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Fiat

Demel's Dilemma

NEUTRAL

Reason for Report: Reinstatement of Coverage

Volatility Risk: HIGH

Price - Local / ADR: EUR6.74 / $7.85

Estimates (Dec)	2002A	2003E	2004E
EPS - Reported	(6.40)	(0.87)	(0.29)
EPS - Adjusted	(1.85)	(0.67)	(0.29)
EPS Growth %	428.1	(64.0)	(56.3)
P/E x	n/a	n/a	n/a
Ind. Avg. P/E x	8.9	10.4	9.4
P/E Relative %	n/a	n/a	n/a
EV/EBITDA x	7.3	5.3	4.9
Ind. Avg. EV/EBITDA x	4.2	4.1	3.5
EV/Sales x	0.2	0.2	0.3
Ind. Avg EV/Sales x	0.4	0.4	0.4
CEPS	(1.56)	0.37	1.92
Price/Cash Flow x	(4.3)	18.1	3.5
ADR EPS - Reported	$-6.72	$-1.01	$-0.34
ADR DPS	$0.33	$0.00	$0.00
ADR CEPS	$-1.64	$0.43	$2.24

Opinion & Financial Data

Investment Opinion – Local:	C-2-9
Investment Opinion – ADR:	C-2-9
Mkt. Value (EUR bn)/ Shares Outstanding (mn):	6.1 / 984.91
2003E P/E Rel. to Mkt:	N/a

Stock Data

52-Week Range – Local:	9.33-5.19
52-Week Range – ADR:	$10-$6.1
Symbol / Exchange – Local:	FIADF / Milan
Symbol / Exchange – ADR:	FIA / Milan
Bloomberg / Reuters:	F IM / FIA.MI
Shares/ADR:	1.00
Exchange Rate:	EUR0.86/USD
Free Float:	60%

All figures are in Euro except where otherwise noted.
Note: Due to currency factors, the investment opinion of the ADR may differ from the underlying share.

Highlights

- **Incoming Fiat Auto CEO Mr Herbert Demel faces a raft of challenges. His intermediate term product pipeline remains firmly in the small car segment. Volume may stabilise a little, but margins will likely remain under severe pressure. We expect the slide in Fiat's market share to continue, a function of the brand's waning relevance beyond small cars. Cost discipline is paramount, but as long as Italian automotive capacity remains sacrosanct, low utilisation rates will be a drag.**
- **The restructuring plan set out targets to 2006 but provided fewer near term milestones to check progress. The closest is for Group break-even in 2004, which may be achievable despite Auto's expected EUR0.5bn loss. The group must earn almost EUR2bn to meet its 2006 operating margin target of 4.1%. We consider this unlikely.**
- **We believe the deliberate focus on longer-term milestones in the restructuring plan was smart, as Fiat is not seen as hostage to near-term events. That said, 2003 Q3 results still came in well below undemanding consensus forecasts. 2004Q4 should be better, but this does not change the fact that 2004 sees Auto suffering further market share erosion, substantial losses and associated cash burn.**
- **Fiat's share price touched a low of EUR5.24 in July during the EUR1.8bn 3-for-5 rights issue period, but had rebounded to EUR7.23 by mid-Sept, up 37.9% on the July low and 44.6% above the EUR5 rights price. This followed the 95% take up of the rights and the receding fear of a near-term liquidity crunch. There was also renewed investor interest in fallen out-of-favour cyclicals.**
- **Valuation provides little comfort from here. Our SOTP model implies EUR6.7 per share, with losses at Auto likely through 2005. On EV/Sales Fiat is trading on 0.25x 2004E sales vs. Euro auto sector average of 0.39x. In our opinion a 35% discount is more than warranted given the risks associated with restructuring and restoring the auto business. On EV/EBITDA it trades on 4.9x vs. the sector average of 3.5x. We are resuming coverage with a Neutral recommendation.**

Refer to important disclosures on pages 50 to 51.
Analyst Certification on page 49.

Merrill Lynch Global Securities Research & Economics Group
Global Fundamental Equity Research Department

RC#60130802

Executive Summary

What Has Changed?

■ Significant Debt Reduction in 2003, however Future Success Questionable

Fiat finds itself in a much less strained financial position with industrial debt standing at EUR2.95bn at 30 September 2003, following the EUR1.4bn sale of Toro division (insurance), EUR1.4bn sale of Fiat Avio (aviation) and its EUR1.8bn rights issue. The flip-side is that Fiat Group has, in effect, sold off most of what could be called its jewels to buy time to finance the far riskier restructuring of its Auto business, which Fiat itself does not expect to make a profit until 2006.

The main part of this report inevitably focuses on Fiat Auto. We make no bones about this. We believe it is vital to understand the dynamics of the issues facing new Fiat Auto CEO, Mr Herbert Demel, to make an informed decision about the fundamental medium term direction of the entire group. Fiat Auto plans that 80% of the products it sells in 2006 will have been launched no earlier than 2002/03. From today's perspective, we think it unlikely that Fiat Auto can boost its Italian market share from the present 28% to the target of 32.4% by 2006. The situation at CNH could improve dramatically compared to today's low point, and Iveco could also pick up, but in the end it all comes back to Auto. This should make or break the prospects for the group. Our opinion, from today's perspective, is not upbeat.

■ Weak Sales and Market Share Decline Across Europe Continuing

Fiat Auto's global registrations fell by 15.4% in 2002. Italy accounts for 58% of Fiat's total European sales, a much higher proportion of domestic dependence than any of its peers. This naturally remains by far Fiat's most profitable market, so the 17.8% slump in registrations hurt badly. Fiat blamed part of this decline on its attempt to improve the quality of sales via reducing the level of zero kilometre registrations and unprofitable fleet sales. However, Fiat sales did not bottom out in 2002 as the company had predicted. Fiat Auto registrations deteriorated by a further 8.6% in its domestic market, and were down by 11.1% globally in 2003 9M. The new Panda and revamped Punto should help in the final quarter, as Fiat maintains that it is holding higher than anticipated dealer and customer orders. 100,000 units of inventory rebuild in the quarter should also help.

Fiat Auto's Italian market share was 35.4% in 2000 FY. This fell to 34.6% in 2001 FY and collapsed to 30.3% in 2002 FY. The rout has not stopped. 2003 9M market share slumped to 28%, with September 2003 alone at 27.2%. In other words, Fiat is presently well short of its June Turnaround plan objective of 2003 matching its 2002 Italian market share.

■ The Latest Restructuring Plan

In its third Restructuring Plan in as many years unveiled in June 2003 accompanying its EUR1.8mn rights issue, Fiat laid out the guidelines for its Automotive Group. These were:

- Focus on cash flow generation and profitability.
- Product development, innovation and marketing. This umbrella includes the renewal of the product ranges, investments in technology, and the revitalisation of the sales network.
- Cost competitiveness: covering engineering, restructuring, reorganisation, and efficiency, and competence building.
- Geographic "refocalisation".

The plan envisages generating EUR4.7bn of incremental operating profit vs. 2002, split EUR1.6bn from higher margins from new products, and EUR3.1bn from cost reductions. Fiat envisages giving back some EUR1.8bn of this figure due to market price erosion, higher depreciation charges, changes in scope of consolidation and exchange rates. The resultant net gain of EUR2.9bn is intended to lift the group's return on sales from a negative -1.4% in 2002 to a positive 4.1% in 2006. This is to be funded by a EUR19.5bn 4-year 2003-2006 investment plan, of which EUR9.1bn will be spent on new products, EUR7.9bn on R&D, EUR0.7bn on the distribution network, and EUR1.8bn on operational restructuring. It is to be entirely self-financed.

■ What Difference Can Fiat's Product Portfolio Really Make?

The new Panda, Ypsilon and revamped Punto with their advanced diesel engines will provide some momentum in the coming months. But does this mark the start of the turnaround? Fiat promises 7 new launches in the next two years, which it expects to reverse the downward slide of the auto business. We are less optimistic. The woeful sales performance of the Stilo, launched with such high expectations in 2001, demonstrates that it takes more than what was (and still is generally agreed to be) a competent product to ensure sales success. This raises a much more worrying question mark over the continuing relevance of the Fiat brand, and its ability to compete above the Punto B small car segment.

There is plenty of action in Fiat's small cars. The Fiat Panda and Lancia Ypsilon have already been launched this year, and the Punto-based Idea MPV goes on sale in January 2004. Then there is a hiatus until 2005 when the launch programme picks up again. Therefore all the new models on sale now or imminently are placed firmly in the A-segment (mini) and B-segment (small), which provide volume support but contribute less to the bottom line. The facelift of the Punto is important and long overdue, considering the 23% fall-off in sales in Western Europe in 2002. More significant than the cosmetic changes are the two Multi-jet JTD diesel engines, offered for the first time. However, the mid-life boost that a facelift can provide is always rather limited and we expect further pressure on Punto in the twelve months period leading up to its replacement in 2005. Fiat is excited by the cost saving involved in moving production of the new Panda to Poland. This does however spotlight the overcapacity issue in Italy, as space is freed up at the Mirafiori plant, which also makes the Punto and Multipla. Indeed, Fiat has an estimated 3,000-4,000 workers returning to its plants after the one year *State of Crisis* expires this month.

Turning to Alfa Romeo, the group's premium brand remains highly desirable, as witnessed by the approval accorded the concept cars exhibited at the Frankfurt Auto Show in September 2003. The problem is turning that allure into hard revenues with the current product range. Put simply, the emotional appeal is there but the hard headed buying decision more often than not leads to the purchase of a German brand. What is even more worrying is this is becoming increasingly obvious in Italy as well, the bedrock of Alfa buyers. After the successful initial reception of the Alfa 147 in 2000, Fiat forecast strong growth for this premium division. Actual Alfa Romeo production in 2001 was only marginally ahead of the previous year, and well below the 250,000+ units anticipated. The 2002 total was almost 100,000 units adrift of where Fiat Auto thought Alfa would be. While Alfa's production fell by -12.3% between 2001 and 2002, other premium players such as BMW registered growth of +2.9%.

■ CNH

The economic downturn in the US and the agricultural crises in Europe caused by the BSE and Foot & Mouth outbreaks, have clearly hurt the fledgling new group since its inception in 1999. Competitors have also not hesitated to attack CNH, as they correctly predicted that CNH would be more focussed on integration issues than on defending its own market shares. CNH has put into effect programmes that promise to save hundreds of millions of dollars. The agricultural equipment division has experienced a moderate recovery, but the weak construction equipment market is retarding a meaningful turnaround in Group performance.

■ Iveco

Iveco's performance deteriorated in the last two years to a point where it barely broke even in 2003Q1, made a small profit in 2003Q2, but lost money again in 2003Q3. This was all the more galling considering the strong results from Volvo and Scania and improved results from Mercedes Trucks in 2003Q3. We do not predict Iveco making a margin above 1% in 2003, which compares to our estimates of 2.9% at Volvo and 10.1% at Scania. Like Auto, Iveco has suffered due to a downturn in demand in Italy, but unlike Auto, it has at least managed to keep its Italian market share constant at around 40%.

■ 2003Q3 Analysis

Despite reduced market expectations, Fiat's 2003Q3 results still came in below consensus estimates. Fiat stated that *The performance of the Fiat Group in the third quarter of 2003, in addition to being affected by unfavourable seasonal factors, reflect the challenges of a difficult transition period...Fiat Auto, in particular, was adversely affected in two key segments as customers deferred buying decisions ahead of the introduction of new models."* Consolidated group revenues totalled fell by –17.9% to EUR9.8bn. The main reasons were the reduced scope of consolidation, unfavourable exchange rate movements and weak markets.

Automotive Division

Revenues in the Automotive division declined by 10.9% to EUR4.16bn. The variance can mostly be explained by a lower volume/mix for Fiat's core models. This came about despite a relatively stable 3.4mn unit market in Europe, including +8% in Spain, +1.2% in UK, and +4.6% in Italy. The progress Fiat has made during the last 12 months in turning around the Auto division was almost invisible to the naked eye. The operating loss of EUR340mn in 2002Q3 fell by a meagre EUR26mn to EUR314mn.

Group

Group operating income/EBIT remained deeply in the red with a loss of EUR285mn vs. EUR339mn loss in 2002Q3.

Extraordinary income of EUR895mn turned consolidated pre-tax profit into positive EUR365mn in 2003Q3 compared to a loss of EUR615mn in 2002Q3.

Adjusted Net Income amounted to EUR(273)mn vs. EUR(318)mn in 2002Q3, which translated in a loss per share of EUR(0.44), down from –EUR(0.52) in 2002Q3.

■ Valuation and Recommendation

Auto's highly publicised new products sit firmly in the small segment (Panda, Idea and Ypsilon) supporting short-term volume. The main part of the product renewal programme begins only in 2005. In the meantime, Fiat's European market share and credibility risk continuing their drift. Capacity utilisation at its Italian production plants remains low.

Valuation provides little comfort. We expect Fiat Group to lose money through 2004E, and therefore P/E based valuation is inappropriate. Considering the likely low level of earnings beyond 2004, this remains the case. On EV/Sales Fiat is trading on 0.25x 2004 sales vs. the European auto sector average of 0.39x. In our opinion at least a 35% discount is warranted given the risks associated with restructuring the loss making Auto business and the introduction of numerous new products over the next two years. On EV/EBITDA Fiat trades on 4.9x, vs. the sector average of 3.5x.

The Group still consists of nine clearly distinguishable divisions and, in our opinion, this increases the relevance of a sum-of-the-parts (SOTP) model. We have attempted to be realistic in the valuation process, and have come up with an implied value of EUR6.7 per ordinary share which is in line with the current share price.

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Refer to important disclosures on pages 50 to 51.

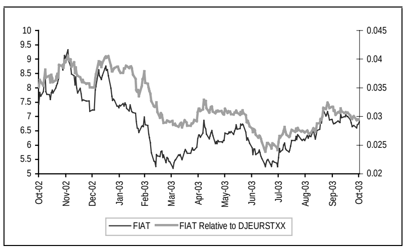
1. Overview

The Turnaround plan hinges on Fiat's product renewal programme

Chart 1: New Fiat Panda

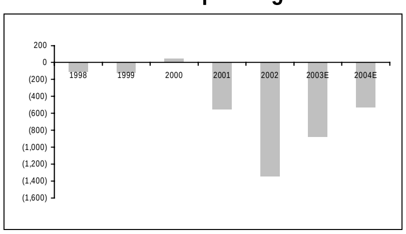
Source: Fiat

Chart 2: Fiat Price & Relative



Source: Datastream

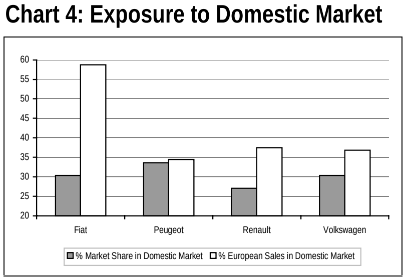
Chart 3: Fiat Auto Operating Results



Source: Company Accounts, Merrill Lynch

The main part of this report inevitably focuses on Fiat Auto

Chart 4: Exposure to Domestic Market



Source: Company Accounts/Merrill Lynch

Fiat finds itself in a much less strained financial position following the EUR2.4bn sale of Toro division (insurance), EUR1.5bn sale of Fiat Avio (aviation) and its EUR1.8bn rights issue. Fiat's net financial position stood at a EUR2.95bn deficit at the end of September 2003, vs. the EUR4.81bn deficit at the end of June 2003 and EUR3.78bn at December 2002. This figure was well below the EUR6.47bn peak deficit at the end of 2000. The flip-side is that Fiat Group has, in effect, sold off most of what were regarded as its jewels to buy time to finance the far riskier restructuring of its Auto business, which Fiat itself does not expect to turn a profit until 2006. In the meantime, we anticipate Auto to burn a further EUR1.6bn of cash (2004-2006). Incoming Fiat Auto CEO, Mr Herbert Demel, must wait until 2005 before the main part of the product renewal programme kicks in. Considering Fiat's recent track record, there is no guarantee of success. Every manufacturer's vehicle launch programme carries risks, but we feel this is much greater at Fiat brand.

The woeful sales performance of the Stilo, launched with high expectations in 2001, demonstrates that it takes more than what was (and still is generally agreed to be) a competent product to ensure sales success. This raises a much more worrying question over the continuing relevance of the brand, and its ability to compete above the Punto B small car segment. One parallel we could draw would be BMW's failure to turn the Rover 75 (a vehicle substantially engineered by BMW) into a success. The car was generally well liked by the press when it was launched in 1998, but this did not translate into the hoped-for sales. BMW belatedly recognised that Rover's brand equity had fallen too far for even a good product to turn it around. BMW disposed of the entire brand in 2000 to the Phoenix consortium, and has not looked back. There is no doubt that many wish that Fiat had also sold its entire Auto business to GM in 2000 when it had the chance. With hindsight, it would have received a great price, and the proceeds would have changed the course of Fiat's recent history.

Even if the Fiat brand was in better shape, its planned new launches still fail to address the fastest growing segment in Europe, namely that of C-segment multi purpose vehicles (MPVs) or minivans. Fiat addresses the far smaller B-segment MPV market with its Punto-based Idea from January 2004, but a Fiat-badged C-segment minivan is not planned until after 2007. This leaves the way clear for Renault, Opel, VW, PSA and Ford to earn above C-segment hatchback average margins. Fiat's near-term response is a restyled and more conventional looking Multipla in 2004. This will, in our opinion, only have a limited impact. Moreover, the competition is not standing still in Fiat's core domestic market. With its C3 small car, the sort of vehicle that had long been Fiat's speciality, Citroen saw its Italian sales jump by 68.6% in 2003 9M. The C3 became the 4th best selling car in Italy over that period, and was 2nd only to Fiat's Punto in the B-segment. Boosted by its new Micra, Nissan has seen a 39.7% surge. Meanwhile, Korean brands Hyundai and Daewoo appear to be consolidating their gains, before resuming their assault.

The main part of this report inevitably focuses on Fiat Auto. We make no bones about this. We believe it is vital to understand the dynamics of the issues facing new Fiat Auto CEO, Mr Herbert Demel, if one is to make an informed decision about the fundamental medium term direction of the entire group. Fiat Auto plans that 80% the products it sells 2006 will date from no earlier than 2002/03. From today's perspective, we think it unlikely that Fiat Auto can boost its Italian market share from the present 28% to its target of 32.4% by 2006. The situation at CNH could improve dramatically compared to today's low point, and Iveco could also pick up, but in the end it all comes back to Auto. This should make or break the prospects for the group. Our opinion, from today's perspective, is not upbeat.

New Fiat Auto CEO

Mr Demel will join Fiat Auto on 15 November

It was confirmed on 8 October 2003 that the search was over for a replacement for Fiat Auto CEO Mr Giancarlo Boschetti, who had been due to retire in 2004. The short list of candidates had been reduced to Mr Martin Leach, ex-CEO of Ford of Europe, and Mr Herbert Demel. Mr Demel, a mechanical engineer by training, had been President and CEO (since the end of 2002) of the Austrian-based Magna Steyr, a leading company in automotive engineering, 2 and 4-wheel drive transmissions and in the development and assembly of vehicles for third-parties. Mr Demel joins Fiat Auto on 15 November.

Mr Demel established a strong reputation at Audi for product development and for the sales success of the unit between 1994-1997

Mr Demel was responsible for the development of ABS systems and quality control at Robert Bosch between 1984 and 1990, and then headed product development at Audi up to 1994. He was CEO of Audi from 1994 to 1997, and became CEO of VW do Brasil from 1997 to 2002. Mr Demel established a strong reputation at Audi for product development and for the sales success of the unit over the period. His high profile at Audi was probably a contributing factor behind his transfer to Brazil. His experience in Brazil will however clearly be a boon, given Fiat's significant exposure to the region.

According to Automotive News on 13 October 2003, incoming Fiat Auto CEO, Mr Demel, is expected to establish engineering, manufacturing and marketing as central functions for all the brands. The heads of these new functions are the first people Mr Demel will hire from the outside. On the product side, Demel could only materially affect new models starting in 2007. The 10 new products to appear from 2004 through 2006 detailed below are scheduled for production and are pretty much set in stone. Any changes on these models could create further delays in a product renewal programme that already lags its competitors.

Further Restructuring

Under the stewardship of the then recently appointed Group CEO, Mr Giuseppe Morchio, Fiat group laid out its third restructuring plan in as many years on 26 June 2003. It set out operating profit, net income and operating cash flow targets for 2004, 2005 and 2006. The key points are:

- Group operating profit breakeven in 2004 and a 4.1% margin in 2006
- Group net income and operating cash flow breakeven in 2005
- Group net financial position to remain stable until 2005
- Auto operating profit breakeven in 2005
- Auto net income and operating cash flow breakeven in 2006

An immediate and obvious shortcoming of the industrial plan was the failure to address the crying need for capacity reduction in Italy

This was to be achieved through:

- Focus on cash flow generation and profitability.
- Product development, innovation and marketing. This umbrella includes the renewal of the product ranges, investments in technology, and the revitalisation of the sales network.
- Cost competitiveness: covering engineering, restructuring, reorganisation, and efficiency, and competence building.
- Geographic "refocalisation".

The plan envisages generating EUR4.7bn of incremental operating profit vs. 2002, split EUR1.6bn from higher margins from new products, and EUR3.1bn from cost reductions. Fiat would have to give back some EUR1.8bn of this figure due to market price erosion, higher depreciation charges, changes in scope of consolidation and exchange rates. The net gain of EUR2.9bn was designed to lift the group's return on sales from a negative -1.4% in 2002 to a positive 4.1% in

2006. This is to be funded by a EUR19.5bn 4-year 2003-2006 investment plan, of which EUR9.1bn was to be spent on new products, EUR7.9bn on R&D, EUR0.7bn on the distribution network, and EUR1.8bn on operational restructuring. It was to be entirely self-financed.

An immediate red flag was raised by the avoidance of a material capacity reduction in Italy, where Auto has been running at less than 70% capacity utilisation for many years. Not for the first time, political expediency won out. This course of action is understandable in an Italian context. According to Fiat, the incremental annual cost of, say, EUR30mn per annum for keeping the Termini Imerese plant in Sicily open was judged an acceptable concession to avoid endangering the EUR3.1bn of targeted cost cuts. Better that it was reasoned than months of industrial and political discord that dogged the company in 2002. However, such compromises mark out the boundaries within which Mr Herbert Demel will be able to operate.

■ Over-manning

Multiple production sites for individual models and low demand meant that excess capacity stood at 800,000 units in 2001, leading to a crippling 61% utilisation rate. This improved to 66% in 2002 with the closure of the Rivalta plant.

Fiat began negotiating with the government at the end of October 2002 to obtain recognition of a "state of crisis" at Fiat Auto and other affected Fiat Group Companies. The plan included a number of measures to revitalize and develop the company, including immediate implementation of a special plan to reduce operating and overhead costs. Fiat Group requested that Special Temporary Layoff Benefits (Cassa Integrazione a Zero Ore) be made available for a period of twelve months starting 2 December 2002. These benefits covered 5,551 employees (4,941 at Fiat Auto, 290 at Comau, and 320 at Magneti Marelli), with another 2,057 to be covered starting June 30, 2003 (1,717 at Fiat Auto and 340 at Comau).

These layoffs were time-limited to 12 months, but could theoretically be rolled over on an annual basis depending on the manning needs of Auto. As a rule of thumb, the government pays 95% of the workers salary during the layoff period. A further 500 non-Auto workers were to be laid off permanently under an early retirement program. The expected total cost savings was put at around EUR300mn per annum.

Fiat received government approval for the State of Crisis in December 2002. It was understood that a large proportion of these workers would be re-hired in 2003Q4, when Fiat could put them to good use to meet the demand for the face-lifted Punto. Indeed, Punto production was restarted at the end of August 2003 at the Termini Imerese plant, which Fiat had originally planned to close. The State of Crisis ends this month, and so a large part of those laid off workers who remain on Fiat’s payroll, will return to work.

■ Further Cuts from the Restructuring Plan

The June 2003 restructuring plan set out a new target of laying-off 12,300 workers across the entire group. Only 2,800 positions related to Italy, where the over-capacity problem is most acute. Fiat also envisaged 1,600 new hires in Italy and 3,800 new hires in the rest of the world over this period, mainly in R&D and marketing, the sales network and back office functions. Perhaps partly as a consequence, Fiat Auto’s original target of reaching 78% capacity utilisation was put back to 2006. Even if Fiat Auto overachieves to the low 80s, it can only really expect low single digit operating margins. The truck business in Italy is also suffering from low capacity utilisation of around 60%, rising to only 67% in 2006.

Table 1: Fiat Group Employee Movements

	1999	2000	2001	2002	2003H1
Fiat Employees @ Jan 1	220,549	221,319	223,953	198,764	186,492
Net Additions/Reductions	**(7,730)**	**(6,166)**	**(7,789)**	**(7,972)**	**(3,051)**
Outsourcing	(5,000)	(3,900)	(1,900)	(400)	0
Changes in Scope of Consolidation	13,500	12,700	(15,500)	(3,900)	(9,300)
Fiat Employees @ Dec 31	**221,319**	**223,953**	**198,764**	**186,492**	**174,141***

NOTE * As at end of 2003H1. Source: Fiat

We remain unsure whether Fiat's new target of 78% capacity utilisation by 2006 corresponds with creating shareholder value, when many of its more successful European peers are working at closer to 100% utilisation. At best, Fiat Auto may achieve very low single digit operating margins accompanied by neutral free cash flow generation. It will be for CNH and Iveco to provide the necessary returns to turn around Fiat's net debt position.

To reach its 2006 Group op. margin target of 4.1%, op. profits will have to approach EUR2bn. Over the past decade Fiat has only exceeded EUR1bn twice

To reach its 2006 Group operating margin target of 4.1%, operating profits will have to approach EUR2bn. Over the past decade Fiat has only twice exceeded EUR1bn of operating profit in 1995 and 1997. What is more, this was achieved with substantially more (profitable) divisions than are currently consolidated. At its 1997 peak, Fiat's New Holland division (now CNH) reported an 11.4% operating margin. It acquired Case in 1999 for a US$4.6bn consideration. CNH's margin came in at 1.8% in 2003 9M and the current combined Case New Holland current market capitalisation today is US$1.8bn (this after a 65% rise in the CNH stock price since July 2003).

Selling the Jewels

The deterioration in Fiat's financial position and prospects over the past two years, which saw net debt hover consistently over the EUR6bn mark, was cited as the reasons for the downgrade of its debt rating to "junk" status on 23 December 2002.

The whole Group has long been effectively "in play", with a special team assembled to actively market and divest the Group's assets. The initial plan was to sell the automotive component businesses, but buyers were few and far between. M&A activity had been muted over the period and no better than firesale prices would have been achieved. Therefore the jewels in the Fiat Group portfolio such as Ferrari, Fiat Avio and Toro were reluctantly placed on the block. Ferrari was the first to go and a 34% stake was sold to Mediobanca for EUR775mn in June 2002. Mediobanca was subsequently forced to reduce this holding and sold a 10% stake to Commerzbank and 6.5% to Lehman Brothers.

Chart 5: Ferrari 360 Modena

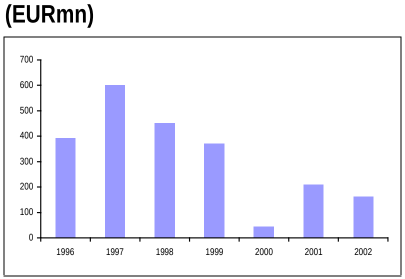
Source: Ferrari

The most recent disposals include the sale of Toro and Fiat Avio (see below) which have assisted in reducing net debt by EUR2.8bn. The downside is that Fiat Group no longer receives EUR270mn in cash dividends from these two businesses (Toro EUR200mn and Avio EUR70mn).

Remaining Industrial Businesses

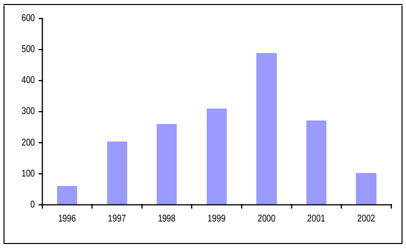
Fiat is now placed firmly in the manufacturing sector with its three core businesses of Auto (43% of revenues), CNH (22% – agricultural and construction equipment) and Iveco (20% – trucks) accounting for 85% of continuing revenues. This clearly contrasts with the original Group intention to balance the industrial exposure with acyclical divisions such as Toro (insurance).

Chart 6: CNH Operating Results (EURmn)



Source: Fiat, ML Estimates

Chart 7: Iveco Operating Results (EURmn)



Source: Fiat, ML Estimates

CNH & Iveco

CNH and Iveco have been severely impacted by the cyclical downturn in their core markets, and the expected recovery remains elusive. In common with Auto, capacity utilisation at the Italian Iveco truck plants is expected to remain low through to 2006. Further restructuring and workforce reductions (ex Italy) at CNH should, at some point, coincide with an expected pick up in its markets and provide CNH with the opportunity to substantially improve on its low single digit margins. But CNH alone cannot turn around Fiat Group's fortunes.

Fiat Auto and the Put

Fiat appears committed (or resigned) for the long haul to turn around its Automotive business by itself, and it is prepared to use the proceeds from its capital issue and disposals to do so. Does this suggest Fiat's tacit acknowledgement that the Auto Put, negotiated with GM in 2000 and originally exercisable from the beginning of 2004, cannot be used without the active co-operation of GM? GM's refusal to date to take up its rights from Fiat Auto's EUR5.0bn recapitalisation means that its stake in Auto has fallen from 20% to 10%. GM has until October 2004 to take part in the issue. This speaks volumes about the balance of power within the relationship.

In statements to securities regulators, GM has said the put could be *"rendered unenforceable by reason of actions Fiat may have taken".* General Motors has alleged that the sale of certain assets of the financing business of Fiat Auto (the sale of 51% of Fidis to a consortium of banks in March, 2003) and the capital increase of Fiat Auto Holdings, carried out by Fiat, constitute breaches of the Master Agreement entitling General Motors to terminate the Master Agreement and with it the put option.

Fiat's official position remains that both of these transactions were wholly proper and did not violate the Master Agreement or any of General Motors' rights. Fiat regards the put option as effective and exercisable in accordance with the provisions of the Master Agreement.

GM remains publicly conciliatory. It says that the agreement has not changed, but stresses that the ideal solution would be for Fiat Auto to fix itself and not seek a buyer. *"There is an answer here,*" GM's Chief Financial Officer Mr John Devine said in September 2003 at the Frankfurt Auto Show. *"It is for Fiat to turn around their car business."* It is worth noting that the GM-Fiat partnership continues to thrive at the industrial joint-venture level with the two JVs being extremely beneficial to both parties.

This view appears to chime with Fiat. Fiat continues to insist that the put is enforceable, but it has no intention of exercising it. It also appears to accept that GM is unlikely to participate in the Fiat Auto recapitalisation. Several meetings have been held between Fiat Group CEO, Fiat Group CFO Mr Ferruccio Luppi, Fiat Auto outgoing CEO Mr Giancarlo Boschetti and GM CEO Mr Rick Wagoner and GM CFO Mr John Devine. The Fiat Auto recapitalization and the put option have been extensively discussed, but nothing has been finalized. The next meeting is planned in Turin, Italy, on 11 December 2003.

In an interview given by in Corriere della Sera on 10 October 2003, Mr Morchio stated *"The put (option) is a right that we have, but we don't have an intention to exercise it. The (relationship) we have with GM is, first of all, an industrial alliance. It is an alliance which works, an alliance made of the things we make together. Their (GM) participation in Fiat Auto recapitalization is not a priority. GM's contribution is not taken into account in our industrial and financial plan. Of course, if they would subscribe (their part), we would be happy."*

The window within which the Put can be exercised has been delayed by one year to start in January 2005

On 26 October 2003, Fiat and GM jointly announced that both parties had agreed to shift the put period by one year. The Master Agreement signed in 2000 originally set the operational period of the put from 24 January 2004 to 24 July 2009. This has now shifted to 24 January 2005 to 24 July 2010. Both parties also agreed not to initiate legal proceedings relating to the Master Agreement until 15 December 2004, while preserving their respective rights. General Motors and Fiat repeated that the joint ventures between Fiat Auto and General Motors are working well, generating synergies, and that both parties would like to see expanded cooperation. They continued that *The Amendment and the Standstill Agreements have been executed in the context of ongoing discussions between Fiat and General Motors regarding the re-defining of the structure of the strategic alliance in order to permit their industrial cooperation to continue constructively and resolve both parties' concerns.*

The latest twist to this saga occurred on 31 October 2003. During the analysts' conference call following the release of the 2003Q3 results, Mr Morchio appeared to suggest that that Fiat might offer GM a deal to annul the put option. Asked whether Fiat might accept a cash offer to kill the put, Mr Morchio replied *The point is, the put has a value... we are open to discuss alternative solutions.*

Fiat's Cash Burn Continues

At 31 March 2002, Fiat's net debt stood at EUR6.6bn, a figure that already included the EUR1bn proceeds from the December 2001 rights issue. The following transactions have been executed since then, bringing in a cash injection of EUR12.8bn. The amounts relate to the net benefit to Fiat Group.

- 28.05.02 EUR3bn convertible loan agreed
- 11.06.02 CNH new share offering – EUR205mn
- 14.06.02 Sale of 14% of Italenergia – EUR576mn
- 27.06.02 Sale of 34% Ferrari – EUR775mn
- 02.08.02 Sale of Teksid Aluminium – EUR290mn
- 30.09.02 Sales of remaining 40% Europ Assistance EUR124mn
- 04.10.02 EUR1.15bn credit facility secured on Fiat's put on remaining 24.6% stake in Italenergia
- 20.12.02 Sale of 5.7% stake in GM – EUR1.16bn
- 23.12.02 Moodys' downgrade Fiat to "junk" status
- 20.01.03 Sales of Fraikin Truck leasing business – EUR400mn
- 28.02.03 Sale of 56% holding in IPI – EUR120mn
- 11.03.03 Sale of 51% of Fidis – EUR370mn
- 01.07.03 Sale of Fiat Avio – EUR1.4bn:
- 01.07.03 Announced 3-5 Rights Issue
- 30.07.03 Sale of Toro – EUR1.4bn
- 30.07.03 Proceeds from rights issue – EUR1.8bn

At the end of 2003H1, Fiat's net debt stood at EUR4.8bn. This already included an accrual for the Toro proceeds (EUR2.4bn transaction price but Fiat's net debt calculation previously included around EUR1bn of net cash relating to Toro). The sale of Fiat Avio was finally authorised by the European Commission and completed on 1 October. Therefore during 2003Q3 Fiat received the proceeds from the EUR1.8bn rights issue and the EUR1.4bn (net proceeds vs EUR1.5bn sales price) from the Fiat Avio disposal. This gave a net debt position at the end of 2003Q3 of EUR2.95bn. Set against this are 2003Q4 cash restructuring charges of around EUR400mn estimated at the Group level. This is in addition to an already anticipated Auto cash burn of EUR1.3bn. A further negative is the completion of the Fidis transaction which, due to the deconsolidation of around EUR800mn of net cash results in the overall negative cash impact of EUR400mn in 2003.(-EUR100mn in 2003Q4) and gives an estimated 2003 year end Group net debt position in the region of EUR2.6bn. We estimate a further EUR1.6bn of Auto cash burn over the next three years and are not convinced that it can return to positive free cash flow by 2006.

Auto Recovery Hopes Based on Product Pipeline

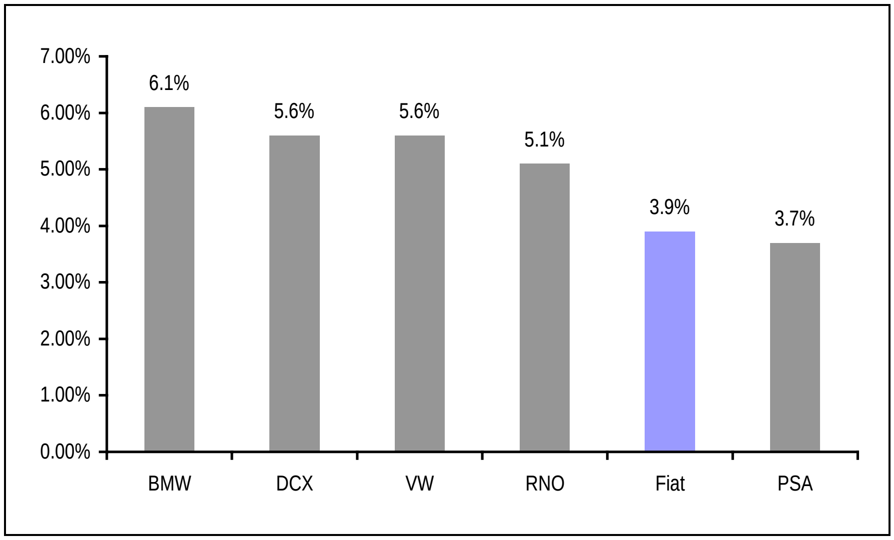
Most restructuring plans have two distinct elements, and it is useful to consider at this stage how vital it is that both of these can be realised. The first element of a restructuring is normally the cost cutting phase while the second phase covers revenue enhancement, mainly through new products. It is while executing the first element that a dynamic management can often “over achieve”. This may be because companies rarely turn out to be as efficient as they have been popularly portrayed. The Stuttgart team parachuted into Chrysler at the end of 2000 found ample scope for economies. It also happens on some occasions that the new management “broom” inadvertently or deliberately low-balls the amount of available “low hanging fruit”, allowing the company to demonstrably exceed its stated objectives. Such successes count for little if the second element of revenue enhancement cannot be executed.

It is in this crucial area that Chrysler has stumbled. Its market share has fallen from 15.5% in 1998 to 14.6% in 2000 FY to 12.6% in 2003 YTD. While the US market grew by 8% between the end of 1998 and the end of 2002, Chrysler Group sales have fallen by a similar amount. As Chrysler has so far stumbled over the second part of its turnaround plan, it has been forced to try to make good the shortfall with ever-greater cost cutting. As to DCX CEO, Mr Juergen Schrempp, admitted, *"We have a revenue problem because of competitive pressure, and we have to solve it with further improvement on the cost side."*

Turning to Fiat Auto, we question the extent to which either of the two elements of Fiat Auto’s turnaround plan, cost cutting and revenue enhancement, is achievable? Is Fiat’s EUR2.2bn cost reduction programme sufficient to offset the cost of further support for its current model range? Is enough being done in Italy to make a real difference? We also fear that Auto’s revenue enhancement plans will fall well short of the group’s expectations.

Fiat bases its confidence on what it styles as a strong Auto product pipeline backed by increased spending. Auto R&D is expected to reach 5% of revenues in 2004 as compared to 3.9% in 2002 as spending is increased by EUR300mn to EUR2bn a year. Fiat reckons that this will help broaden its European market segment coverage from 69% in 2003 to 80% by 2008.

Chart 8: Total R&D Costs as % of Sales in FY2002



Source: Company Accounts, Merrill Lynch

Chart 9: New Fiat Panda

Source: Fiat

Chart 10: New Lancia Ypsilon

Source: Fiat

The Fiat Panda and Lancia Ypsilon were launched in 2003H2, and the Punto-based Idea MPV goes on retail sale from January 2004. Then there is a hiatus until 2005 when the launch programme picks up again. The current launches are placed firmly in the A-segment (mini) and B-segment (small), which provide volume support but contribute less to the bottom line. The facelift of the Punto is arguably long overdue, considering the 23% fall-off in sales in Western Europe in 2002. More significant than the cosmetic changes are the two Multi-jet JTD diesel engines, which are offered for the first time. Indeed there must be a considerable opportunity to boost Fiat's below-par ratio of diesel to total unit sales from 23% at present. However, the mid-life boost that a facelift can provide is always rather limited and we expect further pressure on Punto in the twelve months period leading up to its replacement in 2005.

Fiat is excited by the cost saving involved in moving production of the new Panda to Poland. This does however increase the overcapacity issue in Italy, as space is freed up at the Mirafiori plant, which also makes the Punto and Multipla.

Refer to important disclosures on pages 50 to 51.

Table 2: Fiat Auto Sales 2002

	Unit Sales			Market Share	
MARKET	**2001**	**2002**	**%chg**	**2001**	**2002**
Fiat	*617,248*	*508,254*	*(17.7%)*	*25.6%*	*22.4%*
Lancia	*125,883*	*98,252*	*(21.9%)*	*5.2%*	*4.3%*
Alfa Romeo	*91,915*	*79,822*	*(13.2%)*	*3.8%*	*3.5%*
ITALY	**835,046**	**686,328**	**(17.8%)**	**34.6%**	**30.2%**
GERMANY	**120,712**	**101,928**	**(15.6%)**	**3.7%**	**3.2%**
FRANCE	**110,865**	**88,286**	**(20.4%)**	**4.9%**	**4.1%**
UK	**114,765**	**94,628**	**(17.5%)**	**4.7%**	**3.7%**
SPAIN	**57,026**	**51,479**	**(9.7%)**	**4.0%**	**3.9%**
Fiat	*438,813*	*380,629*	*(13.3%)*	*3.6%*	*3.2%*
Lancia	*22,647*	*11,282*	*(50.2%)*	*0.2%*	*0.1%*
Alfa Romeo	*109,522*	*89,554*	*(18.2%)*	*0.9%*	*0.7%*
W.EUR.EX ITALY	**570,982**	**481,465**	**(15.7%)**	**4.6%**	**4.0%**
Fiat	*1,056,061*	*888,883*	*(15.8%)*	*7.2%*	*6.2%*
Lancia	*148,530*	*109,534*	*(26.3%)*	*1.0%*	*0.8%*
Alfa Romeo	*201,437*	*169,376*	*(15.9%)*	*1.4%*	*1.2%*
W. EUROPE	**1,406,028**	**1,167,793**	**(16.9%)**	**9.5%**	**8.2%**
POLAND	**74,011**	**53,464**	**(27.8%)**	**23.2%**	**17.7%**
BRAZIL	**369,596**	**318,488**	**(13.8%)**	**28.5%**	**25.8%**
ARGENTINA	**15,202**	**6,859**	**(54.9%)**	**10.7%**	**10.0%**
TURKEY	**21,649**	**11,187**	**(48.3%)**	**16.2%**	**12.3%**
INDIA	**13,478**	**28,267**	**109.7%**	**2.2%**	**4.5%**
CHINA	**6,835**	**23,020**	**236.8%**	**0.9%**	**1.8%**
OTHER	**91,878**	**82,714**	**(10.0%)**		
TOTAL REGISTRATIONS	**1,998,677**	**1,691,792**	**(15.4%)**		

Source: Fiat

Chart 11: New Fiat Idea

Source: Tiscali.com

Fiat Idea

The Idea is a small MPV based on the Punto platform. Fiat is targeting sales of 100K units in 2004, but expects only 50% of this figure to be incremental, as the rest are expected to come from Punto customers switching across. As both the Punto and Idea are produced off the same platform at the Melfi plant, there is some flexibility to shift the mix to match demand.

Lancia Ypsilon

The new Ypsilon provides Lancia with a welcome boost. Fiat disclosed that the average transaction price on initial orders is around EUR15,000 vs. the MSRP or list price of EUR12,000. Total Lancia sales in Italy fell by 22% in 2002 to 98,252 units. Lancia brand sales had fallen by a further 11.2% in 2003 9M to 74,350 units. Fiat hopes to sell between 90-100K Ypsilons in 2004.

Alfa Romeo

The Alfa brand received some help from the new GT Coupe and facelifts on the 156 and 166 in 2003, but overall volumes remain relatively small (184K in 2002, down by 15%, and 146K in 2003 9M, down by 7.8%). Alfa will not enjoy a greater scale effect until it is re-launched in North America, using a platform from General Motors. This is unlikely to occur before 2006.

The model launch profile is as follows:

2003

- Punto facelift, Panda, and Lancia Ypsilon

2004

- Idea: Punto based Small MPV
- Facelifts for Multipla and and Alfa 147

2005

- Punto replaced
- New Fiat Large (replaces the long defunct Croma)
- New Fiat SUV
- Alfa 156 replaced
- New Alfa Coupe
- New Alfa Supercar

2006

- Panda facelift
- Stilo replacement
- Alfa Spider replaced
- New Alfa C-segment crossover

Stock Price Performance

Table 3: Sector Performance 2002 & 2003 YTD

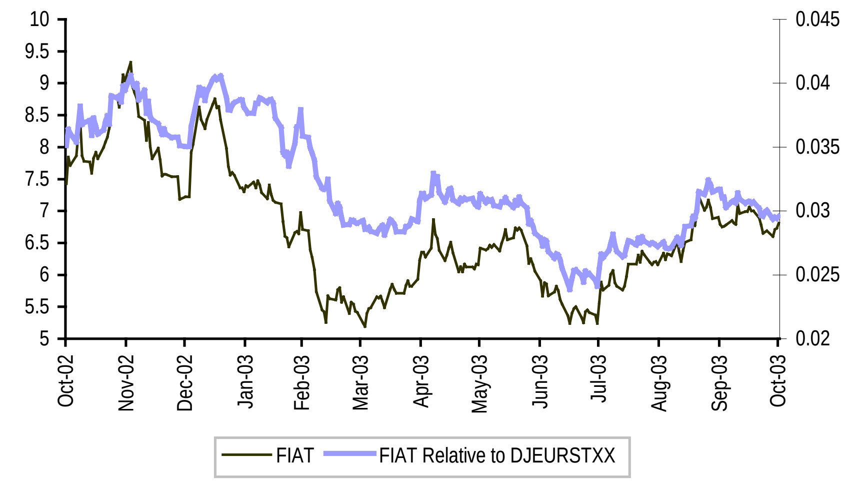
	Year 2002		Year 2003 – Today	
Stock/Sector	**Absolute % Change**	**Relative % Change**	**Absolute % Change**	**Relative % Change**
BMW	(26.8%)	11.8%	17.4%	5.0%
DaimlerChrysler	(39.4%)	(7.4%)	8.8%	(2.7%)
Fiat	**(56.4%)**	**(33.3%)**	**(5.7%)**	**(15.6%)**
Peugeot	(18.6%)	24.3%	(4.6%)	(14.7%)
Porsche	(7.7%)	41.0%	3.8%	(7.2%)
Renault	13.1%	72.7%	28.0%	14.4%
Volkswagen	(34.0%)	0.7%	24.9%	11.7%
Auto Manufacturers	**(31.6%)**	**4.5%**	**12.7%**	**0.8%**

Source: Datastream

As of 31 October 2003, Fiat’s share price stood at EUR6.8, -25% off its peak of EUR9.13 in November 2002. This date marked the beginning of an almost uninterrupted slide, with the price bottoming at EUR5.19 on 1 April 2003, a 43% decline compared to the 2002 high.

Last year Fiat was the worst performer in our universe. It declined by 56.4% in absolute terms and by -33.3% relative to the sector. YTD Fiat is again the weakest stock and declined by -5.7% in absolute terms and 15.6% relative to the to the Dow Jones EUROSTOXX Index. By contrast, other volume manufacturers such as Volkswagen and Renault gained 24.9% and 28.0% in absolute terms.

Chart 12: Fiat Share Price Development –12M & Relative Performance to DJEUROSTOXX



Source: Datastream

Valuation and Recommendation

Fiat Auto's highly publicised new products sit firmly in the small segment (Panda, Idea and Ypsilon) assisting short-term volumes. The main part of the product renewal programme does not begin before 2005, and so we expect Fiat's European market share to continue to drift. Capacity utilisation at its Italian production plants remains low.

On EV/Sales Fiat is trading on 0.25x 2004 sales vs. the European auto sector average of 0.38x

Valuation provides little comfort. We expect Fiat Group to report negative net earnings until 2005 and therefore P/E is inappropriate. On EV/Sales Fiat is trading on 0.25x 2004E sales vs. the European auto sector average of 0.39x. In our opinion at least a 35% discount is warranted given the risks associated with restructuring the loss making Auto business and the introduction of numerous new products over the next two years. On 2004E EV/EBITDA Fiat trades at 4.9x vs. the sector average of 3.5x.

We resume our coverage of Fiat a neutral recommendation

In a bid to materially reduce net debt, a large part of the Fiat Group has been effectively "in play" since 2002 with the subsequent divestment of two major divisions. The Group still consists of nine clearly distinguishable units. In our opinion, this increases the relevance of a sum-of-the-parts (SOTP) model. We have attempted to be realistic in the valuation process, and have come up with an implied value of EUR6.76 per ordinary share which is in line with the current stock price. We resume our coverage of Fiat with a Neutral recommendation.

■ Associated Risks

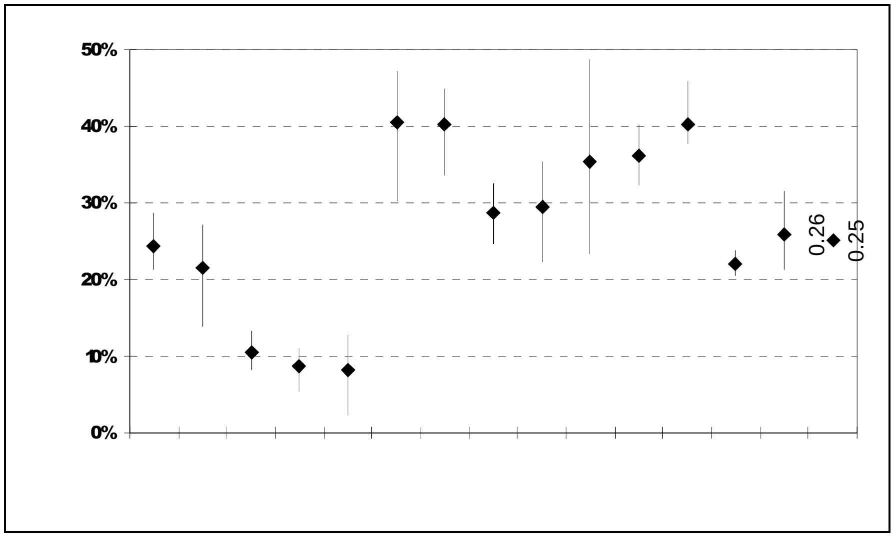
The valuation of Fiat Auto is a major swing factor

The valuation of Fiat Auto is a major swing factor. We had originally assumed that Fiat would exercise its put option on the remaining 80% of Auto sometime in 2004, allowing the market to concentrate on the intrinsic value of the rest of the group portfolio. The proceeds from the numerous disposals and in particular the sales of Avio and Toro will be used to fund the Auto business. We must recognise the challenges and risks inherent in its Auto business. These dramatically increases the systematic risk at Fiat Group:

- The risk of a cancellation of the put to GM with little visibility of how this will be compensated. Fiat Group has already taken up its rights in the EUR5bn recapitalisation of Fiat Auto, and awaits a decision from GM whether it intends to take up its own rights. This adds a further element of uncertainty. GM has until October 2004 to take up these rights.

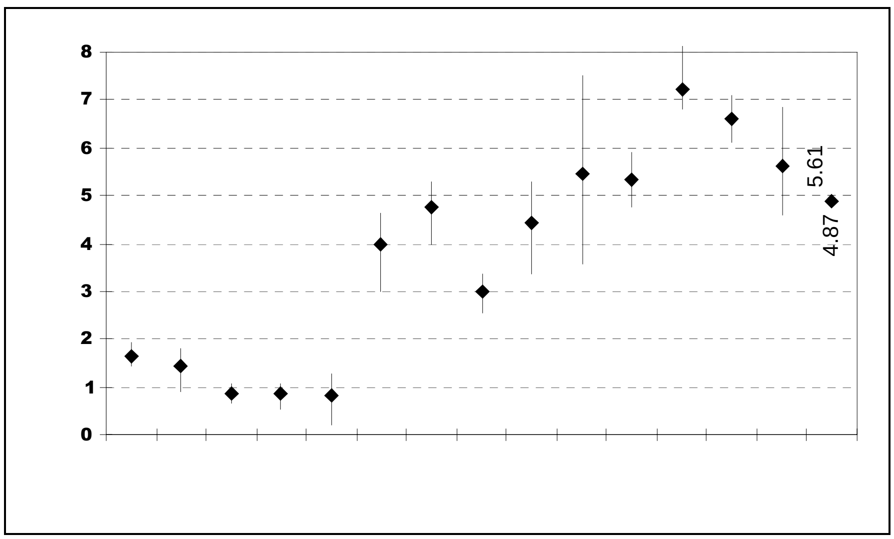
- Uncertainty over its ability to carry out necessary further restructuring in Italy given political and labour resistance.

Chart 13: Fiat Valuation: Enterprise Value/FY+1 Sales (%)



Source: Datastream, Merrill Lynch

Chart 14: Fiat Valuation: Enterprise Value / FY+1 EBITDA (%)



Source: Datastream, Merrill Lynch

Sum-of-the-Parts

The SOTP is split between values based upon ML European average EV/Sales or P/E multiples for the sector. In most cases a further discount or premium is included reflecting the current condition and medium term prospects of the business. Separately listed companies such as CNH are shown at their market value.

Adjusted net debt is the Group balance at end of 2003Q3 EUR2.95bn less the consolidated element of CNH's net debt estimated at EUR3.07bn. Pension provisions of EUR3bn, excluding those of CNH, are added to net debt. Finally 62% (see methodology below) of the sales receivables (factoring) which totalled EUR5.8bn at the end of 2002Q3 is also included as net debt. This gives a total adjusted net debt of EUR5.2bn, which is deducted from our SOTP valuation. A conglomerate discount of 10% is applied.

Refer to important disclosures on pages 50 to 51.

Table 4: Fiat Group Sum-of-the-Parts Valuation

Division	Ownership	2004E Revenues	Sector EV-to-Sales Ratio (x)	2004E Operating Income	2004E Op. Income Taxed @37%	Target 2004 P/E Multiple (x)	Multiple Used	Sector Prem/Disc.	Implied Value (EURmn)
Automobiles (Fiat Auto Holdings)	90.0%	20,000	0.38	(530)	(334)		EV/Sales	50%	3,433
Ferrari & Maserati	56.0%	1,400	1.09	75	47		EV/Sales	**P** 40%	1,176
Commercial Vehicles (Iveco)	100%	9,000		90	57	17.7	P/E	**P** 50%	1,508
Metallurgical Products (Teksid)	66.5%	1,150	1.00	20	13	17.0	EV/Sales	25%	574
Components (Magneti Marelli)	100%	2,500	0.53	35	22	9.5	EV/Sales	25%	994
Production Systems (Comau)	100%	2,500	1.00	15	9	17.0	EV/Sales	25%	1,875
Publishing & Communications (Itedi)	100%	350		5	3	19.7	P/E	0%	62
Business Solutions	100%	2,200		55	35	15.8	P/E	25%	411
Total EUR value prior to discount & debt adjustment									**10,032**
Minus Adjusted Net Debt									(5,503)
Independently Listed Companies		**Market Cap. (EURmn)**							
Agricultural & Construction Equip. (CNH)	85.8%	1,511							1,308
Italenergia	24.6%								939
Mediobanca (Banking)	1.7%	5,568							92
Total EUR Value Prior to 10% Conglomerate Discount									**6,867**
Minus Conglomerate Discount (10%)									(687)
Total SOTP Value									**6,180**
Current Market Capitalisation									**6,085**
SOTP Attributable					**No. of Shares (mn)**	**SOTP Price (EUR)**			
Ordinary Shares					**801.70**	**6.76**			
Preference Shares					103.29	4.05			
NC Saving Shares					79.91	4.25			
					984.91				

Source: Fiat, Merrill Lynch estimates
P = Premium

Fiat Auto

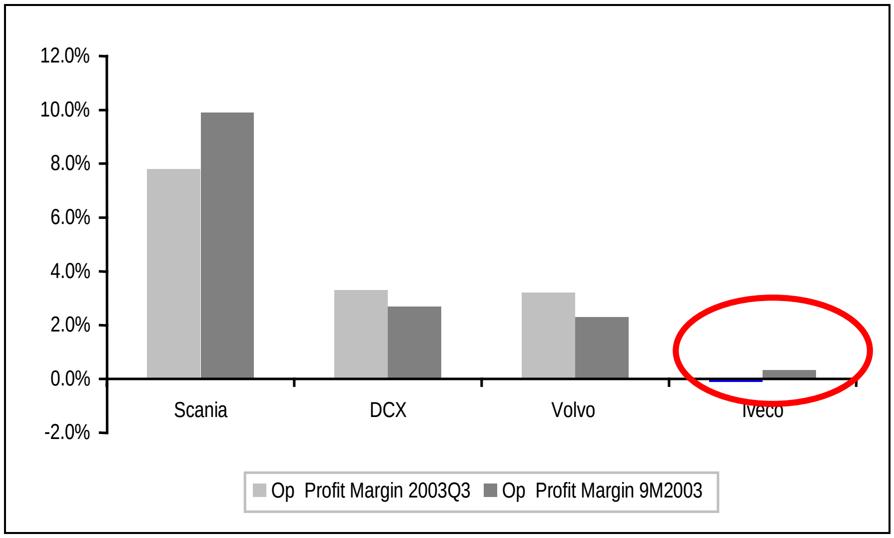
We use a 50% discount to the European auto sector EV/Sales average multiple to imply an enterprise value of EUR3.5bn. Assuming the Fiat Auto holds around EUR2.0bn of net debt following the EUR3bn cash injection from Fiat Group, this values the division EUR1.5bn. For comparison GM paid US$2.4bn, in March 2000, for its 20% (currently diluted to 10%) stake in Fiat Auto.

In its 2002Q3 results, GM wrote down the value of its 20% stake in Fiat Auto Holding (FAH, is the sole owner of Fiat Auto) from US$2.4bn to US$220mn. This value also encompasses GM's 50% stake in the Powertrain and Purchasing Joint Ventures and gives an implied equity value for Fiat's remaining 80% of FAH at EUR815mn (assuming US$1.1=1EUR).

Iveco – Commercial Vehicles

Although Iveco's margins are dwarfed by those of Volvo and Scania, it is nonetheless generally perceived as a good business. The light commercial vans business is extremely profitable. We have (generously) put the business on a 50% premium to the global heavy truck multiple given that Iveco's earnings are recovering from a low point in 2003/4 which implies a value of EUR1.5bn.

Chart 15: Operating Profit Margins Q32003 and 9M2003



Source: Company Accounts, Merrill Lynch

Ferrari

Fiat's remaining 56% holding in Ferrari is valued on an EV/Sales basis using a 40% premium to Porsche's current 2004 multiple of 1.09x. This gives an implied value of EUR1.2bn. We are giving Fiat credit for the control premium inherent within the stake. The valuation compares to the EUR775mn Mediobanca paid for its 34% back in June 2002. Mediobanca's valuation implies a EUR1.27bn price for Fiat's 56%. However, this was transacted when average valuation multiples were far superior.

Other Automotive Companies

Fiat's remaining engineering/automotive companies include Teksid (Metallurgical Products), Magneti Marelli (Components) and Comau (Production Systems). Using a 25% discount to their respective EV/Sales sector multiples we obtain a value of EUR3.4bn on businesses whose turnover exceeds EUR6bn. Fiat has changed its stance on these businesses which were the initial disposal targets. The recent difficult economic conditions made their sale difficult, particularly when Fiat understandably refused to accept fire-sale prices. These businesses are now regarded as core. The failure to divest Magneti Marelli was a key factor behind Fiat's failure to reach its 2001 net debt target.

Business Solutions

This was a focus area for Fiat when it announced its original restructuring plan back in April 2001. Fiat's original aim was to derive 35-40% of Group revenues from non-industrial businesses by 2005, with this division in particular contributing strongly. We estimate that the division will make up only 5% of revenues in 2005 generating a 4% operating income margin. Using our 2004E operating income estimate of EUR55mn and using a 25% discount to the ML European Services sector P/E multiple of 15.8x gives an implied valuation of EUR411mn.

Sales Receivables – To Exclude from, or Include in Net Debt?

There are two schools of thought regarding the EU5.8bn sales receivable financing balance as at the end of 2003Q3. On the one hand it can be regarded as a working capital management tool and should not be recognised as debt, particularly as only one third is with recourse to Fiat. This means that the remaining two thirds or around EUR3.8bn is guaranteed against default by the entity to which Fiat has extended credit (usually its dealers).

Refer to important disclosures on pages 50 to 51.

The counter argument is that European auto companies do not use factoring to the same extent as Fiat. The argument follows that Fiat is artificially understating its net debt position, because it includes the factoring proceeds from sales receivables, which other auto companies would only show in their books as a short-term working capital asset.

As Fiat has no recourse to two thirds of the factored sales receivables, then logically it has no liability for this amount and therefore it cannot be regarded as debt. Fiat is only making more efficient use of its working capital position to the benefit of cash flow.

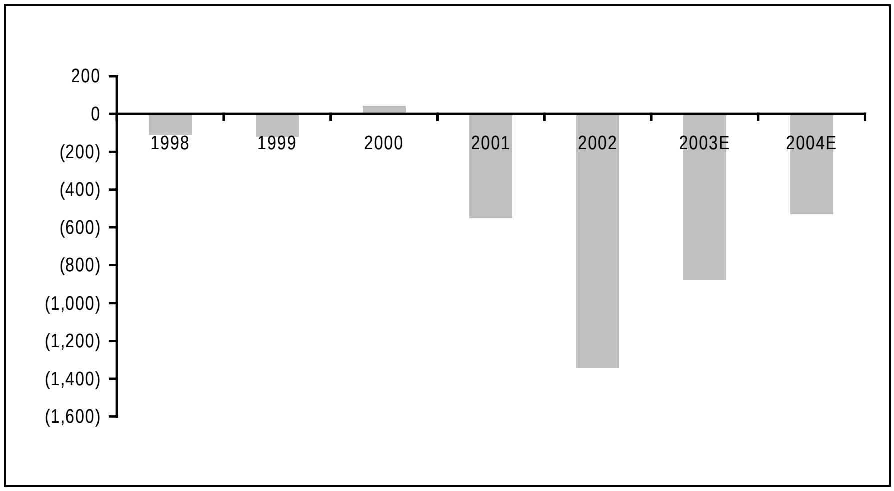
Factoring is spread across Fiat's entire business, and is not exclusively limited to the Auto business where the usual dealer payment terms are 90 days. In the case of CNH's business, dealer stock of agricultural equipment can be financed for up to six months by the manufacturer. Therefore the level of sales receivables disclosed in Fiat Group is not comparable to other pure auto companies. Factoring is also much more widely used as a working capital tool in the US.

The inclusion/exclusion of sales receivables is naturally a major swing factor in the Fiat SOTP valuation. Our decision to include EUR3.6bn as net debt is consistent with our past analysis when we have had a more positive rating on the stock. This calculation takes into account the extended credit terms provided by CNH and Iveco as compared to the Auto business. In other words it would closer reflect the reduction in sales' receivables if only 90 days of dealer credit was available across the whole business.

2. Fiat Auto

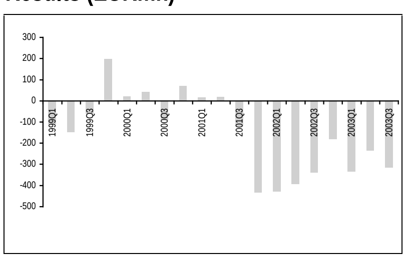
2005 is the major year for Fiat Auto. It sees the replacement of the volume Punto and three launches for the Alfa brand. We are not so concerned with the Alfa brand, except to the extent that its full potential is far from being realised. That may happen in time, but this is a side-show compared with the most pressing issue for Fiat Auto, the ability of the Fiat brand to make market share inroads above the B-segment (small) level. Can it break back into the C-segment?

Chart 16: Operating Result Fiat Auto Division (EURmn)



Source: Company Accounts, Merrill Lynch

Chart 17: Fiat Auto Quarterly Operating Results (EURmn)



Source: Fiat, Merrill Lynch estimates

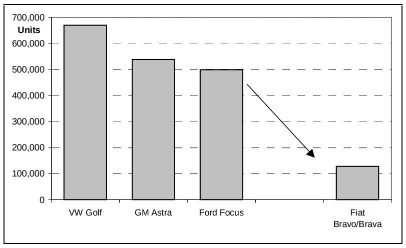
All volume or mass market car manufacturers have in recent years encountered a kind of glass ceiling. They have found themselves increasingly marginalised or shut out of the upper market segment where they traditionally had good volumes and returns. Ford was the first European mass manufacturer to tacitly admit to this when it killed off its Granada/Scorpio range, because so few customers shopping for an executive/near luxury vehicle were prepared to consider the Blue Oval any more. Customers with those budgets have increasingly opted for BMW, Mercedes and Audi. Ford instead tries to channel these customers towards its own Premier Automotive Group brands such as Jaguar and Volvo. Peugeot group has been disappointed with the volume it has achieved on its Peugeot 607 sedan, while Renault's Vel Satis, a bold attempt to woo executive/near luxury customers with an extremely esoteric design, is selling well below budget. Opel's Signum sells poorly, and the less said about the number of Phaetons VW sells, the better. At least companies such as Ford, Renault, VW, Opel and PSA still have healthy and profitable shares in the segments directly below executive, with vehicles like the Mondeo, Vectra, Passat, Laguna and 406 dominating the European D-class. What is more, these companies also dominate the C-segment, the largest part of the European market, which accounts for around one third of all vehicles sold.

Fiat's recent dire experience with its Stilo, launched only in October 2001, raises the question whether Fiat brand can even compete in the C-segment. Along with the ability to take the knife to the Italian cost base, this is perhaps the biggest headache facing incoming Fiat Auto CEO, Mr Herbert Demel.

Refer to important disclosures on pages 50 to 51.

Stilo Bombs

Chart 18: European C-Segment, 2000



Source: JATO Dynamics

Stilo launch timing seemed auspicious – the 307 would be the only competing model less than three years old

Fiat understandably had great hopes for the Stilo. It believed that the model line would re-establish its position in the lower medium segment. The profitability of Fiat Auto's European operations had long been structurally impaired by the inability of its largest brand to compete effectively across the region in the VW-Golf dominated C-segment. For example, the outgoing Fiat Bravo/Brava, which the Stilo replaced, had sold less than a fifth as many vehicles as the VW Golf across Europe in 2000.

Chart 19: Fiat Stilo – 3 and 5 Door Versions

Source: Fiat

What was worse was that the Bravo/Bravas that Fiat managed to sell had significantly lower price realisations/real prices than the VW Golf. Even at it peak in 1996, the Bravo/Brava sold well under 50% of the Golf volume in Europe. That meant that Fiat brand had become over-reliant on its B-segment Punto. The Punto has been commercially successful, but this segment's price points dictate that such models will always provide lower absolute returns.

Fiat anticipated selling 60,000 Stilos in 2001, rising to 300,000 units in 2002 and 400,000 units in 2003 after a station wagon (multi-wagon) version was added in late 2002H2. This sales budget compared to peak Bravo/Brava and Marea production of 395,521 units in 1997. By 2000, European Bravo/Brava/Marea production had slipped to only 226,061 units, or just over half the 1996 level.

Stilo was expected to change Fiat Auto's structural profitability

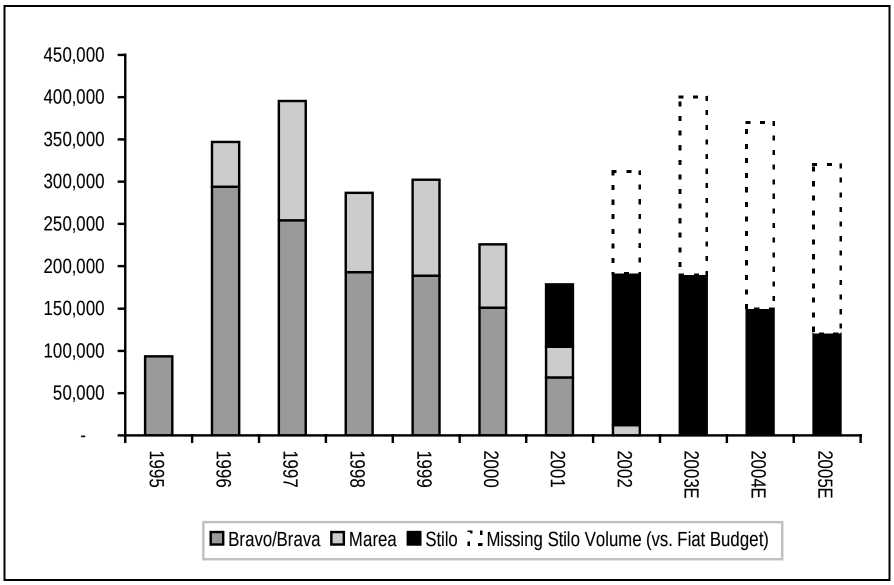
The timing of the launch seemed auspicious for Fiat. Peugeot's new 307, unveiled at the same time as the Stilo in Geneva in March 2001, would be the only competing model from a major European manufacturer under three years old. Models such as the Renault Megane, Volkswagen Golf, Ford Focus and Opel/Vauxhall Astra were beginning to show their age, and the earliest successors would only be widely available in 2003/4. Like Peugeot, Fiat had over a one third market share in its home country and so the key to success would be Europe-wide penetration, in particular Germany, where the Volkswagen Golf reigned.

Initial press reaction was very positive, and helped explain Fiat's early confidence. Here, we quote the conclusion of the British weekly Auto *Express* on the Stilo, published in March 2002: *Ultimately, the Stilo is a good package and arguably one of the most competent Fiats to arrive in the past 20 years. Although the design may lack the kind of flair which fans of the marque are accustomed to, you can expect the Stilo to pose a far greater challenge to the Focus and 307 than its predecessor ever did. Fiat has played it safe with the Stilo. But while almost every aspect of the car follows convention its execution is, in most areas, first rate. Comfortable, refined and well equipped, it answers the compact family brief to the letter. And, while some will yearn for a little more visual excitement - particularly in a market where style and image are increasingly important - the Stilo's fine all-round competence cannot be ignored.*

Playing on the similarity between the German verb s*tiehlen* (vb. to steal) and Stilo, Germany's Auto Bild asked in September 2001, *Will the Stilo steal the show from the Golf?.* Auto Bild raved that *The Stilo was the most German of any Italian car ever made. Never was a Fiat more Golf-like than the Stilo.* This was high praise. Auto Bild was also very taken with the Stilo's price, starting at EUR14,400. It noted that it was cheaper than the Peugeot 307, and still included 6 airbags as standard, ESP electronic stability control, a good radio and fog lamps.

Such reviews appeared to be consistent with our own initial positive if superficial impression of the car earlier in 2001 when we had first been given the opportunity to drive it in April. Re-reading this and other contemporary reviews from across Europe hardly prepares one to expect the sales disaster that Stilo was to become. As Chart 20 shows, Stilo had already fallen well short of its budgeted production and sales targets in 2002, its first full year. Even the addition of the Stilo multi-wagon version in the second half of 2002, a model which Fiat thought would add up to 100,000 units of extra volume (an additional one-third in other words according to the initial planning budget) has failed to re-galvanise sales.

Chart 20: Fiat Brand C-Segment European Production (Units)



Source: Fiat, Merrill Lynch estimates

It is not disputed that the Stilo is far superior to its predecessor, the Bravo/Brava, yet in 2003, its first full year with all derivatives available, it will still struggle to reach 200,000 units. This is half the original target set back in 2001…

It is not disputed that the Stilo is far superior to its predecessor, the Bravo/Brava, yet in 2003, its first full year with all derivatives available, it will still struggle to reach 200,000 units. This is half the original target set back in 2001 and compares to the peak Brava/Brava production of 293,746 units in 1996. To rub further salt into the wound, over 543,500 Peugeot 307s, the vehicle launched at approximately the same time as the Stilo, were produced in 2002, and production should be around 580,000 units in 2003.

Competition from other manufacturers continues to intensify. Renault Megane II launched in 2002Q4 has been extremely successful, while the brand new Volkswagen Golf V, Opel Astra and Ford Focus are on or about to hit the starter's block, putting even more pressure on Fiat's tenuous toe-hold in the C-segment.

Chart 21: Fiat Multipla – Just Too Weird?

Source: Fiat

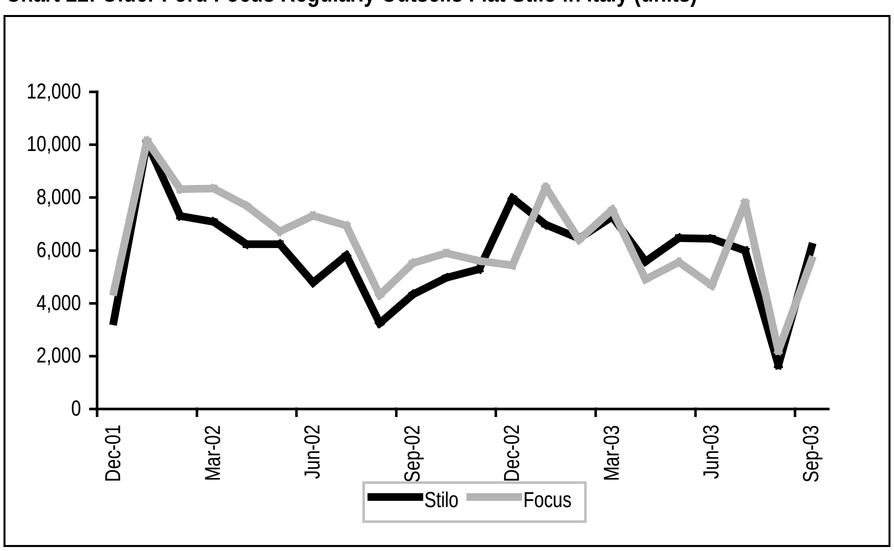
The poor sales performance of the Stilo makes the absence of a Stilo-based MPV or minivan even more inexplicable. Vehicles such as the Renault Megane-based Scenic, Opel Astra-based Zafira, Citroen Xsara-based Picasso and now VW Golf-based Touran have cleaned up in Europe. The first generation of the Megane Scenic launched in 1996 sold around 2mn units through to the end of 2002, and in 2002 accounted for around 58% of the total volume of the Megane sales. Renault launched the 2nd generation of this top-selling product in June 2003. Conspicuously absent from this red-hot segment were VW, Ford and Fiat. Actually, Fiat could offer one product in this segment, the highly innovative Multipla 6-seater (with two rows of 3-along seating). The Multipla launched in 1999 clearly demonstrated the company understood what was needed, but its styling is so esoteric that it was always going to be relegated to an ancillary rather than a mainstream role. In its peak year of 2001, Fiat produced only 50,354 Multiplas. That same year, Renault produced 351,646 Scenics in France, although the peak was 399,250 units in 2000. While VW and Ford have finally made good the gaps in their product ranges this year (VW Touran and Ford C-Max) using their new C-segment platforms, a Stilo-based MPV is only scheduled for after 2006.

■ What Does This Tell Us about Fiat Brand and the C-Segment?

There has naturally been any number of inquests over the dire sales performance of the Stilo. Not having a MPV/minivan derivative is clearly a handicap in the C-segment, although this has not prevented the undisputed success of Peugeot’s 307 range, which went on sale at roughly the same time. Lack of a minivan to-date has also not prevented Ford’s Focus outselling the Stilo in the key Italian market.

The Stilo sold only 73,506 units in Italy in 2002, its first full year of sales. Although it was no surprise that the Punto and Panda were the top selling cars in that market, it must have been galling that Ford’s Focus ranked #3 with sales of 84,725 units. The addition of the multi-wagon to the range in the second half of 2002 (in Fiat’s budget expected to add an additional one third or 100,000 units to global Stilo volume) made little difference to sales. Indeed, Stilo sales in Italy in 2003 9M at 53,524 units were 2.9% *lower* than in the same period in 2002 when this variant had not been available. Admittedly, Fiat brand sales in Italy fell by –9.7% over this period, but the overall market actually *grew* by +1.1%, as the importers’ sales advanced by 5.5%. And the Focus continued to marginally outsell the Stilo. So we really cannot blame the state of the Italian market for the Stilo’s tepid reception.

Chart 22: Older Ford Focus Regularly Outsells Fiat Stilo in Italy (units)



Source: Anfia

Was the Stilo too expensive when it was first launched? This was initially true in Italy. The Stilo was a move upscale in almost every area, with standard features such as eight airbags, keyless ignition, automatic headlamps, adaptive cruise control and electronic stability programme, and Fiat looked to price the vehicle accordingly. Why did it think it could raise prices? The answer lay in its success with the Alfa 147 launched in 2000. On this model, Fiat boasted that it was achieving price realisations (transaction prices – what the customer really pays rather than the list price) in Italy that were on average 39% higher than those for its 145/146 predecessor. Fiat initially figured on price realisations for Stilo that would on average be 30% higher than for the then heavily discounted Bravo/Brava ranges that it replaced, and therefore comparable to those on the Ford Focus. At the same time, Fiat forecast production cost savings for Stilo in the region of 20% over the Brava/Bravo, and this even before any synergies arising from the GM alliance were taken into account. It was therefore easy to understand Fiat's initial confidence that the Stilo would be the catalyst to turn Auto around.

Despite the positive press reaction and the manifest improvement over its predecessor, the Stilo did not take off as planned in Italy

Despite the positive press reaction and the manifest improvement over its predecessor, the Stilo did not take off as planned in Italy. An over-rich launch mix was the initial scapegoat. Why had this occurred? The answer was that when Fiat had launched the second generation Punto in 1999, it had been caught short by the demand for higher specified vehicles. Dealers had lots of entry-level versions but customers wanted their cars to be fully loaded, and it took some time for the production system to catch up. What initial demand there was for the Stilo on the other hand was for cheaper, lower specified versions. Maybe this was a function of the depressed state of the market, which was down by –13.4% in 2002H1. Fiat brand did even worse at –20.2%, and the Ford Focus outsold the then new Stilo by 18% (49,384 units vs. 41,856 units). Rather than cut prices immediately, which Fiat feared would undermine all its attempts to improve brand image, Fiat decided to wait until it could launch lower-specified and lower-priced Stilos in the course of 2002. As noted above, even with these cheaper versions and the launch of the multi-wagon, Stilo sales in Italy in 2003 9M at 53,524 units were 2.9% *lower* than in the same period in 2002.

We have seen a similar depressing pattern in the Stilo's main target market for conquest sales, Germany. There sales of the Stilo/Marea in 2002 9M were 53% higher than those of Bravo/Brava/Marea in the same period in 2001. However, Stilo sales were down by over 6.9% YoY in 2003 9M while the overall German market was only down by 0.3%. Based on list prices, the entry level Stilo is priced at EUR13,900 in Germany, which compares to EUR14,140 for the base Ford Focus. The situation is even more desperate in the UK. Sales of the Stilo and outgoing Brava/Bravo were down by –17.6% in 2002 9M vs. sales of the Bravo/Brava alone in 2001 9M. Sales of the Stilo fell by a further 32.4% in 2003 9M vs. the same period in 2002.

■ Question About Brand Equity

What it all comes down to is that the Stilo and therefore Fiat brand is no longer seen as a legitimate competitor to the Golf, Megane, 307 and other cars in the C-segment

So Fiat has cut the price of the Stilo and launched its multi-wagon, but still the sales' volume is not coming through. We think this speaks volumes about the health of the Fiat brand and its ability to compete above the B-segment. It is a reflection of the customer perception about Fiat rather than a judgement on the quality of the product. A little experiment that we often do in Italy is revealing. When discussing the Fiat brand range of products with Italian institutional investors, we start with the smaller models. Most agree that the Punto is competitive, and that the new Panda should meet its objectives. The Punto-based Idea MPV is well regarded as well. Then we turn to the Stilo. This is either greeted with a derisive laugh or just silence. When we ask why they have reacted in this way, they admit that the Stilo is now seen as something of a joke. We then ask why? Is it so ugly that people are turned off? The answer is no, and when pushed they will even admit that the 3-door is quite handsome. Is it well-built? Yes. Is the Stilo over-priced? Not any more. In the end, we agree that it is more a reaction to the image of the Fiat brand. What it all comes down to is that the Stilo and therefore Fiat brand is no longer seen as a legitimate competitor to the Golf, Megane II, 307, Astra and other cars in the C-segment.

Better Fiat marketing cannot change such attitudes. It took Audi 10 years (and some say it was closer to 20 years) to transform its image

Better Fiat marketing cannot change such prejudices over a short period of time. It took Audi 10 years (and some say it was closer to 20 years) to transform its image. As noted, according to the early press reviews, the Stilo had all the ingredients needed to be a success, and should have certainly done better than the Bravo/Brava it replaced. Stilo's flaw is that it lacks is a brand that makes even the previously loyal Italian buyers of such cars feel good about driving it. If Italians will not buy enough Stilos, preferring instead the Ford Focus, who will?

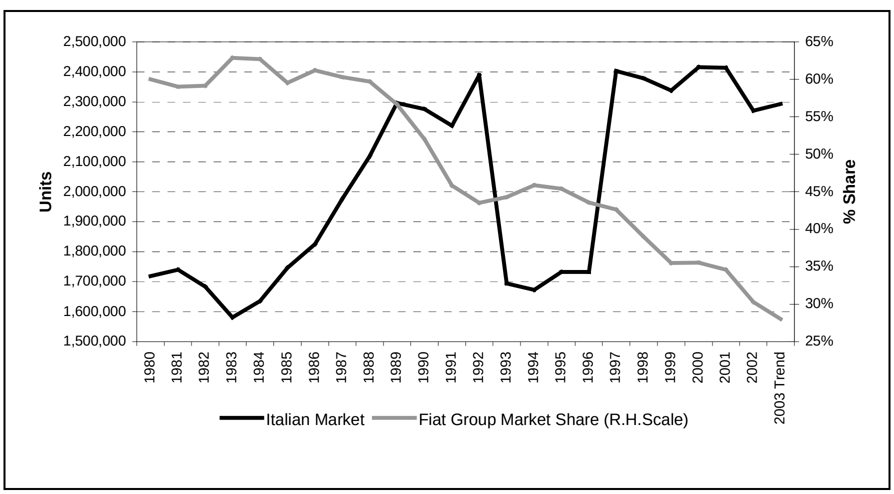
In order for Fiat brand to become economically viable, Fiat must massively expand its dealer presence outside Italy

This raises a further challenge. In order for Fiat brand to become economically viable, Fiat must massively expand its dealer presence outside Italy. 57% of all Fiat brand's European car sales were in Italy in 2002. In order to attract the necessary high quality dealer that it needs, Fiat must present a viable business case through a cohesive product offering. No dealer, particularly outside the Italian market, can survive just selling Pandas and Puntos in volume. He needs a strong contender in the Golf C-segment, where the Stilo has failed, and he naturally also has to be present in the D-segment (Mondeo/Passat). The D-segment Fiat Large, the successor to the long defunct Croma, is due in 2005, but we are not optimistic about its reception. An incentive to offset these gaps might be the offer of the Alfa Romeo franchise as well, but this raise another problem. In order for luxury brands to grow, they need to be distanced from their volume brand siblings. It will not be forgotten by Mr Demel that Audi fought for many years to separate its sales from those of Volkswagen, a brand in significantly better shape than Fiat. Putting Alfa together with Fiat in major European locations would probably severely crimp Alfa's growth prospects.

Fiat Auto Market Share Loss Accelerating – Already Well Behind Latest Plan

Fiat's global registrations fell by 15.4% in 2002. In Italy, which accounts for 58% of Fiat's total European sales and is by far its largest and most profitable market, registrations were down by 17.8%. Fiat blames its attempt to improve the quality of sales via reducing the level of zero kilometre registrations for part of this decline. However, Fiat sales did not bottom out in 2002. During 2003 9M, Fiat Auto registrations deteriorated by a further 8.6% in its domestic market (vs a market increase of 1.1%), and were down by -11.1% globally. The Panda and the revamped Punto should help in the final quarter.

Chart 23: Italian New Car Market

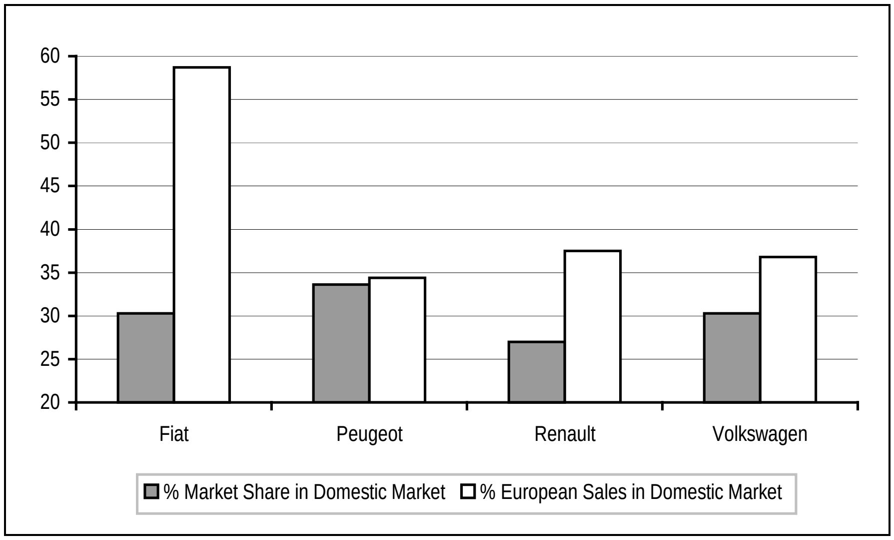


Source: Anfia/Merrill Lynch estimates based on 2003YTD data

Fiat Auto's market share in Italy averaged 35.4% in 2000 FY. This had fallen to 34.6% in 2001 FY and collapsed to 30.3% in 2002 FY. The rout has continued, with 2003 9M market share slipping to 28.0%, with September 2003 alone at 27.2%. This is a long way adrift of the 30.2% full year market share target for 2003 that Fiat announced in its June 2003 Turnaround programme.

Chart 24 shows that considering the share of European sales made in the domestic market, Fiat at 58% has by far the largest exposure.

Chart 24: Domestic Market Sales – 2002



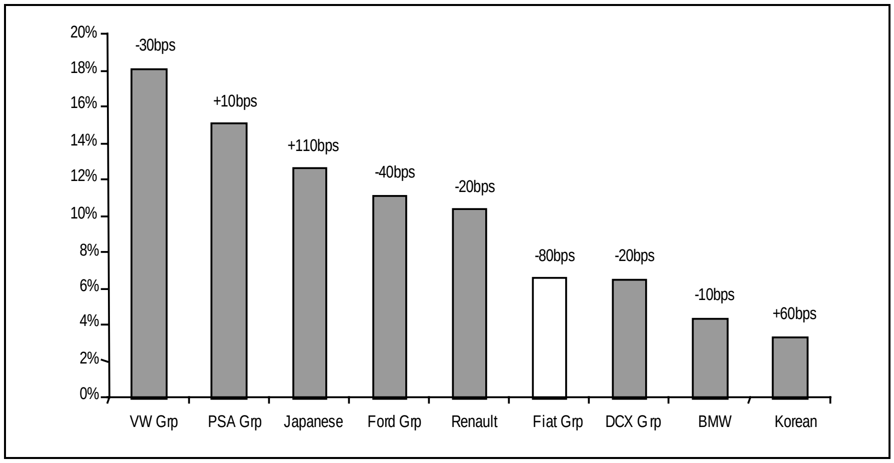
Source: ANFIA, CCFA & KBA

■ B-Segment Under Tremendous Pressure

The new Panda, Idea, Ypsilon and revamped Punto all appear reasonably competitive vehicles in our opinion. What is more, these are underpinned by a comprehensive range of engines, including two new acclaimed multijet JTD diesel units. However, the competition is not standing still. Peugeot-Citroen's recent launches have been focused on the small car segment. The Citroen C3 had become the 4th best-selling car in Italy in 2003 9M with a market share of 4.9%. The Punto's market share in 2003 9M had fallen to 8.3% from 9.5% in 2002 9M. Another Punto competitor, Renault Clio, saw its market share rise over the same period from 3.0% to 3.4%. Renault comes out with its own B-segment MPV in 2004H2. This takes on the Fiat Idea as well as the incumbents such as the Opel Meriva and Ford Fusion.

The heat is intensifying below the Punto as well. Citroen's new C2 small car goes head-to-head with the new Panda in 2003Q4. Other brands that are also making inroads into Fiat's traditional territory include the Japanese and Korean OEMs. The Toyota Yaris, Daewoo Matiz and Nissan Micra have all made a profound impact at the expense of Fiat.

Chart 25: European Market Share by OEM – Year-to-September 2003



Source: ACEA

We believe it is the defection to other brands by those who could once be counted upon as loyal Italian Fiat customers which is Mr Demel's biggest headache. Fiat brand long ago abdicated its position in the D-segment and above – hence the sales success of marques such as Audi, BMW and Mercedes in Italy. We ceased to take notice many years ago when an Italian colleague announced that he or she had just bought an Audi sedan rather than a locally produced product. What is of greater concern is when we see the same colleagues buying the Toyota Yaris or Citroen C3s rather than the Punto as second car or third cars.

Table 5: Fiat Auto Sales 2003 Year-to-September

	Unit Sales			% of Total Sales		Market Share	
MARKETS	**2002**	**2003**	**% Chge**	**2002**	**2003**	**2002**	**2003**
Fiat	391,527	353,539	(9.7%)			22.9%	20.4%
Lancia	74,350	66,015	(11.2%)			4.3%	3.8%
Alfa Romeo	62,427	63,264	1.3%			3.7%	3.7%
ITALY	**528,304**	**482,818**	**(8.6%)**	**40.4%**	**41.5%**	**30.9%**	**27.9%**
GERMANY	77,640	63,838	(17.8%)	5.9%	5.5%	3.2%	2.6%
FRANCE	67,868	53,511	(21.2%)	5.2%	4.6%	4.2%	3.5%
UK	78,579	69,706	(11.3%)	6.0%	6.0%	3.8%	3.4%
SPAIN	38,939	40,923	5.1%	3.0%	3.5%	3.9%	4.0%
Fiat	301,654	251,589	(16.6%)			3.2%	2.7%
Lancia	8,822	9,896	12.2%			0.1%	0.1%
Alfa Romeo	71,248	61,531	(13.6%)			0.8%	0.7%
W.EUR.EX ITALY	**381,724**	**323,016**	**(15.4%)**	**29.2%**	**27.8%**	**4.1%**	**3.5%**
Fiat	693,181	605,128	(12.7%)			6.2%	5.5%
Lancia	83,172	75,911	(8.7%)			0.7%	0.7%
Alfa Romeo	133,675	124,795	(6.6%)			1.2%	1.1%
W. EUROPE	**910,028**	**805,834**	**(11.4%)**	**69.5%**	**69.3%**	**8.2%**	**7.4%**
POLAND	40,780	42,832	5.0%	3.1%	3.7%	17.9%	16.8%
BRAZIL	**238,093**	**199,503**	**(16.2%)**	**18.2%**	**17.2%**	**25.9%**	**24.3%**
ARGENTINA	5,679	8,283	45.9%	0.4%	0.7%	9.8%	12.2%
TURKEY	7,012	11,870	69.3%	0.5%	1.0%	12.9%	10.0%
INDIA	25,866	7,764	(70.0%)	2.0%	0.7%	5.4%	1.3%
CHINA	12,826	28,166	119.6%	1.0%	2.4%	1.4%	1.9%
OTHER	68,315	58,497	(14.4%)	5.2%	5.0%		
TOTAL REGISTRATIONS	**1,308,599**	**1,162,749**	**(11.1%)**				

Source: Fiat

Alfa Romeo Fails to Deliver

While Fiat competes for the title of least appreciated brand in Europe, the group's Alfa Romeo brand remains highly desirable…the problem is that allure turning that into hard sales with the products that are actually available to sell

While Fiat competes for the least appreciated brand in Europe title, the group's Alfa Romeo brand remains highly desirable. This was again underlined by the approval accorded the concept cars that Alfa Romeo exhibited at the Frankfurt Auto Show in September 2003. The problem comes translating that allure into hard sales.

After what appeared to be the successful launch of the Alfa 147 in 2000, Fiat forecast strong growth for this premium division. Actual Alfa Romeo production in 2001 was only marginally ahead of the previous year, and well below the 250,000+ units anticipated. The 2002 total was almost 100,000 units adrift of where Fiat Auto thought Alfa would be. While Alfa's production fell by -12.3% between 2001 and 2002, BMW registered growth of +2.9%.

Table 6: Alfa Romeo Assembly

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003E	2004E	2005E
Alfa 145	21,587	55,870	29,157	45,324	26,357	24,908	17,774					
Alfa 146	211	45,033	38,119	56,718	36,391	30,401	26,422					
Alfa 147	-		-	-	-	-	18,321	107,539	106,594	94,000	86,000	75,000
Alfa 33	30,861		-									
Alfa 155	38,820	33,895	23,135	10,873								
Alfa 156				30,693	109,117	116,918	118,669	88,181	69,781	64,000	55,000	70,000
Alfa GTV		6,113	10,039	6,968	6,371	4,925	2,602	2,407	975	900	900	800
Alfa Spider	55	5,600	6,936	5,078	5,283	4,220	3,505	3,613	1,922	2,500	4,000	3,000
Alfa 166					14,161	26,964	19,543	11,898	8,165	6,000	7,000	6,000
Alfa 164	16,563	10,356	6,414	4,936								
Total	**108,097**	**156,867**	**113,800**	**160,590**	**197,680**	**208,336**	**206,836**	**213,638**	**187,437**	**167,400**	**152,900**	**154,800**

Source: Anfia, Fiat, Merrill Lynch estimates

The image of Alfa Romeo is clearly much better than that of Fiat brand, but even that and the new volume 147 could not prevent Alfa Romeo falling well short of objectives

The image of Alfa Romeo is clearly much better than that of Fiat brand, but even that and the new 147 range could not prevent Alfa Romeo falling well short of objectives. Here we can lay some blame the poor distribution network outside Italy, and the absence from the US market. What is clear is that it will take many years for Alfa Romeo to get close to fulfilling its potential. We repeat that selling Alfa Romeos alongside Fiats to provide a non-Italian dealer with adequate segment spread is not going to advance the cause of the brand and create a base for sustained sales' growth, in our view.

Cost Reduction Plan

Fiat's cost reduction plan envisages saving EUR3.1bn over the four years to 2006. The bulk of the savings are meant to come from Fiat Auto (EUR2.2bn) with the remainder spread between CNH, Iveco and the component businesses. There are three main areas for saving:

- Material and Components cost savings of EUR2.0bn
- Other Production Costs providing EUR0.7bn benefit
- Lower Variable Commercial costs of EUR0.4bn

Fiat plans to reduce the level of Materials and Components as a percentage of revenues from 42.7% of 2002 revenue to 39% of 2006 revenue. In 2002, the 42.7% ratio equated to EUR21bn of Group revenues, excluding the now divested Fiat Avio and Toro divisions. The EUR2bn reduction to EUR19bn implies 2006 Group revenues of EUR48.7bn as compared to our 2004E forecast of EUR45.3bn. The EUR2.0bn total is broken down further:

- Cross sector teams EUR0.2bn
- Global sourcing EUR0.4bn

Refer to important disclosures on pages 50 to 51.

- Improvement of supplier processes EUR0.2bn
- GM synergies (see below) EUR0.3bn
- Suppliers' co-design/co-development EUR0.3bn
- Technical efficiencies EUR0.6bn

In our opinion, some of the cost saving targets appear reasonable, but we question whether they will be enough to turn around the business.

State of Crisis

Multiple production sites for individual models and low demand meant that excess capacity stood at 800,000 units in 2001, leading to a crippling 61% utilisation rate. This improved to 66% in 2002 with the closure of the Rivalta plant.

Fiat began negotiating with the government at the end of October 2002 to obtain recognition of a "state of crisis" at Fiat Auto and other affected Fiat Group Companies. The plan included a number of measures to revitalize and develop the company, including immediate implementation of a special plan to reduce operating and overhead costs. Fiat Group requested that Special Temporary Layoff Benefits (Cassa Integrazione a Zero Ore) be made available for a period of twelve months starting 2 December 2002. These benefits covered 5,551 employees (4,941 at Fiat Auto, 290 at Comau, and 320 at Magneti Marelli), with another 2,057 to be covered starting 30 June 2003 (1,717 at Fiat Auto and 340 at Comau).

These layoffs were time-limited to 12 months, but could theoretically be rolled over on an annual basis depending on the manning needs of Auto. As a rule of thumb, the government pays 95% of the workers salary during the layoff period. A further 500 non-Auto workers were to be laid off permanently under an early retirement program. The expected total cost savings was put at around EUR300mn per annum.

Fiat received government approval for the State of Crisis in December 2002. It was understood that a large proportion of these workers would be re-hired in 2003Q4, when Fiat could put them to good use to meet the demand for the face-lifted Punto. Indeed, Punto production was restarted at the end of August 2003 at the Termini Imerese plant, which Fiat had originally planned to close. The State of Crisis ends this month, and so a large part of those laid off workers who remain on Fiat's payroll, will return to work.

Further Cuts from the Restructuring Plan

The June 2003 restructuring plan set out a new target of laying-off 12,300 workers across the entire group. Only 2,800 positions related to Italy, where the over-capacity problem is most acute. Fiat also envisaged 1,600 new hires in Italy and 3,800 new hires in the rest of the world over this period, mainly in R&D and marketing, the sales network and back office functions. Perhaps partly as a consequence, Fiat Auto's original target of reaching 78% capacity utilisation was put back to 2006. Even if Fiat Auto overachieves to the low 80s, it can only really expect low single digit operating margins. The truck business in Italy is also suffering from low capacity utilisation of around 60%, rising to only 67% in 2006.

Table 7: Fiat Group Employee Movements

	1999	2000	2001	2002	2003H1
Fiat Employees @ Jan 1	220,549	221,319	223,953	198,764	186,492
Net Additions/Reductions	**(7,730)**	**(6,166)**	**(7,789)**	**(7,972)**	**(3,051)**
Outsourcing	(5,000)	(3,900)	(1,900)	(400)	0
Changes in Scope of Consolidation	13,500	12,700	(15,500)	(3,900)	(9,300)
Fiat Employees @ Dec 31	**221,319**	**223,953**	**198,764**	**186,492**	**174,141***

NOTE * As at end of 2003H1. Source: Fiat

Table 8: Fiat Auto Production Capacity

Plants	Capacity	Models
Italy		
Cassino	325,000	Stilo
Melfi	450,000	Punto
Mirafiori	375,000	Punto, Idea
Pomigliano	250,000	Alfa Romeo
Termini Imerese	150,000	Punto
Total Italian Production	**1,550,000**	
Poland		
Tychy	250,000	Panda, Palio
Bielsko Biala	50,000	Palio
Brazil		
Belo Horizonte	550,000	Palio
India		
Kurla	80,000	Uno
Total Capacity	**2,480,000**	

Source: Merrill Lynch estimates

Fiat/General Motors Alliance

Fiat announced its strategic alliance with General Motors on 14 March 2000. The alliance was cemented with a share exchange in July 2000, with GM acquiring a 20% stake in the newly constituted Fiat Auto Holding entity (which includes the Fiat, Alfa Romeo and Lancia brands, but not Ferrari and Maserati) in exchange for US$2.4bn which translated into 32mn GM shares (now 5.6% of GM after its subsequent buy-back). Fiat sold its GM stake on 20 December 2002 for EUR1.16bn to reduce its spiralling net debt position.

As part of the deal, Fiat Group negotiated a put option, originally exercisable between 2004 and 2009, requiring GM to buy its remaining 80% stake for "fair market value" as determined by four investment banks. Additionally, Fiat Group may sell its 80% interest at any time after one year from the completed deal, with GM having the right of first offer but not first refusal.

■ Reasoning Behind the Put

After 36 years at GE, of which the last 12 years were spent heading GE's international operations, Mr Paolo Fresco, Fiat's Chairman 1998-2002, had concluded that Fiat as the sixth largest global carmaker had little chance of moving into the premier rankings. Mr Fresco subscribed to the GE ethos that to be successful you needed to be number one or two in your industry. Moreover, Fiat's iconic status in Italy made it extremely difficult to undertake the sort of deep operational streamlining that some of its European peers had carried out. Short of selling out of Fiat Auto entirely, and as there were powerful forces who opposed this, an alliance with GM seemed an ideal compromise. The alliance would provide the economies of scale of a number one ranking automaker while retaining independence, with a viable exit strategy if required.

As Mr Fresco told *Barrons* on 2 April 2001 "*We could have got rid of cars, though I admit it would have been difficult. And yes, the alliance does offer a parachute. But you can't get out of bed with a partner who is five times bigger than you are without having an exit strategy because, the more successful the alliance, the more interdependent you become. If the alliance is as successful as I suspect and, 10 years out, the shareholders of this company decided they don't want to be in cars, they would have no buyer other than GM. So you need a formula that will fix the right price*".

GM was attracted to Fiat Auto by the prospect of economies of scale with its own Opel/Vauxhall operations in Europe and with its strong market shares in emerging

Refer to important disclosures on pages 50 to 51.

markets such as Brazil, Poland and Turkey. It also fast-tracked GM's access to advanced common rail diesel engine technology, which had been a competitive weakness of GM as demand for diesel-engined vehicles soared. Ford had also been at a competitive disadvantage over diesels in Europe, and subsequently set up a joint venture with Peugeot group to provide a new series of high-pressure direct-injection (Hdi) diesel engines from 2001.

Economies of scale and share development were major attractions to Fiat Auto. In powertrains, Fiat has already cancelled plans to build a new family of V-6 gasoline engines, and now it had access to GM's range. Fiat also announced plans for the Alfa Romeo brand to return to the US in 2005. It would use its access to GM's vast technology and distribution resources to ensure that these vehicles met US demands.

Alliance Synergy Benefits

One of the few successes for Fiat Auto in recent years has been the joint ventures set up with GM. Fiat Auto and GM's European and Latin American powertrain and purchasing operations were combined in two joint ventures leveraging scale. Further synergies are gained through financial services and R&D. The synergy gains have exceeded all targets since the first full year in 2001 and Fiat's share is forecast at a cumulative EUR600mn for 2003E against the original target of EUR580mn. This is anticipated to rise to EUR1.05bn in 2006.

Purchasing

Purchasing is the key driver in the GM-Alliance

Purchasing is the key driver in the GM-Alliance as the cost base is extended across 4.5mn vehicles compared to Fiat's current 1.8mn annual European production capacity. Of the EUR1.05bn synergy target for 2006 around 70% is likely to be derived in this area. Benefits from the use of common components did not materialise until 2003.

Powertrain

Total cumulated saving between 2001 and 2007 is expected to almost double

Under the powertrain rationalisation plan, the number of engine and transmission product families has been substantially reduced (see table). After less than a year into the joint venture, additional opportunities for convergence and synergies beyond that of the initial agreement were identified. The total cumulative saving between 2001 and 2007 are expected to be almost double the EUR950mn originally forecast.

Table 9: Engine and Transmission Convergence from 2001

Type	Fiat Families	GM Families	Current Total	Fiat-GM Alliance
Gasoline Engines	8	6	**14**	**8**
Diesel Engines	3	3	**6**	**3**
Transmission	5	7	**12**	**7**

Note: GM relates to Europe and Latin America only.
Source: Fiat.

Platform Sharing

In 2002 Fiat-Alfa had 13 platforms in production, of which only one was shared with GM. As per Fiat's restructuring plan the total number of platforms is expected to increase to 14 by 2006 with only seven carried over from 2002 and the remaining seven new platforms shared with GM. During 2008-2012 period, this is expected to shrink to eight platforms in total, and all will be shared. The benefit in terms of lower development costs is anticipated at between 20%-35% per vehicle and a 12% saving on retooling costs.

Delaying the Put Option

In statements to securities regulators, GM has said the put could be *"rendered unenforceable by reason of actions Fiat may have taken."* General Motors has alleged that the sale of certain assets of the financing business of Fiat Auto (the sale of 51% of Fidis to a consortium of banks in March, 2003) and the capital increase of Fiat Auto Holdings, carried out by Fiat, constitute breaches of the Master Agreement entitling General Motors to terminate the Master Agreement and with it the put option.

Fiat's official position remains that both of these transactions were wholly proper and did not violate the Master Agreement or any of General Motors' rights. Fiat regards the put option as effective and exercisable in accordance with the provisions of the Master Agreement.

GM remains publicly conciliatory. It says that the agreement has not changed, but stresses that the ideal solution would be for Fiat Auto to fix itself and not seek a buyer. *"There is an answer here,"* GM's Chief Financial Officer Mr John Devine said in September 2003 at the Frankfurt Auto Show. *"It is for Fiat to turn around their car business."* It is worth noting that the GM-Fiat partnership continues to thrive at the industrial joint-venture level with the two JVs being extremely beneficial to both parties.

In an interview given by in Corriere della Sera on 10 October 2003, Mr Morchio stated *"The put (option) is a right that we have, but we don't have an intention to exercise it. The (relationship) we have with GM is, first of all, an industrial alliance. It is an alliance which works, an alliance made of the things we make together. Their (GM) participation in Fiat Auto recapitalization is not a priority. GM's contribution is not taken into account in our industrial and financial plan. Of course, if they would subscribe (their part), we would be happy."*

The window within which the Put can be exercised has been delayed by one year to start in January 2005

On 26 October 2003, Fiat and GM jointly announced that both parties had agreed to shift the put period by one year. The Master Agreement signed in 2000 originally set the operational period of the put from 24 January 2004 to 24 July 2009. This has now shifted to 24 January 2005 to 24 July 2010. Both parties also agreed not to initiate legal proceedings relating to the Master Agreement until 15 December 2004, while preserving their respective rights. General Motors and Fiat repeated that the joint ventures between Fiat Auto and General Motors are working well, generating synergies, and that both parties would like to see expanded cooperation. They continued that *The Amendment and the Standstill Agreements have been executed in the context of ongoing discussions between Fiat and General Motors regarding the re-defining of the structure of the strategic alliance in order to permit their industrial cooperation to continue constructively and resolve both parties' concerns.*

The latest twist to this saga occurred on 31October 2003. During the analysts' conference call following the release of the 2003Q3 results, Mr Morchio appeared to suggest that that Fiat might offer GM a deal to annul the put option. Asked whether Fiat might accept a cash offer to kill the put, Mr Morchio replied *The point is, the put has a value... we are open to discuss alternative solutions.*

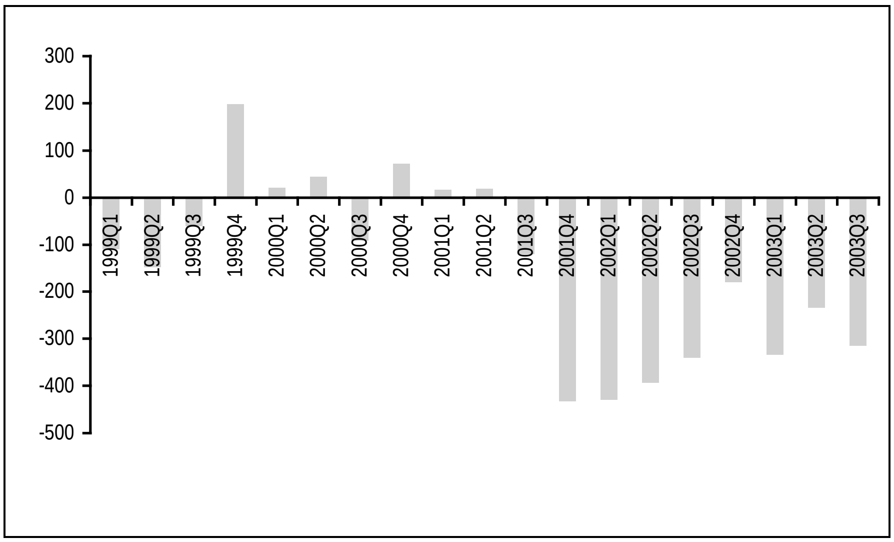
Refer to important disclosures on pages 50 to 51.

Outlook – 2003Q3 Results

According to Fiat's 2003 Q3 release from 31 October 2003, *the performance of the Fiat Group in the third quarter of 2003, in addition to being affected by unfavourable seasonal factors, reflect the challenges of a difficult transition period...Fiat Auto, in particular, was adversely affected in two key segments as customers deferred buying decisions ahead of the introduction of new models.*

Revenues in the Automotive division declined by 10.9% to EUR4.16bn in 2003Q3, while the operating loss fell slightly from EUR340mn in 2002Q3 to EUR314mn in 2003Q3. Cost savings of EUR173mn were achieved, of which materials and components accounted for EUR76mn, other costs EUR68mn, and overhead EUR29mn. Volume (-6.8%) mix and others were a combined negative EUR75mn, for a pro-forma loss of EUR254mn. Foreign exchange losses and the change in scope of consolidation (primarily the sale of Fidis) accounted for a further negative EUR60mn, explaining the EUR314mn loss.

Chart 26: Fiat Auto Quarterly Operating Result (EURmn)



Source: Fiat Accounts, Merrill Lynch

The recently launched/facelifted models will have their first full quarter sales in 2003Q4. Fiat says that these models have been well received, and it has good orders which will translate into sales this quarter. Combined with an element of inventory rebuild, we anticipate that Fiat Auto's losses will be substantially down on the previous three quarters, and may well end up approaching zero. The acid test comes in 2004Q1, the weakest quarter of the last two years. It is then that we will probably be able to make the first realistic assessment of how the restructuring is going.

3. CNH Global

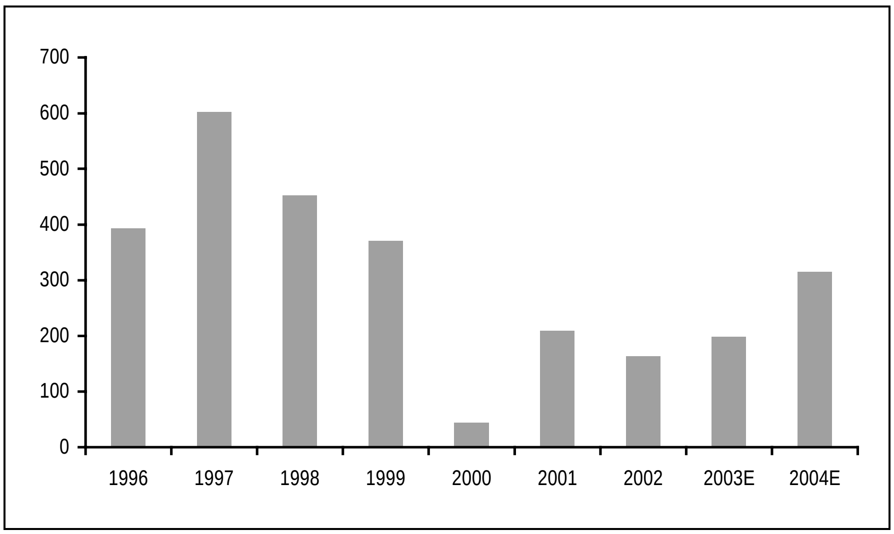
CNH Global (85.8% owned by Fiat) is covered by Steve Haggerty (+1 212 449 0175).

The economic and cyclical agricultural downturn in the US and the agricultural crises in Europe caused by the BSE and Foot & Mouth outbreaks, have clearly hurt the fledgling new group since its inception in 1999. Competitors have also not hesitated to attack CNH, as they correctly reasoned that CNH would be more focussed on integration issues than on defending its own market shares. However, CNH has been able to regain its market share with a strong new product line-up in 2002/03. CNH has put into effect programmes that will save hundreds of millions of dollars. CNH's North American agricultural equipment and construction equipment segments are experiencing a moderate recovery. CNH's profitability continues to be negatively impacted by Agricultural Equipment division's launches in Europe and high fixed costs in the construction equipment manufacturing operations in Europe. Increased healthcare and pension costs are a further burden adding a further US$90mn of annual costs from 2003 onwards.

CNH merger process complete

The CNH merger was completed in 1999, after Fiat combined its New Holland business with Case Corp. The combination created the joint global leading agricultural equipment supplier with Deere & Co, in a global market worth US$50bn in 2002. CNH is also the third largest construction equipment supplier behind Caterpillar and Komatsu in a global market worth US$60bn in 2002.

Chart 27: CNH Annual Operating Result (EURmn)



Source: Fiat, Merrill Lynch estimates

With the benefit of hindsight, it is hard to imagine worse timing for Fiat's purchase of Case

With the benefit of hindsight, it is hard to imagine worse timing for Fiat's purchase of Case to form Case New Holland (CNH). The total consideration for Case was US$4.3bn cash, and the assumption of US$300mn of debt. Fiat subsequently merged its own New Holland division's assets into the business.

CNH encountered a tough first year of life in 2000 and turned in a net loss of US$134mn. Divestitures imposed by the EU Commission caused major difficulties as the agricultural sector entered a downturn. Uncertainty and a significant loss of dealer confidence over whether CNH would continue with its multi-brand strategy combined with aggressive behaviour from its competitors caused a loss in market share. CNH insists this has now been resolved with a commitment to a multi-brand strategy, and multiple distribution channels. It is also rapidly introducing superior substitute products, which were temporarily lost through the imposed divestitures.

Refer to important disclosures on pages 50 to 51.

After slumping to an all time low of US$5.95 in March 2003, the CNH share price has recovered to close to US$13.7, giving the group a market capitalisation of US$1.8bn. Fiat Group holds 85.8% of CNH, which is now worth around US$1.5bn.

Recent Offering

In June 2002, CNH completed a secondary offering of 50mn shares at US$4. Simultaneously, it issued 325mn shares to Fiat Group in exchange for US$1.3bn in debt. The effect of the transaction was to reduce CNH's debt-to-capital ratio from 75% before the deal (excluding inter-segment debt) to 54% pro-forma post the deal. The related reduction in interest expense amounts to US$0.14 annually in EPS. Due to the debt for equity swap, Fiat Group's ownership increased from 84.6% to 85.8%.

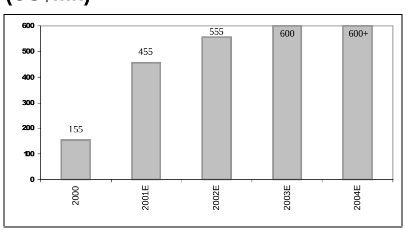
CNH has subsequently had additional transactions. A recapitalisation with a $2bn contingent convertible in early March (reverse split was part of that transaction) and a $1bn private offering that improved the term structure of their debt.

In April 2003, CNH undertook a 5:1 share consolidation, which reduced the shares in issue to 131.1mn.

Synergy Benefits

CNH's original four-year plan was designed to generate synergies in excess of US$600mn by 2003. This was subsequently revised with a new target of EUR850mn by 2005 and involves combining areas of overlap such as in purchasing, R&D and sales. As at the end of 2003H1, CNH had achieved US$606mn, with US$59mn generated in 2003H1. The aim is to achieve an additional US$100mn in 2003 to offset the increased healthcare and pension costs of EUR90mn in 2003.

Chart 28: Cumulative Synergies (US$mn)



Source: CNH

The workforce has been reduced from 36,000 to 28,523 at the end of 2002. The number of plants has been cut by around 25% from the initial 46 and 14 of the 45 distribution depots have been closed. The total number of suppliers should more than halve from 6,600 in 1999 to an anticipated 3,000 by 2004.

The final stage in the restructuring process is to reduce the number of Case and New Holland product platforms to 60 from the present level of 100. Synergies of US$155mn were already realised in 2000, and stood at US$547 at the end of 2002.

Operating Forecasts

Fiat provided no operating targets for CNH in its restructuring plan although it is clear that CNH plays a large part in achieving the 2006 target of a 4.1% operating margin. Our forecasts below are based on the breakdown that Fiat provides in its own accounts adjusted for Fiat's accounting policies. Our forecast of a 4.8% operating margin in 2006E is still some way below CNH's own 8% average cycle operating margin objective.

Table 10: CNH Global Forecasts

Year End December (EURmn)	1997	1998	1999	2000	2001	2002	2003E	2004E	2005E	2006E
Revenues	5,284	5,126	5,246	10,770	10,777	10,513	9,250	9,543	10,346	10,894
Operating Income	602	452	371	45	209	163	198	315	408	525
Operating Margin (%)	11.4%	8.8%	7.1%	0.4%	1.9%	1.6%	2.1%	3.3%	3.9%	4.8%

Source: Fiat, Merrill Lynch estimates

Agricultural Equipment

Agricultural equipment, which accounts for over 60% of CNH revenues, is clearly a cyclical business with the major drivers including population growth, diet habits, mechanisation of farming practices, the number and size of farms and more significantly agricultural commodity prices. In 2003H1 North American industry sales surged by 17%, in Europe there was a decline of 2%, Latin America was up by 4% and the rest of the world registered a 12% increase.

In its monthly World Agricultural Supply and Demand Estimates (WASDE) published in October 2003, the US Department of Agriculture (USDA) forecasts 2003/2004 corn crop to be an all time high of 10.2bn bushels (bu). The USDA lowered its forecast price range for corn. Corn production is higher and the price of corn is lower than we were expecting. However, the USDA also cut its forecast of soybean production to lower than expected level of 2.47bn bu. and significantly raised its forecast price range. We estimate that changes in estimates for corn and soybeans cancel each other in terms of their impact on the Farm Cash Receipts outlook.

■ Corn Production

The USDA raised its forecast for U.S. corn production for the 2003/2004 season to a record high of 10,207mn bu., up 2.6% from August estimate of 9,944mn bu. The new forecast represents a 13.3% increase over the last year's crop. The markets were expecting the USDA to raise its production estimate to a range of 10,000-10,100mn bu. The USDA raised its world production forecast by 0.2% to 23,974mn bu.

■ Corn Demand

The USDA raised its forecast of 2003/2004 demand for US corn. The demand for US corn is now forecast at 9,950mn bu., up 417mn bu. or 4.4% from a year ago. The USDA slightly raised its forecast of global corn usage in 2003/2004 by 125mn bu. to 27,792mn bu.

■ Corn End Stocks to Use Ratio (ESUR)

The higher production forecast for 2003/2004 impacted U.S. ESUR. The ESUR is now 13.6%, up meaningfully from a previous estimate of 10.7%. ESUR ratio is now back in-line with where it was earlier in the summer. The U.S. ESUR outlook for corn remains low by historical standards, providing the base for reasonable corn prices in 2003.

■ Price

The USDA lowered its price estimate for corn in the 2003/2004 crop year by $0.20 to a range of $1.90-$2.30.

■ Soybeans

USDA lowered its soybean production forecast to 2.47bn bu. from 2.64bn bu. a month ago. This is below the market expectation of 2.56bn bu. The USDA raised its price forecast for soybeans to a range of $6.05-$6.95/bu., compared with $5.25-$6.15 a month ago.

■ Outlook

Going into 2003Q4, CNH's global agricultural outlook is unchanged from its June forecast with global market sales expected to be up slightly. CNH expects sales of tractors to remain flat in Europe while sales of combines are expected to decrease. The prolonged period of hot weather may have a negative impact and in general the company is more and more pessimistic about the European outlook and optimistic about North American.

In North America the combination of a record corn crop and reasonable prices should provide the basis for rising farm cash receipts in 2003. High soybean and livestock prices also continue to support rising farm cash receipts. This should continue to support higher US agricultural equipment sales for CNH in the second half of 2003 and 2004.

Recent agricultural equipment market share gains in North America reflect new product introductions. Replacement products for products sold after the CNH merger in the >100HP segment are boosting share in that segment and a new rotor combine from New Holland is lifting share in that segment.

Construction Equipment

We expect 2003 to be another tough year for CE

Construction equipment made up just under 30% of CNH revenues in 2002. The division slipped into the red in 2002 with an operating loss of US$75mn.

North America remains the division's largest region with 46% of revenues followed closely by Europe with 40% in 2002. In 2003H1, industry sales of construction equipment were down by 1% in Europe, down 2% in North America, down 17% in Latin America and up by 28% in the rest of the world.

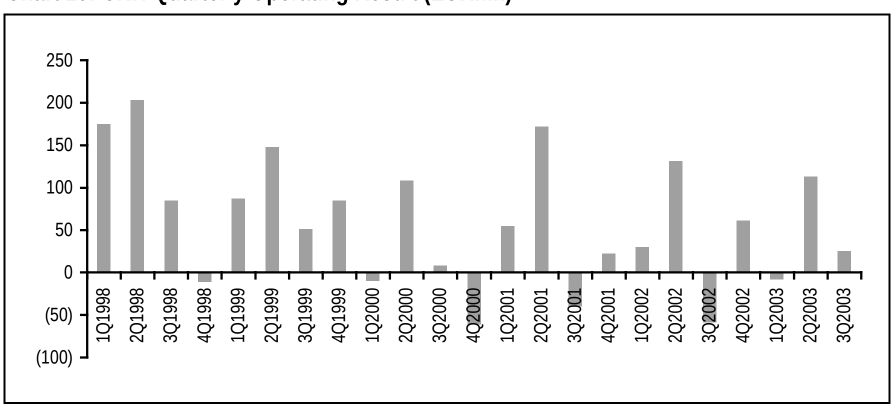
In 2003H1 CNH launched several new models at the Intermat Fair in Paris. Of the 96 products exhibited by different CNH brands, 42 were new products. This is most pronounced in North America where Case has a series of new model introductions replacing the old H series and the first compact excavators. In 2004 81% of products sold will be new and on common platforms. This compares to 15% in 2001 and 61% anticipated in 2003.

In terms of outlook, CNH anticipates that industry sales in Europe of heavy construction equipment will be down and remain flat in North America. The economic environment in Latin America is not conducive to improved infrastructure spending which will negatively impact the division in 2003H2.

2003Q3 Results Analysis

CNH reported a 2003 Q3 loss of $0.11 per share. This quarter's result compares with a loss of $0.45 per share reported a year ago. CNH's 2003 Q3 GAAP EPS was a loss of $0.27.

Chart 29: CNH Quarterly Operating Result (EURmn)



Source: Fiat, Merrill Lynch estimates

It was a mixed quarter for CNH. CNH's top-line is benefiting from improving end markets, particularly large agricultural equipment demand in North America. CNH showed operating improvement versus a year ago, but it appears the company's operating performance in its Agricultural and Construction Equipment divisions is being held back by operating issues, primarily in its European operations.

Table 11: CNH 3Q:03 versus 3Q:02 Performance Summary

	3Q:03	3Q:02	Change
Revenue (USDmn)	2,355	2,099	12.2%
Gross Margin	14.5%	14.2%	0.3%
R&D	2.6%	3.7%	-1.0%
SG&A	8.8%	11.1%	-2.2%
Operating Margin	3.1%	-0.5%	3.5%
Net Operating Income	(15)	(58)	43
Operating EPS	$(0.11)	$(0.45)	$0.34

Source: Company reports, Merrill Lynch estimates

CNH reported strong revenue growth of 12% in the quarter, as the company gained market share in the recovering North American agricultural equipment market.

CNH's profitability in the quarter was negatively impacted by Agricultural Equipment division product launches in Europe, and high fixed costs in the Construction Equipment manufacturing operations in Europe.

CNH's operations still appear to be a "work-in-progress". We believe that the company's outlook for the fourth quarter is conservative and that CNH will meet its stated financial goals. However, it also appears that the company's full operating leverage is not there yet, as it continues to restructure and introduce new products.

■ Good Revenue Growth

Table 12: CNH 3Q:03 Sources of Revenue Growth by Division

	Volume	Currency	Pricing	Total
Agriculture Equipment	9.2%	7.6%	1.0%	17.8%
Construction Equipment	-8.7%	6.6%	2.2%	0.1%
Total	3.5%	7.2%	1.4%	12.2%

Source: Company reports, Merrill Lynch estimates

CNH's revenues rose 12% in the quarter. We estimate that net of currency and pricing, revenue increased 3.5% in the quarter.

We expect CNH to continue to deliver strong revenue growth going into the fourth quarter as the North American markets for agricultural and construction equipment continue to improve.

Agricultural Equipment

Agricultural Equipment division revenues were 17.8% higher than a year ago, we estimate volumes rose a robust 9.2%, and were the main contributor to the overall increase. The growth in Agricultural Equipment revenues was driven by improvements in North America. A strong new agricultural product line up in North America is paying off for CNH. We estimate that CNH's North American agricultural revenues grew over 25% in the third quarter and accounted for almost all of the volume growth in the Agricultural Equipment division.

CNH noted that its Agricultural Equipment revenues in Europe held up relatively well in the quarter, despite a drought there.

The company mentioned the possibility of relatively higher production volumes in the fourth quarter to meet rising demand in North America. Furthermore, we expect that the East Moline facility will have higher production volumes in the quarter to ensure an adequate North American inventory of combines as this facility is closed sometime in 2004.

Refer to important disclosures on pages 50 to 51.

Construction Equipment

Construction Equipment division revenues were flat in the quarter. We estimate that volumes declined by 8.7% in the quarter. Weak volume growth in the quarter is a combination of weak markets in Western Europe and under-production, particularly in the improving North American light construction equipment market.

For example, CNH has been under-producing backhoe loaders at its Burlington, IA facility and not taking a full advantage of the rising demand in the North American market.

■ Europe Limits Operating Leverage

CNH posted improved operating results from a year ago. However, the operating performance was weaker than we would expect given the healthy revenue growth in the quarter.

Agricultural Equipment Operating Performance

CNH reported that the Agricultural Equipment division operating profit margin rose to 4.2%, up from 2.5% reported a year ago. The division's profitability improvement is primarily driven by higher volumes in its North American manufacturing operations. However, the profitability improvement was less than we would expect given robust volume growth. We calculate that Agricultural Equipment operations earned only a 13% incremental margin in the quarter.

Agricultural Equipment profitability in the quarter was negatively impacted by the new product launch costs in Europe. These higher costs will persist into the fourth quarter, limiting the Agricultural Equipment division's leverage to increased volumes in North American agricultural equipment sales.

Table 13: CNH Operating Improvements

	Y/Y Change ($USmn)		Imputed
	Volume	Operating Profit	Incremental Margin (%)
Agricultural Equipment	255	35	14%
Construction Equipment	1	47	4700%

Source: Company reports, Merrill Lynch estimates

Construction Equipment Operating Performance

Most of the operating profit improvement in the quarter came from the Construction Equipment division despite the fact that the division's reported revenues remained essentially flat versus a year ago, and that the product mix was unfavorable versus a year ago in North America.

We estimate that most of the improvement took place in the North American operations, as the European operations continue to be impacted by what the management referred to as a "complex" industrial footprint in Europe.

■ Cash Flow

CNH's free cash flow (cash flow from operations minus capex) in the quarter was a use of cash of $8mn, down from being a source of cash of $170mn in the third quarter a year ago. The deterioration in free cash flow generation this year reflects working capital uses to support rising production volumes in the face of relatively low levels of working capital at the end of 2002.

Table 14: CNH Free Cash Flow* Generation Relative to Peers

	YTD Free Cash Flow ($USmn)		
	2003	2002	YTD Revenue Growth
CNH	(237)	53	6.7%
Caterpillar	452	418	10.1%
Deere	314	355	13.9%

Source: Company reports, Merrill Lynch estimates
Note: *Free Cash Flow = Operating Cash Flow from Manufacturing Operations Less Capex

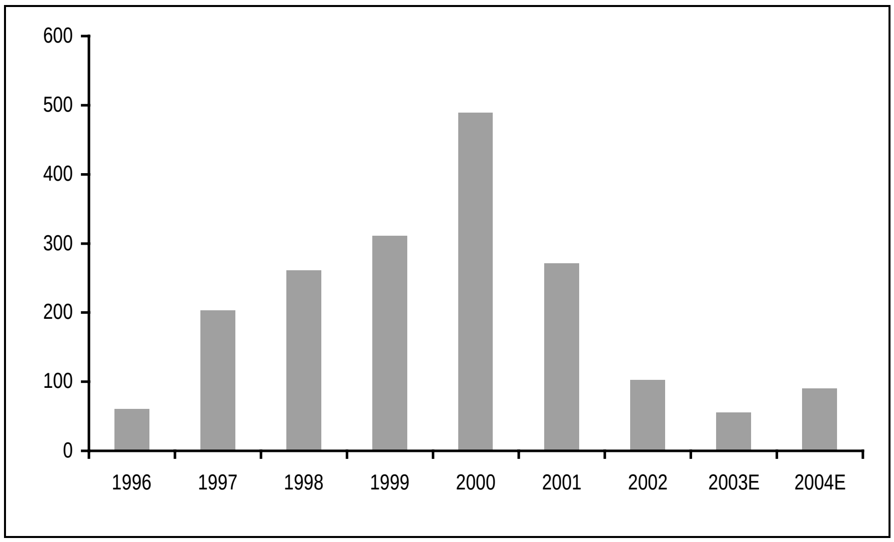
On a relative basis, CNH's working capital management year-to-date lags that of its peers. Both Deere and Caterpillar have been able to maintain cash flow generation roughly similar to that of a year ago, despite strong revenue growth. We think that free cash flow performance this year reflects a relatively weak operating performance for CNH in Europe.

Refer to important disclosures on pages 50 to 51.

4. Iveco

Wholly-owned Iveco was the best performing division in Fiat Group during 2000 with adjusted operating income of EUR401mn for a 4.6% margin. This contrasted with the miserable performance of Auto (EUR44mn) and CNH (EUR45mn). This was not to last. Iveco's performance subsequently deteriorated to a point where it barely broke even in 2003Q1 with a EUR2mn operating profit, made a small positive result in 2003Q2 and was marginally loss making in 2003Q3. We anticipate Iveco will achieve a EUR55mn operating profit for the full year which translates into a 0.6% operating margin. Like Auto, Iveco has suffered from the downturn in demand in Italy, but unlike Auto, it has managed to keep its Italian market share constant at around 40%. The sale of Fraikin, its French truck leasing business helped reduce the Groups net financial position by EUR400mn but has resulted in around EUR40mn lower operating profits in 2003E.

Chart 30: Iveco Operating Profit Progression (EURmn)



Source: Fiat, Merrill Lynch estimates

Table 15: Iveco Geographical Breakdown of Unit Sales

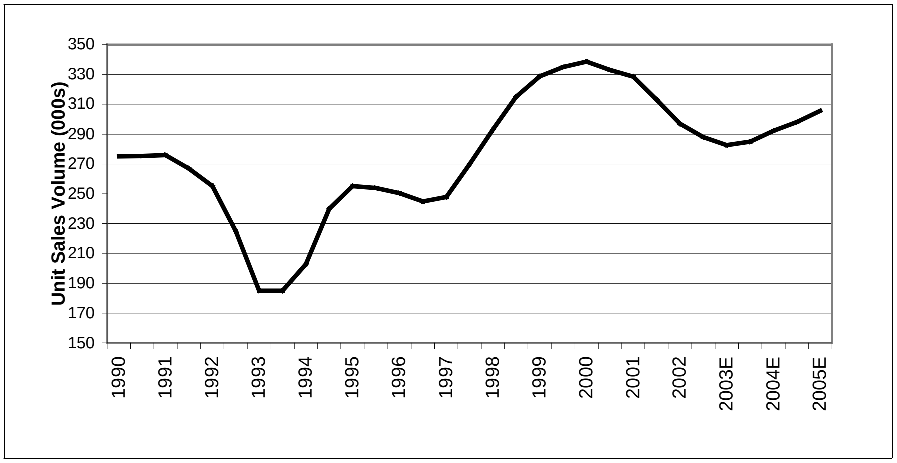
EURmn	2000	% Shr.	2001	% Shr.	% Chg.	2002H1	% Shr	2002	% Shr.	% Chg.	2003H1	% Shr.	% Chg.
France	23,100	14.0%	22,900	14.3%	(0.9%)	9,000	12.0%	17,600	10.9%	(23.1%)	9,400	12.7%	4.4%
Germany	18,400	11.2%	16,300	10.2%	(11.4%)	6,800	9.1%	15,000	9.3%	(8.0%)	7,000	9.5%	2.9%
Great Britain	13,100	7.9%	15,400	9.6%	17.6%	6,300	8.4%	16,200	10.0%	5.2%	6,500	8.8%	3.2%
Italy	45,800	27.8%	39,300	24.5%	(14.2%)	20,800	27.8%	44,300	27.4%	12.7%	19,000	25.7%	(8.7%)
Spain	15,800	9.6%	15,200	9.5%	(3.8%)	8,000	10.7%	14,700	9.1%	(3.3%)	7,800	10.6%	(2.5%)
Western Europe	130,900	79.4%	128,400	80.0%	(1.9%)	62,000	82.9%	128,800	79.6%	0.3%	60,600	82.0%	(2.3%)
Other Markets	33,900	20.6%	32,000	20.0%	(5.6%)	12,800	17.1%	33,100	20.4%	3.4%	13,300	18.0%	3.9%
Total Market	**164,800**		**160,400**	**168.0%**	**(2.7%)**	**74,800**		**161,900**		**0.9%**	**73,900**		**(1.2%)**

Source: Fiat

West European Demand

Demand for commercial vehicles in Europe peaked in 2000 after three years of strong growth. This has gradually declined and we anticipate the bottom to be plumbed in 2003, followed by modest growth of 3.5% in 2004E. Manufacturers have been plagued over the last three years by weak demand, overcapacity, and intense price competition. Following the 2003Q3 results, a more positive outlook has been the consensus among the major European truck companies, most notably Scania who are usually very conservative. *"...Economic growth in Scania's main* *markets in western Europe was weak but is expected to improve somewhat next year. Earnings for the rest of 2003 is expected to remain at a satisfactory level,"* Scania CEO, Mr Östling concluded.

hart 31: West European Truck Sales (>6 Tonnes)



ource: JD Power-LMC, Merrill Lynch estimates

■ Light Commercial Vehicles

Light commercial vehicles account for 55% of Iveco's unit sales. The highly successful Daily van was launched in June 1999, and awarded Van of the Year 2000, and is still the joint market leader (18%) in Europe competing alongside the Mercedes Benz Sprinter in 3.5 to 6 tonne segment. The introduction of a new 2.3l HPI Unijet engine in 2003 should help the Daily retain this position.

Table 16: Iveco Truck Unit Sales

By GVW	2001	% Shr.	% Chg.	2002	% Shr.	% Chg.	2003E	% Shr.	% Chg.	2004E	% Shr.	% Chg.
Light (2,8 - 6,0 t.)	96,200	60.0%	(1.3%)	91,600	56.6%	(4.8%)	89,000	55.9%	(2.8%)	86,250	54.1%	(3.1%)
Medium (6,1 - 15,99 t.)	24,000	15.0%	(3.6%)	24,600	15.2%	2.5%	24,250	15.2%	(1.4%)	25,700	16.1%	6.0%
Heavy (>16 t.)	31,600	19.7%	(4.2%)	31,600	19.5%	0.0%	31,500	19.8%	(0.3%)	32,500	20.4%	3.2%
Irisbus	4,900	3.1%	(12.5%)	8,800	5.4%	79.6%	9,000	5.7%	2.3%	9,400	5.9%	4.4%
Speciality	3,700	2.3%	(2.6%)	5,300	3.3%	43.2%	5,500	3.5%	3.8%	5,650	3.5%	2.7%
Total Iveco	160,400	100.0%	(2.7%)	161,900	100.0%	0.9%	159,250	100.0%	(1.6%)	159,500	100.0%	0.2%

Source: (*) Note: Irisbus 50% owned by Renault in 2001. 100% Owned in 2002 . Source: Fiat, Merrill Lynch estimates

■ Light Commercial Vehicles

Iveco is the second largest medium truck producer in Europe

The medium truck segment (6 to 15 tonnes) accounts for 15% of Iveco's unit sales with 24,600 trucks sold in 2002. Iveco is the second largest producer in Europe behind Mercedes Benz. It is no surprise that it has a dominant position in Italy (58% market share) and strong positions in Spain and the UK. We expect the medium truck segment to fall by 7.6% in 2003E and increase by 3.4% in 2004E. We anticipate Iveco to outperform the market in 2004E with its new EuroCargo truck launched in 2003.

■ Heavy Trucks

We anticipate demand in Western Europe to approach 208,000 units in 2003, which will be 15% below the industry peak of 245,832 units in 2000. Over the last three years, over-capacity and intense pricing pressure have reduced margins to barely break-even for many European truck makers. It has only been in the past twelve months that price increases have appeared to stick, and margins have returned to such an extent that Scania was able to report operating margins of 10.9% in 2003H1. During this period, Iveco's heavy truck market share has

Refer to important disclosures on pages 50 to 51.

recovered, to reach an expected 11.3% in 2003E on the back of its new Stralis heavy truck range. This was voted “Truck of the Year 2002”. The decline in 2003E can be attributed to a tough comparative year 2002 and the weakness in Fiat’s two main markets of Italy and France.

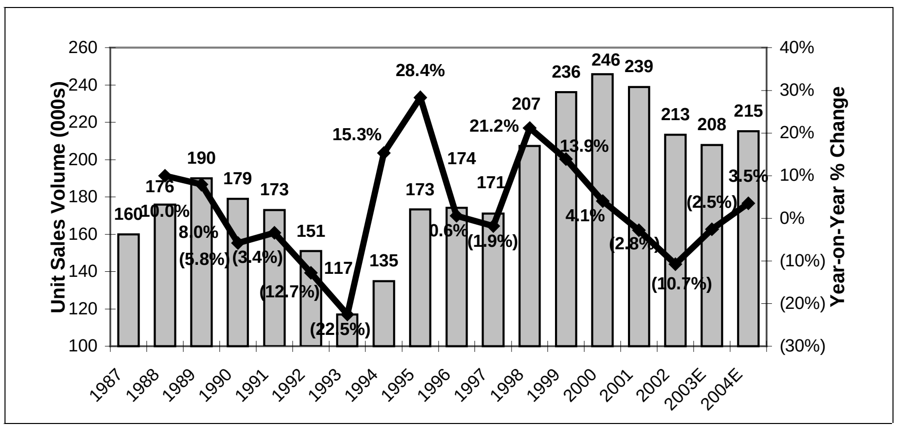
Table 17: West European Heavy Truck Market Shares

Truck Sales Unit Sales >16t -	1990 YR	1991 YR	1992 YR	1993 YR	1994 YR	1995 YR	1996 YR	1997 YR	1998 YR	1999 YR	2000 YR	2001 YR	2002 YR	2003 Est	2004 Est
Mercedes (DCX)	22.6%	26.2%	26.4%	25.5%	21.9%	20.6%	18.8%	21.3%	20.6%	20.9%	19.6%	19.3%	19.0%	18.4%	18.6%
Volvo	12.9%	12.5%	12.1%	12.1%	15.8%	16.1%	16.7%	15.3%	15.2%	15.0%	14.9%	14.4%	14.1%	15.4%	15.7%
Scania	11.3%	10.8%	10.9%	11.2%	12.7%	14.3%	15.4%	15.1%	15.1%	14.8%	15.5%	13.5%	13.5%	14.0%	14.0%
Iveco (Fiat)	**13.2%**	**14.4%**	**13.4%**	**13.3%**	**12.6%**	**12.6%**	**12.3%**	**11.5%**	**10.6%**	**11.0%**	**11.1%**	**10.8%**	**12.0%**	**11.3%**	**10.7%**
RVI (Volvo)	12.0%	11.3%	9.7%	10.2%	11.1%	12.1%	11.8%	11.4%	11.8%	11.6%	11.8%	12.3%	12.9%	11.5%	11.6%
MAN	10.5%	13.1%	14.8%	15.9%	13.7%	11.7%	12.3%	12.9%	12.6%	13.5%	14.1%	15.0%	13.6%	14.4%	14.2%
DAF	10.0%	8.5%	9.0%	7.0%	7.9%	8.8%	9.3%	9.4%	10.4%	9.8%	9.8%	11.6%	12.2%	12.6%	12.7%
Other Manufacturers	7.5%	3.2%	3.7%	4.9%	4.4%	3.9%	3.4%	3.1%	3.6%	3.4%	3.2%	3.2%	2.7%	2.5%	2.5%
Western Europe	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Industry Sources

In a strong first nine months of the year, Heavy truck sales have beaten all early expectations and year-to-Sep 2003 are up by 0.4%. The winners have been Volvo and MAN who have recorded YoY increases of 11.7% and 3.8% respectively. On the flip side for Volvo its RVI brand has suffered with a 8.2% YoY decline. Iveco which is exposed to similar southern European markets has registered a 8.6% YTD decline.

hart 32: Western Europe Heavy Truck Demand



ource: Industry Sources, Merrill Lynch estimates

A major revamp of Iveco’s heavy truck range was completed in 2001 with a redesigned cab, a full range of Cursor engines and a major overhaul of the key operating systems. 2000Q4 saw the production start of a modified cab, accompanied by an improved aerodynamics package and an automated electronic gearbox. In 2001 new suspension, braking, safety and other electronic equipment became available. This is the first stage of an initiative to provide a common platform of components, designed to reduce complexity and cut the 40,000 part numbers in 2001 by half.

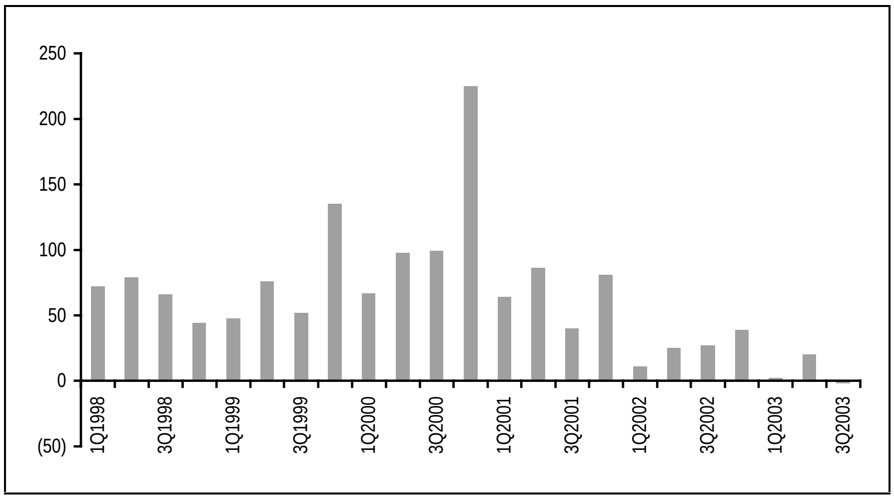
Engine Production

Over 360,000 engine units produced in 2002

Iveco is a major diesel engine player, producing 361,200 engines in 2002 (down 13.0%). The main reason for the downfall was a drop in light engine production for non-captive customers and weak demand in the power generating business. About 42% found their way into Iveco's own truck range, although an increasing amount are being sold to third parties (including Fiat Auto), which improves overall margins and increases scale. As part of the restructuring of the CNH business it now incorporates Iveco engines in its new models launched since 2001. Given a surge of new CNH models in 2003, this should bolster Iveco production in 2004.

Significant R&D expenditure in recent years has resulted in a total revamp of the engine range with a modular approach being adopted to increase commonality across the range and a reduce the variety of components used. The final phase of the programme was completed in 2002 with all engines being fully Euro 3 compliant, and having the capability of Euro 4 compliance.

Chart 33: Iveco Operating Profit - Quarterly Progression (EURmn)



Source: Fiat, Merrill Lynch estimates

Refer to important disclosures on pages 50 to 51.

5. 2003Q3 Results Analysis

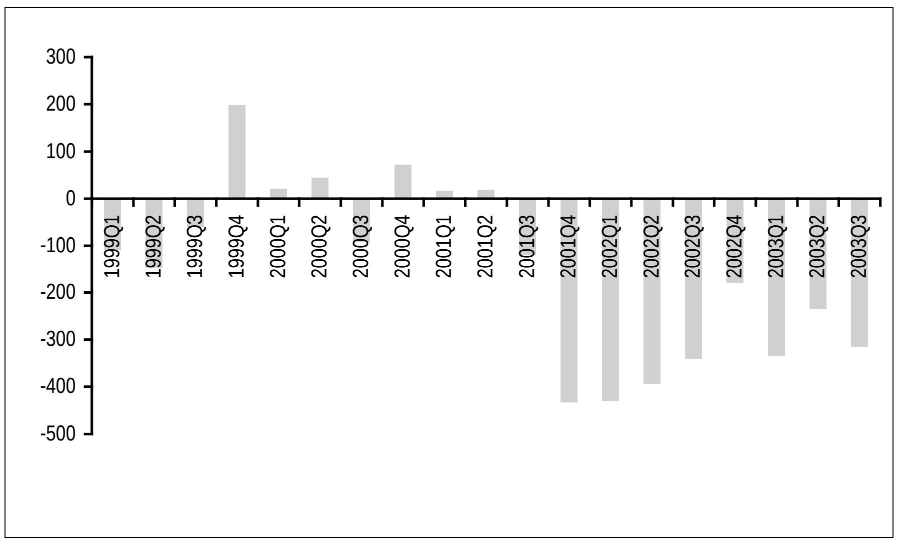
2003Q3 Analysis

Once again Fiat's quarterly results disappointed. The released figures mirror what Fiat management states as: *"the performance of the Fiat Group in the third quarter of 2003, in addition to being affected by unfavourable seasonal factors, reflect the challenges of a difficult transition period...Fiat Auto, in particular, was adversely affected in two key segments as customers deferred buying decisions ahead of the introduction of new models."* Consolidated Group revenues totaled 9.8bn, significantly below the EUR12.0bn (-17.9%) in 2002Q3. The main reasons were the scope of consolidation, unfavourable exchange rate movements and weak markets.

Automotive Division

Revenues in the Automotive division declined by 10.9% to EUR4.16bn. The variance can mostly be explained by a lower volume/mix for Fiat's core models. This comes despite a relative stable 3.4mn units sold in Europe (+8% in Spain, +1.2% in UK) and a gain in Italy by +4.6%. The progress Fiat has made during the last 12 months in turning around the Auto division is almost insignificant. The operating loss of EUR340mn in 2002Q3 was reduced by a meagre EUR26mn to (EUR314mn).

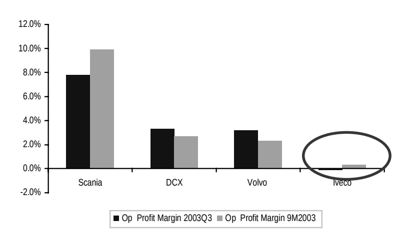
Chart 34: Operating Profit Fiat Auto Division (EURmn)



Source: Fiat accounts, Merrill Lynch

Iveco

Chart 35: Operating Profit Margins; Scania, Volvo, DCX, Iveco – 2003Q3



Source: Company Accounts

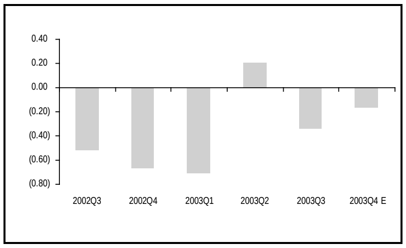
- Iveco joins the loss making divisions with a loss of EUR2mn vs EUR27mn operating income 2002Q3. Revenues declined on an adjusted basis (sale of Fraikin, change in consolidation for the Naveco JV in China) by 11% to EUR1.8bn from EUR2.2bn in 2002Q3. The truck division was hit by a slow-down particular acute in Italy. This compares to Scania which reported an operating margin of 7.8% during the equivalent quarter.
- Consolidated operating income/EBIT remained deeply in the red and came in at a loss of EUR285mn, a decline of only 54mn compared to the EUR339mn loss in 2002Q3.
- Extraordinary income of EUR895mn turned. pre-tax profit into positive EUR365 compared to a loss of 615mn in 2002Q3.

Adjusted Net Income amounted to EUR(273)mn vs. EUR318mn in 2002Q3 which translated in a loss per share of EUR(0.44), down from EUR(0.52) in 2002Q3.

Group Indebtedness

At 30 September the group's net financial position showed net indebtedness of EUR2.95bn, which is a decrease of EUR828mn compared to the December 02 level. Cash proceeds from the sale of Toro (EUR1.4bn), FiatAvio (EUR1.4bn) and the capital increase (EUR1.8bn) was partly offset by a significant increase in working capital of EUR643mn (net) and a reduction in discounted receivables.

Chart 36: EPS by Quarter (EUR/share)



Source: Company Accounts, Merrill Lynch

Outlook Remains Foggy

Despite the end of the year coming to a close in only 60 days Fiat was not able to give a more specific guidance for 2003FY and Q4. The Company reaffirms the objectives stated in its Relaunch plan, which *"aims a significantly smaller operating loss in 2003 than in 2002 and an improved net financial position."*

Table 18: Fiat Quarterly P&L

	2002Q3	2003Q3	% Chg
Net Revenues	11,987	9,837	(17.9%)
Cost of Goods Sold	(10,049)	(8,077	(14.5%)
Depreciation and Amortisation	(478)	(512)	7.1%
Gross Operating Margin	**1,460**	**1,248**	**(14.5%)**
as a % of Sales (%)	12.2%	12.7%	
SG&A	(1,341)	(1,085)	(19.1%)
as a % of Sales (%)	(11.0%)	(11.0%)	
R&D	(403)	(386)	(4.2%)
as a % of Sales (%)	(3.1%)	(4.0%)	
Other Operating (Expense) / Income	(55)	(62)	12.7%
Production Costs	(12,326)	(10,634)	(13.7%)
Gross Operating Income/ EBIT	**(339)**	**(285)**	**(15.9%)**
Financial Income/(Expenses)	(93)	(220)	136.6%
Write down Fin. A./ Non op. Inc.	(177)	(25)	(85.9%)
Income Before Tax & Extraordinaries	(609)	(530)	(13.0%)
Extraordinary Income/(Expenses)	(6)	895	
Income Before Tax (Consolidated)	**(615)**	**365**	
Pre-Tax Margin (%)	(5.1%)	3.7%	
Income Tax	**136**	**(510)**	
Minority Income	66	61	(7.6%)
Attributable Net Income	(413)	(84)	(79.6%)
Attributable Net Income (adjusted)	(318)	(273)	(14.1%)
EPS (EUR)	(0.67)	(0.14)	(79.6%)
EPS (EUR) Adjusted	**(0.52)**	**(0.44)**	**(14.1%)**

Source: Fiat accounts, Merrill Lynch

Table 19: Companies Mentioned in this Report

	ML Ticker	Price	Rating
Renault	RNSDF	EUR57.3	B-1-7
Peugeot	PEUGF	EUR37.1	B-2-7
BMW	BMW/ BAMXF	EUR34.0	B-1-7
CNH Global	CNN	USD13.36	C-2-7

Refer to important disclosures on pages 50 to 51.

6. Financials

Table 20: Fiat Group Revenues by Division

Year End December (EURmn)	Dec-1997 YR	Dec-1998 YR	Dec-1999 YR	Dec-2000 YR	Dec-2001 YR	Dec-2002 YR	Dec-2003 Estimate	Dec-2004 Estimate	Dec-2005 Estimate
Automobiles (Fiat Auto)	26,202	24,859	24,101	25,361	24,440	22,147	19,500	20,000	20,500
Agricultural & Construction Equip. (CNH)	5,284	5,126	5,246	10,770	10,777	10,513	9,250	9,543	10,346
Commercial Vehicles (Iveco)	5,850	6,649	7,387	8,611	8,650	9,136	8,700	9,000	9,250
Ferrari	-	-	-	-	1,058	1,208	1,320	1,400	1,450
Metallurgical Products (Teksid)	1,190	1,165	1,682	1,873	1,752	1,539	1,050	1,150	1,200
Components (Magneti Marelli)	3,451	3,793	4,062	4,451	4,073	3,288	2,850	2,500	2,750
Production Systems (Comau/Pico)	841	843	1,693	2,440	2,218	2,320	2,400	2,500	2,600
Aviation (Fiat Avio)	1,263	1,361	1,361	1,491	1,636	1,534	617	-	-
Rolling Stock & Railway (Fiat Ferroviaria)	384	389	375	-	-	-	-	-	-
Chemicals (Snia)	1,473	-	-	-	-	-	-	-	-
Publishing & Communications (Itedi)	406	437	413	354	347	360	380	350	350
Insurance (Toro Assicurazioni)	2,016	2,959	3,922	4,363	5,461	4,916	2,486	-	-
Business Solutions'	-	-	-	-	1,805	1,965	2,100	2,200	2,350
Miscellaneous & Eliminations	(2,105)	(1,813)	(2,119)	(2,159)	(3,153)	(3,277)	(3,000)	(3,300)	(3,300)
Group Sales	**45,995**	**45,755**	**48,402**	**57,555**	**58,006**	**55,649**	**47,653**	**45,343**	**47,496**

Source: Company Accounts, Merrill Lynch

Table 21: Fiat Group Operating Profit by Division

Year End December (EURmn)	Dec-1997 YR	Dec-1998 YR	Dec-1999 YR	Dec-2000 YR	Dec-2001 YR	Dec-2002 YR	Dec-2003 Estimate	Dec-2004 Estimate	Dec-2005 Estimate
Automobiles (Fiat Auto)	758	(108)	(121)	44	(549)	(1,343)	(878)	(530)	(150)
Agricultural & Construction Equip. (CNH)	602	452	371	45	209	163	198	315	408
Commercial Vehicles (Iveco)	203	261	311	489	271	102	55	90	140
Ferrari	-	-	-	-	62	70	20	70	109
Metallurgical Products (Teksid)	54	42	76	101	15	27	15	20	30
Components (Magneti Marelli)	99	56	108	55	(74)	(16)	25	35	55
Production Systems (Comau/Pico)	27	(1)	43	87	60	(101)	0	15	26
Aviation (Fiat Avio)	56	59	109	143	186	210	53	0	0
Rolling Stock & Railway (Fiat Ferroviaria)	26	18	13	-	-	-	-	-	-
Chemicals (Snia)	83	-	-	-	-	-	-	-	-
Publishing & Communications (Itedi)	11	19	17	10	(2)	3	4	5	6
Insurance (Toro Assicurazioni)	(118)	(168)	(103)	(56)	68	147	44	0	0
Business Solutions'	-	-	-	-	73	67	50	55	70
Miscellaneous & Eliminations	(10)	116	(36)	(63)	(1)	(91)	(100)	(100)	(100)
Group Operating Income	1,791	746	788	855	318	(762)	(513)	(25)	595

Source: Company Account, Merrill Lynch

Table 22: Fiat Group Operating Margins by Division

Year End December (EURmn)	Dec-1997 YR	Dec-1998 YR	Dec-1999 YR	Dec-2000 YR	Dec-2001 YR	Dec-2002 YR	Dec-2003 Estimate	Dec-2004 Estimate	Dec-2005 Estimate
Automobiles (Fiat Auto)	2.9%	(0.4%)	(0.5%)	0.2%	(2.2%)	(6.1%)	(4.5%)	(2.7%)	(0.7%)
Agricultural & Construction Equip. (CNH)	11.4%	8.8%	7.1%	0.4%	1.9%	1.6%	2.1%	3.3%	3.9%
Commercial Vehicles (Iveco)	3.5%	3.9%	4.2%	5.7%	3.1%	1.1%	0.6%	1.0%	1.5%
Ferrari	-	-	-	-	5.9%	5.8%	1.5%	5.0%	7.5%
Metallurgical Products (Teksid)	4.5%	3.6%	4.5%	5.4%	0.9%	1.8%	1.4%	1.7%	2.5%
Components (Magneti Marelli)	2.9%	1.5%	2.7%	1.2%	(1.8%)	(0.5%)	0.9%	1.4%	2.0%
Production Systems (Comau/Pico)	3.3%	(0.1%)	2.5%	3.6%	2.7%	(4.4%)	0.0%	0.6%	1.0%
Aviation (Fiat Avio)	4.5%	4.4%	8.0%	9.6%	11.4%	13.7%	8.6%	n/a	n/a
Rolling Stock & Railway (Fiat Ferroviaria)	6.7%	4.5%	3.5%	-	-	-	-	-	-
Chemicals (Snia)	5.6%	-	-	-	-	-	-	-	-
Publishing & Communications (Itedi)	2.7%	4.3%	4.1%	2.8%	(0.6%)	0.8%	1.1%	1.4%	1.7%
Insurance (Toro Assicurazioni)	(5.8%)	(5.7%)	(2.6%)	(1.3%)	1.2%	3.0%	1.8%	n/a	n/a
Business Solutions'	-	-	-	-	4.0%	3.4%	2.4%	2.5%	3.0%
Group Operating Margin	**3.9%**	**1.6%**	**1.6%**	**1.5%**	**0.6%**	**(1.4%)**	**(1.1%)**	**-0.1%**	**1.3%**

Source: Company Account, Merrill Lynch

Table 23: Fiat Group Profit & Loss Account

Year End December (EURmn)	Dec-1998 YR	Dec-1999 YR	Dec-2000 YR	Dec-2001 YR	Dec-2002 YR	Dec-2003 Estimate	Dec-2004 Estimate	Dec-2005 Estimate
Net Revenues	**45,769**	**48,123**	**57,555**	**58,006**	**55,649**	**47,653**	**45,343**	**47,496**
Cost of Goods Sold	(36,210)	(38,451)	(45,909)	(46,974)	(46,068)	(41,125)	(36,456)	(37,591)
as a % of Sales (%)	(79.1%)	(79.9%)	(79.8%)	(80.2%)	(82.0%)	(86.3%)	(80.4%)	(79.3%)
Depreciation and Amortisation	(2,310)	(2,354)	(3,052)	(2,880)	(2,551)	(2,116)	(2,358)	(2,470)
Gross Operating Margin	7,249	7,318	8,594	8,152	7,030	6,528	6,529	7,436
as a % of Sales (%)	15.8%	15.2%	14.9%	14.1%	12.6%	13.7%	14.4%	15.7%
SG&A	(5,031)	(5,084)	(6,108)	(6,149)	(5,782)	(5,194)	(4,775)	(4,987)
as a % of Sales (%)	(11.0%)	(10.6%)	(10.6%)	(10.6%)	(11.3%)	(10.9%)	(10.6%)	(10.5%)
R&D	(1,264)	(1,406)	(1,725)	(1,817)	(1,748)	(1,811)	(1,800)	(1,900)
as a % of Sales (%)	(2.8%)	(2.9%)	(3.0%)	(3.1%)	(3.1%)	(3.8%)	(4.0%)	(4.0%)
Other Operating (Expense) / Income	(208)	(40)	94	132	(262)	(36)	21	46
Production Costs	(45,023)	(47,335)	(56,700)	(57,688)	(56,411)	(48,166)	(45,367)	(46,902)
Operating Income/ EBIT	**746**	**788**	**855**	**318**	**(762)**	**(513)**	**(25)**	**595**
Financial Income/(Expenses)	363	(101)	(617)	(680)	(671)	(710)	(600)	(549)
Write down Fin. A./ Non op. Inc.	43	4	(102)	(494)	(881)	(100)	0	0
Income Before Tax & Extraordinaries	1,152	691	136	(856)	(2,314)	(1,323)	(625)	46
Extraordinary Income/(Expenses)	290	333	914	359	(2,503)	1,000	0	0
Income Before Tax (Consolidated)	**1,442**	**1,024**	**1,050**	**(497)**	**(4,817)**	**(323)**	**(625)**	**46**
Income Tax	(526)	(518)	(472)	(294)	554	(707)	231	(17)
Minority Income	(295)	(153)	86	346	315	176	106	30
Attributable net income	621	353	664	(445)	(3,948)	(854)	(287)	59
Attributable net income (adjusted)	431	282	172	(193)	(1,143)	(1,854)	(287)	59
EPS (EUR)	**1.13**	**0.64**	**1.21**	**(0.81)**	**(6.40)**	**(0.87)**	**(0.29)**	**0.06**
EPS (EUR) Adjusted	**0.78**	**0.51**	**0.31**	**(0.35)**	**(1.85)**	**(0.67)**	**(0.29)**	**0.06**

Source: Fiat, Merrill Lynch estimates

Refer to important disclosures on pages 50 to 51.

Table 24: Fiat Group Summary Cash Flow

Year End December (EUR mn)	Dec-1998 YR	Dec-1999 YR	Dec-2000 YR	Dec-2001 YR	Dec-2002 YR	Dec-2003 Estimate	Dec-2004 Estimate	Dec-2005 Estimate
Net Income Before Minority Interest	916	506	578	(791)	(4,263)	(1,030)	(393)	29
Depreciation & Amortisation	2,310	2,354	3,052	2,880	2,614	2,716	2,358	2,470
Change in Employee Severance Indemnities	(66)	(104)	(58)	(77)	(70)	(70)	(70)	(70)
Change in Insurance Policy Liabilities	1,695	2,336	0	0	0	0	0	0
Changed in deferred taxation	(188)	0	(289)	(588)	(884)	(250)	0	0
Gain on Disposals/Extraordinaries	(244)	(368)	(2,753)	(1,749)	124	(1,000)	0	0
Revaluation and w/d of equities	0	0	73	372	525	0	0	0
Impairment	0	0	0	0	991	0	0	0
Cash Flow	**4,423**	**4,724**	**605**	**47**	**(963)**	**367**	**1,894**	**2,429**
Change in Current Assets & Liabilities	(189)	1,274	1,369	2,388	2,016	(350)	(100)	0
Change in Other Items	300	(191)	0	0	0	0	0	0
Cash Flow from Operating Activities	**4,534**	**5,807**	**1,974**	**2,435**	**1,053**	**17**	**1,794**	**2,429**
Free Cash Flow	***2,959***	***3,776***	***474***	***1,749***	***1,603***	***(483)***	***(406)***	***29***
Investment in Fixed Assets	(2,418)	(2,712)	(3,101)	(3,338)	(2,681)	(3,300)	(2,900)	(2,900)
Investment in Investments	(661)	(6,149)	(4,347)	(1,524)	(563)	(250)	0	0
Investment in Intangible Assets	(354)	(415)	(521)	(473)	(518)	0	0	0
Proceeds from Sale of Fixed Assets	843	681	1,601	2,652	3,231	2,800	700	500
Change in Financial Receivables	(1,674)	(2,046)	(1,816)	(189)	2,456	0	0	0
Change in Securities	(1,243)	(1,781)	(95)	(15)	(175)	50	0	0
Other Investments	120	(244)	(260)	(130)	346	0	0	0
Cash Flow from Investment Activities	(5,387)	(12,666)	(8,539)	(3,017)	2,096	(700)	(2,200)	(2,400)
Net Cash Flow	**(853)**	**(6,859)**	**(6,565)**	**(582)**	**3,149**	**(683)**	**(406)**	**29**
Capital Increase	0	0	2,573	(266)	1,138	1,847	0	0
Payment of Dividends	(352)	(350)	(412)	(380)	(228)	0	(31)	(31)
Change in Debt	777	7,442	4,495	1,364	(2,703)	0	0	0
Cash Flow from Financing Activities	425	7,092	6,656	718	(1,793)	1,847	(31)	(31)
Change in Liquid Funds	**(428)**	**233**	**91**	**136**	**1,356**	**1,164**	**(437)**	**(3)**
Financial Position (Net) Ind. Cos.	***1,420***	***(4,031)***	***(6,467)***	***(6,035)***	***(3,780)***	***(2,616)***	***(3,053)***	***(3,056)***
CEPS (EUR)	8.03	8.58	1.10	0.09	(1.56)	0.37	1.92	2.47

Source: Fiat, Merrill Lynch estimates

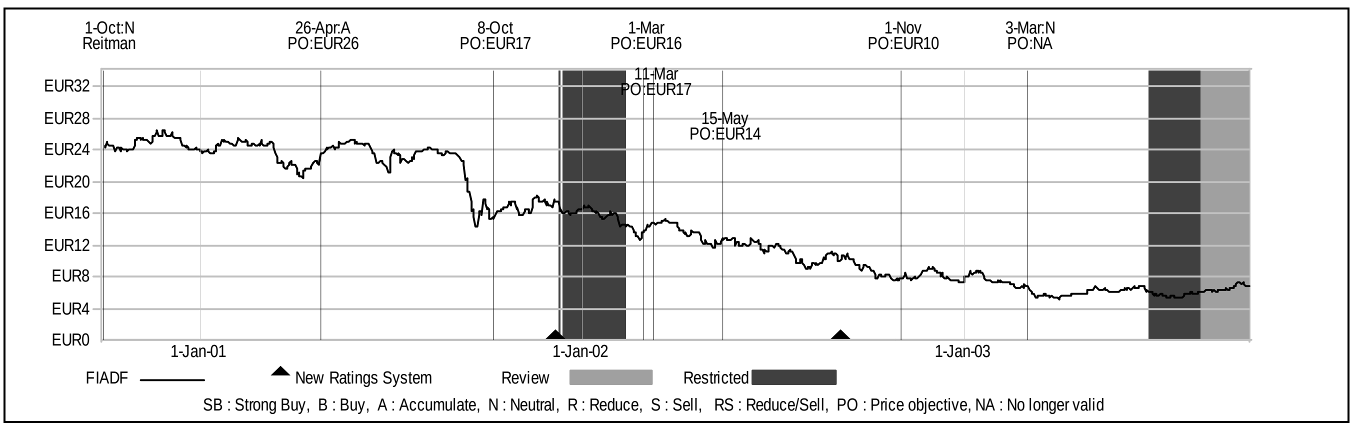
Analyst Certification

We, Stephen Reitman, Michael Dean and Steve Haggerty, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Refer to important disclosures on pages 50 to 51.

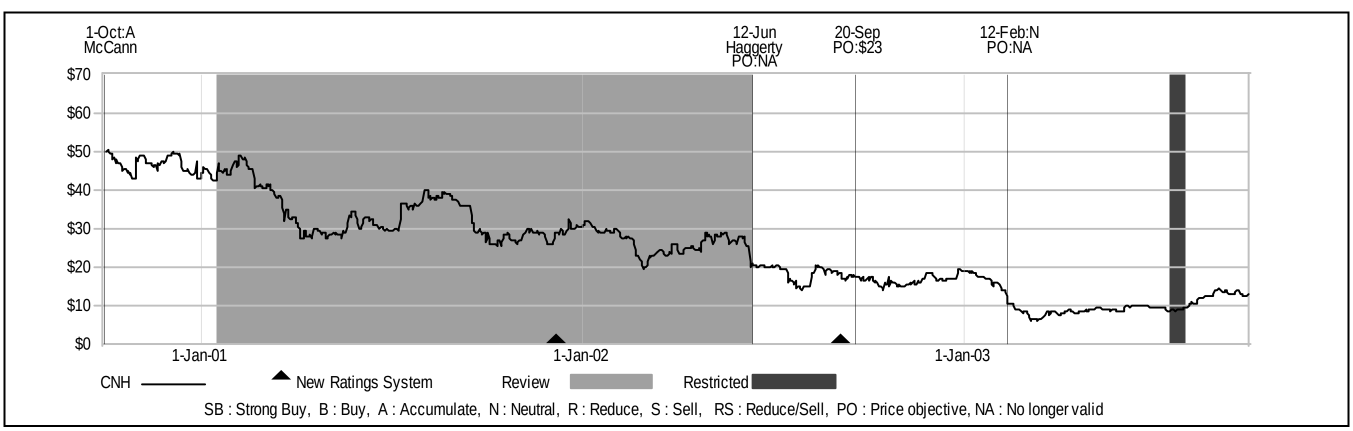
Important Disclosures

FIADF Price Chart



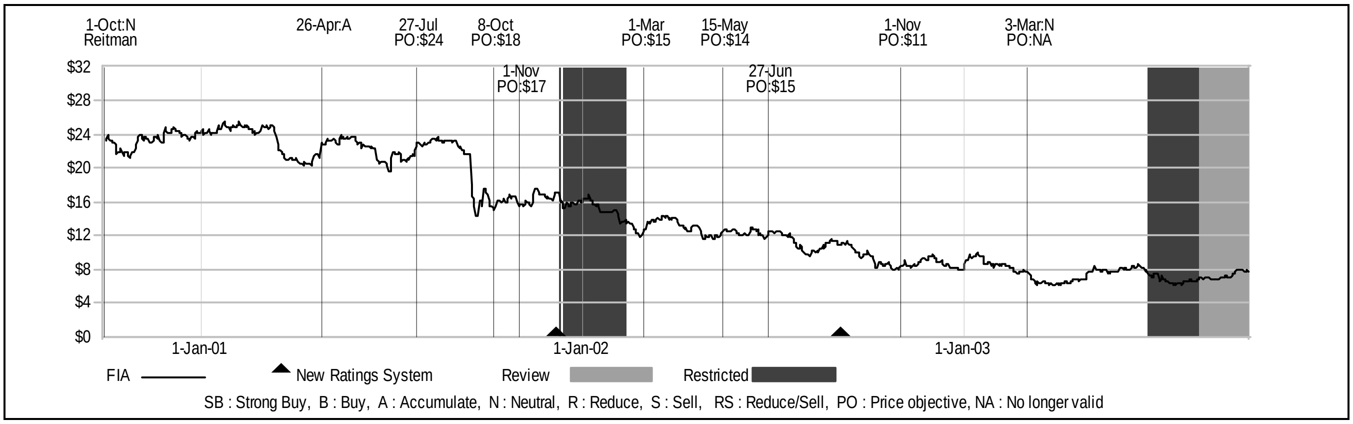
Prior to 8 Dec. 2001, the Investment Opinion System included: Buy, Accumulate, Neutral, Reduce and Sell. From 8 Dec. 2001 to 6 Sep. 2002, the Investment Opinion System included: Strong Buy, Buy, Neutral, and Reduce/Sell. On 8 Dec. 2001 Buy ratings became Strong Buy, Accumulate became Buy, and Reduce and Sell became Reduce/Sell. On 6 Sep. 2002, Strong Buy and Buy ratings became Buy, and Reduce/Sell became Sell. Any exceptions to these rating revisions are reflected in the chart. All price objectives for Neutral and Sell rated securities established before 6 Sep. 2002 were eliminated as of that date. The current Investment Opinion System is contained at the end of the report. Dark Grey shading indicates security is restricted with the opinion suspended. Light Grey shading indicates security is under review with the opinion withdrawn.

CNH Price Chart



Prior to 8 Dec. 2001, the Investment Opinion System included: Buy, Accumulate, Neutral, Reduce and Sell. From 8 Dec. 2001 to 6 Sep. 2002, the Investment Opinion System included: Strong Buy, Buy, Neutral, and Reduce/Sell. On 8 Dec. 2001 Buy ratings became Strong Buy, Accumulate became Buy, and Reduce and Sell became Reduce/Sell. On 6 Sep. 2002, Strong Buy and Buy ratings became Buy, and Reduce/Sell became Sell. Any exceptions to these rating revisions are reflected in the chart. All price objectives for Neutral and Sell rated securities established before 6 Sep. 2002 were eliminated as of that date. The current Investment Opinion System is contained at the end of the report. Dark Grey shading indicates security is restricted with the opinion suspended. Light Grey shading indicates security is under review with the opinion withdrawn.

FIA Price Chart



Prior to 8 Dec. 2001, the Investment Opinion System included: Buy, Accumulate, Neutral, Reduce and Sell. From 8 Dec. 2001 to 6 Sep. 2002, the Investment Opinion System included: Strong Buy, Buy, Neutral, and Reduce/Sell. On 8 Dec. 2001 Buy ratings became Strong Buy, Accumulate became Buy, and Reduce and Sell became Reduce/Sell. On 6 Sep. 2002, Strong Buy and Buy ratings became Buy, and Reduce/Sell became Sell. Any exceptions to these rating revisions are reflected in the chart. All price objectives for Neutral and Sell rated securities established before 6 Sep. 2002 were eliminated as of that date. The current Investment Opinion System is contained at the end of the report. Dark Grey shading indicates security is restricted with the opinion suspended. Light Grey shading indicates security is under review with the opinion withdrawn.

Investment Rating Distribution: Autos Group (as of 30 September 2003)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	17	32.08%	Buy	6	35.29%
Neutral	31	58.49%	Neutral	7	22.58%
Sell	5	9.43%	Sell	1	20.00%

Investment Rating Distribution: Global Group (as of 30 September 2003)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	962	40.56%	Buy	328	34.10%
Neutral	1206	50.84%	Neutral	318	26.37%
Sell	204	8.60%	Sell	44	21.57%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

OPINION KEY: Opinions include a Volatility Risk Rating, an Investment Rating and an Income Rating. VOLATILITY RISK RATINGS, indicators of potential price fluctuation, are: A - Low, B - Medium, and C - High. INVESTMENT RATINGS, indicators of expected total return (price appreciation plus yield) within the 12-month period from the date of the initial rating, are: 1 - Buy (10% or more for Low and Medium Volatility Risk Securities - 20% or more for High Volatility Risk securities); 2 - Neutral (0-10% for Low and Medium Volatility Risk securities - 0-20% for High Volatility Risk securities); 3 - Sell (negative return); and 6 - No Rating. INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure); 8 - same/lower (dividend not considered to be secure); and 9 - pays no cash dividend.

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The analyst(s) responsible for covering the securities in this report receive compensation based upon, among other factors, the overall profitability of Merrill Lynch, including profits derived from investment banking revenues.

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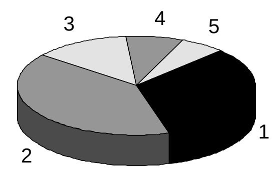
Foreign currency rates of exchange may adversely affect the value, price or income of any security or related investment mentioned in this report. In addition, investors in securities such as ADRs, whose values are influenced by the currency of the underlying security, effectively assume currency risk.

Activities

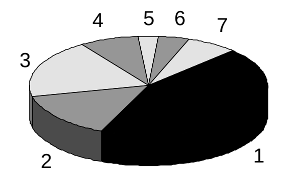
Fiat's 2002 turnover reached EUR55.6bn. Its automotive activities include passenger cars with the Fiat, Lancia, Alfa Romeo, Maserati and Ferrari brands. Main production sites are in Italy, Brazil and Poland. Its truck operations are centred around the Iveco brand which acquired Ford's European operations in the 1980s. Its agricultural and construction equipment operations has changed its name to CNH (Case New Holland). In 2003 the sale of Toro and Fiat Avio and a EUR1.8bn rights issue brought much needed liquidity of EUR4.6bn to Fiat.

Revenues by Geographical Region, 2002



	%
1 Italy	36.2
2 Europe (ex-Italy)	37.9
3 North America	13.3
4 Mercosur	5.9
5 Rest of World	6.7

Revenues by Division, 2002



%	
39.8	Automobiles 1
16.4	Iveco (Comm. Veh.) 2
18.9	CNH (Ag. & Const. Eq.) 3
5.9	Magnetti Marelli (Parts) 4
2.8	Teksid (Metallurgical) 5
4.2	Comau/Pico (Production) 6
12.0	Other 7

Summary Profit & Loss

Y/E 31 Dec (EURmn)	2002A	2003E	2004E
Net Sales	58092	47653	45343
Cost of Goods Sold	(46068)	(41125)	(36456)
R&D Expenditures	(1748)	(1811)	(1800)
SG&A	(5782)	(5194)	(4775)
Operating Profit	762	(513)	(25)
EBITDA	1852	2204	2333
Depreciation & Amortisation	(2614)	(2716)	(2358)
Pre-tax Profit	(4817)	(323)	(625)
Taxation	554	(707)	231
Net Income	(4263)	(1030)	(393)
Net Attributable Income	(3948)	(854)	(287)
Total No of Shares (mn)	616	985	985
EPS (Adjusted)	(1.85)	(0.67)	(0.29)
DPS	0.31	0.00	0.00

Summary Cash Flow

Y/E 31 Dec (EURmn)	2002A	2003E	2004E
Net Income	(4263)	(1030)	(393)
Depreciation & Amortisation	2614	2716	2358
Change in Wkg. Cap	2016	(350)	(100)
Operating Cash Flow	1053	17	1794
Net Capital Expenditure	(3199)	(3300)	(2900)
Net Investments/(Disposals)	3231	2800	700
Change in Liquid Funds	1356	1164	(437)
Net Financial Position	(3780)	(2616)	(3053)
CEPS	(1.56)	0.37	1.92

Valuation Multiples

Y/E 31 Dec	2002A	2003E	2004E
Price – Ord Shares at YE	12.37	6.67	6.67
Total No of Shares (mn)	616	985	985
EPS Growth %	428.1	(64.0)	(56.3)
P/E x	n/a	n/a	n/a
P/E Relative %	n/a	n/a	n/a
CEPS	(1.56)	0.37	1.92
Price/Cash Flow x	(4.3)	18.1	3.5
NAV/Share	14.1	7.8	7.3
Market Cap	6,844	6,094	6,094
Less Net Cash/(Debt)	(3780)	(2952)	(2952)
Plus Pensions Liabs.	1459	1459	1459
Plus Minorities	1038	863	863
Enterprise Value	13121	11368	11368
EV/Sales x	0.2	0.2	0.3
EV/EBITDA x	7.3	5.3	4.9

Refer to important disclosures on pages 50 to 51.