medium-term business expansion or integration. At its €20.2 price target, the stock would trade on 11x EV/EBITDA, 14x EV/EBIT and 19x PE in 2006E.

A fair risk-reward profile for Valentino Fashion at current prices, in our opinion

Table 2: Valentino Fashion Group – price target derivation

	€ a share
51% of Hugo Boss enterprise value	15.5
Valentino enterprise value	6.2
Marlboro Classics and others enterprise value	2.1
NPV of Valentino tax savings	0.4
Valentino Fashion Group DCF enterprise value	24.3
Less 2005E average net debt	5.6
Less 2005E debt deemed provisions	0.3
Valentino Fashion group DCF equity value	18.4
Average potential of our financial scenarios	1.8*
VALENTINO FASHION GROUP PRICE TARGET	20.2

Source: UBS estimates; Note: * Our potential scenarios could suggest a fair value between €19.2 and €22.8/share.

- **Current valuation multiples are fair but potential upside is limited from current prices, in our opinion:** We believe the limited risk of earnings disappointment supports the current valuation. At a €18.5 current price, the stock trades on 11.5-10.2x EV/EBITDA, 15.0-13.1x EV/EBIT and 22.3-17.7x PE in 2005-06E. In our opinion, its 2005E valuation multiples are sustained by its implied growth prospects (1.3x PEG ratio and 1.1x EV/EBITDAG). Given the group's business mix, we have cross-checked its valuation multiples against the combined average of those of other apparel and luxury companies. Valentino Fashion currently trades at a 5% average premium to the 2006E UBS peer group average, which seems appropriate, given its operating and earnings growth prospects, in our view.

- **Strong triggers for the stock in the short term are unlikely, in our view:** Our Neutral 1 rating is largely based on the lack of strong triggers that could lead us to make our valuation approach more aggressive during 2005. In our opinion, Valentino Fashion's delivery on 2005 targets, ie, high single-digit sales growth, improving operating profit margins versus 2004 pro-forma and double-digit Hugo Boss earnings growth, is the main trigger that could drive investor sentiment for the stock in 2005.

Table 3: Valentino Fashion Group – forthcoming newsflow

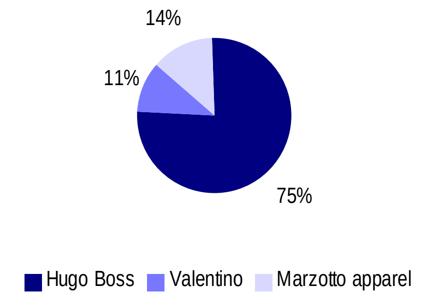
Date	Event
12-Sep	Q2 05 results release
03-Nov	Hugo Boss Q3 05 results release
10-Nov	Q3 05 results release

Source: Valentino Fashion Group, Marzotto and Hugo Boss financial calendars

The company is due to release its quarterly results on 12 September – the first financial event since the stock was floated. Hence, quarterly figures could provide a useful sanity check for our full-year 2005 estimates (namely, balance sheet and cash flow figures) and greater visibility on its medium-term corporate strategy. In our opinion, our valuation already captures the potential of its different brands during 2005-07, based on the current favourable trading conditions and some of its medium-term financial opportunities. Better-than-expected operational results (notably from the Hugo Boss and Valentino brands), further group restructuring and sizeable business expansion could be the main medium-term catalysts for the stock, in our view. Periodic updates on industry trading conditions and the company's results announcements could help provide visibility on its execution of expected margin expansion in the medium term, in our view.

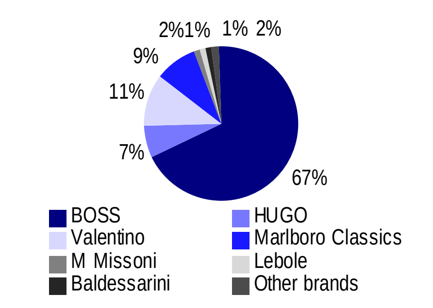
Valentino Fashion Group in brief

Chart 2: Sales split by division



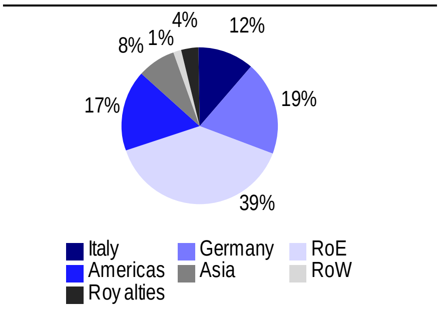
Source: Company data, 2004 pro-forma figures

Chart 3: Sales split by brand



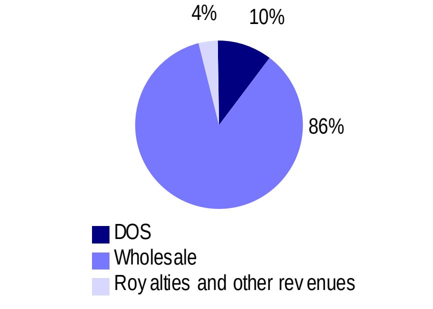
Source: Company data, 2004 pro-forma figures

Chart 4: Sales split by country



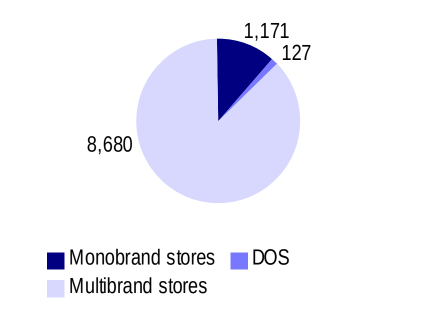
Source: Company data, 2004 pro-forma figures

Chart 5: Sales split by channel



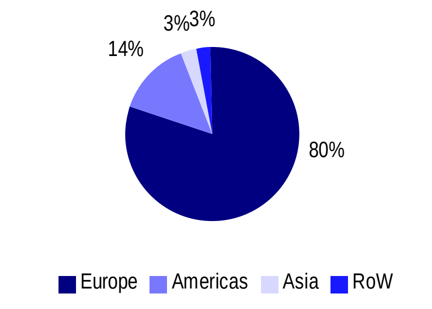
Source: Company data, 2004 pro-forma figures

Chart 6: Distribution network, no of stores



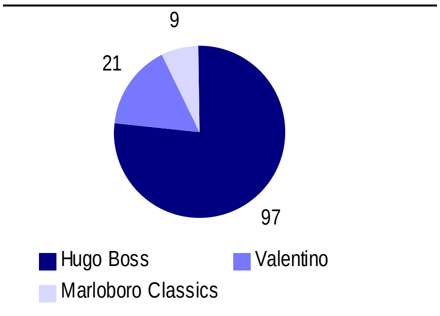
Source: Company data, 2004 number of stores

Chart 7: Stores split by country



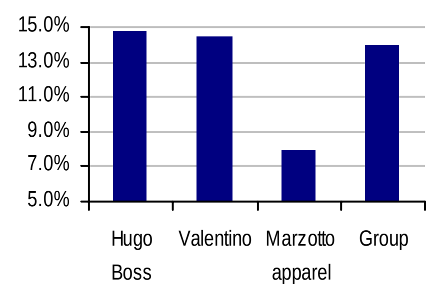
Source: Company data, 2004 pro-forma figures

Chart 8: DOS breakdown



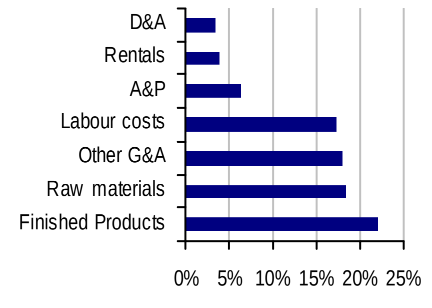
Source: Company data, 2004 pro-forma figures

Chart 9: EBITDA margin by division



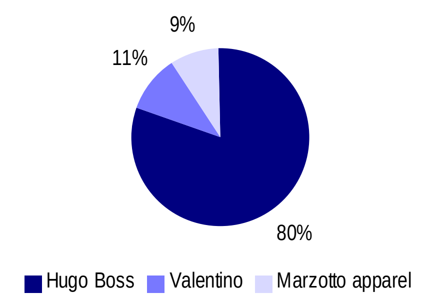
Source: Company data, 2004 pro-forma figures

Chart 10: Operating costs as a % of sales



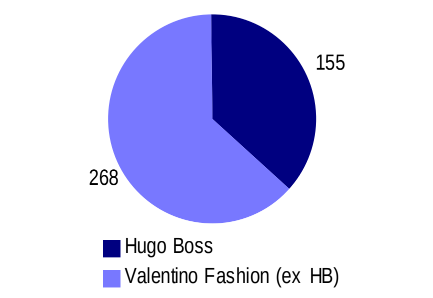
Source: Company data, 2004 pro-forma figures

Chart 11: EBIT split by division



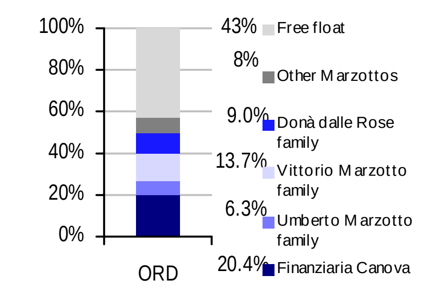
Source: Company data, 2004 pro-forma figures

Chart 12: Net debt split by division (€ m)



Source: UBS estimates at the end of 2004

Chart 13: Shareholding structure



Source: Company data, CONSOB, as of 26 July 2005

Appealing brand values

Valentino Fashion Group operates in the apparel/fashion industry...

Valentino Fashion Group is a leading player in men's classic clothing, women's apparel and luxury goods, sportswear and fashion accessories. More than two-thirds of its revenues are derived from Europe, mostly through its wholesale activities.

...through HUGO, BOSS, Valentino, Marlboro Classics and M Missoni brands

In the fashion apparel industry, it operates through Hugo Boss (BOSS, HUGO and Baldessarini brands), Valentino, Lebole and Principe as owned brands; and Marlboro Classics and M Missoni as licensed brands. Approximately 80% of its sales are achieved in the male clothing segment. Hugo Boss is a listed company in Germany. Valentino Fashion Group holds 79% of Hugo Boss common shares and 51% of the total outstanding shares of Hugo Boss, and fully consolidates Hugo Boss financials (line-by-line).

Valentino Fashion Group shares – ordinary, convertible saving and saving shares – were listed on the Milan Stock Exchange on 1 July 2005, following the spin-off deal completed by parent company Marzotto SpA. In this section, we analyse the group's operations that were included in the spun-off company, Valentino Fashion Group, and highlight that 2003-04 historical financials and our first half 2005 underlying estimates are pro-forma data. Table 4 below summarises its business model.

Table 4: Valentino Fashion Group – business description by brand

	BOSS Man**	BOSS Woman	HUGO	Baldessarini	Valentino	Marlboro Classics	M Missoni, Lebole
2004 sales (€ m)	975	69	107	17	170	142	46
% of group sales	63%	4%	7%	1%	11%	9%	3%
Product type	Business wear, casual wear, sportswear, shoes, bags, accessories, body wear, eyewear, watches, fragrances	Business wear, casual wear, shoes, bags, accessories, eyewear, watches, fragrances	Business wear, casual wear, shoes, body wear, eyewear, fragrances	Business wear, casual wear, accessories, fragrances	Women's couture, business and casual wear, men's wear, shoes, bags, accessories, eyewear, fragrances	Men and women's casual wear (American country style), shoes, bags and accessories	M Missoni is young women's apparel and Uomo Lebole is men's business wear
Sales split by product category	58% business wear, 42% leisure wear	62% business wear, 31% leisure wear, 7% shoes and accessories	74% menswear, 26% woman	Almost entirely high-end menswear	62% haute couture, 19% prêt-à-porter, 17% accessories, 2% others	97% wholesale, 3% DOS sales; 82% menswear, 12% women's wear, 6% accessories	Almost entirely wholesale activities
Country presence	102	58	43	34	58	35	28
Sales split by country	23% Germany, 46% RoE, 19% Americas, 10% RoW, 2% royalties	26% Germany, 38% RoE, 9% Americas, 17% RoW, 10% royalties	41% Germany, 33% RoE, 11% Americas, 3% RoW, 12% royalties	33% Germany, 32% RoE, 12% Americas, 7% RoW, 14% royalties	26% Italy, 31% rest of Europe, 27% Americas, 16% Asia	96% Europe, 4% Americas	84% Europe, 16% Americas
Points of sales	>4,500	c650	1,000 man, 350 woman	125	c900	2,438	>1,200
Mono brand stores*	c485	c160	c45	2	76	491	2
Store sales	30% of sales	51% of sales	20% of sales	50% of sales	c35% of sales	c20% of sales	Not meaningful

Source: Company data. *Mono-brand stores include franchise stores and DOS (directly operated stores); mono-brand store sales split is a UBS estimate; **BOSS man includes BOSS Black, BOSS Selection, BOSS Orange and BOSS Green

Group strategy is focused on widening its product range and expanding its geographical exposure outside Europe

The company aims to extend its product range (notably in women's and leisure wear), geographical exposure (mainly in the US and Asia/Japan) and retail activities (directly operated store (DOS) sales accounted for 10% of group sales in 2004). In our opinion, this expansion strategy could be supported by the global brand awareness of Hugo Boss in the premium-priced apparel sector, Valentino in luxury goods and Marlboro Classics in the medium-priced casual wear segment. We believe the following drivers should sustain our positive sales growth expectations:

(1) **New products and brand extensions** (mostly shoes, accessories, leather products and leisure wear);

(2) **The increasing penetration of Valentino and BOSS brands in the women's clothing segment,** and in young and casual wear products (R.E.D. Valentino, BOSS Orange, BOSS Green);

(3) **Additional store openings** (both DOS and mono-brand stores) combined with the expansion of shops-in-shop in multi-brand stores;

(4) **Increasing product penetration** in emerging markets, the US and Japan.

Table 5: Valentino Fashion Group – SWOT analysis

	BOSS Man	BOSS Woman	HUGO	Baldessarini	Valentino	Marlboro Classics	M Missoni, Lebole
Strength	Global brand, broad range of products	Fast-growing sales, leveraging the brand's appeal	Success of its brand franchise	Premium-priced market position	Expertise in the luxury goods sector, fast-growing sales	Niche positioning	Niche positioning
Weakness	Brand maturity, fashion risk	Intense competition	European player, low global presence	Small player, low product extension	Fashion risk, large invested capital base, outsourced production	Sales are mostly dependent on the Italian and French markets	Small player, low financial resources
Opportunity	Retail and country expansion in emerging markets	Product and country expansion	Women, accessories and retail expansion	Limited	Product and country expansion	Accessories and women's product extension	Country expansion outside Europe, new apparel licences
Threat	Higher fixed cost structure, downturn in consumer confidence	Fashion trend and consumer changes	Risk of lower control of its wholesalers	Increasing competition levels	Luxury sector consolidation, increasing capex requirements (costly retail expansion)	Strong sales dependence in the European casual industry, product pricing pressure	Loss of some licences, increasing competition

Source: UBS's opinion of the different brand prospects in the medium term

Valentino predicts 2005 sales growth to be broadly in line with its first-quarter sales performance

Our expectations are broadly in line with the company's stated guidance for 2005. Valentino Fashion Group predicts 2005 sales growth broadly in line with its first-quarter sales performance (+8% y/y), supported by: (1) a 15% y/y order backlog increase for its spring/summer collection; (a) 9% y/y order backlog increase for its autumn/winter collection; and (3) a c40% y/y DOS sales increase (January-May 2005). The group forecasts improving operating margins in 2005 compared with 2004 pro-forma figures (10.5% EBIT margin in 2004). By division, Hugo Boss predicts 10% y/y sales growth (excluding forex and in line with the current trading conditions) and double-digit earnings growth in 2005 (source: analyst presentation, 30 March 2005; reiteration 28 July). Valentino Fashion predicts double-digit sales growth and an improved operating margin for the Valentino brand (excluding forex), and slightly positive sales growth and improving operating margins for the Marlboro Classics brand (source: spin-off document, 8 April 2005).

The first quarter 2005 results release supports our full-year 2005 estimates. In the first quarter, Marzotto group (pre spin-off deal) reported sales of €572 million (+7.7% y/y), operating income of €89 million (15.5% margin, which compares with 14.4% in first quarter 2004) and net income of €30 million – up 35% y/y.

Table 6: Marzotto group – Q1 05

€ m	Q1 04	Q1 05	Y/y
Hugo Boss	357	406	14%
Valentino	45	52	16%
Marzotto appar	77	76	-2%
Textile – wool	64	54	-16%
Textile – linen	7	6	-11%
Net intra-group	-20	-22	11%
Sales	531	572	8%
Reported EBIT	77	89	16%
EBIT	78	91	17%
Rep net income	22	30	35%
Net income	27	34	29%

Source: Company data

Table 7: Valentino Fashion Group – 2005 guidance by business

	y/y sales growth (%)	Profitability
Group	High single-digit growth	Improving EBIT margin from 2004
Hugo Boss	10% y/y ex forex	c€100m net profit
Valentino	Double-digit growth	Improving EBIT margin from 2004
Marlboro Classics and others	Stable sales	Improving EBIT margin from 2004

Source: Valentino Fashion Group, Marzotto, Hugo Boss

Group reorganisation, Valentino's profit turnaround and the likely favourable trading conditions for Hugo Boss support our forecast for positive earnings momentum in 2005-07

Based on our divisional estimates described above, we expect Valentino Fashion sales to grow by 8.1% y/y in 2005, mostly due to Hugo Boss sales growth of 8.3% y/y (75% of 2005E group sales) and Valentino sales growth of 21.8% y/y (12% of 2005E group sales). We forecast that the group EBIT margin will improve by 50 basis points to 11.0% in 2005, given improved Valentino profitability (from a 10.5% 2004 EBIT margin to 12.5% in 2005E), while we assume that the 2005 Hugo Boss operating profit margin will be broadly in line with that of 2004. This should drive positive earnings growth expectations in 2005: we estimate net profit of €62 million (+10.3% y/y) and EPS of €0.83 (up 10% y/y). Table 8 below summarises our 2005-07 estimates. We foresee the disclosure of quarterly figures as the main trigger that could lead us to revise our 2005 earnings expectations.

Good track record and corporate governance by Valentino Fashion Group management

In our view, the main risks of earnings disappointment rest with underperformance against 2005 targets and any drastic deterioration in current fashion industry conditions, notably in Europe. We believe execution risk should be limited in the short term by the current delivery on Valentino's brand turnaround and the positive first half 2005 earnings momentum of Hugo Boss (first half 2005 pre-tax profit increased 14% y/y). Furthermore, we believe the track record of its top management, referred as Marzotto management by the equity market, is good even though Valentino Fashion Group only listed recently. In addition, we acknowledge the high level of periodic financial disclosure (by brand and units) by the company's management. Conversely, we only have scant details about the long-term shareholding strategy of Marzotto family members (fragmented shareholding structure; see appendix for a description of the shareholding).

Valentino Fashion Group earnings likely to be less dependent on Hugo Boss earnings in the medium term, due to increased Valentino profits contribution

Our double-digit EBIT growth forecast for 2006-07 should be supported by 6.4% y/y annual group sales growth, a 20 basis point annual improvement in Hugo Boss's EBIT margin and incremental profits arising from Valentino's turnaround. In addition, we believe declining future tax rates, providing Valentino with tax savings (as detailed in the June 2005 spin-off document), should accelerate 2006-07E group earnings growth. We estimate EPS of €1.05

(+26% y/y) in 2006 and €1.25 (+20% y/y) in 2007, adjusted for goodwill amortization (in line with IFRS requirements). In the medium term, our expectation for greater future profits contributions by Valentino should lower its dependence on Hugo Boss profits, despite the latter remaining significant. We estimate Hugo Boss profits to account for c90% of group profits before minority interests in 2005, falling to 79% in 2007.

Our ordinary dividend expectations are based on a 50% average pay-out ratio in 2005-07E

Looking at our balance sheet and cash flow expectations, we do not expect drastic medium-term changes to the group's financial structure. Over the period 2005-07, we forecast that a 5% average equity FCF yield (pre-dividend) should provide sufficient financial resources to pay dividends to both Hugo Boss (61% average dividend pay-out ratio in 2005-07E versus 69% in 2002-04) and Valentino Fashion Group shareholders (50% average dividend pay-out ratio in 2005-07E), and to reduce group net debt by an annual average of €33 million. We analyse the financial opportunities related to the group's debt capacity in the valuation section of this report.

Table 8: Valentino Fashion Group – financial summary, 2004-07E

€ m	2004	2005E	2006E	2007E	€ m	2004	2005E	2006E	2007E	€ m	2004	2005E	2006E	2007E
Sales	1,551	1,676	1,788	1,898	Tangibles	228	257	265	274	Net profit	91	110	131	152
y/y growth (%)	5.5%	8.1%	6.7%	6.2%	Intangibles	332	338	342	344	D&A	52	57	59	62
Value added	483	510	552	597	Other assets	6	19	19	19	Goodwill amort.	17	(0)	(0)	(0)
Margin (%)	31.1%	30.4%	30.8%	31.4%	Net fixed assets	566	614	627	637	Change in NWC	5	(18)	(25)	(22)
Labour costs	(267)	(268)	(282)	(300)	NWC	431	449	475	497	M/L provisions	(6)	(2)	(2)	(1)
EBITDA	216	241	269	297	% of sales	27.8%	26.8%	26.6%	26.2%	Op cash flows	159	146	163	190
Margin (%)	13.9%	14.4%	15.1%	15.7%	Capital employed	998	1,064	1,101	1,134	Capex in tangibles	(51)	(74)	(55)	(58)
D&A	(52)	(57)	(59)	(62)	Pension provisions	(30)	(30)	(29)	(28)	Intang investments	(20)	(18)	(16)	(15)
EBIT*	163	185	210	235	Other provisions	(49)	(48)	(47)	(47)	(Acquisitions)	(25)	0	0	0
y/y growth (%)	17.8%	13.0%	13.6%	12.1%	Net cash (debt)	(423)	(410)	(378)	(323)	Enterprise FCF	64	55	92	118
Margin (%)	10.5%	11.0%	11.7%	12.4%	Fin gearing	1.5x	1.2x	0.9x	0.7x	Valentino dividends	0	0	(29)	(30)
Net fin charges	(16)	(17)	(16)	(16)	Debt/EBITDA	2.0x	1.7x	1.4x	1.1x	Hugo Boss div	(27)	(29)	(31)	(33)
Exceptionals	(4)	(1)	(1)	(1)	Capital	496	578	647	736	Capital increase	0	2	0	0
PT	143	168	193	219	Shareholder funds	289	351	399	462	Consolidation diff	(10)	(13)	0	0
Taxes	(52)	(58)	(62)	(67)	Minorities	207	226	248	274	Increase/(decrease)	26	12	32	55
Tax rate (%)	36%	35%	32%	31%										
Minority interests	(43)	(48)	(54)	(59)										
Net income*	56	62	77	93										
y/y growth (%)	72.2%	10.3%	25.7%	19.9%										

Source: UBS estimates; Note: 2004 figures are pro-forma, following the spin-off deal; EBIT and net profit figures include exceptional items and exclude goodwill amortisation; 2005E consolidation difference of €13 million is related to the extraordinary dividends paid by Marzotto International to Marzotto SpA before the spin-off.

Positive momentum for Hugo Boss

Valentino Fashion owns 51% of Hugo Boss, a worldwide player of fashion and apparel products

Valentino Fashion holds 51% of Hugo Boss (corresponding to 35.9 million shares of the total number of outstanding shares of 70.4 million). It owns 79% of Hugo Boss ordinary shares (equal to 28.2 million voting ordinary shares) and 22% of the preference shares (equating to 7.6 million non-voting preference shares).

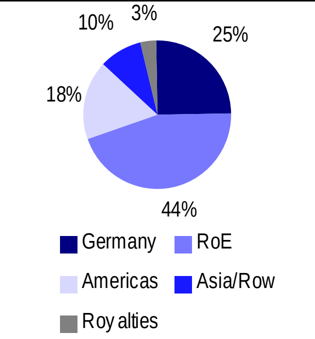
Hugo Boss is a listed company in Germany and its daily operations are managed independently (chairman Bruno Sälzer, CFO Jörg-Viggo Müller). We do not currently see potential material operating synergies or capital/asset benefits between Valentino Fashion and Hugo Boss. Valentino Fashion's management is part of the Hugo Boss supervisory board and Valentino holds 79% of the voting shares. The group consolidates 100% of Hugo Boss financials (line-by-line) and accounts interests for Hugo Boss minority shareholders (€43 million minority interest in 2004).

While we do not cover Hugo Boss, we reflect underlying assumptions regarding its operations in our Valentino Fashion Group estimates and valuation. No financial changes or corporate actions occurred when the shareholding control of Hugo Boss moved from the Marzotto group to the new-listed entity, Valentino Fashion.

Hugo Boss sales are mostly dependent on BOSS branded products and European wholesale operations

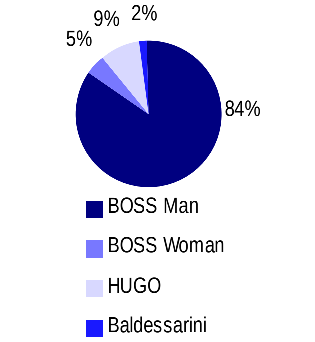
Hugo Boss is a global player in fashionable men's and women's clothing (2004 sales of €1.2 billion) through its three owned brands: BOSS, HUGO and Baldessarini. Europe represents the core region for Hugo Boss and Germany the key country (Europe 69% of 2004 sales, of which Germany accounted for 25%). More than 90% of its revenues are derived from wholesale activities. Hugo Boss products were sold by 729 mono-brand stores (of which 97 were DOS) and 4,657 multi-brand stores (namely 3,558 stores in Europe and 890 in the Americas) in 2004. Hugo Boss's top-line drivers are shown below.

Chart 14: Hugo Boss – 2004 sales by country



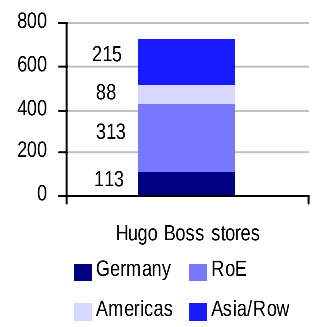
Source: Company data; Note: Royalties mostly derived from licensing agreements for Hugo Boss branded eyewear, watches and perfumes

Chart 15: Hugo Boss – 2004 sales by brand



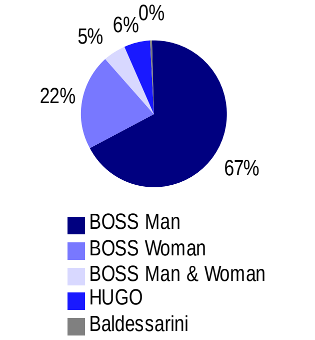
Source: Company data; Note: BOSS Man is sold at 4,500 points of sales, BOSS Woman 650, Hugo Man 1,000, Hugo Woman 350, Baldessarini 125.

Chart 16: Hugo Boss – 2004 mono-brand stores by country



Source: Company data; Note: Hugo Boss mono-brand stores totalled 729 in 2004, of which 632 were franchised stores and 97 DOS

Chart 17: Hugo Boss – 2004 mono-brand stores by brand



Source: Company data; mono-brand store breakdown includes DOS

Hugo Boss profits represent more than 80% of Valentino Fashion EBIT

Hugo Boss is the group's main asset and its sales/earnings performance is a key driver of Valentino Fashion's earnings momentum and valuation. Table 9 shows the key financial data for Hugo Boss for the period 1994-2004. In 2004, Hugo Boss accounted for 75% of Valentino Fashion's pro-forma sales and 83% of its pro-forma EBIT. Over the past three years, Hugo Boss has made an average annual dividend payment of €28 million (ie, an average dividend pay-out ratio of 69%), benefiting Marzotto's cash flow statement (pre spin-off deal). We do not expect drastic changes to its dividend policy in the next few years.

Table 9: Hugo Boss – financials, 1994-2004

€ m	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Sales	438	461	509	581	684	753	923	1,095	1,093	1,054	1,168
y/y growth (%)	1.3%	5.1%	10.5%	14.2%	17.7%	10.1%	22.6%	18.5%	-0.1%	-3.6%	10.8%
EBITDA	54	60	72	100	106	123	184	182	134	152	173
Margin (%)	12.2%	13.0%	14.1%	17.1%	15.3%	16.4%	19.4%	16.1%	12.7%	14.3%	14.4%
Reported EBIT	47	53	63	88	93	105	164	155	102	119	135
y/y growth (%)	-0.8%	12.7%	17.9%	40.4%	5.2%	13.6%	55.6%	-5.8%	-34.2%	17.3%	13.5%
Margin (%)	10.7%	11.5%	12.3%	15.0%	13.4%	14.1%	17.3%	13.6%	9.6%	11.2%	11.3%
Reported net profit	27	30	39	42	50	57	109	118	75	82	88
y/y growth (%)	-31.5%	10.3%	31.7%	8.6%	17.8%	13.7%	92.8%	7.9%	-36.5%	10.3%	7.1%
Total fixed assets	34	33	38	68	81	105	127	200	219	222	263
Inventories	74	75	81	95	111	107	152	229	218	215	251
% of sales	16.9%	16.2%	15.8%	16.4%	16.2%	14.2%	16.5%	20.9%	20.0%	20.4%	21.5%
Net working capital	93	86	104	121	146	156	224	319	337	354	362
% of sales	21.3%	18.7%	20.4%	20.8%	21.3%	20.7%	24.2%	29.2%	30.8%	33.6%	31.0%
Shareholders' funds	104	122	147	160	186	223	305	375	391	400	422
Pension provisions	15	16	17	21	22	23	25	25	23	20	14
Other provisions	29	27	38	55	46	60	76	96	87	74	81
Net cash (debt)	16	41	55	49	26	44	32	(97)	(139)	(146)	(155)
Financial gearing	Cash	Cash	Cash	Cash	Cash	Cash	Cash	0.26x	0.36x	0.37x	0.37x
Net debt/EBITDA	Cash	Cash	Cash	Cash	Cash	Cash	Cash	0.53x	1.04x	0.96x	0.90x
Total capex	(6)	(6)	(14)	(42)	(27)	(39)	(37)	(92)	(54)	(35)	(78)
Free cash flow	21	38	27	23	1	41	23	(71)	15	68	58
Dividends paid	(46)	(11)	(14)	(34)	(21)	(25)	(28)	(93)	(53)	(53)	(55)

Source: Historical company data, Hugo Boss fiscal year ends in December. Note: 2004 operating profits include higher personnel costs and depreciation due to the purchase of MH Shoes & Accessories, and its increased production capacity in Izmir (Turkey). Previously Hugo Boss financials were consolidated through fully-owned unit Marzotto International NV, making some consolidated figures different from the financials released by Hugo Boss.

Historical performance

BOSS brand, Europe's fashion market and product/store expansion plans are likely to be the main drivers of Hugo Boss's 2005-07E earnings performance

Hugo Boss confirmed its global leadership in the high-end men's apparel sector (13% market share) with double-digit sales growth in all brand categories – with the exception of Baldessarini (2% of sales), whose sales declined by 8% y/y – and a double-digit percentage rise in all key countries during fiscal year 2004. Despite consumer preferences and apparel trading conditions being unfavourable in Europe last year, we believe Hugo Boss proved its ability to stimulate fashion demand by offering appealing clothing collections and strengthening its brand awareness.

Hugo Boss is capturing the value chain

In our opinion, following the solid performance of its menswear operations and increased vertical integration, Hugo Boss is now well placed to further develop its interests in womenswear, accessories (notably shoes, handbags and leather goods) and informal clothing (leisure and sportswear) where the business is under-represented. We note that royalty sales declined by 24% to €40 million in 2004 as the production of some textile products (ie, socks, body wear and knitwear), which were previously licensed out, was integrated into the group during 2003. In addition, the production of shoes and leather accessories (€72 million in 2004) was incorporated in Hugo Boss, following the acquisition of MH Shoes & Accessories in January 2004. Given its higher vertical integration and positive sales momentum, we expect an annual 20 basis point improvement in its gross margin to be achievable in 2005-07E.

Hugo Boss has expanded its retail outlets (ie, licensed flagship stores and directly operated stores) in recent years, stimulating solid growth from this distribution channel (+11% 2002-04 sales CAGR). Flagship stores increased to 729 in 2004 (sales of €358 million, +9% y/y) from 636 in 2003 and 387 in 2000. Hugo Boss DOS increased to 97 stores in 2004 (sales of €98 million, +18% y/y) from 81 in 2003 and 37 in 2000. In our view, the retail stores play a strategic role in terms of brand recognition and the related financial benefit of capturing the retail margin could provide incremental profits for Hugo Boss in the medium term. We expect Hugo Boss to continue its store expansion strategy in selected markets in the medium/long term.

We expect Hugo Boss to continue enlarging its distribution network in the medium term

2005 quarterly results

Hugo Boss released first quarter 2005 results as follows (April 2005):

- **Sales of €406 million (up 14% y/y, +15% y/y excluding forex);**
- **€77 million reported EBIT (19% margin – in line with first quarter 2004);**
- **€52 million reported net income (+17% y/y);**
- **Enterprise free cash flow before dividends of €28 million.**

Table 10: Hugo Boss – first half 2005 growth

Sales	Y/y growth (%)
BOSS Man	+12%
BOSS Woman	+31%
HUGO	+9%
Germany	+9%
RoE	+12%

Source: Hugo Boss

BOSS Woman sales rose 37% y/y to €26 million in first quarter 2005, confirming the successful re-launch of this brand. In Europe, key countries, such as Germany, France, the UK, Italy and Spain, recorded double-digit sales growth in first quarter 2005 with the exception of Germany, whose sales grew 5% y/y to €84 million. The US market generated sales of €40 million (up 17% y/y, 23% y/y ex forex) and Asia sales were up 28% y/y (32% y/y ex forex) to €42 million.

Hugo Boss released second quarter 2005 results as follows (July 2005):

- **Sales of €219 million (up 11% y/y);**
- **-€6.6 million reported EBIT (versus -€6.8 million in second quarter 2004),**
- **-€6.2 million reported net income (-€5.0 million in second quarter 2004).**

In second quarter 2005, the company confirmed double-digit growth by the BOSS brand and positive sales performance in all countries. First half 2005 results support our full year 2005 estimates. During its quarterly results releases (20 April and 28 July), Hugo Boss anticipated 10% y/y sales growth (excluding forex) and net income of c€100 million (+13% y/y) in FY 05.

Hugo Boss management predicts 10% y/y sales growth (ex forex) and 13% y/y earnings growth in 2005E

Our 2005-15 estimates

Table 11 shows our underlying medium/long-term assumptions for Hugo Boss. Its earnings momentum and cash flow growth prospects are largely dependent on its sales performance, which we expect to grow by 8% y/y in 2005E and by an annual average of 6% y/y over the period 2006-07E. Our sales assumptions are mostly based on the planned initiatives to widen its product range and strengthen its distribution channels, and discount the current favourable trading conditions for Hugo Boss products.

2005 key estimates for Hugo Boss: Sales of €1,266 million (+8% y/y), EBIT of €146 million (11.5% margin), and net profit of €98 million (+11% y/y)

Table 11: Hugo Boss division – DCF model, 2005-15E

€ m	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
BOSS man	975	1,035	1,085	1,131	1,171	1,212	1,254	1,298	1,343	1,390	1,439	1,489
BOSS woman	69	98	117	141	155	170	187	206	227	249	274	302
HUGO	107	116	124	132	136	141	146	151	157	162	168	174
Baldessarini	17	17	18	18	18	18	18	18	18	18	18	18
Sales	1,168	1,266	1,344	1,421	1,480	1,541	1,605	1,673	1,744	1,819	1,899	1,982
y/y growth (%)	10.8%	8.3%	6.2%	5.7%	4.1%	4.1%	4.2%	4.2%	4.3%	4.3%	4.4%	4.4%
BOSS Man, Hugo and Baldessarini EBIT	133	143	152	162	169	176	184	192	199	207	215	223
Margin (%)	12.1%	12.3%	12.4%	12.7%	12.8%	12.9%	13.0%	13.1%	13.1%	13.2%	13.2%	13.3%
BOSS woman EBIT	2	4	8	12	14	16	18	20	22	25	29	32
Margin (%)	3.0%	4.0%	6.4%	8.7%	8.9%	9.2%	9.4%	9.7%	9.9%	10.2%	10.4%	10.7%
Operating profits	135	147	160	174	183	192	202	212	222	232	243	255
y/y growth (%)	13.5%	8.8%	8.6%	9.1%	4.9%	4.9%	5.0%	5.0%	4.7%	4.8%	4.8%	4.9%
Margin (%)	11.6%	11.6%	11.9%	12.3%	12.4%	12.5%	12.6%	12.7%	12.7%	12.8%	12.8%	12.9%
Effective tax rate (%)	31%	31%	31%	31%	31%	31%	31%	31%	31%	31%	31%	31%
NOPLAT (taxed EBI)	93	102	110	120	126	132	139	146	153	160	168	176
Margin (%)	8.0%	8.0%	8.2%	8.5%	8.5%	8.6%	8.7%	8.7%	8.8%	8.8%	8.8%	8.9%
D&A	37	43	45	47	50	53	56	59	62	65	68	71
Gross cash flow	131	145	155	167	176	186	195	205	215	225	236	247
Capex	(78)	(70)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)	(50)
Additional investment in working capital	(8)	(21)	(18)	(17)	(17)	(17)	(18)	(18)	(18)	(18)	(19)	(19)
Changes in provisions	7	3	(3)	(1)	0	0	0	0	0	0	0	0
Enterprise free cash flow	52	58	84	99	109	118	127	137	147	157	167	178
Discount factor (WACC)		1.00	0.92	0.85	0.78	0.72	0.67	0.61	0.56	0.52	0.48	0.44
Present value of FCF		58	77	84	85	85	85	84	83	82	80	79

PV of enterprise free cash flow	825
PV of terminal value	1,433
Hugo Boss discounted cash flows	2,258
51% of Hugo Boss DCF	1,150
Valentino Fashion shares (million)	74.1
Hugo Boss DCF/Valentino Fashion share	15.5

Debt to equity	10%
COD pre tax	3.3%
COE	9.1%
WACC	8.5%
Perp growth	3.0%
TV as % DCF	63%

Sensitivity of HB DCF/Valentino Fashion share		Perpetuity growth		
		2%	3%	4%
	8.0%	15.3	17.2	20.0
WACC	8.5%	14.0	15.5	17.7
	9.0%	12.9	14.1	15.9

Source: UBS estimates

Positive sales growth expectations

We assume 5% average sales growth annually for Hugo Boss in the medium term

We are confident of Hugo Boss achieving 5% y/y annual average future sales growth, given its strengthened in-house capability, additional fashionable apparel products, increasing product penetration in Asia and stronger distribution platform (new commercial units and store openings). In addition, we believe our long-term expectations are supported by the preliminary financial delivery from the re-launch of BOSS Woman (6% of Hugo Boss sales, +36% y/y sales growth and profit break-even in 2004) and widening range of informal clothing products. Our long-term estimates are more conservative than Valentino Fashion's stated indications of high single-digit sales growth and strong operating margin expansion in the long term.

Positive earnings momentum

We expect 11% y/y EPS growth in 2005, broadly in line with the company's guidance

As Hugo Boss is largely a clothing wholesale business, we believe its operating margins are mostly determined by its sales growth trend and the control of its operating expenses (namely fixed costs). We expect its EBITDA margin to improve annually over the period 2005-07E by 20 basis points (from 14.8% in 2004) on the back of our improving gross margin projections (increased production/commercial efficiencies) while we expect its EBIT margin to remain stable in 2005, given planned investments (c€70 million in 2005). The expansion of its retail business is a strategic goal of Hugo Boss. We forecast 15 new directly operated stores in 2005 and 10 new stores a year in the long term, and estimate net profits to be €99 million in 2005 (+12% y/y) and €109 million in 2006 (+10% y/y).

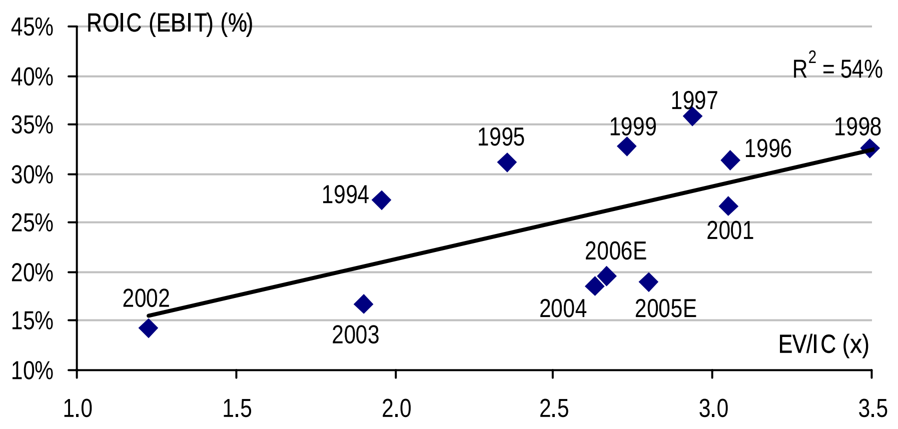
4% free cash flow yield in the medium term

Our expected enterprise free cash flows for Hugo Boss should support the payment of solid dividends to Valentino Fashion

A 2005-06E free cash flow yield of 4% could sustain an annual dividend payment of €32 million to Valentino Fashion, based on our expectations. Hugo Boss invested €78 million in fixed assets in 2004 to increase its production capacity (€17 million), expand its retail offering (€11 million), implement software (i.e., Columbus project, €9 million) and consolidate/acquire (€21 million) as well making other asset investments (€20 million).

Our 2005-07 cash flow estimates assume average investments as a percentage of annual sales of 4% – lower than our European textile and retail apparel sector average of 4.8% – in order to support its store expansion. Based on our underlying assumptions for Hugo Boss, the stock currently trades on 11.1-10.3x EV/EBITDA, 14.4-13.2x EV/EBIT and 19.9-18.0x PE in 2005-06E. The implied valuation multiples of our DCF model would be 11x EV/EBITDA, 14x EV/EBIT and 19x PE in 2006E, which seem to fully capture its growth potential, in our view.

Chart 18: Hugo Boss – EV/IC relative to its ROIC (EBIT)



Source: UBS estimates; Price as of 27 July 2005

The main risk to our earnings expectations is the customer reception to its clothing collections (fashion risk). In addition, global conditions influencing the apparel market and sharp changes in consumer confidence could affect our earnings expectations in the medium term. Despite exchange rate fluctuations having a negative financial impact (31% of revenues are derived outside Europe), we believe the risk of earnings forecasts being revised lower is not high, given that Hugo Boss usually hedges its operational exposure against adverse currency movements. Based on the current trading conditions, we do not expect earnings disappointment in the short term.

Superior profits for Valentino brand

The Valentino brand has delivered a vigorous recovery in terms of profitability following the implementation of a strategy aimed at: (1) restoring the brand's image; (2) extending its product range with lower-priced fashionable products; and (3) improving both its operating cost structure and profits execution during 2003-04. We expect Valentino to continue consolidating its position within the luxury goods sector by widening its distribution network (DOS expansion), and expanding its presence in Asia and outside Europe. The US market also represents an appealing long-term opportunity, as the brand is under-represented in this market, in our opinion.

Valentino Fashion Group owns 100% of the Valentino brand, which is expected to account for 12% of group sales and 14% of group EBIT in 2005E

The main risks to our divisional estimates are consumer demand for luxury products, intense competition among luxury players, and currency fluctuations. Table 12 provides a proxy for industry competition (a multitude of different brands) and Valentino brand positioning. We expect the Valentino brand to remain a fast-growing sales story in the medium term, given its expansion strategy and relatively small sales base. Conversely, we perceive the main risks to our 2005-07 earnings estimates to be the maturity of the luxury goods industry and any potential pressure on incremental capex requirements.

Table 12: Valentino – brand positioning within the sector

Price positioning	Brand positioning: Available	Accessible	Exclusive
High			Hermes, **Valentino**, Dior, Jean Paul Gualtier, YSL, John Galliano, Vivienne Westwood, Chanel
High			Burberry, **Valentino**, Roberto Cavalli, Giorgio Armani, Chloè, Dolce & Gabbana, Marc Jacobs, Prada, Luis Vuitton, Gucci, Meschino, Mikael Kors
Moderate		Giorgio Armani, **Hugo Boss**, Donna Karan, Ralph Lauren, Calvin Klein, Fendi, Loewe, Etro, Missoni	
Moderate	Tommy Hilfiger, Polo Ralph Lauren	Emporio Armani, **Valentino RED**, Max Mara, Guess, Alberta Ferretti, Byblos, Krizia, Celine, Emilio Pucci, Narciso Rodriguez, Strenesse, Mariella Burani, Blumarine, Iceberg, Kenzo, MIU MIU, Strenesse, SportMax, D&G, DKNY	
Moderate	Timberland, M Missoni, Lacoste, **Marlboro Classics**		
Low	Benetton		
Low	H&M, Zara		

Source: UBS estimates, based on Neiman Marcus retail prices and its autumn/winter 2005 collections

Historical performance

Table 13 shows the historical earnings performance of the Valentino division since its acquisition by the Marzotto group in 2002 (27 March 2002, €240 million enterprise value, of which €204 million was net debt and €36 million acquisition outlay). In 2004, Valentino sales grew by 13% y/y, almost entirely driven by the volume increase of its clothes (€112 million of clothing sales from €99 million in 2003), mostly due to the initial benefits of its brand re-vamping in

Valentino is on target to deliver the planned restructuring all countries. Valentino operations accounted for 11% of both group sales and operating profits in 2004.

Table 13: Valentino division – financials, 2001-04

€ m	Pre-acquisition 2001PF	2002PF*	2003	2004	Y/y growth (%, 2004)	% of 2004 sales
Wholesale	74.4	68.8	72.3	91.9	27%	54%
Retail	40.0	50.7	52.4	59.0	13%	35%
Royalties	18.1	15.6	16.5	18.3	11%	11%
Other sales	0.0	0.5	9.8	1.0	NM	1%
Italy	34.4	30.1	34.0	39.0	15%	23%
RoE	33.7	35.3	40.4	47.6	16%	28%
North America	24.6	25.3	28.1	39.5	41%	23%
Asia	14.9	20.4	21.0	24.3	16%	14%
RoW	6.8	8.4	2.9	1.5	NM	1%
Italian royalties	18.1	15.6	16.5	18.3	11%	11%
Other sales	0.0	0.5	8.1	0.0	NM	0%
Sales	132.5	135.6	151.0	170.2	13%	
y/y growth (%)		2.3%	11.4%	12.7%		
Reported EBIT	(15.6)	(12.6)	6.0	17.8	>100%	10%
Margin (%)	-11.8%	-9.3%	4.0%	10.5%		
Reported net profit	(28.5)	(44.0)	(19.3)	2.8		2%
Provision utilisation		10.0	9.0	2.8		
Net profit		(34.0)	(10.3)	5.6	>100%	3%
Invested capital			235	234		
Capex			9.3	4		
Mono-brand stores			83	85		
Of which DOS			20	21		

Source: Valentino Fashion Group, Marzotto company data. Note: * Valentino was consolidated for seven months in 2002

2005 quarterly results

The Marzotto group (pre spin-off deal) released first quarter 2005 results for the Valentino brand as follows (May 2005):

- **€52 million of sales (up 16% y/y, 17% y/y excluding forex);**
- **€8 million reported EBIT (15.3% margin in line with first quarter 2004);**
- **€2.5 million reported net income (flat y/y).**

Table 14: Valentino – first quarter 2005 growth

Sales	Y/y growth (%)
Italy	11%
RoE	3%
Americas	13%
Asia	73%

Source: Marzotto group

Most of its quarterly sales growth was derived by the consolidation of its Japanese distributor (Valentino Boutique Japan) with sales of c€3 million (23 additional DOS) and positive US momentum (first quarter 2005 sales of €10 million vis-à-vis €9 million in first quarter 2004). Our full year 2005 estimates are supported by the first quarter 2005 results release and order backlog increase for its autumn/winter collection. Valentino Fashion is due to release interim 2005 results on 12 September 2005.

Our 2005-15 estimates

Key 2005 estimates for Valentino brand: sales of €207 million (+22% y/y), EBIT of €26 million (12.5% margin) and net profit of €18 million

Table 15 shows our underlying assumptions for Valentino in the medium/long term. Valentino's earnings momentum and cash flow growth prospects are mostly dependent on its EBITDA performance. We expect EBITDA to grow by 37% y/y, to yield an EBITDA margin of 16.2% in 2005E and 20% by 2007E versus a 24% average EBITDA margin for the UBS European luxury goods sector in 2005E. Our sales assumptions are largely based on the company's plan to widen its product range (lower-priced clothing, new luxury accessories) and strengthen its distribution network outside Europe. We estimate 22% y/y sales growth in 2005, comprising 11% y/y Japanese retail sales consolidation, incremental y/y sales of 3% from DOS openings and 8% y/y organic growth, which is supported by product extension and country expansion of multi brand stores. For both the Valentino and Marlboro Classics divisions, we discount the expected cash flows by different annual discount rates. These vary from 6.0% in 2006E to 7.7% WACC in the long term, given our variable annual debt-to-equity ratios (from 60% in 2006E to a long-term average of 30%) and cost of equity (from 11% in 2006E to a long-term average of 10%) in 2006-15E.

Table 15: Valentino division – DCF model, 2004-15E

€ m	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Wholesale	92	112	130	150	162	175	189	198	208	218	229	241
Retail	59	73	80	91	100	110	121	133	146	161	177	195
Royalties	18	21	24	27	29	32	36	39	43	47	52	57
Other sales	1	2	2	0	0	0	0	0	0	0	0	0
Sales	170	207	236	267	291	317	345	370	397	427	458	493
y/y growth (%)	12.7%	21.7%	13.9%	13.4%	8.9%	8.9%	8.9%	7.3%	7.3%	7.4%	7.4%	7.5%
EBITDA	25	34	44	55	60	66	72	78	84	91	98	106
Margin (%)	14.4%	16.2%	18.8%	20.4%	20.6%	20.7%	20.9%	21.0%	21.2%	21.3%	21.5%	21.6%
Operating profits	18	26	36	46	50	55	60	65	70	75	82	88
y/y growth (%)	NM	46.2%	38.5%	26.5%	9.7%	9.7%	9.7%	7.8%	7.9%	7.9%	8.0%	8.1%
Margin (%)	10.5%	12.6%	15.3%	17.0%	17.2%	17.3%	17.4%	17.5%	17.6%	17.7%	17.8%	17.9%
Taxes – IRES (excluding tax savings)*	(5)	(5)	(8)	(11)	(13)	(14)	(16)	(18)	(20)	(22)	(24)	(26)
Taxes – IRAP	(2)	(2)	(2)	(3)	(3)	(3)	(4)	(4)	(4)	(4)	(5)	(5)
NOPLAT (taxed EBI)	11	19	26	32	34	37	40	43	46	50	53	57
Margin (%)	6.3%	9.3%	10.9%	11.9%	11.7%	11.7%	11.7%	11.7%	11.6%	11.6%	11.7%	11.6%
D&A	7	7	8	8	8	8	9	9	9	10	10	10
Gross cash flow	17	26	33	40	42	46	49	52	55	59	63	68
Capex	(4)	(14)	(12)	(12)	(15)	(16)	(17)	(18)	(20)	(21)	(23)	(25)
% sales	-2.4%	-6.7%	-5.1%	-4.5%	-5.0%	-5.0%	-5.0%	-5.0%	-5.0%	-5.0%	-5.0%	-5.0%
Additional investment in working capital	(6)	(11)	(9)	(9)	(10)	(10)	(10)	(11)	(11)	(11)	(11)	(12)
Enterprise free cash flow	8	1	13	19	18	20	21	23	25	27	29	31
Discount factor (WACC)		1.00	0.94	0.89	0.82	0.76	0.70	0.63	0.59	0.55	0.51	0.47
Present value of FCF		1	12	17	15	15	15	15	15	15	15	15

PV of enterprise free cash flow	147
PV of terminal value	314
Valentino discounted cash flows	461
Valentino Fashion shares (million)	74.1
Valentino DCF/Valentino Fashion share (€)	6.2

Debt to equity	41%*
COD pre tax	3.7%
COE	10%*
WACC	7%*
Perpetuity growth	3.0%
TV as % DCF	68%

Sensitivity of EV per share (€)		Perpetuity growth		
		2%	3%	4%
Capex	3.0%	5.7	6.5	7.6
% of	5.0%	5.5	6.2	7.3
sales	7.0%	5.2	6.0	7.1

Source: UBS estimates; Note: We include the expected tax savings related to the Valentino brand acquisition and historical profit losses at the corporate level; * 2004-15E average

A brand story of product and country expansion

Valentino aims to increase its product penetration by extending its product range in different luxury pricing categories. It is already established in the following luxury segments:

We assume 9% y/y annual medium-term sales growth for the Valentino brand, given its current relatively low sales penetration

- **Women's haute couture and prêt-à-porter with the Valentino brand;**
- **The women's diffusion segment with Valentino Roma;**
- **The low-priced segment (both women's and men's wear) with R.E.D. Valentino;**
- **Men's prêt-à-porter with Valentino Black Label;**
- **The men's diffusion segment with Valentino White Label;**
- **Luxury accessories with Valentino Garavani.**

We forecast that the combination of a wider range of products (accessories, new product lines in women's wear), the planned geographical expansion (notably in Japan, the US and emerging markets), and the further development of its DOS network (we estimate two new DOS per annum in the medium term) should sustain a 9% y/y sales CAGR over 2005-15E. Within that period, we expect an 11% sales CAGR over 2005-10 and a 7% sales CAGR over 2010-15E. Following its delivery on double-digit sales growth in 2003-YTD 2005, and its current relatively small size in terms of sales, we do not doubt that its sales growth potential could be exploited further. We see the release of figures on the quarterly sales performance of this brand as the main trigger that could lead us to revise our expectations for Valentino in the medium term.

Long-term profitability versus the luxury goods average

We expect Valentino brand profitability to be in line with the luxury goods industry average in the medium term

At the gross margin level, we do not expect strong improvements in 2005 from the 62% posted in 2004, mainly because its production process is entirely outsourced. In 2007E, the higher contribution from its retail activities (35% of Valentino brand sales in 2005E) and the incremental profits from higher-margin products should slightly increase its gross margin to 62.6%. However, we expect its EBITDA margin to improve to 16% in 2005 from 14% in 2004, on the back of its operational leverage and a more efficient cost structure (notably at the distribution level). Management's focus on Valentino's cost structure should support its operating margin potential, which we would see as in line with that of the European apparel industry in the long term. In the long term, we expect the company to achieve a 20% EBITDA margin (vis-à-vis the peer group average of 24% in 2005E) and a 17% EBIT margin (vis-à-vis the peer group average of 20% in 2005E) by 2007E. We caution that any drastic acceleration of its store strategy (currently two to three store openings per annum on average) could affect our operating growth prospects in the short to medium term.

Implied brand valuation in line with European luxury sector

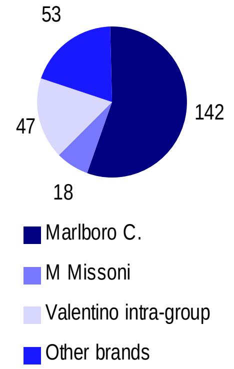
Our underlying assumptions imply that the Valentino brand valuation should stand at 7.1x EV/EBITDA and 15.8x PE in 2006E

We hold the fundamental qualities Valentino brand in high regard, and its implied valuation multiples seem to fairly balance the potential business risks and rewards of its expansion strategy, in our view. Our underlying assumptions yield a €6.2 DCF enterprise value per share for the Valentino brand (ie, €461m DCF enterprise value). Based on that, we calculate that the implied valuation of the Valentino brand – 14x and 10x EV/EBITDA and 24x and 17x PE (excluding the group financial releveraging) in 2005E and 2006E, respectively – looks to be at a c10% premium to the UBS universe of European luxury companies weighted average in 2005E, but at a 5% discount in 2006E. In our opinion, the strong earnings momentum of Valentino in 2005-06E fully supports our implied brand valuation.

Stable cash flows of the other apparel brands

The other apparel business consists of the production and distribution of apparel products. The owned brands are Lebole and Principe, and the licensed brands are Marlboro Classics and M Missoni. The business also includes the clothing manufacturing activities for the Valentino division (the other apparel division made €47 million worth of wholesale sales to the Valentino division in 2004). The Marlboro Classics licence agreement is due to expire in 2019, while the M Missoni licence was renewed in 2004 and has medium-term maturity. These licence agreements cover the production and distribution of Marlboro Classics and M Missoni products by the Valentino Fashion Group, which pays royalties as a percentage of sales to the brand owners (we estimate that royalties at 5-10% of sales). The company does not usually release the details of the licence agreements.

Chart 19: Other apparel sales, € m



Source: Valentino Fashion Group, 2004 pro-forma sales split

This division was named 'Marzotto apparel' before the spin-off deal. For clarity, we describe it as the 'Marlboro Classics and others' division in this report. We believe the main sales drivers are Marlboro Classics (8% of Valentino Fashion sales in 2005E) and wholesale sales to Valentino (3% of Valentino Fashion sales in 2005E). The Marlboro Classics brand is mostly oriented to casual-wear customers that appreciate US country-clothing styles. M Missoni is a young collection of the traditional Missoni-brand style. Uomo Lebole and Principe brands are mostly oriented to business menswear. The three main lines are illustrated in the following three images.

Marlboro Classics – US country style

Source: Valentino Fashion Group

M Missoni – young Missoni collection

Source: Valentino Fashion Group

Uomo Lebole – business menswear

Source: Valentino Fashion Group

Historical performance

Marlboro Classics and intra-group sales to the Valentino division are the key drivers of divisional sales performance

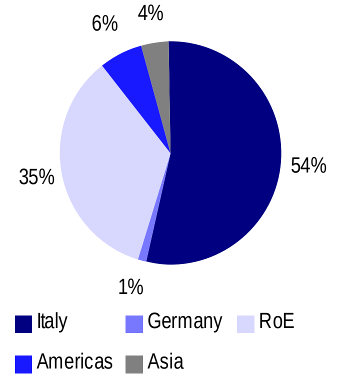
This performance of this apparel division was mostly driven by the Marlboro Classics brand (€142 million of sales in 2004). The brand accounted for 55% of the division's sales, and 9% of the pro-forma sales of the Valentino Fashion Group in 2004. We highlight that the divisional DOS sales are not material (our forecast is for 11 Marlboro Classics stores in 2005). We note that the divisional sales performance of this division was negatively affected by the licence termination on the Gianfranco Ferrè brand during 2004 (sales fell from €56 million in 2003 to c€5 million in 2004). The loss of the Ferrè licence was partly offset by the increased intra-group revenues from sales of finished products to the Valentino brand division (€47 million in 2004). Europe is the key driver of the division's sales performance: 89% of its products were sold in Europe in 2004, and Italy was especially important (53% of the division's sales in 2004). The following table reports the historical key financials for the Marlboro Classics and others division.

Table 16: Marlboro Classics and others division – financials, 2001-04

€ m	2001	2002	2003	2004
Marlboro Classics	133	147	144	142
y/y growth (%)	18.3%	10.9%	-1.7%	-1.8%
Ferrè licence	77	75	56	5
M Missoni	16	14	14	18
Lebole and Principe	44	40	37	28
Other brands	48	37	18	20
Product sales to Valentino	-	-	11	47
Sales	317	314	281	260
y/y growth (%)	6.9%	-1.1%	-10.5%	-7.3%
y/y growth (%) - ex Ferrè licence	NA	-0.7%	-5.6%	13.3%
y/y growth (%) - ex intra-group and Ferrè	6.9%	-0.5%	-9.7%	-2.2%
Reported EBIT	20	21	17	16
Margin (%)	6.2%	6.7%	6.2%	6.0%
Capital employed	69	72	58	62
Capex	5	8	4	5
Employees	1,211	996	794	789

Source: Marzotto group

Chart 20: 2004 geographical split of other apparel sales



Source: Marzotto group, Valentino Fashion

2005 quarterly results

Before the spin-off deal (May 2005), Marzotto group released first quarter 2005 results as follows:

- **Marlboro Classics sales €38 million (-10% y/y);**
- **M Missoni sales €7 million (+47% y/y);**
- **Lebole and Principe sales €10m (-1% y/y);**
- **Other branded sales €7.5 million (-19% y/y);**
- **Revenues from intra-group sales to the Valentino division €52 million (up by 21% y/y).**

In first quarter 2005, this division posted €5 million operating profits, and a 6.7% margin versus 5.6% in first quarter 2004. Valentino Fashion is due to release its interim 2005 results on 12 September 2005. We do not see strong triggers that could lead us to revise our divisional expectations in the short term.

No sign of strong long-term growth prospects

Based on the current weak sales momentum, our view on this division is more cautious than company guidance

The following table shows our underlying assumptions for the Marlboro Classics and others division in the medium to long term. Based on the current industry outlook, we forecast Marlboro Classics sales momentum to remain weak in 2005. We expect its divisional management to be focused on further restructuring its operating cost structure, and extending the Marlboro Classics range of products into shoes, accessories and women's clothing. The company has already reorganized part of its Italian production, intensifying production activities in East European countries over the last two years. We also expect the focus to be on improving operating margins in the medium term, rather than on optimistic sales growth prospects for 2006-15E (we see a long-term annual sales growth average of 1.5%). This should secure average enterprise free cash flow generation per annum of €11 million in 2005-15E, in our opinion. Based on our underlying assumptions (ie, €159 million enterprise DCF), we calculate that the implied valuation multiples of this division are 11-14x EV/EBIT, broadly in line with the European apparel average in 2005-06E.

Table 17: Marlboro Classics and other brands – DCF model, 2004-15E

€ m	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E
Sales – net of intra-group revenues	212	203	208	210	213	216	219	223	226	229	233	236
y/y growth (%)	-20.0%	-4.1%	2.4%	0.7%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Operating profits	12	11	14	15	16	16	17	17	18	18	19	19
y/y growth (%)	-5.0%	10.0%	20.8%	9.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Margin (%)	5.4%	5.7%	6.7%	7.2%	7.3%	7.4%	7.5%	7.6%	7.8%	7.9%	8.0%	8.1%
Effective tax rate on EBIT (%)	52%	50%	48%	47%	47%	47%	46%	46%	46%	45%	45%	45%
Taxes	(6)	(6)	(7)	(7)	(7)	(7)	(8)	(8)	(8)	(8)	(8)	(9)
NOPLAT (taxed EBI)	5	6	7	8	8	9	9	9	10	10	10	11
Margin (%)	2.6%	2.8%	3.5%	3.8%	3.9%	4.0%	4.1%	4.1%	4.2%	4.3%	4.4%	4.5%
D&A	9	7	7	7	7	8	8	9	9	9	10	10
Gross cash flow	14	13	15	15	15	16	17	18	18	19	20	21
Capex	(5)	(8)	(10)	(11)	(10)	(9)	(9)	(9)	(8)	(8)	(7)	(7)
% sales	-2.4%	-3.9%	-4.6%	-5.0%	-4.7%	-4.4%	-4.1%	-3.8%	-3.6%	-3.4%	-3.2%	-2.9%
Additional investment in working capital	18	14	1	5	(1)	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Changes in provisions	0	(5)	1	(0)	0	0	0	0	0	0	0	0
Enterprise free cash flow	27	13	7	9	5	6	8	9	10	11	12	13
Discount factor (WACC)		1.00	0.94	0.89	0.82	0.76	0.70	0.63	0.59	0.55	0.51	0.47
Present value of FCF		13	7	8	4	5	5	6	6	6	6	6

PV of enterprise free cash flow	59
PV of terminal value	99
Marlboro & others discounted cash flows	158
No. of Valentino Fashion shares (million)	74.1
Apparel DCF/Valentino Fashion share (€)	2.1

Debt to Equity	41%*
COD post tax	3.7%
COE	10%*
WACC	7%*
Perpetuity grow.	1.5%
TV as % DCF	63%

DCF value per share (€)		Perpetuity growth		
		1%	2%	3%
avg	6	1.1	1.2	1.3
FCF	11	2.0	2.1	2.4
(€ m)	16	2.9	3.1	3.4

Source: UBS estimates; Note: * 2005-15E average. For both the Valentino, and Marlboro Classics and others divisions, we discount the expected cash flows by different annual discount rates that vary from 6.0% in 2006E to 7.7% WACC in the long term, given our different debt-to-equity ratios per annum (from 60% in 2006E to a 30% long-term average) and the cost of equity (from 11% in 2006E to a 10% long-term average) during 2006-15E.

Valuation and opportunities

Our Neutral 1 rating and €20.2 12-month price target, which offers 9% potential upside and 4% total forecast excess return from current prices, are based on the following considerations:

(1) **Strong earnings momentum in 2005-07E:** Based on our divisional estimates, we expect positive earnings momentum in the next few years. (18% 2004-07E EPS CAGR). This momentum is mostly driven by our expectations for double-digit earnings growth for Hugo Boss in 2005-07E, the expected profit turnaround of the Valentino brand (from €16 million net profit in 2004 to €36 million in 2007E). Our 2005 earnings estimates are broadly in line with company's stated indications. In our opinion, the current positive earnings momentum of the Hugo Boss operations should limit the execution risk in the short term. Moreover, we believe that the current delivery on the Valentino brand profit turnaround should reduce the risk of earnings disappointment in the short term, and we do not believe its brand potential, price positioning and status awareness has been fully exploited yet. In our view, the main risks of earnings disappointment lie in less-than-full delivery against 2005 disclosed targets, and in any drastic deterioration in current fashion industry conditions, especially notably in Europe.

(2) **Deserved valuation multiples, but limited upside potential from current prices:** The limited risk of earnings disappointment that we see in the short term supports the current valuation multiples. In our opinion, the potential risks and rewards of the stock profile are fairly discounted in the current valuation. For 2005E and 2006E, the stock currently trades on 11.7x and 10.4x EV/EBITDA, 15.3x and 13.4x EV/EBIT, and 23.2x and 18.4x PE. We believe its 2005E valuation multiples are fully sustained by its implied growth prospects (1.3x PEG ratio and 1.0x EV/EBITDAG). The stock trades at a 5% average premium to the UBS European apparel and luxury universe's valuation multiples in 2006E.

(3) **Our price target of €20.2** is based on a 10% premium to our €18.4 DCF valuation per share, and partly captures the potential benefits of some financial opportunities that could occur in the medium to long term. Our price target is 10% above our DCF value per share. Although the company has never mentioned any further potential financial restructuring of its balance sheet, our expected cash flows could sustain further business expansion and integration in the medium to long term, in our opinion. Our forecast scenarios suggest a potential fair value of between €19.2 and €22.8 per share. In our opinion, the recent spin-off deal by Marzotto group and the separate listing of the Valentino Fashion Group stock demonstrate management's commitment to leverage the value of the different owned brands and the Marzotto family's intention to restructure its equity assets. At our €20.2 price target, the stock would trade on 11x EV/EBITDA, 14x EV/EBIT and 19x PE in 2006E.

(4) **We do not see strong catalysts in the short term:** Our Neutral 1 rating is mostly based on the lack of strong triggers that could lead us to raise our

earnings expectations during 2005-07. In our opinion, our valuation already captures the value of the various brands over 2005-07E, based on the current trading conditions. Better-than-expected results from its operations (notably the Hugo Boss and Valentino brands), and further group restructuring or expansion opportunities, could be the main catalysts for the stock in the medium term, in our view.

(5) **Brand potential and good management track record:** Our predictability level of '1' reflects two factors: our confidence in the growth potential of its brands in the medium to long term; and the good track record of its management. Although the stock was listed only recently, its top management is well known through its track record as Marzotto group management.

Discounted cash flows

Our DCF model yields a value of €18.4 per share (3% below current prices), and largely supports our price target of €20.2 for Valentino Fashion Group's ordinary shares. In our opinion, different DCF models for each brand, as detailed in the previous sections, are the most appropriate way to value Valentino Fashion Group and to capture the long-term growth prospects of its brands. We have taken a 10-year time horizon for our cash flow analysis, using different discount rates and DCF assumptions for each brand, as highlighted in the next table. We exclude the expected tax savings of Valentino and minority considerations in our divisional DCF models, analyzing them at group level.

The combination of our DCF models for each brand yields €18.4 per Valentino Fashion share – 9% below our price target of €20.2

Table 18: Valentino Fashion Group – DCF assumptions and conclusions by division

€ m	Hugo Boss	Valentino division	Other apparel brands
Debt to equity ratio (%)	10%	From 63% in 2005E to 30% in 2012-15E	
Cost of debt – pre-tax (%)	3.3%	3.7%	3.7%
Equity risk premium (%)	5.0%	5.0%	5.0%
5-year geared beta	1.15	From 1.42 in 2005E to 1.2 in 2012-15E	
Cost of equity	9.5%	From 11% in 2005E to 10% in the long term	
WACC	8.8%	From 5.7% in 2005E to 7.7% in 2012-15E	
Terminal growth	3.0%	3.0%	1.5%
Discounted cash flows (€ m)	1,150*	461	158
% of total DCF value	65%	26%	9%
No. of shares (million)	74.1	74.1	74.1
DCF EV/per share (€)	15.5	6.2	2.1

Source: UBS estimates; Note: * 51% ownership of Hugo Boss DCF enterprise value

Two-thirds of our enterprise value for Valentino Fashion derives from Hugo Boss's discounted cash flows

Table 19 below illustrates the derivation of our DCF equity value per Valentino Fashion Group share, based on the sum of the divisional discounted cash flows and the net present value of the Valentino Fashion tax savings. Excluding Hugo Boss taxation (31% tax rate average in 2005-07E), the group may benefit from the deduction of c€152 million in tax loss carry-forward in the next few years. Our €1.8 billion enterprise value of Valentino Fashion group is driven by the 51% ownership of the Hugo Boss discounted enterprise free cash flows (64% of the group EV), Valentino (26%), Marlboro Classics and other brands (9%) and net present value of tax savings (2%).

Table 19: Valentino Fashion Group – DCF equity value

	€ m	€ a share
51% of Hugo Boss EV	1,150	15.5
Valentino EV	461	6.2
Marlboro Classics and others EV	158	2.1
NPV of Valentino tax savings	32	0.4
Valentino Fashion group DCF	1,800	24.3
Less 2005E average net debt	417	5.6
Less 2005E debt deemed provisions	24	0.3
Valentino Fashion group DCF equity value per share	1,360	18.4

Source: UBS estimates

EV calculation and relative valuation

We show the current enterprise valuation of Valentino Fashion Group in the table below. Our estimates include the €1.0 billion minority buy-out related to the current Hugo Boss minority shareholders (ie, 21% of common shares and 78% of preferred shares) at the current market value.

Table 20: Valentino Fashion Group – valuation multiples

€ m	2005E	2006E	2007E
Market capitalisation	1,421	1,421	1,421
Net debt	417	394	351
Buy-out of minorities	964	964	964
Debt deemed provisions	24	24	23
Other claims	0	0	0
Total enterprise value	2,826	2,803	2,760
EV/sales (x)	1.7	1.6	1.5
EV/EBITDA (x)	11.7	10.4	9.3
EV/EBIT (x)	15.3	13.4	11.7
EVIC (x)	2.7	2.5	2.4
PE (x)	23.2	18.4	15.4
P/CE (x)	12.1	10.4	9.2

Source: UBS estimates; current price of €19.0 as of 27 July 2005

We believe the current valuation multiples are mostly supported by the implied growth prospects (1.3x 2005E PEG)

At the current share price, Valentino Fashion Group trades on 11.7x and 10.4x EV/EBITDA and 15.3x and 13.4x EV/EBIT in 2005 and 2006E, respectively. The PE stands at 23.2x and 18.4x in 2005 and 2006E, respectively. In our opinion, its current valuation is sustained by its implied growth prospects: a PEG ratio of 1.26x on the 2004-07E CAGR and EV/EBITDA to EBITDA growth of 1.07x on the 2004-07E CAGR. At our €20.2 price target, the stock would trade on 10.7x EV/EBITDA, 13.7x EV/EBIT and 19.3x PE in 2006E.

Given the group's business mix, we primarily focus our relative multiple valuation analysis on the apparel and luxury companies. In our view, the most comparable companies for the Valentino brand are luxury companies, while for Hugo Boss they are global fashion/apparel wholesalers. Although we do not identify strictly comparable companies, we believe Valentino Fashion should remain within the average multiples of the European apparel and luxury companies (see the following tables). The stock currently trades at a 5%

premium to the average of the UBS-covered peer group in 2006E, a premium that seems sustainable to us, given Valentino's strong earnings momentum. Its status as a clothing retailer may imply a deeper comparability to the European apparel retailers in the long term, in our view.

Table 21: Valentino Fashion Group – relative valuation

	EV/sales (x)		EV/EBITDA (x)		EV/EBIT (x)		EV/IC (x)		PE (x)		PCE(x)		Div yield (%)	
	05E	06E	05E	06E	05E	06E	05E	06E	05E	06E	05E	06E	05E	06E
Valentino Fashion	1.7	1.6	11.7	10.4	15.3	13.4	2.9	2.8	23.2	18.4	12.1	10.4	2.0	2.1
European Apparel & Luxury	2.5	2.2	11.2	10.0	13.7	12.4	4.3	3.8	19.4	17.5	15.4	13.9	1.7	1.8
Benetton	1.2	1.2	7.4	7.1	13.2	12.4	1.1	1.1	15.5	14.7	7.8	7.6	4.1	3.2
Bulgari	3.2	2.9	15.1	13.7	19.3	17.2	5.2	4.7	23.1	20.6	17.3	15.6	3.0	3.4
Folli Follie	3.4	NA	10.5	NA	11.1	NA	5.8	NA	14.5	12.9	13.6	12.2	1.0	1.2
Hermès	4.1	3.8	13.7	12.7	15.7	14.6	6.7	6.0	26.8	25.1	21.4	19.9	1.2	1.3
Luxottica	2.6	2.3	13.6	11.6	16.4	13.6	3.1	3.0	22.4	19.5	18.8	16.7	1.3	1.3
LVMH	2.9	2.7	12.5	11.0	14.8	12.9	3.0	2.9	21.5	18.8	16.3	14.4	1.9	2.1
Richemont	2.3	2.1	12.0	10.3	14.9	12.5	1.9	1.9	17.2	15.5	19.2	17.5	2.2	2.5
Swatch Group	2.1	1.9	9.9	8.6	12.5	10.9	2.7	2.5	16.8	15.3	13.3	12.2	1.1	1.2
Burberry	2.6	2.4	10.3	9.7	12.0	11.4	6.0	5.8	18.4	16.6	14.8	12.8	1.7	1.6
adidas-Salomon	1.1	1.0	9.2	8.4	10.6	9.7	3.2	3.2	16.4	15.5	13.1	12.1	1.1	1.2
Puma	1.9	1.7	8.1	7.3	8.5	7.7	9.8	7.8	13.6	12.7	12.5	11.7	0.5	0.5
Tod's	2.7	2.4	11.4	9.9	15.9	13.5	3.4	3.3	26.3	22.9	16.3	14.6	1.9	2.3
European Retail, Apparel	1.6	1.4	9.0	8.1	11.4	10.3	6.5	5.9	16.6	14.8	12.6	11.3	3.0	3.0
Brown (N)	1.2	1.2	8.3	7.6	9.9	9.1	1.6	1.5	13.2	12.2	10.1	9.3	4.9	3.9
Burberry	2.6	2.4	10.3	9.7	12.0	11.4	6.0	5.8	18.4	16.6	14.8	12.8	1.7	1.6
H & M	3.4	2.9	14.0	11.7	15.5	12.9	25.1	22.6	24.8	21.5	29.2	25.1	1.8	2.0
Inditex	2.1	1.7	9.9	8.5	13.3	11.5	6.3	5.8	19.6	17.3	12.5	11.2	2.5	1.8
JJB Sports	0.6	0.6	6.9	6.6	10.5	9.7	1.3	1.3	13.7	13.4	8.0	7.8	4.2	5.2
Matalan	0.8	0.8	7.9	7.3	10.8	9.9	3.5	3.4	15.8	13.1	10.0	8.5	4.4	4.5
Next	1.4	1.3	8.0	7.3	9.4	8.6	6.8	5.6	13.0	11.9	10.2	9.2	2.7	2.8
Voegele	0.7	0.6	6.5	6.1	10.1	9.3	1.3	1.3	14.0	12.5	6.3	6.2	1.8	2.0
US Apparel & Luxury	1.0	0.9	7.6	6.8	9.1	8.0	2.3	2.4	14.5	13.3	13.4	11.1	0.9	0.9
Jones Apparel	0.9	0.8	6.9	5.4	8.1	6.3	1.1	0.9	12.0	10.0	9.7	7.3	1.2	1.2
Kellwood Company	0.4	0.4	5.6	4.6	7.2	6.1	0.8	0.8	11.7	10.8	11.1	7.8	1.7	2.3
Liz Claiborne	0.9	0.8	6.6	5.8	8.0	6.9	2.0	1.8	13.6	12.2	12.9	8.7	0.5	0.5
Polo Ralph Lauren	1.5	1.4	9.0	7.8	11.0	9.8	3.4	3.2	17.7	16.6	13.5	11.2	0.5	0.4
Tommy Hilfiger	0.6	0.6	5.1	4.6	8.1	6.7	0.6	0.7	16.7	14.2	8.4	8.9	0.0	0.0
VF Corp	1.0	0.9	6.5	5.9	7.5	6.8	1.8	2.2	12.9	12.3	15.8	15.7	1.8	1.8
Nike	1.5	1.4	10.6	10.4	11.9	11.6	3.9	4.3	17.6	16.3	16.7	14.4	1.0	1.2
Reebok International	0.8	0.7	7.3	7.8	8.0	8.9	2.3	2.3	11.0	12.0	14.4	11.4	0.7	0.7
Timberland	1.3	1.2	8.2	7.4	8.8	8.0	4.2	5.5	14.7	13.0	12.0	11.2	0.0	0.0
Wolverine World Wide	1.1	1.0	10.4	7.9	12.6	9.3	2.4	2.2	17.3	15.6	19.5	14.3	1.3	1.4

Source: UBS estimates; current price of €19.0 as of 27 July 2005

Table 22: Valentino Fashion Group – profitability and momentum

	Mkt cap (€ m)	Ccy	Price	Rating	y/y sales growth (%) 05E	06E	y/y EPS growth (%) 05E	06E	EBITDA margin (%) 05E	06E	EBIT margin (%) 05E	06E	Capex % sales 05E	NWC % sales 05E
Valentino Fashion	1,421	EUR	19.3	N1	8.1	6.7	10.3	25.7	14.4	15.1	11.0	11.7	19.1	4.4
European Apparel & Luxury					10.9	8.2	13.2	10.3	22.1	22.3	18.5	18.8	35.1	5.3
Benetton	1,500	EUR	8.3	N2*	(4.4)	0.7	(21.1)	4.7	15.1	15.4	9.2	9.5	8.5	8.9
Bulgari	2,939	EUR	9.9	NA	12.1	9.8	16.8	12.4	21.4	21.6	16.8	17.1	26.9	6.0
Folli Follie	867	EUR	26.3	B2*	19.9	19.8	17.3	11.9	31.8	30.6	30.3	29.2	52.8	2.3
Hermès	6,299	EUR	171.1	R1	5.6	6.5	11.7	6.6	29.0	29.1	25.8	25.8	42.6	9.0
Luxottica	8,710	EUR	19.1	N1*	29.4	9.2	17.1	14.6	18.8	19.8	15.7	17.0	18.7	5.2
LVMH	33,806	EUR	69.0	R2	11.6	7.6	13.4	14.4	23.5	24.3	20.0	20.6	20.6	5.0
Richemont	16,825	EUR	45.8	NA	10.1	6.3	19.2	10.5	19.1	20.2	15.5	16.7	12.9	3.9
Swatch Group	6,945	CHF	186.2	N1*	4.3	6.2	22.2	9.9	21.3	22.1	16.9	17.4	21.3	6.3
Burberry	2,961	GBP	425.3	R2	8.2	8.9	6.2	11.0	25.1	24.8	21.5	21.1	50.1	5.1
adidas-Salomon	6,746	EUR	147.1	N1	8.2	8.0	14.0	6.0	12.4	11.8	10.8	10.2	30.6	3.5
Puma	3,613	EUR	225.4	N2	7.4	8.4	3.2	7.0	24.1	23.8	22.7	22.5	114.9	3.6
Tod's	1,378	EUR	45.6	R2	18.8	7.6	38.6	14.8	23.1	24.3	16.7	17.9	21.7	4.7
European Retail, Apparel					5.2	6.7	3.3	11.6	16.5	16.7	13.3	13.4	50.7	5.4
Brown (N)	672	GBP	159.0	N2	1.5	1.9	5.5	8.2	14.7	15.1	12.3	12.6	15.7	3.0
Burberry	2,961	GBP	425.3	R2	8.2	8.9	6.2	11.0	25.1	24.8	21.5	21.1	50.1	5.1
H & M	24,365	SEK	278.5	N1	14.1	14.4	24.9	15.8	24.4	24.7	22.2	22.5	162.6	3.2
Inditex	13,862	EUR	22.2	N2	19.4	18.6	12.9	13.6	20.8	20.4	15.5	15.0	47.5	11.0
JJB Sports	641	GBP	191.3	N2	(3.8)	4.5	(32.4)	2.2	8.9	9.3	5.9	6.3	12.1	7.7
Matalan	1,242	GBP	205.0	N2*	(3.7)	0.5	(5.6)	19.9	10.0	10.7	7.4	7.9	32.6	3.9
Next	5,823	GBP	1578.0	B1	6.9	6.9	6.0	9.4	17.5	17.7	14.9	15.0	72.6	6.2
Voegele	484	CHF	85.8	N2*	(1.1)	(2.1)	8.9	12.4	10.3	10.6	6.6	6.9	12.8	3.3
US Apparel & Luxury					5.3	5.3	11.4	9.2	12.9	13.3	10.8	11.2	24.3	2.4
Jones Apparel	3,316	USD	32.5	B1	11.5	6.0	13.8	19.4	13.3	14.5	11.4	12.5	13.4	1.1
Kellwood Company	650	USD	28.0	N2	(4.4)	3.2	(5.2)	8.4	6.8	7.6	5.3	5.8	11.4	1.3
Liz Claiborne	3,811	USD	41.6	B1	7.7	8.0	6.6	11.6	13.3	13.4	11.0	11.3	25.6	3.2
Polo Ralph Lauren	4,314	USD	49.2	N2*	10.0	5.4	20.3	6.7	16.6	17.3	13.5	13.9	31.2	4.5
Tommy Hilfiger	1,048	USD	13.8	N2	(5.0)	(2.8)	(7.3)	17.0	12.3	13.2	7.8	9.1	8.0	5.2
VF Corp	5,664	USD	60.1	N2	7.7	5.0	10.5	5.1	14.7	15.0	12.9	12.9	24.5	1.4
Nike	18,987	USD	84.4	N2	9.3	7.5	17.1	8.2	14.6	13.8	13.0	12.3	32.9	2.1
Reebok International	2,200	USD	42.8	N2	2.5	5.5	30.2	(7.9)	10.7	9.1	9.6	8.0	28.8	2.2
Timberland	2,002	USD	35.2	B2	5.7	8.0	11.9	13.0	16.4	16.3	15.1	15.1	47.8	1.6
Wolverine World Wide	1,093	USD	22.1	N1	7.8	7.0	16.0	11.0	10.6	12.5	8.7	10.6	18.9	1.4

Source: UBS estimates; current price of €19.0 as of 27 July 2005. Note: * (RRD) = rating/return divergence

Financial capacity and opportunities

We estimate 2005 net debt/EBITDA at 1.7x for Valentino Fashion Group, 0.8x at Hugo Boss and 4.9x at Valentino Fashion (ex Hugo Boss)

In this section, we analyse the group's financial structure and potential financial opportunities in the medium to long term. Based on our cash flow and dividend expectations in 2005-06, the company's net debt position is set to decrease by €12 million to €410 million in 2005E, and by €32 million to €378 million in 2006E. Our 2005-06 estimates encompass a 4.5% average equity FCF yield (pre-dividend) and a 63% dividend payout ratio for Hugo Boss in 2005-06E, and a 1.4% average equity FCF yield (pre-dividend of Valentino Fashion Group (ex Hugo Boss)) and a 43% dividend payout ratio for Valentino Fashion. The following table shows our financial estimates by division.

Table 23: Valentino Fashion Group – net financial position

€ m	Hugo Boss		Valentino Fashion (ex HB)		Valentino Fashion Group	
	2005E	2006E	2005E	2006E	2005E	2006E
Net debt	(161)	(142)	(250)	(236)	(410)	(378)
EBITDA	190	204	51	65	242	270
Net debt/EBITDA (x)	0.8	0.7	4.9	3.6	1.7	1.4
EBIT	147	160	38	50	185	210
Financial charges	(5)	(4)	(11)	(12)	(17)	(16)
Interest cover (x)	27.6	40.0	3.4	4.1	11.2	13.0

Source: UBS estimates

During the spin-off deal, Marzotto's senior management (ie, Valentino Fashion Group's senior management) stated its commitment to create value for Marzotto and Valentino Fashion Group shareholders through:

Following the recent business and corporate restructuring (spin-off deal), a very aggressive approach could assume further strategic developments in the long term, in our view

(1) **Direct investment in the two businesses** (Marzotto and Valentino Fashion Group);

(2) **Greater flexibility in the future development of corporate strategy** at each business and greater visibility of divisional performance;

(3) **Managements focused on each business**;

(4) **Growth opportunities through partnerships/combinations**.

We now analyse the potential long-term opportunities for further expansion or business combinations. The timing and execution of these are uncertain.

Leveraged balance sheet with the exception of Hugo Boss division

Excluding the Hugo Boss operations, the residual business is highly leveraged,...

If we exclude Hugo Boss from the balance sheet, Valentino Fashion Group is highly leveraged (5x net debt/EBITDA in 2005E), mostly because of the €240 million of additional debt from the Valentino brand acquisition in 2002, in our view. If we assume normalised taxes, we forecast that the group enterprise free cash flows (ex Hugo Boss) are entirely dedicated to the payment of its net debt costs in 2005E, while they start reducing the group net debt from 2006E, as highlighted in the table below. We predict that the most likely use of the Valentino Fashion (ex Hugo Boss) cash flows over the next few years is debt reduction. Based on the current financial structure, we do not see a high probability of external expansion by Valentino Fashion Group in 2005-06E if the Hugo Boss strategy remains focused on organic growth. However, we believe the forecast fast-growing profits and accelerating cash flow generation of the Valentino brand could provide sizeable expansion opportunities (eg, the acquisition of new brands or aggressive retail expansion) from 2007-08.

...so its cash flow generation is likely to be dedicated to the reduction of group debt in the short term

Table 24: Valentino Fashion Group (excluding Hugo Boss) – free cash flows

€ m	2004	2005E	2006E	2007E
EBITDA	43	51	65	77
Capex	(17)	(22)	(22)	(23)
Other cash costs	(0)	(3)	(2)	(2)
OpFCF	25	27	41	52
Financial charges	(11)	(13)	(13)	(13)
Normalised taxes	(15)	(14)	(18)	(21)
Minority interests	0	0	0	0
Equity FCF	(0)	0	10	18
Mkt cap*	398			
Less NPV of tax savings	32			
Adj. mkt cap	366			
EFCF yield	-0.1%	0.1%	2.8%	4.9%

Source: UBS estimates. Note: The market capitalisation of Valentino Fashion Group, excluding Hugo Boss, has been calculated based on the current group market capitalisation minus 51% of the Hugo Boss market capitalisation; current price of €19.0 as of 27 July 2005

Potential expansion of opportunities for Hugo Boss in the long term

Around two-thirds of the value of Valentino Fashion Group derives from Hugo Boss's enterprise value. Hugo Boss's financial strategy has not been aggressive over the past five years, and its management seems to us to be focused on securing solid organic growth and returns in the medium term, rather than looking for external growth. Over the past two years, Hugo Boss returned more than 60% of its net profits as dividend payments to its shareholders. Following its increased vertical integration – parts of its licensing production were internalised and the company acquired additional production capacity in Italy during 2004 – and its planned geographical and retail expansion, we expect Hugo Boss's equity FCF yield to become more appealing from 2006E.

5% Hugo Boss FCF yield average in 2005-07E could sustain further expansion opportunities or increased dividend expectations in the medium term, in our view

Table 25: Hugo Boss – free cash flows

€ m	2004	2005E	2006E	2007E
EBITDA	173	190	204	222
Capex	(57)	(70)	(50)	(50)
Other cash costs	(6)	1	1	1
OpFCF	110	121	155	173
Financial charges	(5)	(4)	(3)	(2)
Taxes	(42)	(44)	(48)	(52)
Minority interests	0	0	0	0
Equity FCF	62	73	105	118
Mkt Cap	1,693	1,963	1,963	1,963
EFCF yield	3.7%	3.7%	5.3%	6.0%

Source: UBS estimates; current price of €19.0 as of 27 July 2005

We have conducted a sensitivity analysis of Valentino Fashion's valuation relative to the financial impact of a potential re-leveraging of Hugo Boss's balance sheet through high dividend payments – a re-leveraging where the timing, technicalities and execution are wholly uncertain. This scenario would imply a more aggressive financial strategy at Hugo Boss than we have seen in the past. All other assumptions being equal, our best-case scenario of 4.0x

Any increased leverage of Hugo Boss's balance sheet could indirectly benefit Valentino Fashion's share price

2005E net debt/EBITDA would increase Hugo Boss's enterprise value by 10%, and Valentino Fashion Group's enterprise value per share by €1.5 to €25.8 (2% incremental upside). Moreover, any sizeable acquisition could create not only re-leverage benefits but also economic value added, in our opinion. Although we do not perceive the company's external expansion strategy to be intensifying in the short term, we believe Hugo Boss's healthy balance sheet and solid returns should be partly rewarded in our valuation approach.

Table 26: Hugo Boss – sensitivity analysis to its net debt/EBITDA

	UBS 2005E	Potential re-leveraging scenarios		
Net debt/EBITDA	0.8x	2.0x	3.0x	4.0x
Financial gearing	35%	83%	1.2x	1.7x
Debt to equity ratio	8%	19%	29%	39%
Cost of debt - pre tax (%)	3.3%	3.6%	3.8%	4.1%
Marginal tax rate (%)	31%	31%	31%	31%
Cost of debt - post tax (%)	2.3%	2.4%	2.6%	2.8%
Risk-free rate (%)	3.8%	3.8%	3.8%	3.8%
Equity risk premium (%)	5.0%	5.0%	5.0%	5.0%
5-year ungeared beta	1.03	1.03	1.03	1.03
5-year geared beta	1.06	1.13	1.20	1.27
Cost of equity	9.1%	9.5%	9.8%	10.1%
WACC	8.5%	8.1%	7.7%	7.3%
51% of Hugo Boss discounted cash flows	1,150	1,186	1,223	1,262
Hugo Boss EV/Valentino share (€)	15.5	16.0	16.5	17.0
Incremental upside		3%	6%	10%

Source: UBS estimates

Sensitivity analysis of a potential business combination between Hugo Boss and Valentino Fashion Group

Although Valentino Fashion has not disclosed such a strategy, a potential integration of Valentino Fashion and Hugo Boss could generate value for shareholders

Although Valentino Fashion Group has not stated any intention to integrate the Hugo Boss operations with the Valentino and Marlboro Classics brands, we have analysed the potential impact of a full merger between Hugo Boss and Valentino Fashion Group. Our first impression is that the group would strongly benefit from the removal of the Hugo Boss minority interests, and could generate some operating savings.

In our opinion, any potential merger plan would depend strictly on the Marzotto's family willingness to cede part of its shareholding control (in the case of a potential merger scenario financed by shares) or to sustain high levels of debt in the long term (in the case of a potential merger scenario financed by debt). In addition, these potential scenarios are subject to the views of Valentino Fashion Group minority interests. The group holds 79% of Hugo Boss voting shares. In our view, our basic sensitivity analysis is not particularly sophisticated (due to the many different variables), but provides an indication of the potential value creation that could accrue from these scenarios. At the operational level, we would see two main benefits from a merger between Valentino Fashion and Hugo Boss. Firstly, an integrated distribution platform could improve the group operating margins (ie, creating a lower fixed cost structure) and could increase the group's bargaining power relative to its suppliers (centralised sourcing) and its wholesale distributors. Secondly, a potential merger could generate production efficiencies if some Valentino-Marlboro brand were integrated into the Hugo Boss production capacity. Additionally, at a financial level, a potential merger could allow financial resources and cash flows to be allocated more efficiently, in our opinion.

Potential scenario 1: Valentino Fashion and Hugo Boss merger, financed by shares

Table 27 below shows a sensitivity analysis of the potential outlook for Valentino Fashion Group if the current Hugo Boss shares were converted into a similar amount of Valentino Fashion shares at current share prices, all other assumptions being equal. We predict some operational savings if this scenario occurs. This scenario would increase our 2005 earnings estimates by 5%, thanks to the lack of minority interests, and our price target for Valentino Fashion ordinary shares by c10%. In this potential scenario, we note that the total shareholdings of Finanziaria Canova and Marzotto family members would fall to 34% from 57%.

Table 27: Valentino Fashion Group – Scenario 1: Potential merger financed by shares

€ m	Pre-merger	Post-merger (1:1 conversion)
Market capitalisation	1,398	2,362
No. of Valentino Fashion Group shares - pre	74	125
Marzotto's family shareholding (ORD)	57%	34%
2005E EPS (€)	0.83	0.88
EPS enhancement (%)	-	5%
NPV of 2007-15E incremental cash flows*	-	74
Valentino Fashion – enterprise value	1,801	2,996
Valentino Fashion – equity value	1,360	2,556
Valentino Fashion – equity value/share (€)	18.4	20.5

Source: UBS estimates. Note: Our incremental cash flow estimates include 0.5% NWC improvement per annum and €12 million operating cost savings (namely G&A costs); current price of €19.0 as of 27 July 2005; our post-merger scenario discounts the expected cash flows at 8.1% WACC

Potential scenario 2: Valentino Fashion and Hugo Boss merger, financed by cash

Table 28 below shows a sensitivity analysis of the potential outlook for Valentino Fashion Group in the case of a minority buy-out of Hugo Boss shares at current prices, financed by cash, all other assumptions being equal. We argue that the increase of the group debt by €963 million (at the current Hugo Boss share price) could be aggressive for the group financial structure. It would take more than ten years to repay, based on our cash flow estimates.

Table 28: Valentino Fashion Group – Scenario 2: Potential merger financed with cash

	Pre-merger	Post-merger (by cash)
2005E Net debt	417	1,380
2005E Net debt/EBITDA	1.73x	5.71x
2005E Pre-tax	168	119
2005E EPS (€)	0.83	1.04
EPS enhancement (%)	-	26%
NPV of 2007-15E incremental cash flows*	-	74
Valentino Fashion – enterprise value	1,801	3,090
Valentino Fashion – equity value	1,360	1,687
Valentino Fashion – equity value/share (€)	18.4	22.8

Source: UBS estimates. Note: Our incremental cash flow estimates include 0.5% NWC improvement per annum and €12 million operating cost savings (namely G&A costs); current price of €19.0 as of 27 July 2005; our post-merger scenario discounts the expected cash flows at a 6.8% WACC in 2005-15E and 8% WACC at terminal.

We do not agree with a holding company valuation approach

Valentino Fashion is an industrial company and effectively controls 79% of Hugo Boss's voting shares

Considering that two-thirds of our valuation for Valentino Fashion Group derives from the listed company Hugo Boss, some investors may argue that an alternative valuation approach could be a net asset value methodology that considers Valentino Fashion Group as a holding company (see our NAV valuation in the table below). We do not agree with this valuation approach, because we see Valentino Fashion Group as an industrial company. The following points support our opinion:

(1) Its asset portfolio is entirely focused on apparel activities (holding companies usually diversify their investments among different sectors and industries).

(2) Following the spin-off deal, assets that were not considered strategic for an apparel company remained in the Marzotto group (eg, the equity stake in Mediobanca).

(3) Valentino Fashion Group's management is fully involved in the day-to-day operations of Valentino and other apparel brands, and is a strategic decision-maker for Hugo Boss (Valentino Fashion Group holds 79% of Hugo Boss's voting shares).

(4) The parent Valentino Fashion Group SpA is an operating company that includes Marlboro Classics and other brands and does not have material corporate expenses and/or debt. The group net debt is almost entirely held by the two operating companies Hugo Boss AG and Valentino SpA/Emmeffe srl. Moreover, its board of directors could consider a potential merger between Valentino Fashion Group SpA and Valentino SpA to establish a single operating entity in the second part of 2005 (Source: company press release, 14 March).

Table 29: Valentino Fashion Group – NAV

	% held	UBS NAV (€ m)	Target valuation (€ m)	Comment
Listed companies				
Hugo Boss	51%	1,000	900	10% discount in line with UBS approach on the Italian holding companies
Unlisted equity stakes				
Valentino	100%	450	450	0% discount
Marlboro & other brands	100%	151	151	0% discount
Less net group debt ex.		(241)	(241)	
Subtotal		1,360	1,260	
Net group debt at		0	0	
Total NAV		1,360	1,260	
Mkt cap		1,398	1,398	
Upside (downside)		-3%	-10%	

Source: UBS estimates; current price as of 27 July

Appendix

Spin-off deal details

The Marzotto family members are core shareholders of Valentino Fashion Group, and the recent corporate actions were influenced by changes in the family's strategy and shareholdings. During 2003-04, the many Marzotto family members, who controlled 55% of Marzotto's ordinary shares, formed two syndicate pacts in order to provide shareholding stability, and to reduce the family influence on its management structure and daily operations (eg, the exit as a shareholder of its CEO and core shareholder Mr. Pietro Marzotto in June 2004). At the operational level, Marzotto group saw a Hugo Boss sales expansion, a reorganisation of its textile division on the production side, the delivery on the profitability turnaround of the Valentino brand (acquired in 2002), a general reorganisation of group assets, and the announced split between its apparel and textile activities. On 14 March 2005, Marzotto announced its intention to separate its apparel and textile activities into two separately owned, managed and listed companies. The deal was structured as follows: all fashion/apparel assets and operations were spun off from Marzotto group into the new vehicle, Valentino Fashion Group, which was listed on the Milan Stock Exchange on 1 July 2005. A detailed document about the spin-off technicalities is available (IPO document, 23 June 2005). The textile assets and operations and non-core assets remained with the Marzotto group.

Table 30: Marzotto – shareholding structure (before stock option exercise)

Pre spin-off

Shareholding	Stake
Members of Marzotto family	28% stake, 18.6m ORD
Finanziaria Canova and syndicate pact	28% stake, 18.6m ORD
Free Float	44% stake, 29.3m ORD
Marzotto group	
Hugo Boss - BOSS man, HUGO, BOSS woman, Baldessarini	51% total stake, 28m ORD (79%) and 8m PREF (22%)
Valentino - Valentino, Donna Roma, Valentino Garavani, R.E.D.	100%
Marzotto Apparel - Marlboro Classics, M Missoni, Lebole	100%
Linificio e Canapificio - Linen yarns	33%, 9.2m ORD
Marzotto Textile - Woollen/cotton yarns/fabrics	100%
Non-core assets	
Property and plants	100%, €42.6m asset BV in 04
Mediobanca	0.43%, 3.3m ORD
Zucchi	22.0%, 5.3m ORD, 0.9m SAV
Mascioni	28.4%, €11.8m pro-quota BV
Aree Urbane	32.5%, €6.0m pro-quota BV

Post spin-off

Shareholding	Stake
Members of Marzotto family	28% stake, 18.6m ORD
Finanziaria Canova and syndicate pact	28% stake, 18.6m ORD
Free Float	44% stake, 29.3m ORD
Valentino Fashion Group	
Hugo Boss - BOSS man, HUGO, BOSS woman, Baldessarini	51% total stake, 28m ORD (79%) and 8m PREF (22%)
Valentino - Valentino, Donna Roma, Valentino Garavani, R.E.D.	100%
Marlboro Classics and others - Marlboro Classics, M Missoni, Lebole	100%

Shareholding	Stake
Members of Marzotto family	28% stake, 18.6m ORD
Finanziaria Canova and syndicate pact	28% stake, 18.6m ORD
Free float	44% stake, 29.3m ORD
Marzotto Textile	
Linificio e Canapificio - Linen yarns	33%, 9.2m ORD
Marzotto Textile - Woollen/cotton yarns/fabrics	100%
Non-core assets	as pre-spin-off

Source: Marzotto, CONSOB. Note: Marzotto group has 72.3m outstanding shares, of which 66.6m are ordinary shares, 3.3m convertible saving shares and 2.5m non-convertible saving shares; both Valentino Fashion Group and Marzotto Textile had the same number of shares as Marzotto group; Hugo Boss has 70.4m outstanding shares, of which 35.9m are ordinary shares and 34.5m preferred shares; Linificio e Canapificio's outstanding shares comprise 27.7m ordinary shares.

On 1 July 2005, equity holders of Marzotto shares (ordinary, convertible savings, non-convertible savings) received a proportional amount of Valentino Fashion Group shares. On paper, the transaction simply put the assets and liabilities of the apparel division into a new vehicle owned by the same shareholders, with ownership pro rata to the existing ownership of the spinning-off company. The deal did not change ownership and did not involve cash considerations or capital raising. Our first impression is that the deal split how shareholders receive returns and risks in the underlying businesses and increases the visibility on the different brand values. No shareholding change occurred at the Hugo Boss level, following the deal approval by the German regulator (Bundesanstalt für Finanzdienstleistungsaufsicht).

In our opinion, the spin-off deal represented an attractive solution to the strategic misalignment of the investment plans/resource absorption of its apparel and textile divisions and to inefficiencies within the existing structure, be they strategic, operational (eg, cost allocation), management, capital structure or valuation based. We believe the preliminary impact of this deal will lie in potential strategic changes, restructuring, and the building of two separate reputations and track records for its apparel and textile businesses. Marzotto's enterprise value and market capitalisation fell dramatically as the value was 'hived off'. We highlight that the spun-off operations represented 90% of Marzotto group's market capitalisation. In terms of operations, revenues, EBITDA, earnings, cash flows and book values were partitioned between the new company, Valentino Fashion, and Marzotto.

Table 31: Marzotto group – impact of the spin-off deal on its market capitalisation

	Marzotto group	Valentino Fashion	Combined value
Ordinary share price – 03 Jan 05 (€)	14.4		14.4
Ordinary share price – 30 Jun 05 (€)	21.5		21.5
Ordinary share price – 01 Jul 05 (€)	2.3	20.1	22.5
Ordinary share price – Closing (€)	3.2	18.5	21.6
Price perf. since the spin-off	+37%	-8%	-4%
Mkt Cap (pre spin-off) as of 03 Jan (€ m)	1,042		1,042
Mkt Cap (pre spin-off) as of 30 Jun (€ m)	1,557		1,557
Mkt cap (post spin-off) as of 1 Jul (€ m)	174	1,491	1,665
Current market capitalisation (€ m)	233	1,370	1,603
YTD 05 mkt cap performance			+54%

Source: UBS; current price as of 1 August

Little-known facts

- **Shareholding structure:** Valentino Fashion Group's core shareholder is the financial company Finanziaria Canova (20% stake), followed by a multitude of Marzotto family members that hold approximately 37% of Valentino Fashion Group's ordinary shares. The previous two syndicate pacts, which owned 55% of Marzotto's ordinary shares, were terminated before the spin-off deal in second quarter 2005.

- **What is Finanziaria Canova?:** Finanziaria Canova SpA is Valentino Fashion Group's core shareholder. Finanziaria Canova was established in 2001. It is a financial company (corporate advisory, entrepreneurial family office, financial investments) resulting from the spin-off of the branch 'Partecipazioni ed Affari Speciali' of the Italian company WestLB Italia Finanziaria SpA, which is controlled by the German banking Group Westdeutschelandesbank Girozentrale. Finanziaria Canova capital is controlled by its senior management (CEO Mr. Dario Segre, managing director Mr. Marco Castiglione and CFO Mr Roberto Giacobone, mostly through Filos Partecipazioni Finanziarie). Other shareholders are the De Agostini group (15% stake), Gruppo Credito Valtellinese (10% stake), Industrie Zignago (7.5% stake) and WestLB (10% stake).

- **Marzotto group:** The group dates back to 1836 when Luigi Marzotto founded Marzotto & Figli textile company in Valdagno, Italy. The company strengthened its textile presence through Italian acquisitions during the late 1980s – Basetti group (1985), Lanerossi group (1987), and Lanificio Guabello (1991) – and through licence agreements (Marlboro Classics, Missoni, Ferrè). Its expansion strategy became more aggressive during the 1990s as it entered the apparel industry: Hugo Boss (1991), the Czech production plant Novà Mosilana (1994), the Lithuanian production plant Liteksas & Cakw (2000), and finally the purchase of the luxury brand Valentino (2002). Mr. Pietro Marzotto controlled and managed the company from 1972 to 2004.

- **The Marzottos:** Valentino Fashion Group shareholding is fragmented into different stakes, owned by members of Marzotto family. Shareholders are the family members of the following brothers: Mr. Pietro Marzotto (Umberto, Ita, Marina, Pier Leone), Mr. Umberto Marzotto (Paola, Vittorio, Diamante, Matteo), Mr. Vittorio Marzotto (Gaetano, Stefano, Luca, Nicolò), Mrs Itala Marzotto Donà Delle Rose (Rosanna, Isabella, Marco, Andrea Donà Delle Rose), Mr. Giannino Marzotto (Margherita, Cristiana, Maria Rosaria), Mr. Paolo Marzotto (Veronica, Dominique) and Mrs. Laura Marzotto (Francesca, Ugo). Different family members hold the following financial assets: Valentino Fashion Group SpA, Marzotto SpA (€3.2, not rated), Gruppo Industrie Zignago Santa Margherita SpA (€18.5, not rated), Linificio e Canapificio Nazionale SpA (€3.0, not rated), an Italian winery company and a textile machinery producer. The family has been recently split in two different coalitions because of two tender offers to buy-out Zignago's minorities (see Zignago press releases): (1) first coalition is composed by: Andrea, Rosanna and Isabella Donà Delle Rose, Umberto Marzotto, financial holding Trenora and Mr. Antonio Favrin; (2) the second coalition is composed by Marco Donà Delle Rose, Vittorio Marzotto's sons and Pietro Marzotto.

- **Who is Antonio Favrin?:** Antonio Favrin (born in 1938) is currently involved in all activities where the Marzotto family is a core shareholder. His appointments are: Valentino Fashion Group chairman (2005); Marzotto group CEO (2001); Zignago chairman (2003, he joined Zignago in 1973); Linificio vice-president (2003); Hugo Boss vice-president and board member; Valentino chairman (2002); Finanziaria Canova board member; and Vincenzo Zucchi board member (2002). Before the spin-off deal, Mr Antonio Favrin owned 1.2 million shares in Marzotto (stock options were exercised on 26 May 2005), shares in Finanziaria Canova (not listed), 490,000 shares in Zignago (as of December 2004), and 100,000 in Linificio (as of December 2004).

The Marzotto group after the spin-off

Following the spin-off deal, the current listed Marzotto group operates in the areas of textile fabrics (Marzotto, Guabello, Marlane and Tessuti di Sondrio brands), wool yarns for the knitwear industry (Lanerossi Filati brand), linen yarns, through its 33.44% stake in the world's largest linen-fiber producer Linificio e Canapificio Nazionale (€3.0, not rated), and owns some financial assets (see Table 32). We note that the Italian listed company Zignago (€18.5, not rated), controlled by the Marzotto family, holds a 34.4% stake in Linificio. It may be that the separation of this business (see spin-off deal) could open it up subsequently to potential acquirers or takeover potential. Conversely, its small size and the current uninspiring sales growth prospects could reduce the stock's attractiveness.

Table 32: Marzotto – main financial assets

	% stake	Book value (€ m)
Mediobanca SpA	0.4	18.0
Vincenzo Zucchi	22.0	32.2
Mascione Spa*	28.4	11.7
Aree Urbane srl*	32.5	6.7

Source: Company data released in first quarter 2005; Note: * Unlisted equity assets

Its textile business is split as follows:

(1) **Yarns:** Lanerossi Filati is one of the largest wool yarn producers worldwide (10 million yarn kilos per annum, mostly produced in Italy and Lithuania); Linificio e Canapificio Nazionale is currently the world's major producer of long fibre linen yarns – accounting for approximately 25% of Western European production. Its linen production is around 5,000 tonnes per annum and is located in Italy, Tunisia and Lithuania. We expect increasingly stronger and keener competition levels – notably from Chinese production – in this segment during 2005-06E.

(2) **Fabrics:** Marzotto holds the world leadership in wool fabric production (Marzotto, Guabello, Marlane) and offers a growing selection of high-quality cotton fabrics (Tessuti di Sondrio).

(3) **Europe is the key driver of its divisional sales performance:** 38% of its textile products were sold in Italy in 2004, and 46% in rest of Europe. Around 10% of wool sales are distributed to other Marzotto group units. We estimate that 40% of linen production is exported outside Italy. The following table shows the division's historical financials.

Table 33: Marzotto textile – financials, 1998-2004

€ m	1998	1999	2000	2001	2002	2003	2004
Wool	359	335	356	322	279	268	271
y/y growth (%)		-6.6%	6.2%	-9.6%	-13.3%	-3.9%	1.2%
Linen	57	61	71	59	57	35	32
y/y growth (%)		7.9%	16.7%	-16.9%	-3.7%	-38.2%	-8.8%
Intra-group transactions	(1)	(1)	(1)	(1)	(1)	(1)	(1)
Textile gross sales	414	395	426	380	335	302	302
y/y growth (%)		-4.6%	7.8%	-10.8%	-11.8%	-9.8%	-0.2%
Intra-group transaction	(30)	(31)	(40)	(36)	(34)	(30)	(28)
Textile net sales	384	365	386	344	301	273	273
y/y growth (%)		-5.1%	5.9%	-10.9%	-12.4%	-9.5%	0.2%
Wool	14	19	20	0	(17)	(9)	4
Margin (%)	4.3%	6.2%	6.2%	0.1%	-6.7%	-3.7%	1.5%
Linen	4	4	9	2	(0)	4	4
Margin (%)	7.3%	6.7%	13.1%	3.9%	-0.7%	10.1%	11.8%
Textile EBIT	18	23	29	3	(17)	(5)	8
Margin (%)	4.4%	5.8%	6.8%	0.7%	-5.0%	-1.8%	2.5%
Capital employed	292	255	297	348	334	263	218
Capex	26	19	41	45	28	12	7
Employees	5,251	5,202	5,707	5,591	5,078	3,688	3,499

Source: Company. Note: In the first quarter of 2005, this division posted €60 million OF sales (-16% y/y), of which €54 million were wool sales (-16% y/y) and €6 million linen sales (-11% y/y), and €1 million operating income (1.5% margin).

■ Valentino Fashion Group

Valentino Fashion Group is a leading manufacturer of men's classic clothing, women's apparel/luxury goods, sportswear and accessories. More than two-thirds of its revenues come from Europe, mostly through wholesale activities. The group mainly operates through Hugo Boss and Valentino as owned brands, and Marlboro Classics and M Missoni as licensed brands. Valentino Fashion Group holds 51% of the listed firm Hugo Boss (as a percent of total outstanding shares), and fully consolidates Hugo Boss financials. The company is the spun-off unit of Marzotto group and was listed on 1 July 2005.

■ Statement of Risk

Valentino Fashion Group's sales performance reflects its offer of clothing and fashion products, notably in Europe and through wholesale activities. Thus, our earnings expectations are exposed to changes in consumer confidence because of economic and/or political factors. In addition, increasing competition could affect the group's product penetration and profitability in the long term, in our view. Moreover, our earnings are dependent on its operating cost structure. Any drastic change to its production process or retail network could influence our estimates.

Valentino Fashion Group holds 79% of Hugo Boss common shares and 22% of Hugo Boss preference shares, equivalent to a 51% holding of the total number of outstanding shares. The company has consolidated 100% of Hugo Boss financials and accounts for its minority interests. Hence, Valentino Fashion Group's earnings are subject to the earnings performance of Hugo Boss, which is listed in Germany. Hugo Boss press releases and financial events could indirectly influence our earnings expectations and investor sentiment for the Valentino Fashion Group, in our view.

■ Analyst Certification

Each research analyst primarily responsible for the content of this research report, in whole or in part, certifies that with respect to each security or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about those securities or issuers; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by that research analyst in the research report.

Required Disclosures

This report has been prepared by UBS Limited, an affiliate of UBS AG (UBS).

For information on the ways in which UBS manages conflicts and maintains independence of its research product; historical performance information; and certain additional disclosures concerning UBS research recommendations, please visit www.ubs.com/disclosures.

UBS Investment Research: Global Equity Ratings Definitions and Allocations

UBS rating	Definition	UBS rating	Definition	Rating category	Coverage[1]	IB services[2]
Buy 1	FSR is > 10% above the MRA, higher degree of predictability	**Buy 2**	FSR is > 10% above the MRA, lower degree of predictability	**Buy**	40%	41%
Neutral 1	FSR is between -10% and 10% of the MRA, higher degree of predictability	**Neutral 2**	FSR is between -10% and 10% of the MRA, lower degree of predictability	**Hold/Neutral**	49%	43%
Reduce 1	FSR is > 10% below the MRA, higher degree of predictability	**Reduce 2**	FSR is > 10% below the MRA, lower degree of predictability	**Sell**	11%	35%

1: Percentage of companies under coverage globally within this rating category.

2: Percentage of companies within this rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS; as of 30 June 2005.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.
Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (an approximation of the equity risk premium).
Predictability Level The predictability level indicates an analyst's conviction in the FSR. A predictability level of '1' means that the analyst's estimate of FSR is in the middle of a narrower, or smaller, range of possibilities. A predictability level of '2' means that the analyst's estimate of FSR is in the middle of a broader, or larger, range of possibilities.
Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.
Rating/Return Divergence (RRD) This qualifier is automatically appended to the rating when stock price movement has caused the prevailing rating to differ from that which would be assigned according to the rating system and will be removed when there is no longer a divergence, either through market movement or analyst intervention.

EXCEPTIONS AND SPECIAL CASES

US Closed-End Fund ratings and definitions are: Buy: Higher stability of principal and higher stability of dividends; Neutral: Potential loss of principal, stability of dividend; Reduce: High potential for loss of principal and dividend risk.
UK and European Investment Fund ratings and definitions are: Buy: Positive on factors such as structure, management, performance record, discount; Neutral: Neutral on factors such as structure, management, performance record, discount; Reduce: Negative on factors such as structure, management, performance record, discount.
Core Banding Exceptions (CBE): Exceptions to the standard +/-10% bands may be granted by the Investment Review Committee (IRC). Factors considered by the IRC include the stock's volatility and the credit spread of the respective company's debt. As a result, stocks deemed to be very high or low risk may be subject to higher or lower bands as they relate to the rating. When such exceptions apply, they will be identified in the Companies Mentioned table in the relevant research piece.

Companies mentioned

Company Name	Reuters	Rating	Price	Price date/time
Hugo Boss	BOSG_p.DE	Not rated	€27.02	01 Aug 2005 21:11 BST
Marzotto	MZTI.MI	Not rated	€3.20	01 Aug 2005 21:11 BST

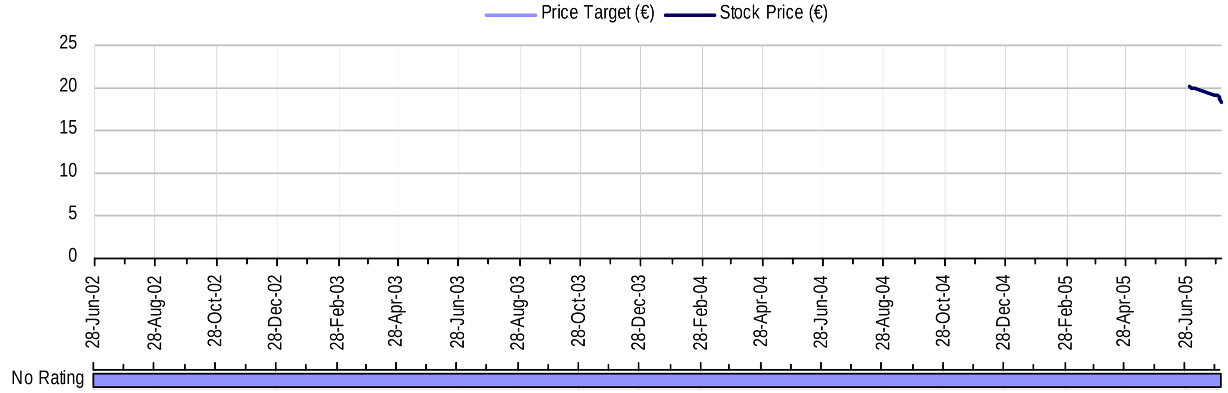
Company Name	Reuters	Rating	Price	Price date/time
Valentino Fashion	V.MI	Neutral 1	€18.40	01 Aug 2005 21:11 BST

Source: UBS. BST: British summer time.

This report was sent to the issuer prior to publication solely for the purpose of checking for factual accuracy, and no material changes were made to the content based on the issuer's feedback.

Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Valentino Fashion Group (€)



Source: UBS; as of 1 August 2005.

Global Disclaimer

UBS

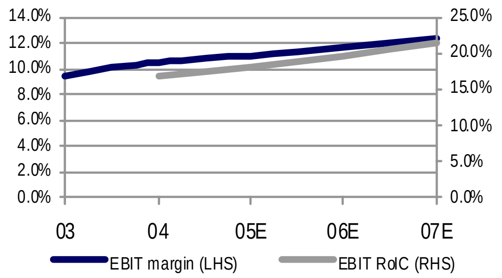
Valentino Fashion Group (euro)

Per share (€)	12/03	12/04	12/05E	12/06E	12/07E
EPS (UBS adjusted, basic)	0.44	0.75	0.83	1.05	1.25
Cash EPS (UBS adjusted, basic)	1.08	1.46	1.60	1.85	2.09
Dividend per share (common, net)	0.00	0.00	0.39	0.40	0.42
NAV per share (BVPS)	3.55	4.23	5.13	5.84	6.76
Profit & loss (€ m)					
Revenues	1,470	1,551	1,676	1,788	1,898
EBITDA (adjusted)	186	216	241	269	297
Operating income (EBIT, adjusted)	139	163	185	210	235
Pre-tax income (adjusted)	128	147	168	194	220
Net income (UBS adjusted)	32	56	62	77	93
Cash flow (€ m)					
Operating income (EBIT, adjusted)	139	163	185	210	235
Depreciation & amortisation	48	52	57	59	62
Net change in working capital	23	5	(18)	(25)	(22)
Other (operating)	(3)	6	(2)	(2)	(2)
Operational cash flow	207	227	221	241	273
Tax paid	(51)	(52)	(58)	(62)	(67)
Capital expenditure	(62)	(71)	(92)	(72)	(73)
Net interest	(11)	(16)	(17)	(16)	(16)
Dividends paid	0	0	0	(29)	(30)
Net (acquisitions) / disposals	0	(25)	0	0	0
Other items		(90)	(67)	(95)	(143)
(Increase) decrease in net debt		(26)	(12)	(32)	(55)
Operating free cash flow (OpFCF) (€ m)					
EBITDA (core)	186	216	241	269	297
Less maintenance capital expenditure	(35)	(45)	(49)	(35)	(35)
Less maintenance net working capital	(9)	(9)	(9)	(9)	(10)
OpFCF	143	163	183	225	252
Balance sheet (€ m)					
Net tangible fixed assets	215	228	257	265	274
Net intangible fixed assets	321	332	338	342	344
Net working capital	436	431	449	475	497
Total invested capital (IC)	972	991	1,044	1,082	1,115
Financial & other fixed assets	39	37	49	48	47
Net cash / (debt)	(449)	(423)	(410)	(378)	(323)
Provisions	0	0	0	0	0
Minority interests	(195)	(207)	(226)	(248)	(274)
Shareholders' funds	243	289	351	399	462
Profitability					
EBITDA margin	12.7%	13.9%	14.4%	15.1%	15.7%
EBIT margin	9.4%	10.5%	11.0%	11.7%	12.4%
EBIT RoIC		16.7%	18.2%	19.7%	21.4%
Net RoE		21.0%	19.3%	20.7%	21.6%
Interest cover (EBIT)	13.0x	10.2x	11.2x	13.0x	15.0x
Dividend cover (net)	NA	NA	2.2x	2.6x	3.0x
Productivity					
Labour % sales					
Depreciation % sales	3.2%	3.4%	3.4%	3.3%	3.3%
Capex % sales	4.2%	4.6%	5.5%	4.0%	3.8%
Invested capital turnover		1.6x	1.6x	1.7x	1.7x
Tax rate	40.0%	35.4%	34.4%	32.0%	30.6%
Net debt / total equity	102.5%	85.3%	71.2%	58.4%	43.9%
Momentum					
Revenue growth	NM	+5.5%	+8.1%	+6.7%	+6.2%
EBIT growth	NM	+17.8%	+13.0%	+13.6%	+12.1%
Net earnings growth	NM	+72.2%	+10.3%	+25.7%	+19.9%
Dividend growth	NM	NM	NM	+5.0%	+5.0%
Value*					
Market capitalisation (€ m)	NA	NA	1,366	1,366	1,366
Plus: Core net debt / (cash)	449	436	417	394	351
Plus: Pension provisions	23	24	24	24	23
Plus: Buy out of minorities	557	830	965	965	965
Less: Non-core assets	-	-	-	-	-
Enterprise value (EV, avg)			2,772	2,749	2,705
EV/Sales (core)			1.65x	1.54x	1.42x
EV/EBITDA (core)			11.5x	10.2x	9.1x
EV/EBIT (core)			15.0x	13.1x	11.5x
EV/OpFCF			15.1x	12.2x	10.7x
EV/Invested capital			2.7x	2.6x	2.5x
P/CE			11.6x	10.0x	8.9x
P/E			22.3x	17.7x	14.8x
Dividend yield (net)			2.08%	2.19%	2.30%
P/BV (average)			3.6x	3.2x	2.7x

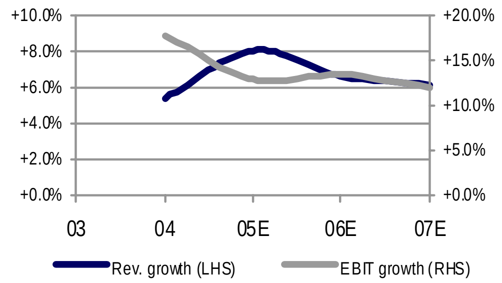
Source: UBS estimates, * Historical valuations are based on an `average for the year' share price. Current & future valuations are based on a share price of €18.50 on 02/08/2005

Valentino Fashion Group is a leading manufacturer of men's classic clothing, women's apparel/luxury goods, sportswear and accessories. More than two-thirds of its revenues come from Europe, mostly through wholesale activities. The group mainly operates through Hugo Boss and Valentino as owned brands, and Marlboro Classics and M Missoni as licensed brands. Valentino Fashion Group holds 51% of the listed firm Hugo Boss (as a percent of total outstanding shares), and fully consolidates Hugo Boss financials. The company is the spun-off unit of Marzotto group and was listed on 1 July 2005.

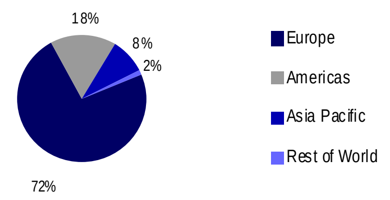
Profitability (EBIT margins & RoIC)



Momentum (Revenue & EBIT growth)



Geographic exposure (Revenues)



Value (EV/OpFCF & P/E)