

4 July 2006

Amplifon (AMP.MI)

HOLD (2)
Medium Risk (M)

Access to the UK market through the main entrance...we need some delivery now!

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Year to Dec	Sales (EURm)	PBT (EURm)	EPS (EUR)	EPS (Old) (EUR)	P/E	EBITDA (EURm)	FV/ EBITDA	Net DPS (EUR)	Div Yield (%)	
2004A	471	22	0.06	0.06	113.0	61	25.5	0.02	0.3	
2005A	534	71	0.24	0.24	29.1	93	16.6	0.03	0.4	
2006E	624	77	0.25	0.26	28.0	105	14.7	0.04	0.5	
2007E	712	96	0.31	0.29	22.3	122	12.7	0.04	0.6	
2008E	755	110	0.36	0.33	19.5	135	11.5	0.05	0.6	
52W Price Range: EUR8.14 to 5.00					Price Performance (%)		Ytd	-1m	-3m	-12m
Expected Share Price Return	11.9%	Shares Outstanding	197.8m		Absolute	22.80	-2.80	-2.30	32.10	
Expected Dividend Yield	0.5%	Market Cap.	EUR1,378.8m		Relative to Local	14.79	-3.33	1.71	12.22	
Expected Total Return	12.4%	ROE (Curr Yr)	24.8%		Relative To DJ STOXX Ex UK	16.04	-3.28	2.02	9.53	

Sources: Company reports and Citigroup Investment Research estimates.

Price: EUR6.97	Target: EUR7.80	Rating: Unchanged	EPS: Changed
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Summary

- **Amplifon has closed an important acquisition by buying Ultravox, the leading company in the UK in the distribution of hearing aids**
- **We expect Ultravox's profitability to reach the level of the Amplifon's current profitability by 2010, in line with management expectations**
- **For the current year, the acquisition will have a dilutive effect at the net profit level**
- **We expect revenues to reach c€800 million by 2009: this is less than management's guidance of €1 billion – we think the other €200 million might come from acquisitions**
- **Although the management track record is good in turning around acquired companies, we would await some delivery in the UK before upgrading our profitability numbers: Ultravox represents the biggest acquisition closed by Amplifon**
- **We maintain our €7.8 target price and Hold/ Medium Risk (2M) rating**

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Opinion

Amplifon enters the UK market as market leader

The Deal

Amplifon has announced its entrance into the UK market through the acquisition of 100% of the share capital of Ultravox.

The value of the transaction is £63.4 million in cash.

According to Amplifon management, Ultravox had turnover of c£57 million in the last 12 months with an EBITDA margin on sales in the range of 2%-4%. Moreover, they said that Ultravox had a negative net financial position of c£1.5 million, which implies that Amplifon closed the acquisition at an EV/Sales ratio of 1.14x, in line with recent acquisitions closed by the company.

Together with the acquisition, Amplifon signed a multi-year supply agreement with GN ReSound, which held a c25% stake in Ultravox.

Ultravox in a nutshell

Ultravox is the leading company in the UK hearing aid market and realized a turnover of c£57 million in the last twelve months. The company employs 336 audio-prosthetists and it is present in the UK with a network of 138 points of sale and 126 service centres.

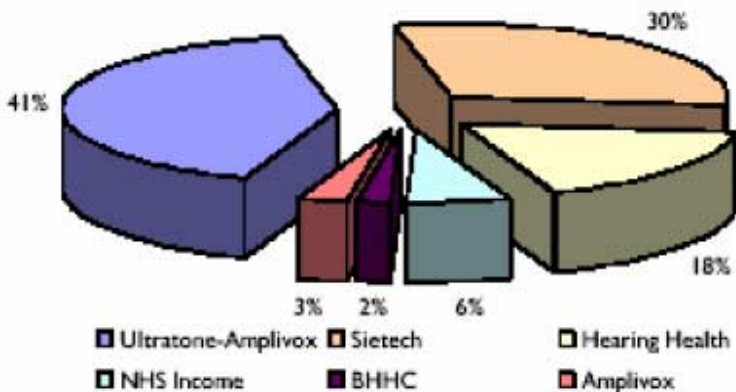
Ultravox's net financial position at the end of 2005 was c£1.5 million.

Thanks to a partnership (PPP) with the NHS (National Health Service) signed in 2003, Ultravox is one of the two companies authorized to provide hearing aids and conduct hearing tests, against payment by the NHS. The public sector in the UK is 80% of the total market, which is the second biggest market worldwide with 895,000 hearing aids sold every year. In the private sector, Ultravox is leader, thanks to a 23% market share.

Ultravox sells nearly 38,000 hearing aids per year.

The following chart highlights the split of turnover for each division for the year ending 31 October 2005.

Figure 1. Ultravox — Income by Division (2004/05)



Source: Company Presentation.

The following tables summarise Ultravox's historical financials.

Figure 2. Ultravox – 2002A-04A Profit and Loss (£ million)

YE 31st October	2002A	2003A	2004A
Gross Turnover	41.9	44.7	48.7
High-Street Healthcare Income	40.5	42.6	45.4
COGS	-6.8	-7.1	-8.0
Gross Profit	33.7	35.6	37.5
<i>Gross Margin (%)</i>	<i>83.2%</i>	<i>83.4%</i>	<i>82.5%</i>
NHS Income	0.1	0.4	0.8
Other Income	0.1	0.1	0.2
Profit Before Expenses	33.8	35.7	38.5
Selling and Branch Overheads	-25.0	-26.6	-29.6
Contribution	8.8	9.1	8.9
Group Overheads	-5.9	-6.6	-6.4
Exceptionals and Minority Interests		0.2	0.1
Recurring EBIT	2.9	2.7	2.6
Depreciation and Amortization	1.5	1.9	2.1
Recurring EBITDA	4.4	4.6	4.7
Recurring EBITDA (%)	10.6%	10.3%	9.6%

Source: Company Presentation.

Figure 3. Ultravox – Unaudited 2005A Balance Sheet (£ million)

	2005A
Intangible Assets	0.660
Tangible Assets	10.331
Fixed Assets	10.991
Stock	1.657
Trade Debtors	3.246
Deferred Tax	0.732
Other Debtors	0.905
Current Assets	6.540
Bank Overdraft	-0.199
Trade Creditors	-4.268
Corporate Tax	-0.399
Other Taxes	-0.768
Dispenser Commissions	-0.516
NHAGS Deferred Income	-0.950
Other Creditors	-1.621
Current Liabilities	-8.721
Long-term Loans	-3.633
Provisions	-2.004
Long-Term Liabilities	-5.637

Source: Company Presentation.

Forecast Changes

Following the closing of the acquisition we have included Ultravox in our model for Amplifon. The company will be consolidated for just 6 months in 2006.

We forecast sales to reach c.€800 million by 2009. During the FY05 results presentation, CEO Mr. Moschetti said that the company would reach c.€1 billion of sales by 2009 so our assumption is that those 'extra' €200 million of sales would come from further acquisitions. The US market, thanks to the agreement with Wal-Mart, would represent a key growth driver, together with other cherry-picking acquisitions in markets where the company is already present and it would like to reinforce its presence (eg Germany).

We forecast that Amplifon will achieve a margin of c18.5% by 2009. This figure is below our previous estimate of 19%. This is due to the fact that the UK operations turnaround will last 3-4 years, according to Amplifon management.

In particular, the turnaround of Ultravox should be achieved through two main pillars:

1. Revenues expansion thanks to:
 - a. Organic growth through the application of effective marketing strategies and tools aimed at delivering high-quality service standards
 - b. Endemic industry factors: continued migration from the public to the private sector
 - c. Further consolidation: once integrated, Amplifon is going to pursue its local consolidation strategy, successfully being implemented in other countries (eg France and Spain)
 - d. New openings
2. Cost synergies:
 - a. Marketing synergies: management strategy to date has focused on obtaining market share and over a period of time the number of brands will be reduced to maximise brand recognition and reduce marketing spend; moreover, marketing spending is currently considered to be very high (c18% of revenues)
 - b. Purchasing synergies: multi-year agreement with GN ReSound for Europe and UK
 - c. Cost reduction program: more efficiency in marketing, distribution, logistics and G&A.

Amplifon management did not provide any guidance on Ultravox's margin expansion pattern; in our model we assume EBITDA margin to reach circa the 'old' level by next year (ie c10%) and to land around the group's present profitability (c17%) by 2010.

Figure 4. Amplifon – Profit and Loss, 2001A-2009E (€ in million)

Year to Dec	2001	2002	2003	2004	2004 IFRS	2005A	2006E	2007E	2008E	2009E
Turnover	360.8	391.9	443.5	470.7	470.7	533.5	624.5	711.9	755.5	795.0
Cost of Goods Sold	-120.6	-137.3	-150.2	-156.1	-133.3	-150.4	-175.7	-199.3	-208.5	-217.0
Gross Oper. Profit	240.3	254.6	293.2	314.6	337.5	383.1	448.8	512.6	547.0	578.0
Gross margin	64.7%	62.3%	63.1%	63.4%	71.7%	68.4%	68.4%	68.9%	69.3%	69.6%
Selling Commissions	-35.1	-39.4	-42.5	-45.9	-142.4	-155.0	-181.4	-205.7	-215.3	-223.0
Advertising	-17.8	-19.7	-23.5	-27.4						
Labour Costs	-83.4	-91.4	-109.6	-121.4	-122.7	-140.4	-164.5	-187.6	-199.0	-209.5
Other operating expenses/revenues	-63.1	-54.8	-57.2	-59.3	1.0	5.2	2.5	2.5	2.5	2.5
EBITDA	40.9	49.3	60.4	60.6	73.3	93.0	105.3	121.8	135.1	148.0
EBITDA Margin	11.3%	12.6%	13.6%	12.9%	15.6%	17.4%	16.9%	17.1%	17.9%	18.6%
Depreciation	-7.3	-7.8	-8.7	-9.0	-14.3	-14.2	-20.3	-17.8	-17.3	-17.8
Amortisation	-3.9	-3.9	-5.0	-5.6	-2.1	-4.8	-2.5	-0.7	-1.7	-2.4
EBIT	25.0	29.4	35.7	30.7	56.9	74.0	82.6	103.3	116.1	127.9
Net Interest	-6.9	-7.6	-6.0	-6.0	-3.6	-3.9	-5.8	-7.2	-6.0	-4.3
Other Income (expenses)	0.2	-0.0	0.0	0.0	-0.9	0.9	0.0	0.0	0.0	0.0
Extraordinary	-8.3	0.1	-6.5	-3.3	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	10.1	21.9	23.2	21.5	52.3	70.9	76.7	96.1	110.1	123.5
Taxation	-5.8	-6.6	-10.4	-18.4	-17.3	-23.7	-27.6	-34.6	-39.7	-44.5
Profit after Tax	4.3	15.3	12.8	3.0	35.0	47.3	49.1	61.5	70.5	79.1
Minority Interest	-0.2	-0.2	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Profit	4.1	15.1	12.6	3.1	35.0	47.3	49.1	61.5	70.5	79.1

Source: Company Data and Citigroup Investment Research estimates.

Figure 5. Amplifon – Balance Sheet, 2001A-2009E (€ in million)

Year to Dec.	2001	2002	2003	2004	2004 IFRS	2005E	2006E	2007E	2008E	2009E
Working Capital	89	80	73	54	55	38	50	60	67	73
Investments	3	2	3	4	4	7	4	4	4	4
Fixed Assets	26.6	29	31	33	41	46	44	43	44	45
Intangibles	77.8	137	135	155	156	218	337	361	384	407
Capital employed	197	248	242	247	256	310	434	468	499	529
Other I/t Liabilities	-23	-9	-9	-8	-13	-17	-18	-18	-19	-19
Net capital required	174	239	233	239	242	293	417	450	481	510
Cash & securities	139.2	42.7	20.1	36.4	14.6	28.5	8.3	13.7	21.8	32.0
Short-term Debt	(85.0)	(37.0)	(30.0)	(26.7)	(7.3)	(14.3)	(34.4)	(29.1)	(29.1)	(29.1)
Long-term Debt	(100.0)	(107.8)	(85.5)	(92.9)	(95.7)	(103.2)	(143.5)	(132.9)	(108.6)	(77.8)
Net Cash (Debt) at Y/E	(45.8)	(102.0)	(95.3)	(83.2)	(88.4)	(88.9)	(169.6)	(148.4)	(116.0)	(74.9)
Share Capital	39.2	39.2	39.2	39.4	39.4	39.4	39.4	39.4	39.4	39.4
Reserves	88	97	96	114	115	164.0	207	262	324	395
Shareholders' Funds	127	136	135	153	154	203.4	247	301	364	434

Source: Company data and Citigroup Investment Research estimates.

Figure 6. Amplifon – Cash Flow Statements, 2001A-2009E (€ in million)

Year to Dec	2001	2002	2003	2004	2004 IFRS	2005E	2006E	2007E	2008E	2009E
Net Profit	4	15	13	3	35	47	49	62	70	79
Depreciation & Provisions	14	17	21	23	16	19	23	18	19	20
Cash Flow from Operations	18	32	34	26	51	66	72	80	89	99
Capex & Acquisitions	-29	-77	-22	-48	-89	-89	-136	-42	-43	-44
Dividends Paid	0	-1	-3	-4	-5	-6	-7	-8	-8	-9
Working Capital	-24	9	7	19	16	-11	-11	-7	-6	
Others	1	-2	-9	1	1	1	1	1	1	
Share Issues/Gov. nt grants	96	0	0	0	0	0	0	0	0	
Net Free Cash Flow(Deficit)	63	-39	7	-5	51	-11	-81	21	32	41
Cash at Y/E	139	43	20	36	15	29	8	14	22	32
Short-term Debt at Y/E	-85	-37	-30	-27	-7	-14	-34	-29	-29	-29
Long-term Debt at Y/E	-100	-108	-85	-93	-96	-103	-144	-133	-109	-78
Net Cash (Debt) at Y/E	-46	-102	-95	-100	-88	-89	-170	-148	-116	-75

Source: Company Data and Citigroup Investment Research estimates.

Investment Thesis

After having closed the Ultravox acquisition, very important both in terms of size (c13% of sales) and country (UK is the second largest market worldwide), the company will try to replicate its model and bring the acquired company on track as far as profitability is concerned. On the other side, management will still focus on external growth to reach the €1 billion revenues target by 2009. As it stands now, the company offers highly visible free cash flow (maintenance capex is only 3.5%-4% of sales, and the group's working capital is expected to drain very little cash) and relies on a credit line of €250 million (agreed with the banks more than twelve months ago) at Euribor 3M + 110bp. Given the fact that the company is operating in all the most important markets, further opportunities can be found by cherry-picking in countries in which the company already operates (in Europe, for example, we expect Amplifon to strengthen its position in Germany).

Even during this external growth phase, the group has been able to deliver on important targets, and the visibility of its ability to generate cash has increased substantially. The group currently enjoys visible free cash flow generation as a result of rapid growth in the US (which enjoys negative working capital) and a significant reduction (in terms of the weight of the overall business) of the Italian operations (historically, the most cash draining). We continue to see Amplifon as one of the few consolidators in the hearing aid retail market, and we believe that the group will continue to enjoy increasing discounts from suppliers, particularly as the suppliers are increasingly moving their production to Asia.

We keep our target price at €7.8 per Amplifon and our rating at Hold/Medium Risk (2M).

Valuation

Amplifon's stock now trades at a discount of about 10% compared with its international peers. The multiples comparison approach indicates a fair value for Amplifon of about €7.8. Our DCF valuation returns a €6.2 value per Amplifon share. In our calculation for the DCF, we have assumed an 8% WACC and a perpetuity growth of 3%, which could prove to be conservative, given the fact that Amplifon is expanding in growing markets and it is consolidating its leadership in the markets where it is already present. We would highlight that with our assumptions the DCF exit EV/EBITDA multiple would be 6.8x, which is clearly at a discount compared to the current multiple on which the market is trading. Finally, at the current price the market appears to be discounting a perpetuity growth rate of c3.8%, which still does not appear to be too aggressive given the company's strong record (i.e. revenue CAGR for 1999-2005 of 21% and EBITDA CAGR for 1999-2005 of 41%). We keep our target price at €7.8 and our rating at Hold/Medium Risk (2M).

Figure 7. Valuation Summary (€)

	Average 2006 Peers	Amplifon Fair Value	Premium/Discount to Current Price	Average 2007 Peers	Amplifon Fair Value	Premium/Discount to Current Price	Average 2008 Peers	Amplifon Fair Value	Premium/Discount to Current Price
EV/EBITDA	16.8	8.1	-11.3%	14.7	8.3	-13.5%	13.2	8.5	-15.1%
EV/EBIT	18.7	6.6	9.3%	16.3	7.8	-7.8%	14.6	8.0	-10.3%
P/E	25.7	6.2	16.7%	22.1	6.9	4.1%	19.6	7.0	2.9%
P/CF	21.9	8.0	-9.9%	19.0	7.7	-6.9%	17.0	7.7	-6.9%
Average		7.2	-0.2%		7.7	-6.4%		7.8	-7.8%
Minimum Value		6.2	16.7%		6.9	4.1%		7.0	2.9%
Maximum Value		8.1	-11.3%		8.3	-13.5%		8.5	-15.1%

Source: Citigroup Investment Research estimates and IBES consensus for Audika, Phonak and William Demant. Priced at close on 3 July 2006.

Figure 8. Amplifon – DCF (€ in million)

	2004	2005	2006E	2007E	2008E	2009E
Value of Production	471	534	624	712	755	795
YoY Growth		13.3%	17.0%	14.0%	6.1%	5.2%
EBITDA	73	93	105	122	135	148
EBITDA Margin	15.6%	17.4%	16.9%	17.1%	17.9%	18.6%
EBIT	57	74	83	103	116	128
EBIT Margin	12.1%	13.9%	13.2%	14.5%	15.4%	16.1%
Unlevered PBT	52	71	77	96	110	124
Tax Rate	-33.1%	-33.4%	-36.0%	-36.0%	-36.0%	-36.0%
Unlevered Taxes	-19	-25	-30	-37	-42	-46
Capex	-48	-89	-136	-42	-43	-44
Other Cash Adjustments	19	16	-11	-11	-7	-6
Unlevered Adjusted Free Cash Flow	26	-5	-72	32	43	52
Amplifon Value per Share (€)						6.2

Source: Citigroup Investment Research estimates.

Risks

We rate Amplifon as Medium Risk. Our risk rating on the stock is derived after consideration of a number of factors. These factors include an assessment of industry-specific risks, financial risk and management risk. In addition, we consider historical share price volatility, based on the input of the Citigroup Investment Research quantitative research team, as a possible indicator of future stock-specific risk. With regard to Amplifon, we would highlight in particular that key risks to our target price being achieved relate to the company's ability to restructure the acquired companies around the world (Amplifon operates in 12 different countries now). Other risks relate to changes in reimbursement regulations in countries in which Amplifon operates, mainly in Europe. If the impact on the company from any of these factors proves to be greater than we expect, the stock will likely have difficulty in achieving our financial and price targets. Likewise, if any of these factors proves to have less of an effect than we expect, the stock could materially outperform our target.

ANALYST CERTIFICATION

Appendix A-1

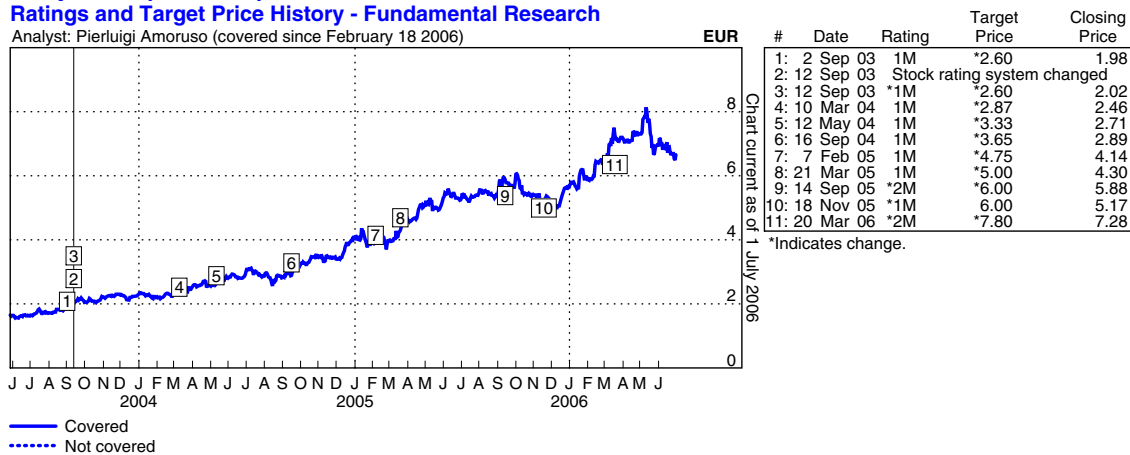
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IMPORTANT DISCLOSURES

Amplifon (AMP.MI)

Ratings and Target Price History - Fundamental Research

Analyst: Pierluigi Amoruso (covered since February 18 2006)



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Data current as of 30 June 2006

	Buy	Hold	Sell
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classified stocks into the same four risk categories. In the major markets, our Industry rating system -- Overweight, Marketweight, and Underweight -- took into account each analyst's evaluation of their industry coverage as compared to the primary market index in their region over the following 12 to 18 months.

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