Company In-Depth

SMALL & MID CAP

4 September 2006 | 60 pages

Piaggio & C SpA (PIA.MI)

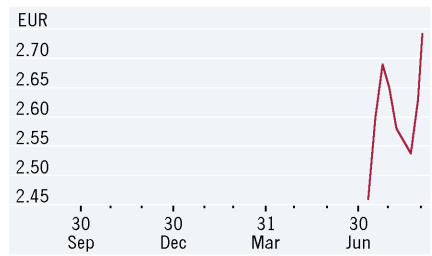
Doing Wheelies: There Is Room for Acceleration

- Initiation of Coverage — we initiate coverage on scooter and motorcycle manufacturer Piaggio with a 1M (Buy/ Medium Risk) rating with a price target of €3.3, c20% above current market levels.
- A Solid Equity Story — The leading player in the European 2-wheeled vehicles market, Piaggio is also the No. 2 player in the fast-growing light transport vehicle market in India. With 7 strong brands, expertise in product innovation and a flexible production base as well as a management with a proven track record, Piaggio is targeting entry into new markets for motorcycles and scooters.
- Acceleration in growth has only just started — With the turnaround of Piaggio in the bag and that of more recently acquired Aprilia due to drive growth to 2008 (we estimate 12% EBITDA and 41% net profit 05-08 CAGR), the management team that took over at end-2003 is now aiming to penetrate the fast-growing emerging markets of Asia. These should drive growth beyond 2008.
- Projected Growth Is Potentially Underestimated — We believe company guidance, market consensus and our forecasts are likely to prove conservative with regards to the growth prospects provided by the target markets up to 2008, potentially leading to a series of upgrades of market expectations.
- Valuation Undemanding — Both on absolute and relative valuations Piaggio appears undemanding: the shares are trading on FCF yields of 8.5% and 10.2% in 2006-07E, and at an earnings PEG of 0.39x and cash flow PEG of 0.50x. Piaggio shares are trading at a 16% discount to its peer group, which we view as unjustified.

See page 58 for Analyst Certification and important disclosures.

Buy/Medium Risk	1M
Price (04 Sep 06)	€2.78
Target price	€3.30
Expected share price return	18.7%
Expected dividend yield	1.8%
Expected total return	20.5%
Market Cap	€1,078M
	US$1,384M

Price Performance (RIC: PIA.MI, BB: PIA IM)



Piaggio & C SpA (EUR)

Year to 31 Dec	2004A	2005A	2006E	2007E	2008E
Sales (€M)	1,084.2	1,452.3	1,580.1	1,711.2	1,820.2
Net Income (€M)	23.9	38.4	65.7	90.0	108.0
Diluted EPS (€)	0.06	0.10	0.17	0.23	0.27
Diluted EPS (Old) (€)	0.06	0.10	0.17	0.23	0.27
PE (x)	43.5	27.1	16.8	12.2	10.2
EV/EBITDA (x)	12.9	8.9	7.2	6.1	5.3
DPS (€)	0.00	0.00	0.05	0.07	0.08
Net Div Yield (%)	0.0	0.0	1.8	2.5	2.9

Alessandro Falcioni[1]
+39-02-8648-4718
alessandro.falcioni@citigroup.com

Mauro Baragiola[1]
mauro.baragiola@citigroup.com

Pierluigi Amoruso[1]
pierluigi.amoruso@citigroup.com

[1]Citigroup Global Markets Ltd

Fiscal year end 31-Dec	2004	2005	2006E	2007E	2008E
Valuation Ratios					
P/E adjusted (x)	43.5	27.1	16.8	12.2	10.2
EV/EBITDA adjusted (x)	12.9	8.9	7.2	6.1	5.3
P/BV (x)	4.2	3.0	2.5	2.2	1.9
Dividend yield (%)	0.0	0.0	1.8	2.5	2.9
Per Share Data (€)					
EPS adjusted	0.06	0.10	0.17	0.23	0.27
EPS reported	0.06	0.10	0.16	0.23	0.27
BVPS	0.67	0.93	1.10	1.28	1.48
DPS	0.00	0.00	0.05	0.07	0.08
Profit & Loss (€M)					
Net sales	1,084	1,452	1,580	1,711	1,820
Operating expenses	-1,022	-1,358	-1,459	-1,562	-1,652
EBIT	**62**	**95**	**122**	**149**	**169**
Net interest expense	-21	-30	-29	-25	-22
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	**41**	**64**	**93**	**125**	**146**
Tax	-17	-26	-29	-34	-38
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**24**	**38**	**63**	**90**	**108**
Adjusted earnings	24	38	66	90	108
Adjusted EBITDA	123	185	215	242	263
Growth Rates (%)					
Sales	14.8	34.0	8.8	8.3	6.4
EBIT adjusted	190.7	51.9	30.9	20.3	12.9
EBITDA adjusted	282.4	51.0	16.0	12.5	8.7
EPS adjusted	117.2	60.4	61.6	37.1	19.9
Cash Flow (€M)					
Operating cash flow	**-3**	**186**	**191**	**174**	**199**
Depreciation/amortization	60	91	91	93	94
Net working capital	-157	70	36	-9	-4
Investing cash flow	**-234**	**-135**	**-102**	**-102**	**-164**
Capital expenditure	-42	-63	-58	-60	-60
Acquisitions/disposals	-192	-72	-43	-42	-104
Financing cash flow	**309**	**-44**	**-92**	**-72**	**-34**
Borrowings	261	-102	-113	-52	-7
Dividends paid	0	0	0	-20	-27
Change in cash	**73**	**8**	**-3**	**0**	**0**
Balance Sheet (€M)					
Total assets	**1,408**	**1,370**	**1,391**	**1,429**	**1,524**
Cash & cash equivalent	35	43	43	43	43
Accounts receivable	207	151	154	166	177
Net fixed assets	239	260	274	287	298
Total liabilities	**1,157**	**1,021**	**955**	**924**	**937**
Accounts payable	314	297	344	364	384
Total Debt	557	454	342	290	283
Shareholders' funds	**251**	**348**	**436**	**506**	**587**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	11.3	12.8	13.6	14.1	14.4
ROE adjusted	11.2	12.8	16.8	19.1	19.8
ROIC adjusted	6.1	7.4	10.3	12.6	14.1
Net debt to equity	207.6	118.1	68.6	48.8	40.9
Total debt to capital	68.9	56.6	44.0	36.4	32.5

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Investment thesis

Doing Wheelies: There is room for acceleration

We initiate coverage on Piaggio with a 1M rating and price target of €3.30, representing a c20% upside from current levels. We believe Piaggio has a solid equity story based on market positioning, brand portfolio, flexible production structure, and a strong management track record with the completion of the Piaggio turnaround and that of the more recently acquired Aprilia group on the way. The growth story appears far from over: regaining Aprilia's pre-crisis market share appears a preliminary target, with cost synergies and strong growth opportunities in the medium term in the emerging markets of India, China and southeast Asia as well as new opportunities in the US market. Further, we believe company guidance, market consensus and our forecasts are likely to prove conservative with regards to the growth prospects provided by the above markets up to 2008, potentially leading to a series of upgrades of market expectations. Both on absolute and relative valuations Piaggio shares appear undemanding: shares are trading on FCF yields of 8.5% and 10.2% in 2006-07E, and at an earnings PEG of 0.39x and cash flow PEG of 0.50x. Piaggio shares are trading at an unjustified 16% discount to the peer group.

Investment positives

No. 1 player in the world's richest 2-wheeled vehicle market

The Piaggio group is the number one player in the European market for powered two-wheeled vehicles, which represents the largest market in the world in annual sales of scooters and motorcycles. It is a strong number one in the scooter segment, with a growing presence in the European motorcycle market, where it is the strongest player in the low engine displacement (50-125cc) segment.

Strong and comprehensive portfolio of brands

Piaggio operates 7 well-known scooter and motorcycle brands, which represent a unique set up among its competitors, with a complete coverage of the consumer price point, including the very established premium Vespa brand. It is present in the full range of engine displacements ranging in both scooters and motorcycles and has a successful track record in racing activities.

Flexible manufacturing base

Piaggio operates out of a manufacturing base of 7 plants, of which 5 in Europe and one each in India and China. This allows the group to take combined advantage of its strong proprietary know-how and R&D capabilities in Europe as well as the low-cost purchasing of components and manufacturing facilities enabling it to be competitive in both the high and low price segments, both in Europe and in emerging markets.

Very positive management track record

Although it only dates back to October 2003, the track record of Piaggio's management is already very strong. In the past two-and-a-half years it has succeeded in turning around and revamping Piaggio; it has made an important acquisition (that of Aprilia), which consolidates its position and strengthens its product offering in motorcycles; and in just over one year since its acquisition, it has stopped the ailing Aprilia from burning cash and started to revamp its market share and product offering.

Our conservative estimates incorporate attractive growth prospects

Based on what we believe to be conservative estimates, our forecasts to 2008 (2005-08 CAGR) incorporate 8% sales growth, 12% EBITDA growth, 21% EBIT growth and 41% bottom line growth. The main drivers of this growth, we expect, are motorcycles (we are forecasting the re-launching of Aprilia to represent 52% of total sales growth to 2008), Indian light transport vehicle sales (26% of total sales growth) and European scooter sales (12% of total sales growth).

Market still underestimates Piaggio's growth opportunities, in our view

Yet the Piaggio growth story appears to have only just begun. Completing the revamping of Aprilia – only part of the way through – seems to be a short- to medium-term objective, with strong growth opportunities in the North American market and the emerging markets of India, China, Southeast Asia and Latin America to be leveraged in the longer term. We believe company guidance, market consensus and our forecasts are likely to prove conservative with regards to the growth prospects provided by the above markets up to 2008, potentially leading to a series of upgrades of market expectations.

Self-sustainable growth: IPO did not raise capital

The group is already strongly cash generative and is sustaining its growth plan autonomously. Indeed, aside from the €21 million capital issued exclusively to service the management stock option plan, the listing of Piaggio group provided a way out for shareholder banks which helped to finance previous operations (the initial acquisition of Piaggio by IMMSI and the acquisition of Aprilia by Piaggio).

Current Valuation undemanding

Absolute valuation methodologies such as free cash flow yield, REP ratio and DCF point to valuations above current market levels: on 2006 and 2007 estimates we reach fair values of €3.40 on FCF yield, of €3.20 on REP Ratio and DCF to €3.6. At a 2006E PE multiple of 16.0x and PCF of 6.7x, the shares are trading at an earnings PEG of 0.39x and at a cash flow PEG of 0.50x and on EV/EBITDA multiples the shares are trading at a 16% discount to peers.

Investment risks

Over 80% of revenues generated in a mature market with low economic growth

In 2005 83% of revenues were generated by Piaggio in Europe and 40% in Italy which, although rich, are generally mature markets characterized by a potential weakening of consumer purchasing power. However, strong traffic congestion, high fuel prices and growing environmental concerns are at least in part underpinning demand for two-wheeled vehicles, offsetting the impact of a potential weakening of consumer demand in the more mature markets of Europe.

54% of revenues are generated by scooters, the most vulnerable segment to competition from low-cost manufacturers

54% of 2005 revenues were generated by the scooter segment, which is the most vulnerable to competition from low-cost manufacturers, particularly in the 50cc range where Piaggio has 32.2% EU market share. Nevertheless, Piaggio's strategy has been to purchase components from low-cost countries (global sourcing), mainly India, China and Taiwan, and to buy back scooters from the Chinese plant managed in joint venture with partner Zongshen aimed at the low price segment of the market, helping to offset the risk of low price competition eroding group margins.

Strong competition from large and established Japanese manufacturers

Piaggio's competitors are not only niche manufacturers from low-cost countries but are also the large, global Japanese manufacturers (Yamaha, Honda and Suzuki in particular), all with a complete 2-wheeled product range, which compete head-to-head with Piaggio, both in the scooter and motorcycle segments with large volumes and scale economies. As Piaggio will increase the breadth of its market presence outside of the European market, we believe the risk of this competition becoming overwhelming will gradually fade away.

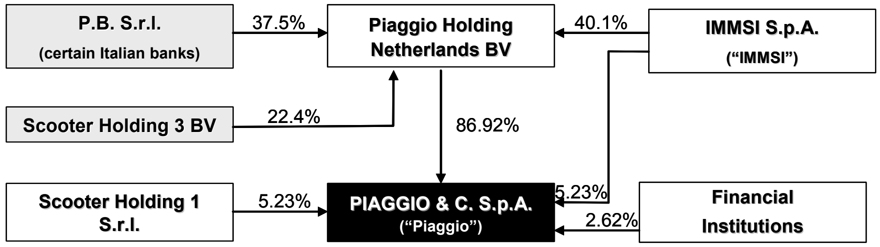
Sales volumes are highly related to product innovation

There appears to be a high correlation between product innovation and sales of a particular model. This implies that the group will have to continue to introduce technical innovation, new designs and new products and product segments to maintain sales in existing markets, thus putting some pressure on its ability to generate new ideas and to invest in their development. Nevertheless, this seems to be a minor risk given that since 1947, when it launched its first Vespa model, the group has been able to renew and maintain the brand through ongoing product and design innovation. Indeed, it has since launched 139 successive models, and today this product still represents a considerable part (12%) of group revenues and an even greater portion of group profitability.

Shareholder structure pre- and post-IPO

Current controlling shareholder IMMSI group, acquired an initial 31.25% concern in Piaggio Holding Netherlands (PHN) in October 2003, from a group of financial investors led by Deutsche Morgan Grenfell, which had acquired control of the company through an LBO in 1999 from the Agnelli family. IMMSI group participated in a capital issue, at the time of the acquisition of Aprilia, at end-2004 raising its stake in PHN to 40%.

Figure 1. Piaggio & C. Shareholder structure pre-IPO and before exercising of management stock options



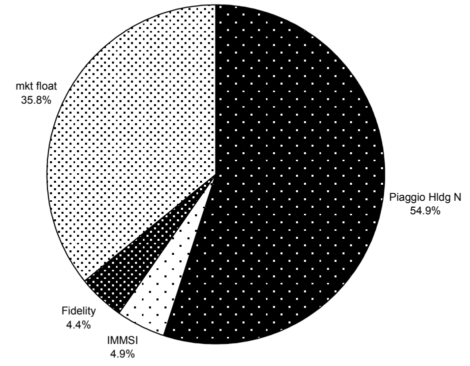
Source: Company Reports

Given that no new capital was issued, the primary purpose of the public listing of Piaggio at the Milan Stock Exchange primarily was to enable banks that participated in a debt-equity swap in October 2003 (through P.B. Srl) and the group of financial investors that acquired control of Piaggio through the LBO (Deutsche Morgan Grenfell through Scooter Holding 1 and 3) to exit their investment in the company.

IMMSI recently raised its stake in Piaggio to 59.8%

Controlling shareholder IMMSI raised its nominal stake of 40% to 59.8% - 4.9% controlled directly and 54.9% through Piaggio Holding Netherlands, which it controls almost entirely (Deutsche Morgan Grenfell should still have a stake of about 3%). This takes into account both the dilution from the stock option plan, Piaggio's IPO valuation, as well as the acquisition pre-IPO of a stake from Scooter Holding 3 at a pre-arranged price of €78.4 million, bringing the total invested by IMMSI since its entrance in Piaggio to €243 million.

Figure 2. Piaggio shareholder structure post IPO



Source:

Company data and Citigroup Investment Research

IMMSI is a long-term strategic shareholder of Piaggio (although lock-up on its stake formerly ends in July 2007). It is indirectly controlled by Roberto Colaninno, former chairman of Telecom Italia and Telecom Italia Mobile, and Managing Director of Olivetti. Since its entrance in Piaggio, IMMSI has directly appointed Piaggio top management and is responsible for the strategic decisions taken by the group such as those involving its operational and financial turnaround as well as its acquisition of Aprilia.

Valuation

- We initiate coverage on Piaggio with a target price €3.3 per share, and a 1M (Buy/ Medium Risk) rating.
- In our view Piaggio's growth story has only just begun. Aprilia's revamping is only part of the way through and seems to be a short- to medium-term growth driver. The strong growth opportunities in the North American market and the emerging markets of India, China, Southeast Asia and Latin America are due to drive growth in the longer term.
- We believe company guidance, market consensus and our forecasts are likely to prove conservative with regards to the growth prospects provided by the above markets up to 2008, potentially leading to a series of upgrades of market expectations.
- Current valuation is in our view undemanding - absolute valuation methodologies such as free cash flow yield, REP ratio and DCF point to valuations above current market levels: on 2006 and 2007 estimates we reach fair values of €3.40 on FCF yield, of €3.20 on REP Ratio and DCF to €3.6. At a 2006 PE multiple of 16.0x and PCF of 6.7x, shares are trading at an earnings PEG of 0.39x and at a cash flow PEG of 0.50x and on EV/EBITDA multiples Piaggio shares are trading at a 16% discount to peers.

Absolute valuation

In valuing small/mid cap companies, we mostly use two absolute valuation methodologies: the REP Ratio and the Free Cash Flow Yield methodologies. We rarely use the DCF methodology because of the high growth, cyclical nature and typically weak long-term visibility of the stocks in our universe. We have however applied all three methodologies to Piaggio.

Rating of economic profit ratio (REP ratio) valuation

Fair value of €3.2 per share

The REP ratio (rating of economic profit ratio) takes the relationship between returns over cost of capital and the market value of the enterprise to capital employed and offers a reasonable indication of the appropriateness of market valuations. A correct relationship between EV/CE and ROCE/WACC would be 1.0x. Based on our estimates for Piaggio, we obtain fair values of €2.5, €3.2 €3.7 per share based on our 2006-2008 forecasts respectively.

Figure 3. ROCE-related valuation

(€ mln unless stated otherwise)	2002	2003	2004	2005	2006E	2007E	2008E
Net capital empl. (yr avge)	386.0	676.2	770.3	947.5	922.1	918.6	964.8
Net capital empl. less treasury sh	386.0	676.2	770.3	947.5	922.1	918.6	964.8
EBIT	-28.6	-68.8	62.4	94.8	124.1	149.3	168.6
EBIT margin	-3.0%	-7.3%	5.8%	6.5%	7.9%	8.7%	9.3%
NOPAT	-39.1	-82.3	45.6	68.9	94.6	115.1	130.6
Asset rotation	2.5	1.4	1.4	1.5	1.7	1.9	1.9
ROCE (%)	-7.4%	-10.2%	8.1%	10.0%	13.5%	16.3%	17.5%
ROCE post tax (%)	-10.1%	-12.2%	5.9%	7.3%	10.3%	12.5%	13.5%
ROCE / WACC	-0.7	-1.1	1.2	1.5	1.8	2.2	2.3
ROCE post tax / WACC	-1.0	-1.4	0.9	1.1	1.4	1.7	1.8
EV / CE	4.2	2.0	2.0	1.5	1.5	1.4	1.3
REP ratio target (€)	**-2.4**	**-3.0**	**0.4**	**1.6**	**2.5**	**3.2**	**3.7**

Source: Company reports and Citigroup Investment Research estimates

Free cash flow yield valuation

Fair value of €3.4 per share

Valuations derived with the free cash flow yield valuation are somewhat higher: €2.9, €3.5 and €4.3 per Piaggio share on our 2006-2008 forecasts respectively. Using a hurdle rate of 7.8% (3.8% risk-free rate + market risk premium of 4.0%), this methodology states that a stock trading at a free cash flow yield (free cash flow before dividends and non-maintenance capex and one-off elements; divided by market cap) above the hurdle rate is undervalued, below it is overvalued and at the hurdle rate it is fairly valued.

Figure 4. Free Cash Flow Yield (priced on 31 August)

(€ mln)	2006E	2007E	2008E
Free cash flow	112.6	51.9	6.9
Non-maintenance invest.s (add-back)	35.1	35.9	36.0
Total dividend paid (add-back)	0.0	19.7	27.0
Other adjustments	-57.9	0.0	64.0
Adjusted free cash flow	89.8	107.5	133.9
Market cap	1050.6	1050.6	1050.6
Free cash flow yield	**8.5%**	**10.2%**	**12.7%**
Fair value (€)	**2.9**	**3.5**	**4.3**

Source: Citigroup Investment Research

We obtained the above fair values adjusting free cash flow yield for extraordinary items, such as the issue of capital this year to service the management stock option plan and the cash generated by the effects of factoring on net working capital in 2006. We also assumed 30% of tangible and intangible investments annually expensed by the company to be growth investments, and thus added them back to our free cash flow calculation. We believe this to be a conservative assumption given that the company is operating with an average capacity utilization of 55-60%, and is investing between 5-6% of sales in tangible and intangible assets per year through to 2008.

DCF Valuation

Fair value of €3.6 per share

We also applied the DCF valuation methodology to Piaggio estimates. We discounted free cash flows resulting from our estimates, after having normalised the tax rate (excluding the benefits from the carried forward losses, which we have added separately at the end) in the three forecast years and also in the calculation of the perpetuity. We discounted the flows using a WACC of 7.3%-7.8% on our 2006-2008 estimates (assuming D/E declining from 69% to 41% in 2006-08) and discounted the perpetuity at 7.7%.

Figure 5. Discounted cash flows calculation (priced on 31 August)

	2002	2003	2004	2005	2006	2007	2008	Perpetuity
EBIT	-28.6	-68.8	62.4	94.8	124.1	149.3	168.6	159.0
Tax	-10.5	-13.5	-16.8	-25.9	-38.2	-49.9	-58.6	-54.2
Depreciation	106.2	100.9	60.3	90.5	90.8	92.5	94.2	94.2
Gross operating cash flow	67.1	18.6	105.9	159.4	176.8	192.0	204.3	199.0
Change in wking cap	-55.9	98.5	-156.5	69.8	36.6	-9.4	-3.8	-3.8
Investments	-63.9	-81.7	-70.1	-99.7	-101.8	-101.6	-100.5	-94.2
Total investments	-119.8	16.8	-226.6	-30.0	-65.2	-111.0	-104.3	-98.1
Free operating cash flow	-52.7	35.4	-120.7	129.4	111.6	81.0	99.9	100.9
Present value of free cash flow					111.6	75.3	86.4	

Source: Company reports and Citigroup Investment Research estimates

Using a valuation horizon of year-end 2006, adding to the carried forward losses and deducting net debt at year-end 2005, we obtain a fair value of €3.6 using a perpetuity growth rate of 1.5% which is possibly conservative considering the high growth of the Indian market. Using a perpetuity growth rate of 2.0% we obtain a fair value of €3.9. This valuation tool possibly incorporates more of the future growth prospects than we have visibility for. On the other hand, we obtain a fair value of €2.5 per share, near the current market level, using a perpetuity growth of -1.5%, which we would consider to be an overly pessimistic assumption.

Figure 6. Cash flow valuation

(€ mln)	Total
Valuation horizon (ye)	2006
PV of cash-flow, 06-08	273.3
PV of cash-flow, FOCF 2009-infinity	1334.4
Non operating assets	244.0
Net debt (end-2005)	-411.4
Total	1440.3
Target price	**3.6**

Source: Citigroup Investment Research

Peer group relative valuation

In valuing Piaggio relative to a peer group, as there is no clear direct comparable, we have compared the group to two different sets of peers. The first is made up of listed companies that manufacture motorcycles, although most not on an exclusive basis. The other is made up by Italian small-mid cap stocks which operate in the automotive/engineering segment.

Motorcycle manufacturing peer group

In the motorcycle peer group, we compare Piaggio to Honda, Yamaha, Suzuki, Bajaj Auto and Harley Davidson. They are all much larger than Piaggio in volume terms. The Japanese manufacturers all have high contribution to sales from segments not 2-wheel related. We exclude Bajaj Auto from the peer group: its multiples are out of range, possibly due to the high growth of the Indian market in which it is focused despite it manufactures 2- and 3-wheeled vehicles like Piaggio. Finally, Harley Davidson focuses on motorcycles; it is a niche player with EBITDA margins twice-thrice the amplitude Piaggio's.

Figure 7. Piaggio comps – multiples (priced on 31 August)

		PE			EBITA			EBITDA			Earnings	EBITDA
	Price	2006	2007	2008	2006	2007	2008	2006	2007	2008	CAGR	CAGR
Honda (Y)	3930.0	12.1	12.3	11.6	7.7	8.4	7.7	5.9	6.1	5.7	9.2%	10.3%
Yamaha (Y)	3070.0	11.3	10.6	10.3	7.8	7.0	6.5	5.6	5.1	4.8	9.9%	9.9%
Suzuki (Y)	2985.0	24.4	18.9	17.7	13.6	12.2	10.8	6.5	5.9	5.3	8.4%	11.6%
Bajaj Auto (In rp)	2709.0	25.3	20.7	17.4	31.4	23.7	19.5	25.8	20.3	16.9	27.2%	34.0%
Harley Davidson (US$)	58.8	15.6	14.3	13.0	10.2	9.6	8.9	9.0	8.4	7.8	5.8%	6.0%
Average ex-Bajaj		**15.9**	**14.0**	**13.1**	**9.8**	**9.3**	**8.5**	**6.7**	**6.4**	**5.9**	**8.3%**	**9.4%**
Piaggio	**2.65**	**16.0**	**11.7**	**9.7**	**10.9**	**8.7**	**7.7**	**6.3**	**5.4**	**4.9**	**41.8%**	**12.4%**
Premium (disc) to peers		0.9%	-16.8%	-26.0%	10.5%	-6.4%	-9.8%	-6.7%	-15.8%	-16.9%		
Premium (disc) to Japanese		0.4%	-16.2%	-26.3%	12.0%	-5.4%	-8.2%	4.9%	-6.0%	-6.8%		

Source: Citigroup Investment Research

On the back of our forecasts Piaggio should grow much faster than any of its peers in the coming years: we forecast Piaggio net earnings to grow by 42% 05-08 CAGR, whilst the average of the peer group ex-Bajaj Auto is a slower 8.3% (05-08 CAGR).

Figure 8. Piaggio margins versus comps (Piaggio's have been adjusted for capitalized R&D costs)

	EBITDA 2005	EBITDA 2006	EBITDA 2007	EBITDA 2008	EBIT 2005	EBIT 2006	EBIT 2007	EBIT 2008
Honda (Y)	9.9%	11.4%	10.0%	10.3%	7.3%	8.8%	7.4%	7.6%
Yamaha (Y)	10.4%	11.4%	11.3%	11.2%	7.5%	8.1%	8.2%	8.2%
Suzuki (Y)	8.7%	8.8%	9.0%	9.0%	4.5%	4.1%	4.3%	4.4%
Bajaj Auto (In rp)	12.6%	15.0%	15.5%	16.3%	9.4%	12.3%	13.3%	14.1%
Harley Davidson (US$)	31.4%	31.1%	31.3%	31.4%	27.5%	27.3%	27.3%	27.5%
Piaggio (€)	10.8%	11.3%	12.1%	12.6%	4.5%	5.5%	6.7%	7.4%

Source: Citigroup Investment Research estimates

From this comparison we would conclude that Piaggio does not deserve to trade at such a strong discount to the peers particularly on the EBITDA multiple, where comparison is easier given the fewer accounting differences and tax (carried forward tax benefits for Piaggio). We believe it would deserve to trade at a discount to Harley but possibly at a premium to the Japanese which have similar margins but are growing slower than Piaggio; that is to say at €3.0 per share, 15% above current levels.

Italian small/mid cap peer group

We compared Piaggio multiples to a group of Italian small and mid cap growth stocks in the engineering and auto components segments as a sanity check on the multiples we derived with the "2-wheeled" vehicle manufacturers, and the out come was of a substantial confirmation in each the PE, EV/EBITDA and EV/EBIT multiples.

Figure 9. Italian auto and engineering small/mid cap peers (priced on 31 August)

		PE			EBITA			EBITDA		
	Price	2006	2007	2008	2006	2007	2008	2006	2007	2008
Guala	4.4	15.9	12.7	10.6	10.3	8.7	7.5	7.2	6.3	5.5
Brembo	8.4	13.8	11.4	10.0	8.8	7.3	6.2	6.0	5.0	4.3
IMA	11.2	20.2	16.6	14.3	9.8	8.4	7.2	8.6	7.4	6.4
Interpump	6.8	15.5	13.4	11.5	9.3	9.0	7.6	8.4	8.2	7.0
Sabaf	22.2	16.7	14.5	12.5	9.9	9.1	7.8	6.7	6.3	5.5
Average		**16.4**	**13.7**	**11.8**	**9.6**	**8.5**	**7.3**	**7.4**	**6.6**	**5.7**
Piaggio	**2.65**	**16.0**	**11.7**	**9.7**	**10.9**	**8.7**	**7.7**	**6.3**	**5.4**	**4.9**

Source: Citigroup Investment Research estimates

Guala Closure is a niche leader in the caps and closures business. Brembo manufactures brakes for cars, commercial vehicles, motorcycles and scooters (including Piaggio) and racing cars (also has an international manufacturing base, India and China included). IMA is a world leader in the manufacturing of pharmaceutical product process and packaging (also tea-bag packaging machinery), Interpump world leader in hydraulic equipment for trucks and high pressure water pumps. Sabaf is the European leader in components in gas cooking appliances – it is really an engineering company, building its own machinery and tooling with 19% EBIT margins.

Leading manufacturer of 2-wheeled motor vehicles in Europe

Group Overview

- European market leader in the 2-wheeled vehicle market and also in the niche market of light commercial vehicles in Europe and in India
- In the midst of an impressive turn-around and revamping
- The Aprilia acquisition has opened up the group to new growth opportunities
- Presence in high-growth markets due to provide additional support to growth
- Solid business model based on strong industrial assets

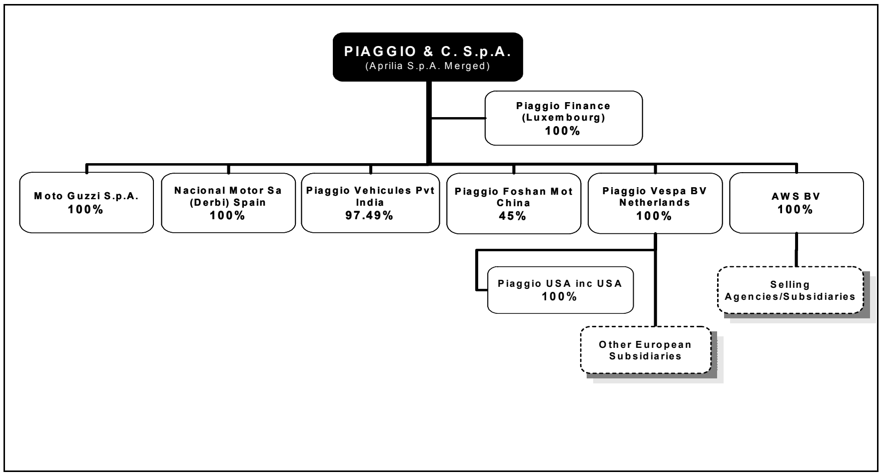
Group snapshot

In its more than 120-year history, Piaggio has been active in almost every area of transport, including naval fittings, construction of locomotives and rolling stock, engines for the aeronautics industry, seaplanes and civil and military aircraft.

Since the 1940s Piaggio has focused on small vehicles, introducing the first Vespa scooter in 1946 and since becoming a major manufacturer of two wheeled vehicles world-wide, selling 16 million Vespa models and a total of over 30 million scooters sold since then.

Today, Piaggio is the leading manufacturer of motorised two-wheeled vehicles in Europe, the world's most attractive and largest market in sales terms. It is the fourth player worldwide after the Japanese manufacturers Honda, Yamaha and Suzuki. It is also one of the main brands in three- and four-wheel light commercial vehicles for utility and personal mobility, which it sells in Europe and India.

Figure 10. Group structure - Piaggio group



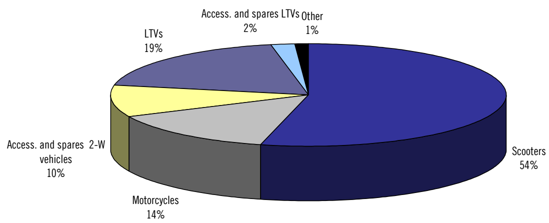
Source: Company Reports

With headquarters in Pontedera, in Tuscany, the group employs over 6,300 employees. It has five R&D centres and seven production facilities: four are in Italy, one is in Spain, one in India and one in China. The latter, managed in JV with local 2-wheeler manufacturer Zongshen, produces scooters, which it imports back for sale into the European market. It eventually expects to sell in the Chinese market as well. In 2005 Piaggio sold 607,700 vehicles, including both 2-wheeled and light transport vehicles, 3- and 4-wheeled.

Acquisition of Aprilia

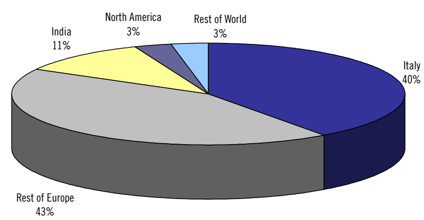
In December 2004, Piaggio acquired the Aprilia group to further strengthen its scooter business and to complement its existing business portfolio with an increased presence in motorcycles. Prior to its acquisition by Piaggio, Aprilia had experienced several years of financial difficulties which Piaggio has started to address in the first year since the acquisition. Aprilia was a key competitor in the Italian scooter business and was the largest purchaser of Piaggio engines. As such, the acquisition of Aprilia embodies significant industrial and commercial synergies for the Piaggio group as a whole.

Figure 11. sales by product (2005)



Source: Company Reports

Figure 12. Piaggio – sales by geographical market (2005)



Source: Company Reports

Full product range in 2-W

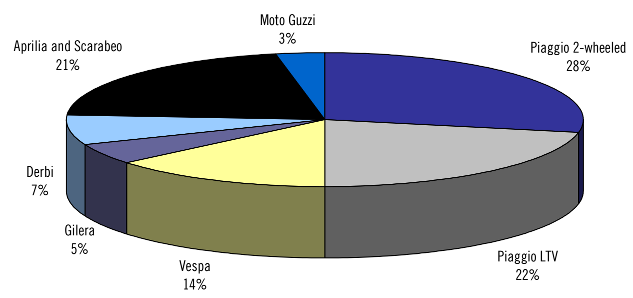
More specifically, with the acquisition of Aprilia, the Piaggio group has expanded its product range into the high-displacement motorcycle segment, and increased its product offering and market share in the scooter segment and in low-displacement motorcycles.

Its product offering now spans from scooters with engine displacement from 50cc to 500cc sold under the Piaggio, Vespa, Gilera, Derbi, Aprilia and Scarabeo brands to motorcycles from 50cc to over 1000cc with Gilera, Derbi, Aprilia and Moto Guzzi brands.

LTV segment, Piaggio is a clear number 1 player in European market

In the LTV market, Piaggio offers the most comprehensive range of 3- and 4-wheeled vehicles available on the market in the niche of load capacity below 1.1 tonnes.

Figure 13. Piaggio - revenues by product brand (2005)



Source: Company Reports

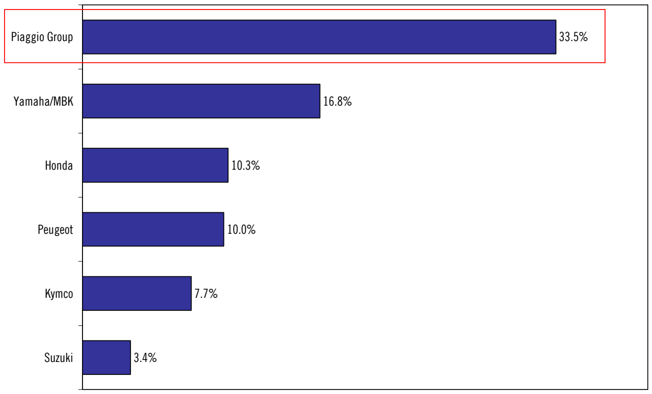
Unparalleled distribution structure in Europe

The group sells its products in 50 countries worldwide through 25 commercial subsidiaries and an unparalleled distribution network of dedicated dealerships, of which for the 2-wheeled vehicles market 9,550 in Europe and more than 270 in North America, and for the LTV market 700 in Europe and 220 in India. Piaggio has a dedicated sales structure serving corporate clients.

European market leader in two-wheeled vehicles and light transport vehicles

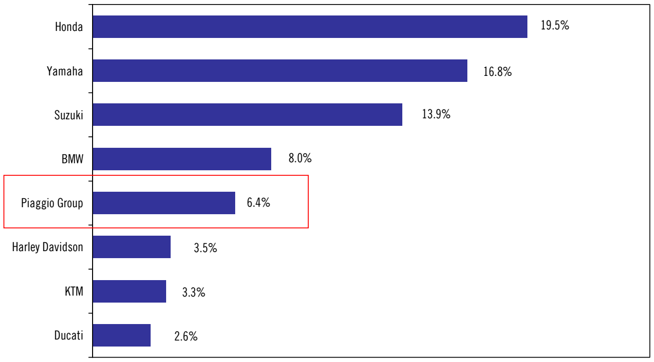
The group has consolidated its 22% (18.2% 2004) market share in the European
2-wheeler market (and of 35% in Italy) and a particularly high market share in the 50cc segment (33.6% in Europe and 60% in Italy).

Figure 14. European scooter market - main competitors



Source: Company Reports

Figure 15. European motorcycle market - main competitors



Source: Company Reports

Scooters: consolidates leadership position in Europe

In the scooter segment, with the acquisition of Aprilia Piaggio has consolidated its leadership position, raising its market share from 28.7% to 33.5% between 2004 and 2005 (in volume terms) mainly thanks to this move. This leadership position in Europe overall reflects its strong positioning in the individual markets of Italy, Spain, the UK, and Germany, with a number 3 position in France. The second-largest player in the European market is Yamaha/MBK with a 16.8% share, followed by Honda and Peugeot at about 10% and the Taiwanese manufacturer Kymco with 7.7%.

Motorcycles: leader in the low-displacement market and fifth-largest overall in Europe

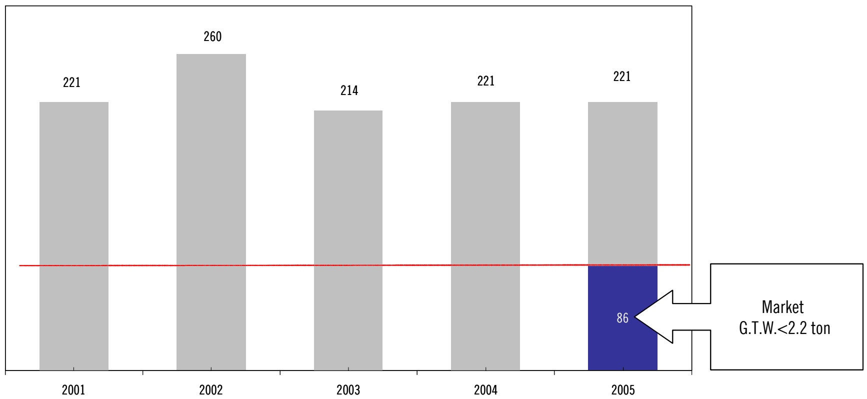
In the motorcycle segment, the acquisition of Aprilia has given Piaggio a position amongst the leading players in the European market, with 6.4% market share (2005 data – 4.0% in 2004 before consolidating Aprilia) behind the three top Japanese manufacturers Honda, Yamaha and Suzuki and the German BMW. We believe this market share is likely to grow in the next couple years, thanks to significant model revamping and to the leveraging of Piaggio's strong distribution structure, allowing Aprilia to recover the market share it lost when it entered financial difficulties.

In motorcycles Piaggio now has a clear European leadership in the low engine displacement range of 50cc-125cc with a 20.5% market share (in 2005). Its position is further strengthened by 23 motorcycle racing championship wins in the 125cc-250cc engine class, and 8 championship wins in the Superbike class. Within individual country markets in Europe, Piaggio is the leading manufacturer in Italy and Spain, occupying the number 3 market position in France and the UK and is number four player in Germany.

LTVs: leadership position in Europe

In the Light Transportation Vehicles (LTV) segment, Piaggio is a clear number one player in the Italian market, the reference market for this sector in Europe, being the sole player present in the market niche of 3- and 4-wheeled vehicles with load capacity below 1.1 tonnes. This is a market niche which is at best holding up if not somewhat contracting in Europe, and where Piaggio has managed to hold up its sales and volumes by increasing and diversifying product range. Piaggio products are attractive on the basis of their characteristics of limited dimensions despite the considerable payload, the high manoeuvrability and low maintenance costs. Further, these products benefit from the fact that they do not require a specific commercial vehicle license to be driven. Piaggio has offset this stagnation in European sales with strong growth in the Indian market, where it has rapidly reached the second position in market share.

Figure 16. Italian LTV market



Source: Company Reports

In the midst of an impressive turnaround

Since IMMSI acquired Piaggio in October 2003 and brought in the current management team, Piaggio has undergone a significant turnaround achieving strong sales growth, rapid recovery in profitability and return to strong cash generation. With 1Q06 results just approved on 4 May, Piaggio's restructuring can be considered completed, although there are still substantial synergies to be fully exploited from the acquisition of the Aprilia group (acquired in December 05).

The Aprilia group has also started to follow the same virtuous path with its restructuring plan is only part of the way through. In Figure 10, 2003 includes only 2 months of consolidation of Derby, net of which 2004 sales growth is of 14.8%.

Figure 17. Piaggio group, inclusive of the Aprilia group from 2005 - Revenue and EBITDA trend

	2003 It GAAP	2004 It GAAP	2004 IFRS	2005 IFRS (1)
Sales	**925**	**1084**	**1084**	**1451.8**
Yoy growth		17.2%		33.9%
EBITDA	**72**	**128**	**123**	**185**
EBITDA margin	7.8%	11.8%	11.3%	12.7%

(1) – 2005 data includes 100% of Aprilia accounts for the first time. Source: Company data

Source: Company Reports

The revamping of Piaggio

In the two years that this management team has been in place, Piaggio's stand-alone sales have increased by 22% and EBITDA margin has almost doubled from 7.8% (Italian GAAP) in 2003 to 14.6% (Italian GAAP, 15.4% under IAS). From an adjusted net loss of €138 million in 2003, the group reported a growing net income both in 2004 and 2005, with positive cash generation in both years and a free cash flow of €111 million (7.6% of yearly sales) in 2005, from €24 million in 2004.

Figure 18. Piaggio - Revenue and EBITDA trend

	2003 It GAAP	2004 It GAAP	2004 IFRS	2005 IFRS
Sales	**925**	**1084**	**1084**	**1135**
Yoy growth		17.2%		4.7%
EBITDA	**72**	**128**	**123**	**175**
EBITDA margin	7.8%	11.8%	11.3%	15.4%

Source: Company Reports

Net debt/EBITDA ratio has fallen from 4.3x in 2004 (Italian GAAP) to 2.2x in 2005 (IFRS). In April 2005, in conjunction with the issue of high yield bond, Piaggio's debt was assigned a rating of B+ rating by S&P and of B1 by Moody's.

The sales growth achieved by Piaggio and its strong recovery in margins have been achieved by revamping the product range and increasing product prices outright (by as much as 2% in 2004). The company also improved the product mix, moving away from the 50cc engine displacement models towards models with higher displacement, where the market is less exposed to low-cost competition from East Asian manufacturers and where product prices benefit from higher value-added content of the products.

The strong recovery of Piaggio over the past two years also strongly benefited from the very positive performance of Piaggio India, where market share gains coupled with strong growth of the Indian LTV market, resulting in 43% and 46% sales growth respectively in 2004 and 2005 for Piaggio products in that market.

The turnaround of the Aprilia group

As for the Aprilia group, after only one year since the acquisition by Piaggio (30 December 2004), 2005 accounts already indicate a strong improvement at all levels. Sales grew by 10.3%, and EBITDA margin improved from negative 5.3% (Italian GAAP) to positive 2.8% (under IFRS); cash flow breakeven was already achieved in the year.

The turnaround has so far principally been the result of the revamping of product range (only partly completed), cost rationalisation and the benefits of some operational leverage. As a result of the revamping of product range, selling volumes (mainly of scooters, where the market is more reactive to product innovation) have started to recover from the lows of 2004: in 2005 overall Aprilia group volumes rose to 348,900 from 318,000, but are still well below 533,000 vehicles sold in 2002.

Figure 19. Aprilia group (including Moto Guzzi) - Revenue and EBITDA trend

	2003 It GAAP	2004 It GAAP	2005 IFRS
Sales	**533**	**318**	**351**
Yoy growth		-40.3%	10.4%
EBITDA	**23**	**-17**	**10**
EBITDA margin	4.3%	-5.3%	2.8%

Source: Company Reports

There is still significant unexpressed potential in terms of volume recovery, with recovery in the motorcycle segment (where brand image has taken longer to recover from the difficulties pre-Piaggio acquisition) expected to materialise over the next two years. EBITDA margin of Aprilia group is targeted to reach 10%-11% on a stand-alone basis from 2.8% reached in 2005.

Leveraging group synergies for growth

Piaggio intends consolidating its leadership position in the European market in the scooter segment, persevering in the effort to revitalise the Aprilia, Moto Guzzi and Scarabeo brands and models to bring market share and volumes back to the levels of 2002-3 in the segments where the group is already present, when the company entered the phase of financial crisis and decline. Aprilia group-related brands (ie Aprilia, Moto Guzzi and Scarabeo) generated sales of 120,700 vehicles in 2005, versus 180,100 in 2003. This implies that Aprilia group brands still need to increase by c50% to reach the same market share levels of 2003.

Additionally, there is room to fill gaps in terms of product offering. One important gap is the intermediate engine displacements, 126-750cc, where product offering has traditionally been weakest. Indeed, prior to the Aprilia acquisition, Piaggio was marginally present in the motorcycle segment overall and mainly present in the low-displacement range with Derbi and Gilera, which were focused in the 50-125cc range. The acquisition of Aprilia extended Piaggio's presence to the above-750cc range, where both the Aprilia and Moto Guzzi brands were strongest, leaving a relatively weak presence in the middle engine displacement classes.

Further, there is room to broaden product offering in segments where Aprilia has traditionally been strong (like the custom and touring segments with the Moto Guzzi brand), extending the presence to all engine classes (not just above 750cc) in order to better exploit economies of scale.

The potential appears strong, given the strength of the brand portfolio and the distribution platform, which is second to none in Europe and which comprises some 11,000 dealerships worldwide, of which a large portion (30%) operating on a dedicated basis. Extending the presence of the Aprilia and Moto Guzzi branded products to new markets has additional potential.

Figure 20. Piaggio group (inclusive of Aprilia group) - sales trend by brand

(mln €)	2002	2003	2004	2005
Piaggio	321.6	348.3	426.9	365.9
Gilera	98.3	89.2	80.6	61.1
Vespa	91.6	119.8	110.0	173.4
Spare parts and accessories				87.0
Derbi	64.6	69.3	85.6	93.3
Total Piaggio 2-Wheels	**576.1**	**626.6**	**703.1**	**780.7**
Aprilia	328.1	322.3	199.9	251.3
Scarabeo	70.8	82.4	48.9	46.6
Moto Guzzi	58.7	57.2	23.3	51.0
Other	66.7	71.2	46.0	
Total Aprilia 2-Wheels	**524.3**	**533.1**	**318.1**	**348.9**
Total two wheels	**1,100.4**	**1,159.7**	**1,021.2**	**1,129.6**
LTVs				
Ape Europe 200 & 700kg	58.8	46.2	33.1	28.2
Ape India 500 & 700kg	60.8	70.5	100.4	146.8
Minivan (Porter) 560-1100kg	74.7	63.2	59.3	65.1
Quargo 750kg	0	0	6.4	25.1
Microcars	20.4	7.1	7.7	5.8
Trackmaster			0	1.1
Spare parts and accessories	161.9	177.1	133.5	31.8
Total LTVs	**376.6**	**364.1**	**340.4**	**303.9**
Other			40.7	18.2
Total group	**1,477.0**	**1,523.8**	**1,402.3**	**1,451.7**

Source: Company Reports and CIR analysis.

Significant synergies could emerge from spreading R&D costs (thus far on average 4% of sales) and overhead costs on a wider product base, on higher volumes. Also, the production of engines in-house, previously outsourced by Aprilia, should contribute maintaining a higher portion of value added within the group.

A more extensive use of global sourcing of components in Piaggio, but particularly by Aprilia, would further help generate synergies.

Strategic presence in India and China with strong growth prospects also in the US

Aside from benefiting from the completion of the restructuring of Aprilia accounts and leveraging new scooter and motorcycle models for growth in Piaggio's traditional markets in Europe, the group's growth should benefit from the exposure to emerging markets and in mature markets that have strong potential for growth, like the American one.

India

The Indian market is strategic for Piaggio, whose presence in this market has so far been focused in the light transport vehicles (LTV) segment. Since 1999, Piaggio has a production plant near Baramati, in the Maharashtra region where it assembles vehicles for this market.

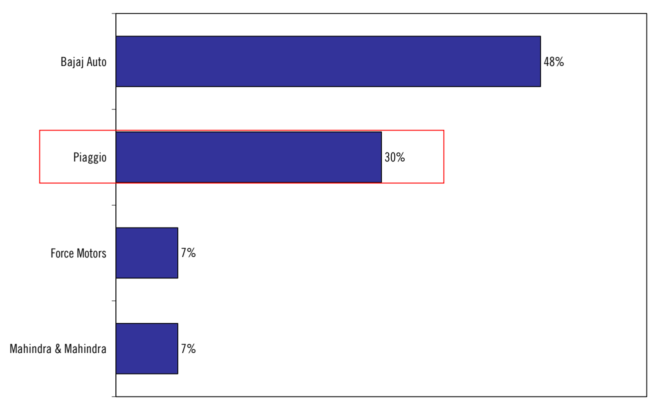
Figure 21. Indian LTV market - and Piaggio market share

(units)	2002	2003	2004	2005	02-05 CAGR
Indian LTV market volumes	230.000	260.000	300.000	340.000	13.7%
Yoy growth		13.0%	15.4%	13.3%	
Piaggio Indian LTV market share	16.6%	19.1%	24.0%	29.8%	
Piaggio Indian sales volumes	38.100	49.600	72.100	101.400	38.6%
Yoy growth		30.2%	45.4%	40.6%	

Source: Company Reports

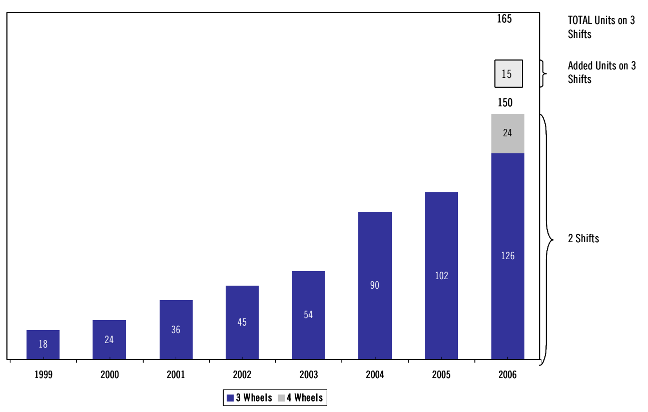
In the Indian market, Piaggio is the number two player with 30% market share behind Bajaj Auto, which is the leading player with a market share of 48% and ahead of Force Motors and Mahindra & Mahindra, which both have a share of 7%.

Figure 22. LTV market India - main competitors in the 3-wheeler segment (2005)



Source: Company Reports

Figure 23. LTV India - production capacity



Source: Company Reports

The LTV segment in the Indian market is segmented into passenger and cargo vehicles, and Piaggio's three-wheel vehicles have experienced very strong growth since the company entered the Indian market in 1999. This market has grown at volumes CAGR of 13.7% between 2002 and 2005, particularly driven by the cargo segment, which has grown at 35% in the same period.

Piaggio has leveraged the strong growth of the cargo segment, where it is the leading player, and is number two in the passenger segment, growing by 38% volumes CAGR in the same period. In the overall Indian LTV market, the company is now a strong number two player with a market share of 30%. The company aims to increase its product range in this market (by introducing gas propelled 3-wheel vehicles and introducing 4-wheel LTVs with less than 1 tonne capacity in 4Q06) to take advantage of the strong growth potential the Indian market represents. It has potential both in terms of economic growth and in terms of penetration of these vehicles, which are particularly suitable to this and other emerging markets thanks to the low running costs and the small size of the vehicle, and high manoeuvrability.

Using India as an LTV production base for other markets in the area

Besides being interested in the India as a destination market for these vehicles, it has recently invested to expand production capacity of the Indian production plant in order to cater to the markets of the Indian sub-continent (Bangladesh and Pakistan), and perhaps at a later stage also to markets in Southeast Asia (Indonesia and Thailand, in particular).

As the Indian 2-wheeled market starts to develop in terms of features and engine displacement, Piaggio could look to also enter the two-wheeled segment, although as yet there is no concrete plan for this in the foreseeable future.

China

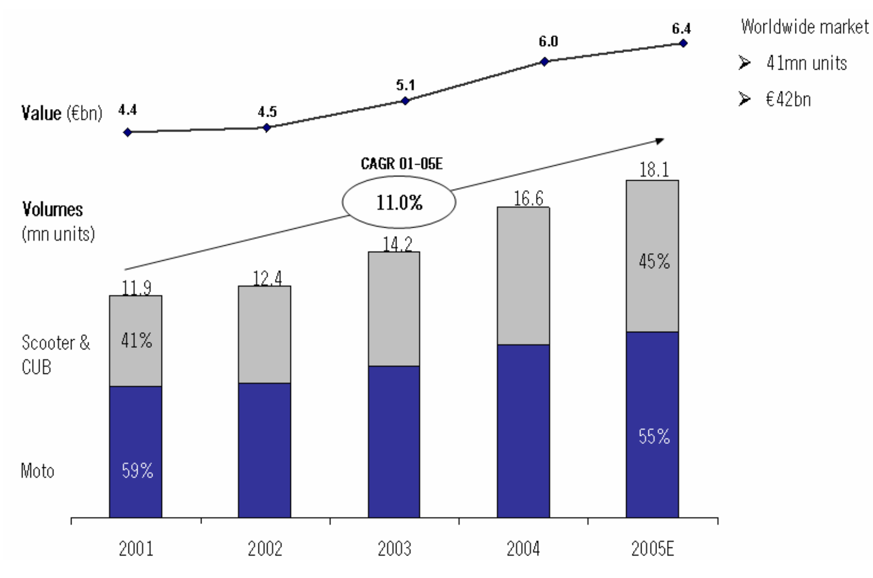
Largest 2-w market worldwide

The Chinese 2-wheeled market is the largest in the world in volume terms, with annual sales of about 18 million units. Despite some improvement in product mix in more recent times, demand is almost exclusively based on basic and low unit value vehicles, and the market is prevalently based on local manufacturers.

Currently exclusively used as a manufacturing and purchasing base

Piaggio has since April 2004 set up a production joint venture in China in with local partner Zongshen in Foshan, Chong Qin prefecture. The JV is 45% controlled by Piaggio, 45% by its partner and 10% by the local authority and Piaggio consolidates its part of the venture with the equity method.
So far this plant has been used to assemble scooters for the export market. Production is shipped to Europe and targeted to the low displacement and price range, an area which Piaggio wants to dominate in order to defend its leadership position in the scooter segment overall.
The Chinese production base has also been important in increasing the amount of low-cost sourcing of components from this market: components are checked and homologated by the Chinese assembly plant also for components bought locally before being shipped to the group's European plants.

Figure 24. Piaggio Zongshen JV - Chinese market overview



Source: Company Reports and CIR estimates.

Intends to launch products for the Chinese market by year-end

Nevertheless, Piaggio is starting to consider the Chinese market as an end market in its own right. The company is developing 4 co-branded dedicated scooters for the Chinese market, the first one being launched in 4Q06 and then through to 2008.

North America

A strong growth opportunity

The North American market represents a strong growth opportunity for Piaggio. The market for 2-wheeled vehicles in this region is relatively rich (high average unit prices) and has been growing strongly over the past few years, fuelled by strong traffic congestion and high fuel prices which are turning consumers from four-wheel vehicles to scooters and motorcycles.

The market for motorcycles has been growing at 5.7% per year between 2001 and 2005 (versus an average of 0.9% in Europe in the same years), whilst that for scooters has grown at a staggering 27% (versus -3.1% in Europe) in the same period.

The North American motorcycle market is mainly focused in the off-road, custom and touring segments, where Piaggio's range has thus far not had a product offering. In the scooter segment, however, Piaggio has become the number 3 player with a market share of 18.5% over a short period of time (Motorcycle Industry Council – not including Chinese, Taiwanese and Korean low-end vehicles, which do not strictly speaking qualify as scooters). The group is now looking to leverage the Aprilia and Moto Guzzi brands in this market - particularly the latter, which has a strong tradition in the custom and touring segments - to increase its presence in the motorcycle segment.

Figure 25. North American motorcycle and scooter market

('000 units)	2001	2002	2003	2004	2005	01-05 CAGR
Motorcycle market	821	889	942	991	1024	5.7%
Yoy growth		8.3%	6.0%	5.2%	3.3%	
Scooter market	50	74	97	109	130	27.0%
Yoy growth		48.0%	31.1%	12.4%	19.3%	

Source: Company Reports

Specifically in the scooter segment, Piaggio has benefited from this market trend thanks to the strength of its brands, almost trebling unit sales from 5,300 in 2003 to 15,900 in 2005, with a similar trend in sales value, from €13 million to €37 million in the same period.

Today, Piaggio has a significant distribution platform in this market, made of 270 distributors at end-2005, and basically nonexistent market share; thus it has much potential to grow, given that this market has only just become a strategic priority.

Piaggio's business model

The turnaround of Piaggio first, and then Aprilia, has been the result of the implementation of a very successful business model which is based on several key elements:

1. enhancing R&D capabilities;
2. increasing globalisation of component purchasing;
3. an increasingly flexible production process;
4. leveraging a strong distribution structure; and
5. quality control and customer satisfaction

R&D capabilities

The research and development capabilities of Piaggio are a centre of excellence and one of the group's competitive strengths, giving the group cutting-edge technology and making its products strongly innovative.

The group has 5 R&D operations which employ 850 employees, 13% of the total workforce. The operations are organised with a central structure in the group's headquarters in Pontedera and with local offices in each of the group's main production plants: in Noale (Aprilia's HQs), in Mandello Lario (production facility of the Moto Guzzi brand), in Barcelona (Derbi manufacturing base), in its Indian production base and in its JV plant in China.

The group spends some 4% of sales in R&D, equal to €55 million in 2005 from €38.6 million the year before, financing the activities of these centres which focus on three main areas.

The first is in finding synergies and cross-fertilisation opportunities across products as well as on cost efficiency. Since 2000, the group has achieved on average 20% cost savings in terms of R&D spending efficiency, has reduced the average capex for new products by 40% (by 60% on products in the low-price segment) and reduced time-to-market by 20% on new models, by 10% on new engines and by 15% on restylings.

Secondly, they focus on the development of new products and on maintaining Piaggio's technological leadership through the ongoing development of new patented designs and parts. For this, Piaggio's R&D centres extend their collaboration with external research centres and universities, they leverage national and EU co-sponsored projects and have strong relationships with strategic partners across Piaggio's supply chain.

Finally, they focus on the development of proprietary technology for engines. Engine manufacturing is perceived as a strategic activity at Piaggio and their development and assembly is therefore kept in-house. Piaggio develops a wide variety of engines, ranging from 50cc to 1.5 litres, 2 and 4 stroke, that run on natural gas, petrol and diesel, of one or more cylinders. It is currently in the testing phase of a hybrid scooter engine, running on both electricity and petrol.

Globalisation of component purchasing

In its activity of manufacturing 2-wheeled vehicles and LTVs, Piaggio is substantially an assembler of components, with total purchases representing 83% of cost of goods sold in 2005. Raw materials represent only 8% of total purchases, and a key element of success for the group is therefore being able to save on component purchases. An important part of Piaggio's business model and of the group restructuring plan is the gradual globalisation of its sourcing, particularly from low cost countries like India, China and Taiwan. In 2005, 11% of the group's components purchasing came from low-cost countries (3% from China and 4% from Taiwan), thereby leaving ample room for further potential cost savings deriving from this area. Management aims to increase this from 11% in 2005 to about 30% by 2008. Global sourcing is much higher at Piaggio, having reached 16-17% in 2005, while it is still very low at Aprilia, 6-7%, thus explaining where a significant part of the margin upside at Aprilia is likely to come this year and in coming years. In 2005, the Piaggio group achieved on average 30% cost savings on sourcing from low-cost countries, saving as much as 63% on shock absorbers for 50cc motorcycles, 32% on mufflers for 125cc engines.

Not all components can be sourced in low-cost countries, and another avenue for improving component costs is to reduce the number of suppliers and to establish a number of key partnerships with them, aimed at co-developing new products and reduce purchasing costs through a more intense relationship with a chosen few suppliers. Piaggio has established this kind of relationship with suppliers from all over Europe, but also from Japan.

Flexible production process

Piaggio has seven dedicated production plants in Italy, Spain and India with state of the art facilities. It also has a plant in China, operated in JV with partner Zongshan, which produces scooters that it currently sells in Europe under the Piaggio brand.

In these plants it has eight assembly lines for engines (in addition to moulding and lathing facilities), 19 assembly lines for 2-wheeled vehicles (eight in Pontedera, nine in Scorze and two in Barcelona) and welding facilities and paint shops. Finally, it has three assembly lines for LTVs (two in Pontedera and 1 in India) as well as dedicated welding and paint shops.

Figure 26. Piaggio's 7 production plants and capacity utilisation

Production site	Type of production	Max. daily capacity	Av.ge utilised capacity in 2005	Cap. utilisation
	Engines	3000	1880	62.7%
Pontedera (Italy) - 3 plants	2-w Piaggio brands	2830	1400	49.5%
	LTVs for EU mkt			
Scorze (Italy)	Aprilia scooters and bikes	1500	500	33.3%
Baramati (India)	LTVs for Indian mkt	600	370	61.7%
Barcelona (Spain)	Derbi scooters and bikes	750-900	235	31.3%
Mandello Lario (Italy)	Moto Guzzi bikes and engines	90	27	30.0%

Source: Company Reports

Its production facilities are operating well under their maximum utilisation capacity, running at 50% utilisation in the Piaggio-branded 2-wheeled vehicles lines and at around 30% utilisation in the Aprilia, Moto Guzzi and Derbi production lines. Capacity at the Indian LTV plant is being raised (€10 million investments) from 420 to 600 daily capacity, leaving this operation at 62% utilisation. All of Piaggio's plants thus have capacity to spare to absorb volume increases foreseen by company growth plans.

Piaggio has recently changed its production process from "stock production" to "line production". This implies not producing to build stock but rather to produce almost on order, thereby reducing inventory both of vehicles and of components but also having enough flexibility to switch production to top-selling products. For this reason Piaggio concentrates 50% of its yearly production volumes in the four months of April-July, which matches the peak period of its sales. The trough of production is concentrated in the three months of November-January.

In order to match the seasonal nature of its new production pattern, Piaggio is required to have a significant amount of flexibility in managing its labour requirements. Piaggio employs a large number of flexible workers, only during the peak production period. The flexible component of the workforce can be up to 40% of the full-time workforce.

Distribution structure

One of the group's strongest assets, its global and well-established distribution structure, comprises of more than 10,000 dealers in 50 countries.

In the 2-wheeled vehicle segment, Piaggio has some 9,550 dealers in total. Of these, 9,000 are located in Europe, covering all its 2-wheeled product brands and products, giving Piaggio its dominant position in the European market. In North America, Piaggio's presence branches through 270 dealerships. In India it has 220 exclusive dealerships, whereas in China, through its JV partner Zongshen, Piaggio will be able to leverage 900 dealerships. It will start selling scooters in that market in 4Q06. Piaggio covers marginal overseas markets mainly through importers.

Figure 27. Piaggio group - distribution network in main markets, 2-w and LTV products

Scooters and Motorcycles	Italy	FEDUK*	N. America	China ZS for JV
Piaggio, Vespa and Gilera	2,413	4,584	100	
Aprilia	416	1,231	117	
Guzzi	132	210	93	
Derbi	147	2,880	-	
Duplicates	*(379)*	*(3,134)*	*(37)*	
TOTAL	**2,729**	**5,771**	**273**	**900**

* France, Spain, Germany, UK

LTVs	Italy	RoE	India
LTVs	154	554	220

Source: Company Reports

Piaggio's distribution structure operates through a double layer of dealerships. There are the primary dealers, which are managed by Piaggio and which distribute both to final clients and to sub-dealerships, which in turn distribute exclusively to retail clients.

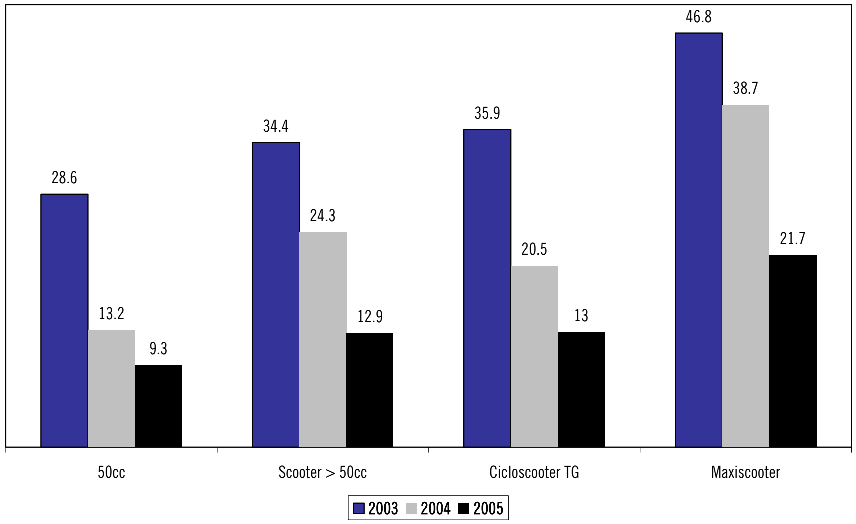
Dealerships can operate as exclusive mono-brand dealers selling only one Piaggio brand with a dedicated sales shop and repair workshop, as an exclusive group multi-brand dealer selling only Piaggio group brands or as a multi-brand dealer selling one or more Piaggio brands as well as competing brands.

Aside from its unparalleled size, the strength of Piaggio's distribution structure lies in the fact that over 30% of its dealers are exclusive mono-brand dealers. The strong relationship that exists between the group and these dealers is a key asset.

Quality control and customer satisfaction

A further key element of success of Piaggio's business model that has contributed to the turnaround of the group has been strict product quality control. Since 2003, faultiness on 2-wheeled products has fallen considerably. As an example, on 50cc scooters produced at the Pontedera site, the faults under warranty in the first three months from the sale of the product have fallen from 28.6% to 9.3% between 2003 and 2005. In these three years, overall "inconveniences" have fallen from 52.3% in 2003 to 23.2%, with customer satisfaction having risen from 79% to 88% in the same period. Linking both management and employee remuneration to the "faultiness" and "customer satisfaction" parameters has helped in achieving these results.

Figure 28. Piaggio group - Pontedera 2W plant - % faultiness under warranty at 3 months after sales



Source: Company Reports

Market, Brands And Products

- European market is the richest and most mature worldwide, but still with value growth potential
- Significant growth opportunities in the US scooter market
- China, Southeast Asia and India the fastest-growing 2-wheeled markets
- Piaggio group – 7 very strong brands, particularly in scooters, and substantial unexpressed potential in the motorcycle segment

World 2-wheeled vehicle market

The world market for 2-wheeled vehicles is worth €42 billion in sales and volumes of 40.8 million vehicles annually. The European market is the largest in value terms, with €10.5 million annual sales, 25% of total, but representing only 2 million vehicle sales per year, or 5% of the world market.

Figure 29. Global 2-wheel market

	Value (€ bn)	Units (mln units)	unit value (€)
Europe	10.5	2.0	5,250
North America	7.4	1.2	6,167
Latin America	1.8	1.2	1,500
India	5.4	6.7	806
China	6.4	18.1	354
Asean[1]	8.7	8.8	989
World	**42.4**	**40.8**	**1,039**

(1) – includes Indonesia, Thailand, Vietnam, Malaysia, Philippines. Source: Company data

Source: Company Reports

The largest market in unit terms is by far the Chinese market with over 18 million units sold yearly, 44% of the world market in number terms. Products are typically still very poor in content terms, with an average unit selling price of €354, compared to the European average of €5,250.

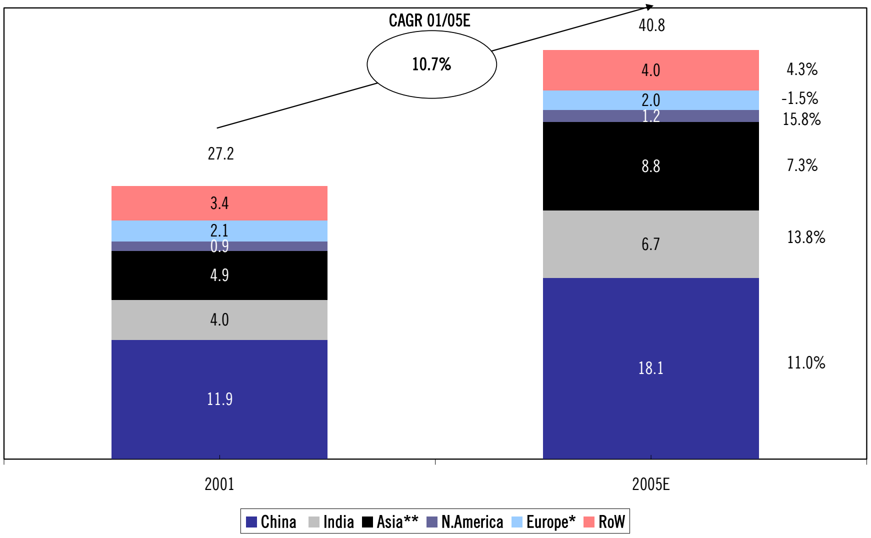
The North American market is smaller than the European one in number terms, representing 3% of the world total, but is richer than the European market with an average unit value of €6,167 versus €5,250 in Europe. The North American market has experienced relatively strong growth over recent years (01-05 CAGR of 7.3%), with particularly strong growth in the scooter segment, which has grown 27% (01-05 CAGR) from a low base and is expected to remain an interesting market in the coming few years.

The Indian and ASEAN markets are also very attractive markets, representing 6.7 million units and 8.8 million units of annual sales respectively with a unit price of just under €1,000.

The ASEAN market (Association of Southeast Asian Nation markets are Singapore, Malaysia, Brunei, Thailand, Indonesia, Philippines) has the strongest growth prospect for the coming years, having also posted the strongest growth since 2001, with a unit sales CAGR of 15.8%, versus 13.8% of the Indian market, with 11% growth in the China.

In terms of products, cubs and mopeds (the most basic motorised 2-wheeled vehicles) have experienced the highest growth, 17.8% in the same period, given they represent the lowest price class of product, and the best seller in high growth-markets like the ASEAN, Indian and Chinese ones, with motorcycles growing at 10%. Scooters have experienced the lowest growth, 5.3%, possibly due to their being principally marketed in developed countries (products are more sophisticated and higher in unit price) whilst motorcycles have benefited from emerging market growth, as swapping the cub for a motorcycle is seen as moving up the social ladder in those countries.

Figure 30. 2-w vehicle world market split by geography



* Italy, Spain, France, Germany, UK, Greece, Netherlands, Belgium, Portugal, Switzerland, Austria, Croatia, Slovenia, Czech Republic, Hungary, Denmark, Finland, Sweden, Norway.

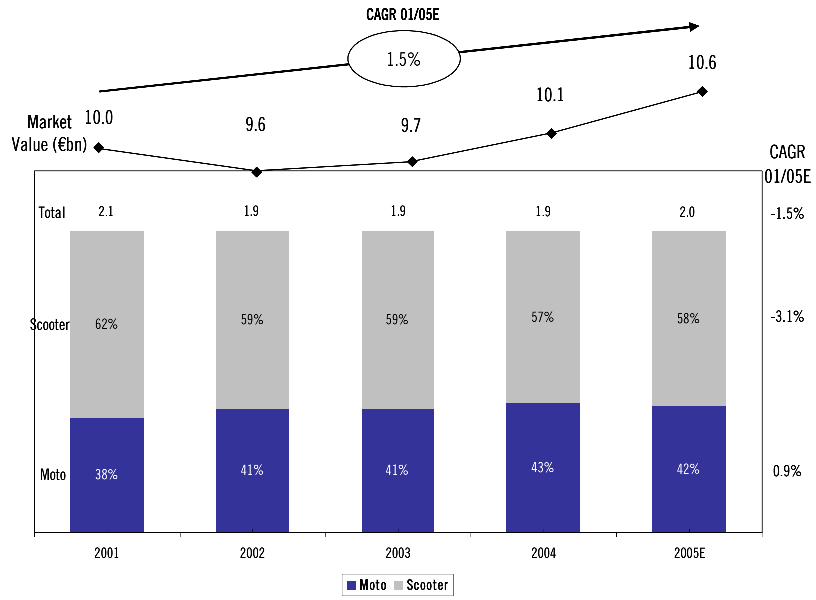
** Indonesia. Thailand, Vietnam, Malaysia, Philippines.

Source: Company Reports

Piaggio's main market – 2-wheeled vehicles in Europe

The European 2-wheeled vehicle market is mature but with moderate value growth. This market has undergone some significant changes over the years. Changes have mainly been induced by demographics: the ageing consumer population implies changing needs and higher disposable income. Consumers have been trading up and are increasingly willing to pay a premium for recognised brand quality.

Figure 31. Europe* - Piaggio's key market



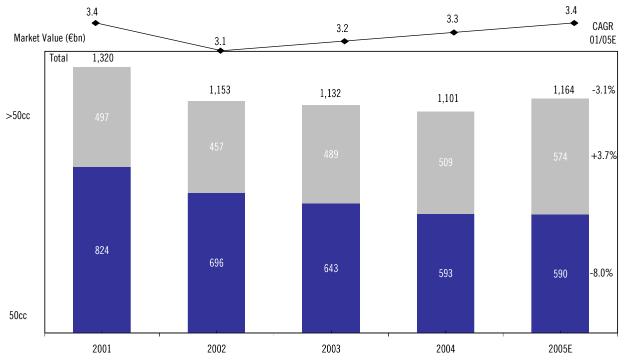
*Europe includes: Italy, Spain, France, Germany, UK, Greece, Netherlands, Belgium, Portugal, Switzerland, Austria, Croatia, Slovenia, Czech Republic, Hungary, Denmark, Finland, Sweden, Norway.

Source: Company Reports

Also usage of 2-wheeled motorised transport for everyday commuting as opposed to motorcars has been on the rise as a result of growing traffic congestion and poor public transportation and parking, as well as an on-going rise in fuel costs.

This has determined a shift towards motorcycles and scooters with higher engine displacements, and a general decline in the 50cc segment as rules concerning their driving requirements have changed.

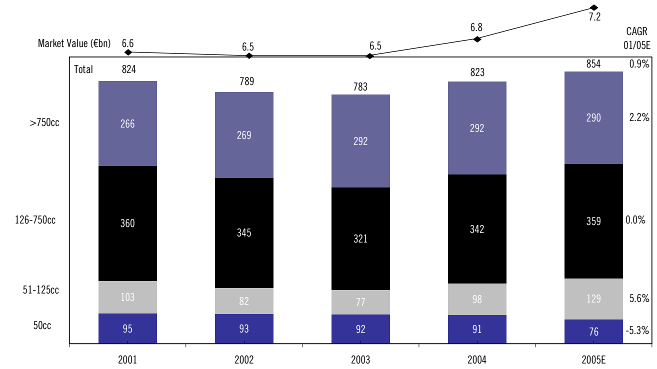
Figure 32. European* scooter market



*Europe includes Italy, Spain, France, Germany, UK, Greece, Netherlands, Belgium, Portugal, Switzerland, Austria, Croatia, Slovenia, Czech Republic, Hungary, Denmark, Finland, Sweden, Norway.

Source: Company Reports

Figure 33. European* motorcycle market



Europe includes: Italy, Spain, France, Germany, UK, Greece, Netherlands, Belgium, Portugal, Switzerland, Austria, Croatia, Slovenia, Czech Republic, Hungary, Denmark, Finland, Sweden, Norway.

Source: Company Reports

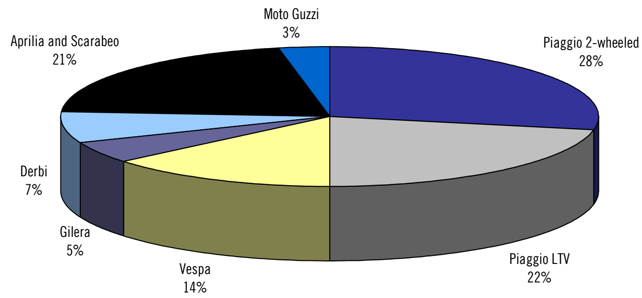
Competitive scenario

Within this market Piaggio uniquely offers a broad product range across several brands, with the largest dealer network in the market. The group's main competitors are first of all the Japanese manufacturers. Honda offers a full product range in both motorcycles and scooters has a high market share in all segments. Yamaha also has a full product offering and is particularly strong in the sports segment. Suzuki is strong in the motorcycle segment, with a weaker offering in scooters. BMW has strong positions in selected segments in the motorcycle market and only occupies a niche position in the scooter sector. Harley Davidson has a strong position only in the custom niche motorcycle segment.

In the low-price segment, typically the 50cc scooter segment, there is the Taiwanese scooter manufacturer Kymco and a number of Chinese and Indian players.

Piaggio's brands

Figure 34. Piaggio group - sales breakdown by brand (2005)



Source: Company Reports

The Piaggio brand

Piaggio-branded scooters include the Beverly, Liberty, X8 and X9 scooters, which represent the largest range of scooters under a single brand in Europe and which cover practically every scooter segment. The marketing strategy for Piaggio brand products is to promote them as safe, solid and stylish products that represent good value.

The Vespa brand

This is Piaggio's first and most famous scooter brand, Vespa products have a strong fashion element and are targeted to consumers in the 25-55 age group. Vespa products are a recognised icon of Italian style and elegance and are original in that they maintain their original style as an all-metal scooter. These elements alongside style and strong brand, allow selling Vespa scooters at a premium relative to Piaggio group's other models.

The Gilera brand

Gilera specialises in the scooter and light motorcycle segment where performance is a key component. A brand with long racing tradition, Gilera was first produced in 1909 and has 45 Grand Prix wins to its name; most recently it won the title in 2003 in the 125cc.

The Derbi brand

Barcelona-based Derbi is the Spanish market leader in small displacement motorcycles for young customers, targeting the age range of 14 to 17 years. The brand had a market share of 5.8% of the European 50cc market for under-16 year olds in terms of units sold. The brand also manufactures 125cc motorcycles for 16-17 year olds, which are recognised as fashionable, exciting, technologically sophisticated and dynamic. This product segment requires very high flexibility in production, with quick time to market of innovations, and the Spanish production facilities are capable of such requirements and have delivered some 20 new models and restyled ones in the time span of two years.

Derbi's niche target market and motorcycle-oriented products make this company very different from others in the group, and this has prevented the company from being more quickly integrated in the rest of the group, which has historically been more focused on scooters. Derbi still continues to operate very much like a stand-alone company with an independent Research and Development, marketing and distribution businesses.

The Aprilia acquisition and the improved operating performance of Derbi have opened up the possibility of integrating Derbi's business into the combined group.

The Aprilia brand

Aprilia is a strong scooter brand in the Italian market and a well known motorcycle brand internationally. Aprilia's bikes are sporty, aggressive, fast and sleek-looking. Aprilia scooters and motorcycles are targeted to the 20-45 year olds who have a passion for 2-wheeled vehicles and riding. Products are known for being innovative and high-tech. The reputation of its products is strengthened by the brand's racing team and by being highly focused on technology, power and performance.

The Moto Guzzi brand

Moto Guzzi is one of the best known touring motorcycles brands in Europe in the touring motorcycle segment. Founded in 1921, the brand combines tradition and elegance with very advanced motorcycle technology for the old-style enthusiasts who want a touring motorcycle, with a tradition in motorcycle racing until it withdrew from competitions in 1957. Often considered a collector's item, 22.8% of 2004 sales of the brand were from spare parts. Acquired by Aprilia in 2000, the brand has a strong customer following and large dealer network, but under the Aprilia management suffered from low investment in new products.

The Scarabeo brand

Aprilia launched the Scarabeo brand in 1993, the first high-wheeled scooter to the market. The high-wheel innovation, which refers to the large diameter of the wheels, makes the scooter easier to handle and more comfortable to ride compared to the small diameter wheeled products, which were the standard until then. The innovative design and the popularity of the product caused other manufacturers to follow Scarabeo's lead in the product segment, in which Scarabeo has maintained the leadership, thanks to its reputation of cutting-edge style and performance. Product offering includes the 50cc displacement model, targeted to 14-16 year olds, and the above 50cc displacement models, which are targeted to 25-45 year olds.

Product range

Two-wheeled products

Based on 10 product platforms, Piaggio manufactures a range of 40 scooter and motorcycle products.

Scooter segment

In the scooter segment, Piaggio's product range presides over each market niche, with a particularly strong market share in the classic segment thanks to the Vespa range of models, with as much as 85% market share in the above 50cc segment and 50% market share in the high-wheel scooters. Overall, the group's market share in the EU scooter segment is 35%.

In terms of price positioning, Piaggio scooter brands are aimed at the premium segment, covering the medium to high price position. Amongst its main competitors, the Japanese manufacturers (Honda) are targeting the mid-price range, whilst the Taiwanese Kymco is targeting the lower price bracket.

Motorcycle segment

In the motorcycle sector Piaggio's product range is only focused in three segments. The Moto Guzzi brand focuses in the comfort/tourism end of the market, whilst Aprilia is at the opposite end of the spectrum in sports/performance segment. Derby is positioned in the middle, with small engine displacements for the young. Overall, Piaggio brands are market leader in the 50cc segment with 45% market share, whilst they have relatively weak presence (5% market share) in the segment of around 1000cc, in the Touring, Naked and Sports segments. This is where Piaggio management wants to build a stronger position in the coming years.

In terms of price positioning, Piaggio's Aprilia brand is mid-market, slightly above the Japanese brands, and aimed at the bracket below Italian Ducati and Agusta brands in the premium price range.

Light Transport Vehicles

In LTVs, Piaggio's product offering covers this market with five models. Its models range from the Ape three-wheelers, with different engine displacements, to the four-wheeled vehicles of under 1.1 tons capacity. Its competitors are the international car makers, but Piaggio is the leader in its well-defined market niche, where it can defend its position against competitors thanks to the characteristics of its vehicles in terms of the manoeuvrability, the low payload (<1.1 tons), the driving license requirements (normal car license is sufficient, in some cases an even simpler license is required), the low maintenance costs and the permits its vehicles have to drive in the traffic-restricted areas in city centres.

In the EU, Piaggio's price positioning for these vehicles is wide: from the low-end for the three-wheeler Ape and the four-wheel Quargo, with the four-wheel Porter having a very competitive price vis-à-vis products of the auto manufacturers.

In India Piaggio is currently only present with the three-wheeler vehicles, but is planning to start selling the Quargo starting in 3Q06. In terms of price positioning, its products are at the top end of the market, with products distinguishing themselves for strong customer service and quality.

Strategy

- Overall European industry context seen as benign
- Strategy in main market is to consolidate leadership position through product mix improvement, product innovation and brand management
- But longer-term growth is due to come from an increase penetration in high growth markets like the Indian one…
- … and from a higher exposure to emerging markets overall
- Economies of scale and low-cost component purchasing to be main margin growth drivers

In a nutshell

In a nutshell, Piaggio's strategy to 2008 is to consolidate its market leadership in the European 2-wheel market, by leveraging the acquisition of Aprilia both from a sales and cost perspective. Indeed, the European market is expected to remain the key area of business for the group and to be a major growth driver over the coming two-three years. Management is implementing an impressive new product pipeline both in the scooter and motorcycle segments in order to consolidate its leadership position in this market.

Beyond 2008 management hopes to increase penetration in markets where the group's position has significant growth potential (North America) and in emerging markets where economic growth is expected to provide a major stimulus to the local 2-wheel market in the coming years. Seeds of this growth have already been planted, with strong initial success in India and in China, but the group can do much more to leverage its know-how and brands in these countries as well as in Southeast Asian markets.

On the cost side, strategy is focused on exploiting all available economies of scale in distribution and manufacturing, low-cost component purchasing from China and leveraging the low-cost production base in China and India, both for the local and export markets.

Scooters

In the scooter market, which is expected to be stable, the strategy is to consolidate the group's 33-35% market share through on-going product rejuvenation whilst shifting the product mix towards higher engine displacements, introducing technological innovation and increasing stylistic content through more frequent restyling and upgrades of models. In the entry-level product segment represented by the low cost 50cc scooters, the plan is to reinforcing the group's presence by leveraging the production base in China.

Motorcycles

In the motorcycle segment, group strategy is to win back market share of Aprilia brands to pre-crisis levels of 8% (from 6.4% in 2005), in a market which is forecast to grow at low-single-digit rates. The company will launch a completely new range of products, shifting product mix towards more value-added medium-high engine displacements. The strategy is then to expand presence in product segments adjacent to those in which it already presides whilst expanding the product offering. Lastly, the strategy is to expand geographical presence, leveraging Piaggio's widespread distribution structure. Racing activities will be used to support brand image.

Light Transport Vehicles

In LTV products, the strategy in Europe is to keep the niche leadership position in Italy and Europe, extending the product range into product segments where the Piaggio brand has credibility, such as farming vehicles and all-terrain vehicles. Piaggio also intends to do more to exploit the Indian production platform, which could even become the production site for products sold in the European market at some point in the future. Strategy also hinges on the strengthening of the distribution network.

In the Indian market, strategy is to continue to strengthen Piaggio's presence there, and to start to export LTV manufactured in the Indian plant to Bangladesh and Pakistan. Know how acquired in India, could further be used to enter Southeast Asian markets (Indonesia in particular), Brazil and in South Africa.

Currently the group has several assets that it can leverage to fuel future growth. These are:

- the very strong position it has in the overall 2-wheeled vehicles market in Europe;
- the completion of Aprilia's turnaround and the revamping its product range;
- the leveraging of the full product range resulting from the merger of the two groups and the exploitation of industrial synergies between Piaggio and Aprilia; and
- the leveraging of the group's strategic presence in India and China and strong growth prospects in North America.

Consolidate market leadership in Europe

European Industry context forecast to be benign…

Piaggio management's growth strategy is being implemented in an industry context that is seen as rather benign. This is based on the fact that the European market, which is the source of 83% of group revenues (2005 accounts), is likely to continue to grow despite having reached maturity in the European 2-wheeled industry and despite the low economic growth from this geographical region. This is due to several factors.

…driven by traffic congestion…

First of all, European cities and their sub-urban surroundings are plagued by strong and still-growing traffic congestion, pushing for individual urban mobility to shift from motorcars to two-wheeled vehicles in an effort to reduce travel times.

…environmental issues…

Besides the traffic congestion, European cities are also suffering from high levels of air and noise pollution. Although still polluting, two-wheeled vehicles are more energy efficient, particularly in their Euro 3 engine versions. Further, manufacturers like Piaggio are working on new-generation hybrid and electric engines for scooters used in the urban areas.

…and rising fuel prices

Finally, the sharp rise in fuel prices, heightened by traffic congestion, is providing consumers with a stimulus to use more fuel efficient means of transportation, particularly favouring the shift from motorcars to 2-wheeled transportation.

On this basis, the European 2-wheeled vehicle market is forecast by the company as stable to growing slightly, with the scooter sector remaining stable and the motorcycle sector growing at low single digits.

To achieve its aim of consolidating its market leadership position in Europe, management is adopting a three-pronged approach:

- enhance product mix;
- widen the customer base; and
- raise barriers for potential new competitors at the entry-level, low-price 50cc scooter segment.

Enhance product-mix

A main strategy is to shift towards higher engine displacements…

This is being implemented in several ways. A main lever in the scooter segment is to manage the product portfolio towards higher engine displacements, the part of the market that is growing in volumes and where consumers look for higher content and value-added in products and are more willing to pay a premium price for these.

but this also involves product innovation…

But this strategy also involves increased product innovation in all brands and product segments.

…through technical innovation…

This is being sought after in technical innovation, of which the three-wheeled scooter is a good example. Indeed, the new scooter which Piaggio is launching in its first version in the month of May (variations of the model will be launched in the following months), besides being very innovative from a design viewpoint, also brings some important technical characteristics like having greater stability when driven in city streets (with cobblestones and tram lines), and it has 5% more leaning angle and 25% more breaking power. Piaggio plans to launch several variations of the three-wheeled scooter, with different styles and engines, thus increasing economies of scale on this product.

Other examples of technical innovation are the hybrid scooter and Euro 3 engines for both scooters and motorcycles.

The hybrid scooter is currently being tested by urban police in Milan, Florence and Rome and is expected to be sold on the market in 2008. This scooter uses a combination of fuel and electric engines, allowing for greater fuel efficiency, reduced emissions, and enhanced power and acceleration.

The Euro 3 scooter engine, which complies with more stringent European emission standards than the Euro 2 engines, will over time become a minimum standard for all new 2-wheeled vehicles but will enable it to be used even on days in which traffic is being restricted due to particularly high levels of air pollution, and when all other vehicles are not allowed to circulate.

… and through restylisting

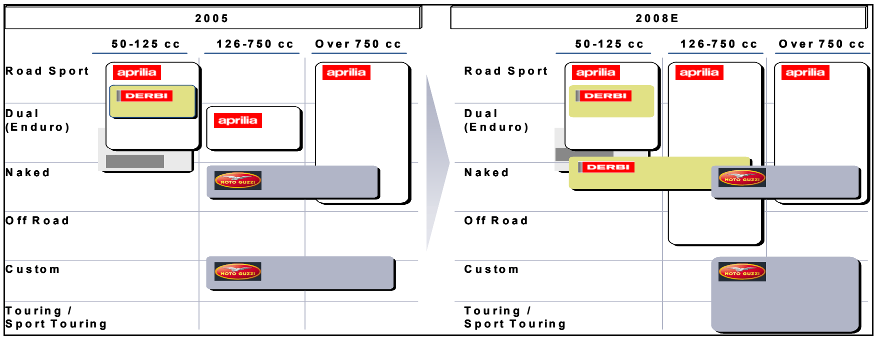
This is also being sought after with increased restyling and face lifting of models in order to balance market needs and maximise efficiency of investments and R&D costs.

Widen the customer base

Piaggio is intending to launch several new products across all brands in both the scooter and motorcycle segments. Particularly in motorcycles, this implies making better use of brand management to strengthen the group's position across all product segments, with a wider product offering in each segment. As an example, this strategy implies expanding the presence of the Aprilia brand in the 126-750cc engine displacement across all product segments, from Road Sport to Enduro, Naked and Off Road bikes (see figure 28). The final aim of this strategy is to use the same engine and motorcycle platform on more brands, product niches and thus make more efficient use of R&D and capex spending.

In the motorcycle segment, brand strategy being implemented is to focus Derbi in the low- to medium-powered vehicles for young consumers, the Aprilia brand in the medium- to high-powered bikes and in new segments (such as off-road), whilst focusing the Moto Guzzi brand in the high-displacement products across all segments, ranging from Sport, to naked, dual-purpose and Custom.

Figure 35. Entering new product segments



Source: Company Reports

Increased leverage of the Chinese JV production base

The entry point for new low-cost competitors into the European scooter market is the 50cc segment. Indeed, this is where products are most commoditised, where technology is most basic, and thus where price is the most important marketing lever.

Lower market price in the entry-level segment

Piaggio's strategy in this segment is to enhance its "value for money" low price product proposition in the 50-100cc segment by increasing the number of scooter product made in its Chinese plant. This allows Piaggio to reduce the street price of these products by 20-30% without having any reduction in margins. Piaggio intends to increase the production of its Chinese assembly plant.

But also lower component costs across all products

Further, the Chinese JV Piaggio sources low-cost components from the Chinese market for products assembled in the European production base, with strong margin benefits on Piaggio's entire range products.

Increase presence in markets with high growth prospects

Aside from consolidating its leadership position in the European market, Piaggio is increasing its presence in markets that have high growth potential. Specifically, these are the Indian and North American markets, the former for LTVs and the latter for two-wheeled vehicles, where the group already has a strong position but where the market is developing strongly. In these markets, the group is either pushed by generally strong economic growth, as is the case for India, or pushed by other macro trends that are specifically driving the market for scooters (oil price, traffic congestion), as in the case for the North American market.

India

In India this implies extending the product range of LTV products and increasing the dealer network. Piaggio is extending the range of LTV products in the 3-wheel range and starting to introduce the 4-wheeled vehicle range. Gas engines are being introduced, in addition to the petrol engine in the cargo and passenger vehicles, to meet city authority regulations which increasingly require gas-propelled vehicles to limit pollution in some urban areas.

Also, as the Indian market becomes more developed, consumers needs change, and Indian consumers are starting to look for four-wheeled LTV vehicles. Tata has very successfully introduced a first model in the early part of the year, and Piaggio is aiming to be the second player to do so by 3Q06 before market leader Bajaj Auto introduces its model at the start of 2007. In the four-wheel LTV segment Piaggio already has two models (the Porter and Quargo) that sell on the European market, and development costs would thus be marginal.

With the recent increase in production capacity of the Indian assembly plant, from an annual production of 102,000 vehicles in two shifts to 165,000 vehicles in three shifts, Piaggio has also catered for an initial 15,000 unit p.a. production of four-wheeled vehicles.

In terms of the dealer network, Piaggio plans to increase the number of dealers in the Indian market from 220 mono-brand, exclusive dealers at the end of 2005 to 300 by the end of 2008, targeting to increasingly exploit the potential of the rural market. Leveraging on its second-largest market positioning in this segment, Piaggio aims to focus on dealer loyalty and to further strengthen brand identity.

Thanks to its strong success in the Indian market, Piaggio intends to leverage this production base to increase 3-wheeled vehicle export to the neighbouring markets (mainly Bangladesh and Pakistan) that currently are only marginally exploited (2,000-3000 units per year). Leveraging on its Indian management and experience, the company is looking for opportunities to establish assembly plants in the Southeast Asian region in order to enter these markets with more competitive prices.

North America

As indicated in earlier parts of this report, the North American market represents a strong growth opportunity for Piaggio in 2-wheeled vehicles. Besides being the richest market in the world, with the highest average unit price, this has also been growing strongly over the past few years, +5.7% in motorcycles and 27% in scooters (2001-05 unit sales CAGR), on the back of strong traffic congestion and high fuel prices. These factors are encouraging consumers to revisit scooters and motorcycles as a means of transportation. Piaggio also offers products in versions different from off-road, custom and touring motorcycles, which have traditionally been strong.

In the North American market, Piaggio has a number 3 market position to leverage in the scooter segment (18.5% market share), which it gained thanks to the Vespa products. This is the only product it has so far made any effort to sell in this market, through a dealer network which was 270-strong at end-2005. Compared to Piaggio's major competitors, this represents a small number, and the group intends to increase it to 300 dealers by yearend 2006 and 400 by end 2008.

The strategy in this market is two-fold: strengthen the dealer network and expand product offering in order to take advantage of the strong growth potential of this market.

The dealer network expansion is building momentum (+30 dealers in 2H05, +10 in 1Q06), feeding on the strength of the brand but also on the expanded product range now that Aprilia and Moto Guzzi are part of the group. It is also supported by the strong new product pipeline that is being directed at this market, which requires little customisation of products.

Increased exposure to emerging markets

Strategy for growth beyond 2008 is focused on emerging markets, particularly China, southeast Asia and Brazil. In China, Piaggio is developing four specific scooters, in the low engine displacement range (50/100cc up to 125/150cc), which it aims to begin selling in this market in 4Q06 as a start to building its market position in this market.

A competitive presence in the southeast Asian and Brazilian markets will require a direct manufacturing presence by Piaggio, of which there are no plans as yet. Nevertheless, the experience and products developed by Piaggio in India and China should help in entering these markets.

Strategy to enhance profitability

Management's strategy to improve profitability is mainly centred on two elements: exploiting synergies from the integration of Aprilia and leveraging cost savings deriving from global sourcing of components. Overall, management believes that it has the potential to increase Aprilia group's EBITDA margin from 2.8% in 2005 to 10-11% in 2006 and to increase that of the Piaggio stand-alone from 12.8% in 2005 to 13-14% in 2006; it is targeting a consolidated EBITDA margin of 14-15% for Piaggio group in the years up to 2008.

Synergies from the integration of the Aprilia group

The integration of the Aprilia group still leaves substantial synergies to be exploited. These include the increase in capacity utilisation of the group's production plants; the renegotiation of purchasing contracts; the gradual in-sourcing of production of engines for Aprilia scooters and motorcycles, all outsourced prior to the acquisition of Aprilia by Piaggio; and the exploitation of economies of scale for R&D costs.

Leverage production economies of scale

As shown in Figure 19 of this report, Piaggio's production plants are operating well below full capacity. We estimate that on average the group's plants are operating at a capacity utilisation rate of just over 50%, with particularly low utilisation at the Aprilia and Moto Guzzi plants (30% each) and the Pontedera site (50%). The Indian facilities have recently invested in new capacity (the plant now operates at an estimated capacity 62%). Piaggio plans to increase production capacity, particularly to recover Aprilia group's market share but also to enter new product segments and expand product offering in each market segment without requiring investments in new capacity, thereby giving rise to economies of scale.

In-sourcing of engine production

Piaggio already manufactures its 2-wheeled vehicle engines in-house, whilst the Aprilia group outsources its production almost entirely. By gradually bringing the production of the Aprilia group engine range in-house, this will grow the amount of value added within the group, enhancing margins. Management has a detailed strategy to in-source engine production up until 2008, aiming to develop six new engine classes ranging from the four-valve 125cc up to a new V twin 1.1litre, due to be used in the Superbike competitions.

Improve leverage of R&D activities

The strategy to widen the customer base, stated in an earlier part of this section, would bring benefits in terms of better exploiting R&D costs. Using the engines developed on a greater number of models, should allow Piaggio to better leverage its R&D activities, improving operational leverage.

Increase global component purchasing

As discussed in the business model section of this report, Piaggio plans to increase the percentage of components sourced globally from 11% of total COGS in 2005 to 30% in the coming years. Aprilia's global sourcing levels (6-7%) are still well below those of the rest of the Piaggio group (16-17%). So far, global sourcing of components has generated savings of 30% on the cost of goods sold with respect to locally sourced components.

Financial Forecasts and 1H06 preview

- Main generators of sales growth: motorcycles, LTVs in India and large scooters.
- EBITDA margin to improve by 140bps in 3 years, benefiting from Aprilia restructuring and operating leverage.
- We estimate (2005-08 CAGR) 8% sales growth, 12% EBITDA growth, 21% EBIT growth and 42% net profit growth.
- Net financial gearing to fall from 1.2x to 0.4x.
- 1H06 results (to be released on 8 September) should confirm strong momentum.

Our forecasts on Piaggio are based exclusively on the expected growth from the European, Indian and North American markets, where Piaggio is already present. They do not include growth from the emerging markets mentioned in previous parts of the report, like the entrance in the Chinese scooter market, the scooter market in Southeast Asia and the LTV market in the Indian subcontinent ex-India, which we believe could become an important growth driver beyond 2008.

Underlying market assumptions

In our forecasts for the Piaggio group we have made growth and market share assumptions for the three main businesses of the Piaggio group: EU scooters, EU motorcycles and Indian LTV, respectively representing 54%, 14% and 10% of 2005 consolidated sales.

Overall, we are estimating the European market to be relatively stable in volume terms, while we are cautiously estimating the Indian LTV market growth to gradually slow down from the high double-digit rates to high single-digit growth.

European market of 2-wheeled vehicles

In the European 2-wheeled vehicle market we are forecasting relatively stable volumes overall, with a growth rate of around 2%, but with slightly differing dynamics between motorcycle and scooter segments. The slight increase is in line with the fact that, despite the European 2-wheel market being mature, we expect the market trend to be positive given that traffic congestion and environmental issues in particular are likely to provide some positive stimulus to the two-wheeled vehicle sector as consumers make some transition from automobiles.

Stable scooter volumes with a shift in favour of large engine displacement

We are forecasting scooter volumes to remain stable, but with a change in mix in favour of models with engine displacements >50cc, with a decrease in the 50cc models.

Figure 36. EU 2-w market, 50cc and >50cc

('000 units)	2002	2003	2004	2005	2006E	2007E	2008E
EU scooter mkt vols 50cc	696.0	643.0	593.0	590.0	578.2	566.6	555.3
Yoy mkt growth	-15.5%	-7.6%	-7.8%	-0.5%	-2.0%	-2.0%	-2.0%
EU scooter mkt vols >50cc	457.0	489.0	509.0	574.0	588.4	603.1	615.1
Yoy mkt growth	-8.0%	7.0%	4.1%	12.8%	2.5%	2.5%	2.0%
Total EU scooter mkt	1,153.0	1,132.0	1,102.0	1,164.0	1,166.6	1,169.7	1,170.4
Yoy mkt growth		-1.8%	-2.7%	5.6%	0.2%	0.3%	0.1%
EU motorcycle mkt vols 50cc	93.0	92.0	91.0	76.0	74.5	73.0	71.5
Yoy mkt growth	-2.1%	-1.1%	-1.1%	-16.5%	-2.0%	-2.0%	-2.0%
EU motorcycle mkt vols >50cc	696.0	691.0	732.0	778.0	797.5	817.4	833.7
Yoy mkt growth	-4.5%	-0.7%	5.9%	6.3%	2.5%	2.5%	2.0%
Total EU motorcycle mkt	789.0	783.0	823.0	854.0	871.9	890.4	905.3
Yoy mkt growth		-0.8%	5.1%	3.8%	2.1%	2.1%	1.7%
Total EU 2-wheeled mkt	1,942.0	1,915.0	1,925.0	2,018.0	2,038.5	2,060.1	2,075.7
Yoy mkt growth		-1.4%	0.5%	4.8%	1.0%	1.1%	0.8%

Source: Citigroup Investment Research

Growing motorcycle volumes with a shift in favour of large engine displacement

We are forecasting motorcycle volumes to grow at low single-digit rates. We expect a shift in product mix in favour of models with engine displacements >50cc, with a decrease in the 50cc models.

Indian three-wheeled vehicle market

In the Indian LTV market we are forecasting the double-digit growth rate of recent times to continue on the back of the high single-digit annual rates economic growth, and for Piaggio's market share to stabilise after almost doubling from 16.6% in 2002 to 29.8% in 2005. This could be a conservative scenario.

Figure 37. Indian LTV markets - and Piaggio share

('000 units)	2002	2003	2004	2005	2006E	2007E	2008E
Indian LTV	230.0	260.0	300.0	340.0	380.8	426.5	456.4
Yoy mkt growth		13.0%	15.4%	13.3%	12.0%	12.0%	7.0%
Piaggio LTV market share	16.6%	19.1%	24.0%	29.8%	31.0%	32.0%	33.0%

Source: Company Reports and CIR Estimates

Indeed, Piaggio has consolidated its position as the number two player in the segment in just a few years, after Bajaj Auto and ahead of Force Motors and Mahindra Mahindra. In 3Q06 it intends to introduce 4-wheeled LTVs, ahead of the market leader Bajaj (48% market share), in an effort to have a head start on this new market.

Sales forecasts

Our sales forecasts for Piaggio are derived from volume forecasts based on the market share calculation taken from above, combined with pricing assumptions. The following are the resulting volume estimates that we incorporate into our sales forecasts.

Figure 38. Piaggio group - volume estimates

('000 units)	2002	2003	2004	2005	2006E	2007E	2008E
Scooters							
50cc	179.30	157.00	157.00	202.000	197.744	193.790	189.914
Above 50cc	137.80	151.10	181.00	219.000	229.457	238.208	242.972
Total scooters	**317.10**	**308.10**	**338.00**	**421.00**	**427.201**	**431.998**	**432.886**
Motorcycles							
50cc	28.40	9.00	36.00	37.000	36.272	35.035	34.335
Above 50cc	3.10	1.00	7.00	28.000	39.873	50.678	60.863
Total motorcycles	**31.50**	**10.00**	**43.00**	**65.00**	**76.144**	**85.713**	**95.197**
Total 2-wheels	**348.6**	**318.10**	**381.00**	**486.000**	**503.345**	**517.711**	**528.083**
Total LTV Europe	29.8	22.0	18.5	20.0	19.253	18.875	18.517
Total LTV India	38.1	49.6	72.1	101.4	118.0	136.479	150.596
Total LTV	**67.9**	**71.6**	**90.6**	**121.4**	**137.301**	**155.354**	**169.112**
Total Piaggio	**416.5**	**389.70**	**471.60**	**607.400**	**640.646**	**673.065**	**697.196**

Source: Company Reports and CIR Estimates

In terms of price/product mix, we are estimating pricing pressure in the 50cc segment both in the scooter and motorcycle segments, in the entry level for any newcomer to the European market and in the segment where competition from low-cost manufacturers is strongest.

In the above 50cc segment, we are estimating a slightly positive trend in the scooter segment and a stronger positive trend in the above 50cc motorcycles, given the product launches which the company is planning in the above 750cc segment to relaunch Aprilia and Moto Guzzi brands and also to fill the middle displacement segment.

In the LTV division, we are forecasting sales to benefit from 4-wheeled vehicles being introduced in India this year, and gaining some additional penetration in Europe.

Figure 39. Piaggio group – Unit price estimates

('000 €)	2002	2003	2004	2005	2006E	2007E	2008E
Scooters							
50cc	1.21	1.25	1.23	1.30	1.27	1.25	1.22
Above 50cc	2.21	2.42	2.38	2.37	2.40	2.42	2.44
Total scooters	**1.65**	**1.82**	**1.85**	**1.86**	**1.88**	**1.89**	**1.91**
Motorcycles							
50cc	1.47	1.78	1.61	1.68	1.64	1.61	1.57
Above 50cc	4.03	3.00	3.29	5.07	5.27	5.48	5.59
Total motorcycles	**1.72**	**1.90**	**1.88**	**3.14**	**3.54**	**3.90**	**4.14**
Total LTV Europe	**5.2**	**5.3**	**5.7**	**6.3**	**6.4**	**6.6**	**6.8**
Total LTV India	**1.6**	**1.4**	**1.4**	**1.4**	**1.5**	**1.5**	**1.6**

Source: Company Reports and CIR Estimates

Figure 40. Piaggio group - sales by engine class and vehicle type

(Euro mln)	2002	2003	2004	2005	2006E	2007E	2008E
Scooters							
50cc	217.2	196.0	193.2	263.0	251.8	241.8	232.2
Above 50cc	304.6	365.0	430.6	520.0	549.7	576.4	593.8
Total scooters	**521.8**	**561.0**	**623.8**	**783.0**	**801.5**	**818.2**	**826.1**
Motorcycles							
50cc	41.8	16.0	58.0	62.0	59.4	56.3	54.0
Above 50cc	12.5	3.0	23.0	142.0	210.1	277.7	340.2
Total motorcycles	**54.3**	**19.0**	**81.0**	**204.0**	**269.5**	**334.0**	**394.2**
Total Piaggio 2-w veh	**576.1**	**580.0**	**704.8**	**987.0**	**1071.1**	**1152.2**	**1220.3**
LTV Europe							
Total 3-w	58.8	46.2	33.0	28.0	24.2	22.5	21.0
Total 4-w	95.1	70.3	73.3	97.0	99.7	102.7	105.8
Total LTV Europe	**153.9**	**116.5**	**106.3**	**125.0**	**123.9**	**125.2**	**126.8**
Total LTV India	**60.8**	**70.5**	**100.6**	**146.8**	**174.3**	**209.6**	**242.8**
Total LTV	**214.7**	**187.0**	**206.9**	**271.8**	**298.2**	**334.8**	**369.6**
Total spare parts and acc.	124.2	129.3	133.1	173.3	190.6	204.0	210.1
Engines and other	37.7	47.8	39.4	20.2	20.2	20.2	20.2
Total Piaggio	**952.7**	**944.1**	**1084.2**	**1452.3**	**1580.1**	**1711.2**	**1820.2**

Source: Company Reports and CIR Estimates

Contribution to group sales growth – motorcycles (52%), Indian LTVs (26%) and large scooters (12%)

We are thus estimating an overall sales growth rate for the Piaggio group of 9.6% in 2006, of 7.8% in 2007 and of 6.4% in 2008. We estimate the main contributors of this growth will be the motorcycle segment (52% of total sales growth to 2008), particularly the above 750cc for which Piaggio is making a large effort to revamp. Another major part of the growth is coming from the Indian LTV market (26%), with large scooters (12%) providing the third-largest contribution.

Our estimates incorporate a substantial shift in sales contribution in the scooter segment, with 50cc scooters sales declining and almost offsetting the growth in over 50cc scooter sales.

Figure 41. Piaggio Sales growth by engine class and vehicle type

(Yoy % growth)	2003	2004	2005	2006E	2007E	2008E
Scooters						
50cc	-9.8%	-1.4%	36.1%	-4.3%	-4.0%	-4.0%
Above 50cc	19.8%	18.0%	20.8%	5.7%	4.9%	3.0%
Total scooters	**7.5%**	**11.2%**	**25.5%**	**2.4%**	**2.1%**	**1.0%**
Motorcycles						
50cc	-61.7%	262.5%	6.9%	-4.1%	-5.3%	-4.0%
Above 50cc	-76.0%	666.7%	517.4%	48.0%	32.2%	22.5%
Total motorcycles	**-65.0%**	**326.3%**	**151.9%**	**32.1%**	**23.9%**	**18.0%**
Total Piaggio 2-w veh	**0.7%**	**21.5%**	**40.0%**	**8.5%**	**7.6%**	**5.9%**
LTV Europe						
Total 3-w	-21.4%	-28.6%	-15.2%	-13.6%	-6.9%	-6.9%
Total 4-w	-26.1%	4.3%	32.3%	2.8%	3.0%	3.0%
Total LTV Europe	**-24.3%**	**-8.8%**	**17.6%**	**-0.9%**	**1.1%**	**1.2%**
Total LTV India	**16.0%**	**42.7%**	**45.9%**	**18.7%**	**20.2%**	**15.9%**
Total LTVs	**-12.9%**	**10.6%**	**31.4%**	**9.7%**	**12.3%**	**10.4%**
Total spare parts and acc.	4.1%	2.9%	30.2%	10.0%	7.0%	3.0%
Engines and other	26.8%	-17.6%	-48.7%	0.0%	0.0%	0.0%
Total Piaggio group	**-0.9%**	**14.8%**	**34.0%**	**8.8%**	**8.3%**	**6.4%**

Source: Company Reports and CIR Estimates

Operating cost structure

Piaggio's cost structure is largely made up of variable costs, with about 68% of total operating costs being raw materials and components, or subcontractor costs that are variable in nature.

Figure 42. Piaggio group – operating cost summary

(% of sales)	2002	2003	2004	2005	2006E	2007E	2008E
Raw materials and supplies	58.3%	61.7%	55.8%	58.3%	56.9%	56.6%	55.7%
Subcontractors	23.2%	23.4%	20.8%	20.6%	20.0%	19.6%	20.3%
Labour costs	15.3%	15.4%	14.5%	15.5%	14.7%	14.1%	13.8%
Depreciation and amortisation	8.3%	8.1%	5.6%	6.2%	5.7%	5.4%	5.2%
Goodwill depreciation	2.9%	2.6%	0.0%	0.0%	0.0%	0.0%	0.0%
Other operating costs	2.0%	2.4%	4.1%	2.7%	2.3%	2.4%	2.4%
Stock option costs	0.0%	0.0%	0.0%	0.0%	0.2%	0.0%	0.0%
Total	**110.0%**	**113.5%**	**100.8%**	**103.3%**	**99.7%**	**98.1%**	**97.4%**

Source: Company Reports and CIR Estimates

Raw materials and Components

Figure 43. Piaggio group - Raw materials forecasts

(Euro mln)	2002	2003	2004	2005	2006E	2007E	2008E
Net raw mats and compon.ts	**555.0**	**582.1**	**605.4**	**847.2**	**899.6**	**968.4**	**1013.6**
% of sales	58.3%	61.7%	55.8%	58.3%	56.9%	56.6%	55.7%
Raw mats. components per unit sold	1.333	1.494	1.284	1.395	1.404	1.439	1.454
Yoy % chge		12.1%	-14.1%	8.7%	0.7%	2.5%	1.0%
Volumes produced	416.500	389.700	471.600	607.400	640.646	673.065	697.196
Change in volumes		-6.4%	21.0%	28.8%	5.5%	5.1%	3.6%
Change in raw material costs	1501.4%	4.9%	4.0%	39.9%	6.2%	7.6%	4.7%
Yoy chge Value of production		-0.9%	14.8%	34.0%	8.8%	8.3%	6.4%

Source: Company Reports and CIR Estimates

In our model we forecast raw material and component costs on the basis of sales growth and of the increase in global sourcing of component purchasing, from 11% in 2005 to a targeted 30% in 2008. Piaggio estimates savings from global sourcing to have been on average 30% in 2005. We estimate that as global purchasing rises from 11% to the 30% level targeted by Piaggio management that the amount of savings the company is able to achieve to fall from the 30% level achieved in 2005.

Figure 44. Piaggio group – Estimated impact of global sourcing on raw material costs

	2005	2006E	2007E	2008E
Global sourcing	11.0%	19.0%	22.0%	30.0%
Additional global sourcing cogs	93.2	73.7	29.2	82.4
Total cost of goods sold	847.2	921.7	974.3	1030.1
% on sales	58.3%	58.3%	56.9%	56.6%
Savings %	30.0%	30.0%	20.0%	20.0%
Savings	28.0	22.1	5.8	16.5
Actual COGS	**847.2**	**899.6**	**968.4**	**1013.6**
Actual COGS/sales	**58.3%**	**56.9%**	**56.6%**	**55.7%**

Source: Company Reports and CIR Estimates

Subcontractor costs

Of subcontractor costs, we have assumed labour (part time and external labour only) through to Product warranty costs to be variable, and have kept them constant as a percentage of sales. Technical, legal and tax advice cost, through to leases and rents we assumed to be fixed and have increased them in line with inflation.

Figure 45. Piaggio group - Subcontractors detail

(% of sales)	2002	2003	2004	2005	2006E	2007E	2008E
Labour expenses (includes part-time)	0.7%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%
Accessory purchasing expenses	0.2%	0.3%	0.3%	0.0%	0.0%	0.0%	0.0%
Electricity, telephone and telex	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Commissions payable	0.3%	0.3%	0.2%	0.2%	0.2%	0.2%	0.2%
Advertising and promotions	4.3%	2.8%	2.9%	3.1%	3.1%	3.0%	4.0%
Sundry marketing expenses	0.8%	1.1%	0.9%	0.8%	0.8%	0.8%	0.8%
Subcontracted activities (microcars)	2.3%	3.4%	3.3%	1.9%	1.9%	1.9%	1.9%
Transportation costs (of vehicles and parts)	3.3%	3.1%	2.9%	3.0%	3.0%	3.0%	3.0%
Registration documents	0.2%	0.2%	0.1%	0.0%	0.0%	0.0%	0.0%
Product warranties	3.0%	2.8%	1.9%	1.0%	1.0%	1.0%	1.0%
Technical, legal and tax advice	4.3%	5.1%	3.9%	4.8%	4.4%	4.3%	4.1%
Emoluments of board members	0.1%	0.0%	0.2%	0.2%	0.2%	0.2%	0.2%
Insurance	0.3%	0.2%	0.2%	0.3%	0.3%	0.3%	0.3%
Other operating costs	0.7%	0.7%	0.9%	2.1%	1.9%	1.9%	1.8%
External maintenance and cleaning	0.8%	0.9%	0.7%	0.5%	0.4%	0.4%	0.4%
Leases and rents	0.9%	0.8%	0.6%	0.9%	0.9%	0.8%	0.8%
Total	**23.2%**	**23.4%**	**20.8%**	**20.6%**	**20.0%**	**19.6%**	**20.3%**

Source: Company Reports and CIR Estimates

Labour costs

We have calculated labour costs on the basis of allowing for some productivity improvements, targeting for the group to reach productivity levels (in terms of units sold per employee) of 2004 by 2007 after the consolidation of Aprilia has reduced productivity levels in 2005. Labour costs should fall as a percentage of sales, on the basis that a significant component of sales growth is being derived from the Indian LTV market, which is being supplied by Piaggio's Indian plant, with very favourable cost of labour.

Figure 46. Piaggio group - Cost of labour

(Euro mln)	2002	2003	2004	2005	2006E	2007E	2008E
Wages	103.9	103.7	112.4	165.7			
Social Security	33.7	33.5	35.6	45.2			
TFR	7.5	7.1	7.3	10.4	11.0	11.6	12.4
Other labour expenses	1.0	0.9	1.9	4.3			
Total labour cost	**146.1**	**145.2**	**157.2**	**225.5**	**231.6**	**240.8**	**251.8**
Change		-0.6%	8.2%	43.5%	2.7%	4.0%	4.6%
Incidence on sales	15.3%	15.4%	14.5%	15.5%	14.7%	14.1%	13.8%
Labour per employee	**0.202**	**0.202**	**0.217**	**0.218**	**0.231**	**0.243**	**0.250**
Units sold per head	88.50	83.25	94.30	91.35	93.81	95.76	95.78
yoy chge		-0.4%	7.5%	0.8%	5.9%	5.2%	2.7%
Staff year average Piaggio	4706	4681	5001	6649	6829	7029	7279
Staff year average Aprilia			1473				
Change	4260	-25	320	1648	180	200	250
Cost per employee (Euro '000)	31.0	31.0	31.4	33.9	33.9	34.3	34.6
Change	-5.3%	-0.1%	1.3%	7.9%	0.0%	1.0%	1.0%
TFR Provisions per head (Euro '000)	1.6	1.5	1.5	1.6	1.6	1.7	1.7
Change	-3.8%	-4.8%	-3.3%	6.3%	3.0%	3.0%	3.0%

Source: Company Reports and CIR Estimates

Depreciation, capex and R&D costs

We have assumed depreciation charges growing somewhat in the coming years, with Piaggio having to finance some capacity expansion in India. Amortisation of intangible assets should also grow due to growing capitalised R&D expenses.

Figure 47. Piaggio group - Calculation of depreciation & amortisation of intangibles and goodwill

(Euro mln)	2002	2003	2004	2005	2006E	2007E	2008E
Gross fixed assets	0.0	690.0	901.5	895.4	953.9	1013.8	1073.8
Depreciation	43.2	39.8	34.9	42.5	43.9	46.6	49.4
Rate		5.768%	3.872%	4.742%	4.6%	4.6%	4.6%
Net intangible assets	82.2	54.3	213.1	195.4	191.7	187.5	183.0
Amortisation of Intangible assets	35.7	36.7	25.4	48.0	46.9	45.9	44.8
Rate	43.431%	67.587%	11.928%	24.591%	24.490%	24.490%	24.490%
Goodwill	421.5	367.1	367.5	429.4	429.4	429.4	429.4
Goodwill amortisation	0.0	13.1	0.0	0.0	0.0	0.0	0.0

Source: Company Reports and CIR Estimates

Figure 48. Piaggio group - Capex and R&D expenditure

(Euro mln)	2003	2004	2005	2006E	2007E	2008E
Invest. in tang. assets	49.0	42.0	63.0	58.5	59.9	60.1
Invest. in intang. assets	7.0	4.0	8.0	6.3	6.8	6.4
Capitalised R&D costs	26.0	25.0	29.0	37.0	34.8	34.0
Total investments	**82.0**	**71.0**	**100.0**	**101.8**	**101.6**	**100.5**
Total capex % on sales	8.7%	6.5%	6.9%	6.4%	5.9%	5.5%
Tangible capex on sales	5.2%	3.9%	4.3%	3.7%	3.5%	3.3%
Intangible capex on sales	0.7%	0.4%	0.6%	0.4%	0.4%	0.4%
Annual D&A	76.5	60.3	90.5	90.8	92.5	94.2
Delta with investments	-5.5	-10.7	-9.5	-10.9	-9.0	-6.3

Source: Company Reports and CIR Estimates

Indeed, we have forecast a step-up in capitalised R&D costs in 2006 through to 2008, due to the large number of models and engines which the group plans to launch as part of its product line expansion, bringing capitalised R&D costs to €37 million from €29 million in 2005. Overall we are estimating tangible and intangible investments to hover above the €100 million annual charge.

Overall margin evolution

On this basis we estimate Piaggio Group's consolidated EBITDA margin to rise from 12.8% reached in 2005, one year after the acquisition of Aprilia, to 14.4% at the end of the forecast period, in 2008. This is in line with management EBITDA margin guidance and would implicitly incorporate Aprilia EBITDA margin to improve to around 11-12% from the 2.8% level achieved in 2005 and -5.3% of 2004 (Italian GAAP), with Piaggio stand-alone EBITDA margin stabilising at an EBITDA margin of 15%.

Financial costs and net financial gearing

We are estimating net financial charges to start gradually dropping after the peak reached in 2005, when balance sheet was laden with the acquisition of Aprilia, completed on 30 December 2004. We estimate the reduction in net interest costs to be gradual, given the high component of fixed interest debt Piaggio group has, with a €150 million high yield bond costing 10%, and a bullet loan of €29 million costing 3.7%, out of the total estimated net debt we estimate of €300 million at the end of 2006.

Piaggio issued the 10% high yield bond, with such a high interest due to difficult market conditions in May 2005 when the loan to finance the acquisition of Aprilia was due to expire shortly thereafter and it had no chance of delaying it. Piaggio has an option to cancel the bond starting in 2009, at a cost of 105%. Until then net interest charges are likely to remain high.

Piaggio also has a €250 million term loan, which it undertook in December 2005 to refinance its previous €317 million bank finance activities – which had been in the context of the Piaggio acquisition by IMMSI. This is also coming to gradually expire in trances by 2012 and it costing an interest cost of EURIBOR + margin, where the margin started at 130bps but is being revised downwards based on the improving Net Debt/EBITDA ratio of the group.

We estimate net financial gearing to fall from 1.2x at end 2005 (and 2.1x at end 2004), to 0.7x at YE 2006. Similarly we estimate net debt/EBITDA to fall from 2.2x at end-2005 (and 4.3x at end 04) to 1.4x at end-2006.

Figure 49. PIAGGIO - Profit & Loss Account (accounts are IFRS compliant from 2004 only

(€ mln)	2002	2003	2004	2005	2006E	2007E	2008E
Turnover	**952.7**	**944.1**	**1084.2**	**1452.3**	**1580.1**	**1711.2**	**1820.2**
% growth		-0.9%	14.8%	34.0%	8.8%	8.3%	6.4%
Other operating revenues	66.6	58.9	70.4	143.2	120.0	116.0	121.0
Materials and components	-555.0	-582.1	-605.4	-847.2	-899.6	-968.4	-1013.6
Gross industrial profit	**464.3**	**420.9**	**549.3**	**748.4**	**800.5**	**858.8**	**927.6**
As % of sales	48.7%	44.6%	50.7%	51.5%	50.7%	50.2%	51.0%
Service costs	-221.1	-220.8	-225.5	-298.9	-315.3	-335.0	-368.7
Value added	**243.2**	**200.1**	**323.7**	**449.4**	**485.2**	**523.8**	**558.9**
As % of sales	25.5%	21.2%	29.9%	30.9%	30.7%	30.6%	30.7%
Labour costs	-146.1	-145.2	-157.2	-225.5	-231.6	-240.8	-251.8
Extraordinary items			0.1	0.0	0.0	0.0	0.0
Other operating costs	-19.5	-22.8	-43.9	-38.6	-38.6	-41.2	-44.3
EBITDA	**77.6**	**32.1**	**122.7**	**185.3**	**214.9**	**241.9**	**262.8**
As % of sales	8.1%	3.4%	11.3%	12.8%	13.6%	14.1%	14.4%
Dep & amort ex-g'will	-78.9	-76.5	-60.3	-90.5	-90.8	-92.5	-94.2
EBITA	**-1.3**	**-44.4**	**62.4**	**94.8**	**124.1**	**149.3**	**168.6**
As % of sales	-0.1%	-4.7%	5.8%	6.5%	7.9%	8.7%	9.3%
Goodwill amort.	-27.3	-24.4	0.0	0.0	0.0	0.0	0.0
EBIT	**-28.6**	**-68.8**	**62.4**	**94.8**	**124.1**	**149.3**	**168.6**
As % of sales	-3.0%	-7.3%	5.8%	6.5%	7.9%	8.7%	9.3%
Net interest	-33.6	-46.7	-21.4	-30.3	-28.7	-24.7	-22.2
Value adjustments	-31.1	-13.4	0.0	0.0	0.0	0.0	0.0
Extraordinary items	-25.4	-44.0					
Pre-tax profit	**-118.7**	**-172.9**	**41.1**	**64.5**	**95.4**	**124.6**	**146.4**
As % of sales	-12.5%	-18.3%	3.8%	4.4%	6.0%	7.3%	8.0%
Tax	-10.5	-13.5	-16.8	-25.9	-29.5	-34.2	-38.0
Net profit (pre-mins.)	**-129.2**	**-186.4**	**24.3**	**38.6**	**65.9**	**90.4**	**108.4**
Minorities	-1.1	-0.3	-0.3	-0.2	-0.3	-0.4	-0.4
Net profit	**-130.3**	**-186.7**	**23.9**	**38.4**	**65.7**	**90.0**	**108.0**
As % of sales	-13.7%	-19.8%	2.2%	2.6%	4.2%	5.3%	5.9%
Adjusted net profit	-102.7	-139.3	23.9	38.4	65.7	90.0	108.0
As % of sales	-10.8%	-14.8%	2.2%	2.6%	4.2%	5.3%	5.9%
Cash flow	3.5	-38.4	84.3	128.9	156.5	182.6	202.2
As % of sales	0.4%	-4.1%	7.8%	8.9%	9.9%	10.7%	11.1%

Source: Citigroup Investment Research

Taxes and carried forward losses

Piaggio has a total of €344 million carried forward losses, of which €189 million in parent company Piaggio & C due to its merger with Aprilia during 2005. The expiration of these carried forward losses is around 2009, and it is unlikely that Piaggio group companies will be able to make full use of them, although it should be able to in large part.

The carried forward losses imply that Piaggio group companies will benefit from tax breaks through 2009, with the overall rate being lower than what it would be under normal circumstances. Due to the carried forward losses we estimate an average consolidated corporate tax rate of 10% to which we add IRAP tax of 4.25% of "value added" (EBIT + cost of labour add-back), bringing the overall apparent tax rate (calculated on pre-tax profit) to 30% in 2006, falling to 26% in 2007 and 24% in 2008.

Figure 50. PIAGGIO - Balance Sheet (accounts are IFRS compliant from 2004 only)

(€ mln)	2002	2003	2004	2005	2006E	2007E	2008E
Net fixed assets	**716.0**	**623.1**	**846.3**	**890.8**	**901.8**	**910.8**	**981.1**
- Tangible	191.7	182.2	239.2	259.6	274.2	287.4	298.1
- Intangible	82.2	54.3	213.1	195.4	191.7	187.5	183.0
- Goodwill	421.5	367.1	367.5	429.4	429.4	429.4	429.4
- Financial	20.6	19.5	26.4	6.5	6.5	6.5	70.5
Current assets	**359.4**	**283.4**	**526.7**	**435.9**	**446.3**	**475.6**	**500.0**
- Stocks	169.3	132.0	212.5	192.0	199.7	216.3	230.1
- Trade receivables	112.3	78.3	207.5	150.9	153.6	166.4	177.0
- Other receivables	77.8	73.1	106.8	93.0	93.0	93.0	93.0
Current liabilities	**303.5**	**326.0**	**412.8**	**391.8**	**438.8**	**458.6**	**479.2**
- Trade payable	232.1	245.1	314.2	296.6	343.7	363.6	384.1
- Other payables	71.4	80.9	98.6	95.2	95.1	95.1	95.1
Net working capital	**55.9**	**-42.6**	**113.9**	**44.1**	**7.6**	**17.0**	**20.8**
Net capital employed	**771.9**	**580.5**	**960.2**	**934.9**	**909.4**	**927.8**	**1001.9**
Financed by:							
					438.6		
Shareholders' funds	**106.2**	**178.5**	**251.2**	**348.5**	**435.5**	**505.9**	**586.8**
- Share capital and reserves	90.2	177.5	250.9	348.2	435.3	505.6	586.6
- Minorities	16.0	1.0	0.3	0.3	0.3	0.3	0.3
Long-term liabilities incl. TFR	**93.2**	**118.6**	**187.5**	**175.0**	**175.0**	**175.0**	**175.0**
Net debt (cash)	**572.5**	**283.4**	**521.5**	**411.4**	**298.8**	**247.0**	**240.1**

Source: Company Reports and CIR Estimates

Dividend policy

We have assumed Piaggio will pay a dividend of 30% payout, starting with 2006 accounts, in line with the restrictions imposed by its debt covenants.

Figure 51. PIAGGIO - Funds flow (accounts are IFRS compliant from 2004 only)

(€ mln)	2002	2003	2004	2005	2006E	2007E	2008E
Net profit (pre-mins)	**-129.2**	**-186.4**	**24.3**	**38.6**	**65.9**	**90.4**	**108.4**
Depreciation & amortisation	106.2	100.9	60.3	90.5	90.8	92.5	94.2
Sever ind provs (net)	0.0	0.0	0.0	-0.3	0.0	0.0	0.0
Other non-cash items	93.2	25.4	68.9	-12.1	0.0	0.0	0.0
Working capital Decrease (incr.)	-55.8	98.5	-156.5	69.9	36.5	-9.4	-3.8
Cash flow from ops	**14.4**	**38.4**	**-3.0**	**186.5**	**193.3**	**173.5**	**198.8**
Capex	-234.9	-30.3	-92.0	-62.8	-58.5	-59.9	-60.1
Invs in intangibles	-539.4	32.5	-184.6	-92.2	-43.3	-41.7	-40.4
Financial investments	-20.6	1.1	-6.9	19.9	0.0	0.0	-64.0
Capital issues	0.0	0.0	0.0	0.0	21.4	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0	-19.7	-27.0
Other	208.0	247.4	48.5	58.7	-0.3	-0.4	-0.4
Net funds inflow	**-572.5**	**289.1**	**-238.0**	**110.1**	**112.6**	**51.9**	**6.9**
Net cash (debt)	**-572.5**	**-283.4**	**-521.5**	**-411.4**	**-298.8**	**-247.0**	**-240.1**

Source: Company Reports and CIR Estimates

1H06 results – Looking for confirmation of strong growth

After market close on 8 September Piaggio is due to release its 1H06 results. We are looking for results to be good and to confirm the strong momentum of the past two years both in terms of sales growth and margin improvement, after stripping out some one-off elements affecting headline numbers.

We forecast strong margin improvement net of extraordinary items

In a nutshell, we are forecasting sales growth of 10.7% in 1H06 to €901.4 million, with headline EBITDA growth of 6.2% to €131.6 million after extraordinary costs of €6.8 million (listing costs and stock option plan costs) versus extraordinary income of €18.3 million (government incentives) a year earlier. Thus, we forecast Adjusted EBITDA to instead grow by 31% to €138.4 million. Finally at pretax level, we forecast 16.2% growth to €74.1 million, and net indebtedness to fall from €445 million to €330 million.

Figure 52. Piaggio group 1H06 preview

	1Q05	2Q05	1H05	1Q06	2Q06E	1H06E
Sales	312.3	502.0	814.3	374.2	527.2	901.4
EBITDA	24.5	99.4	123.9	43.0	88.6	131.6
EBIT	1.1	77.3	78.4	23.0	65.6	88.6
EBT	-6.8	70.6	63.8	15.2	58.9	74.1
Adjustments	0.0	18.3	18.3	0.0	-6.8	-6.8
Adj. EBITDA	24.5	81.1	105.6	43.0	95.4	138.4
Yoy growth						
Sales				19.8%	5.0%	10.7%
EBITDA				75.5%	-10.9%	6.2%
EBIT				n.m.	-15.1%	13.0%
EBT				n.m.	-16.6%	16.2%
Adj. EBITDA				75.5%	17.6%	31.1%
Margin						
EBITDA	7.8%	19.8%	15.2%	11.5%	16.8%	14.6%
EBIT	0.4%	15.4%	9.6%	6.1%	12.4%	9.8%
EBT	-2.2%	14.1%	7.8%	4.1%	11.2%	8.2%
Adj. EBITDA	7.8%	16.2%	13.0%	11.5%	18.1%	15.4%

Source: Company Reports and CIR Estimates

In more detail, at sales level, the 10.7% sales growth in the semester compares to +19.8% in 1Q06, which however benefited from the delivery of the order from the Italian post company worth €35 million all focused in 1Q06 and to be considered one-off in nature. Net of this order, sales growth in 1Q06 was 8.9%, versus 5% which we are estimating for 2Q06.

At EBITDA level, we are forecasting margin post-extraordinary items of 14.6% down 60bps but EBITDA margin pre-extraordinary items growing 240bps to 15.4%, indicating that the group's restructuring plan continues to be on track.

We target net indebtedness to fall from €445 million to €330 million.

Piaggio & C SpA

Company description

Piaggio is the largest player in the European market for scooters and motorcycles, with a 22% market share and the number 2 player in the fast-growing Indian light commercial vehicles market. In the midst of a significant turnaround, the company is growing its presence in high-growth emerging markets.

Investment thesis

Piaggio is the leading player in the European motorised 2-wheeled vehicle market, the richest in worldwide. With a strong tradition in the sector (it invented the Vespa), it has seven strong brand and a presence in both the scooter and motorcycle segments, with a full range of engine displacements. With seven assembly plants in Italy, Spain, India and China , operating at an average utilisation of 55%, Piaggio has capacity to spare to grow and also access to low cost manufacturing facilities, enabling it to be competitive both in the high and low price segments. Its management in place since three years, has a strong track record of achievements. There are still strong opportunities to be exploited, with penetration in emerging markets having just begun.

Valuation

Current Valuation undemanding - absolute valuation methodologies such as free cash flow yield, REP ratio and DCF point to valuations above current market levels: on 2006 and 2007 estimates we reach fair values of €3.30 on FCF yield, of €3.20 on REP Ratio and DCF to €3.6. At a 2006 PE multiple of 16.0x and PCF of 6.7x, shares are trading at an earnings PEG of 0.39x and at a cash flow PEG of 0.50x and on EV/EBITDA multiples Piaggio shares are trading at a 16% discount to peers. Further, we believe company guidance, market consensus and our forecasts are likely to prove conservative with regards to the growth prospects provided by the above markets up to 2008, potentially leading to a series of upgrades of market expectations

Risk

We have a Medium Risk code, in consideration of the following factors which could cause the shares to deviate from our target price. Over 80% of Piaggio's revenues are generated in a mature market with low prospected economic growth (EU markets represent 83% of sales and Italy alone 40%).

54% of revenues are generated by scooters, the most vulnerable segment from low-cost manufacturers, particularly in the 50cc segment, where Piaggio has 32% EU market share - this is partly being offset by company strategy to source components globally and low end finished products from China.

Piaggio is exposed to competition from large and established Japanese manufacturers, all with a complete 2-wheeled product range, with large scale economies. We believe the risk of this competition becoming overwhelming will gradually fade away as the company increases its presence outside the European market.

Sales volumes are strongly related to product innovation, implying the group is under pressure to continue to introduce technical innovation, new designs and new products and product segments to maintain sales in existing markets.

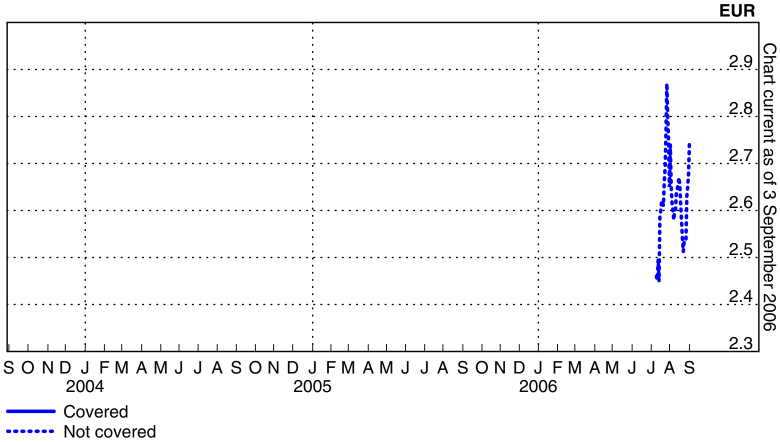
Analyst Certification Appendix A-1

I, Alessandro Falcioni, research analyst and the author of this report, hereby certify that all of the views expressed in this research report accurately reflect my personal views about any and all of the subject issuer(s) or securities. I also certify that no part of my compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

IMPORTANT DISCLOSURES

Piaggio (PIA.MI)

Ratings and Target Price History - Fundamental Research



#	Date	Rating	Target Price	Closing Price

*Indicates change.

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Investment ratings are a function of Citigroup Investment Research's expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating.
For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings are: Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return).
Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

Between September 9, 2002, and September 12, 2003, Citigroup Investment Research's stock ratings were based upon expected performance over the following 12 to 18 months relative to the analyst's industry coverage universe at such time. An Outperform (1) rating indicated that we expected the stock to outperform the analyst's industry coverage universe over the coming 12-18 months. An In-line (2) rating indicated that we expected the stock to perform approximately in line with the analyst's coverage universe. An Underperform (3) rating indicated that we expected the stock to underperform the analyst's coverage universe. In emerging markets, the same ratings classifications were used, but the stocks were rated based upon expected performance relative to the primary market index in the region or country. Our complementary Risk rating system -- Low (L), Medium (M), High (H), and Speculative (S) -- took into account predictability of financial results and stock price volatility. Risk ratings for Asia Pacific were determined by a quantitative screen which 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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