MEDIOBANCA
INDUSTRY RESEARCH

7 July 2003

FIAT

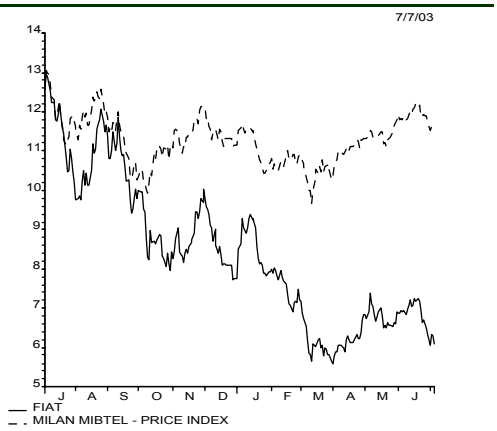
Automotive

Price: € 5.67(*) **Outperform (from Underperform)**

	2002	2003E	2004E
Turnover	55,649	46,574	45,546
Ebit	-758	-616	-45
Net Profit (€ m)	-3,944	-598	-894
EPS Adj.	-2.47	-1.42	-0.30
DPS ord	0.31	0.00	0.00
P/E Adj.	nm	nm	nm
P/CEPS	nm	34.7	4.0
P/BV	1.0	0.5	0.6
EV/Sales	0.2	0.3	0.3
EV/EBIT	nm	nm	nm

N° Shares (m)(*)	Mkt Cap (€ m)(*)	High/low(*)
986	5,199	12.94-5.57

Reuters	Bloomberg
FIA.MI	F IM



Note: Not adjusted for right issue.

Source: DATASTREAM

Rel.Perf.	1m	3m	12m
vs MIBTEL (%)	-11%	-5%	-44%

(*) Adjusted for right issue.

Last chance but one worth taking

- Managing a business turnaround in a gloomy market and from a precarious financial starting point is not an easy task, even with a strongly committed management. Fiat's new business plan appears sound, since the announced targets are expected to be reached mainly thanks to cost efficiencies, and assumptions of market shares and revenue growth are not aggressive. However, we would have preferred to have had more information from Fiat on financial and industrial issues, besides the larger commitment to investment in capex and R&D. Moreover a bigger rights issue would have been a safer bet, to reduce the risk of a further financial crisis.

- A lot has been done. Asset disposals and debt restructuring have put Fiat in a healthier position than a few months ago. Once the financial emergency has been addressed, the disruption to cash flow remains the biggest issue. We believe there is further room for cost cutting but the real challenge will be for the management to boost revenues. Massive funds are to be invested in trying to close the gap with competitors in terms of product portfolio, market share and profitability. Visibility remains low: the 2003 pipeline would help to improve the situation but revenue growth is a long run objective and a real turnaround is not expected before 2005.

- Fiat remains in a tricky situation. Our SOP delivers a fair value (post capital increase) of €7.20 or some 27% higher than current levels. Fiat shares have strongly underperformed the stock market (and the auto sector in particular) in recent weeks, following the official announcement of the capital increase. We do not expect further negative newsflow in the coming months, so we believe the stock could bottom during the capital increase. Shareholders and management know perfectly well that this is the last chance, but maybe it is one worth taking.

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Executive summary

We believe SOP is the best method for valuing Fiat, since a DCF is not appropriate due to the low visibility and cyclicality of the business. Market multiples are not helpful since the company should remain a loss maker at least until 2005.

Our SOP delivers a fair value of € 7.20 after the rights issue, i.e. some 27% higher than current theoretical "ex" prices.

Although we see Fiat as a group based on three businesses—and there is room for significant improvement at CNH and Iveco—we believe future growth depends upon the success of the auto turnaround. This is the reason why our report mainly focuses on the restructuring of the auto business.

We currently value the auto division at 0.2x 2003 sales. *This could be too high or too low...* it depends on the capacity of the management to return Fiat to decent profitability levels. Moreover:

- the 0.20x multiple used represents a slight discount to main competitors;
- in light of a prolonged underperformance the multiples of European car makers in Europe are now particularly squeezed and a sector recovery would also enhance Fiat's multiples.

The Fiat stock has continuously underperformed all its main comparables over any period considered—clearly because of the company's disappointing results. However, there is no fundamental reason for the stock's recent underperformance, which followed the first rumours of an imminent capital increase.

We have little doubt that Fiat is in a more solid situation today than it was six months ago although we realise that visibility on the turnaround is still low. Valuing Fiat remains a tricky task: all in all, at current prices we would bet on the stock. Despite a high risk profile it offers potentially attractive returns over the short and medium term.

Fiat is currently facing a huge industrial and financial crisis, which is clear from 1) the erosion of its market share, 2) low sales volumes and segments targeted, and 3) declining EBIT and continual cash burn.

Overall, we believe that the reasons for Fiat's current weaknesses can be summarised as:

1. Insufficient focus on the core business.
2. Low investment in capex and R&D.
3. Weak product portfolio.
4. Unsatisfactory sales strategies.
5. Low economies of scale.

The Boschetti plan has been a first step in the right direction but there is much more to do.
We believe that the Morchio plan is another step forward. What we like about the Morchio plan is that after several years in which resources have been wasted on non-core activities, the management now seems finally committed to focusing on the core business.

The plan appears sound and the new targets reasonable, as they do not depend on a buoyant market or a huge rise in revenues, but focus more on cost efficiencies (two-thirds of the improved margins are to come from the costs side and the remaining third from the revenues side).

We would have appreciated more details on both financial and industrial issues besides the larger commitment to investment in capex and R&D. Moreover, a bigger rights issue would have been a safer bet, to reduce the risk of a further financial crisis.

Morchio plan main financial and strategic issues

Rights issue	€1.8bn. 3 new shares for every 5 old
Strategic focus	Core business
2006 market car deliveries /000	
Italy	2,200
Rest of EU	11,450
Market share Fiat 2006	
Italy	32.4%
Rest of EU	4.1%
Group EBIT	b/e 2004. 4.1% as of 2006
Fiat Auto EBIT	b/e 2005
Free cash flow	b/e 2005
R&D	2003-2006 total: €7.9bn
CAPEX	2003-2006 total: €9.1bn
Downsizing	12 plants of which 1 in Italy. Some 12,300 employees of which 2,800 in Italy

Source: Mediobanca Industry Research

Boosting revenues remains a challenging task: a longer time is needed for a real turnaround. The models set for launch in 2003 are not expected to be real volume makers, although we believe that they will have some positive impact on market share and brand image. We think the Punto Multijet will ease customers' perception of a technology gap between Fiat and the other major carmakers, while the Lancia Y and Alfa GT coupe are likely to appeal in terms of design. We think the real challenge will come in 2005, which will see the launch of 1) the new Fiat Punto, 2) a new D segment model, the Crossover, 3) the Alfa coupe and a supercar, both in the H segment, and 4) an SUV.

We have based our model on assumptions very similar to those communicated in the business plan, although our EBIT forecasts are more conservative, and see consolidated breakeven coming only in H2 04 rather than in the whole of 2004, as the company believes.

All in all we believe that managing a business turnaround in a gloomy market and from a precarious financial starting point is not an easy task, even with a strongly committed management. It is a steep slope but shareholders and management know perfectly well that this is the last chance—but maybe it is one worth taking.

Valuation

We believe SOP is the best method for valuing Fiat, since a DCF is not appropriate due to the low visibility and cyclicality of the business. Market multiples are not helpful since the company should remain a loss maker at least until 2005.

Our SOP delivers a fair value of € 7.20 after the rights issue, i.e. some 27% higher versus current cum and theoretical "ex" prices respectively.

It is obvious that the auto sector is by far the most crucial both in terms of value and potential turnaround. We see Fiat as a group based on three business areas but we believe that although there is room for significant improvement at CNH and Iveco, future growth depends upon the success of the auto turnaround.

We currently value the auto division at 0.2x 2003 sales. *This could be too much or too low*... it depends on the capacity of the management to return Fiat to decent profitability levels. A simple upgrade of our auto valuation from 0.20x to 0.25x 2003 sales would imply a 13% higher value. That is why we are focusing this first report on Fiat on the auto division.

Moreover:

- the 0.20x multiple used represents a slight discount to main competitors;
- in light of a prolonged underperformance the multiples of European car makers in Europe are now particularly squeezed and a sector recovery would also enhance Fiat's multiples.

Sum-Of-the Parts: € 7.2

We have applied the current stock price for the listed companies held in Fiat's portfolio while for all the other activities our main assumptions are:

- **Fiat Auto**. We used a sales multiple of 0.20x EV/2003E, slightly lower than the peer average of 0.25x, reflecting lower profitability and visibility.

- **Iveco**. We valued Iveco at 0.3x 2003E sales, adding a premium to the 0.26x multiple applied for the acquisition of the 50% stake of Irisbus and the 0.25x multiple used for the RVI deal, for reasons of size and profitability.

- **Ferrari**. We valued Ferrari at an EV of €2,280, i.e. the same valuation used for the acquisition of the 34% stake by Mediobanca.

- **Italenergia**. Since Fiat holds a put option on its stake in Italenergia, we valued it at the fixed floor of €1,147m, minus the cost of exercising the put option, i.e. €127m.

Fiat group: Sum-Of-the-Parts model

Not Listed companies	EV/2003E sales	Total EV	% Held	EV	Per share
Fiat Auto	0.20x	3,677	90.0%	3,309	3.6
Iveco	0.30x	2,719	100.0%	2,719	3.0
Ferrari	Deal	2,280	56.0%	1,277	1.4
Teksid	0.40x	492	66.5%	327	0.4
Magneti Marelli	0.20x	539	100.0%	539	0.6
Comau	0.20x	478	100.0%	478	0.5
Itedi	0.40x	149	100.0%	149	0.2
Business solutions	0.35x	719	100.0%	719	0.8
Fidis	deal price		49.0%	400	0.4
Italenergia	floor put option		24.6%	1,020	1.1
Others				1,412	1.6

Listed companies	Market price	Mkt cap €m	% Held	Eq. V. €m	Per share
CNH	$9.59	1,061	85.3%	905	1.0
RCS Editori	€2.15	1,562	13.2%	206	0.2
Mediobanca	€8.37	6,556	2.1%	138	0.2
Edison	€1.15	4,734	2.9%	135	0.1
Total listed companies		**13,913**		**1,384**	**1.5**
Total EV				**13,733**	**15.1**
Net Debt allocated to unlisted companies				984	
Equity Value				**12,749**	**14.0**
Off-balance				6,200	
Equity value post off-balance				**6,549**	**7.20**

(*) On fully distributed shares post capital increase assuming 40% discount for pref. and sav.

Source: Mediobanca Industry Research

We calculated the debt by adjusting the H1 03E figure of €6,200m by 1) the right issue, 2) taking into account the net effect of the disposal of Toro and Fiat Avio, 3) eliminating the consolidated CNH debt since we valued it at its market value and 4) eliminating the portion of consolidated debt that has to be allocated to minorities.

These assumptions deliver an equity value of €6,549, and given an adjusted number of shares of 909 million, this means a fair equity value of € 8.70 or €7.20 on a fully distributed base, or a discount of 27% versus current prices.

The Fiat stock has continuously underperformed all its main comparables over any period considered—clearly because of the company's disappointing results. However, there is no fundamental reason for the shares' recent underperformance, which has followed the first rumours of an imminent capital increase: chart "Fiat's performance vs. competitors" below shows that in the last two weeks Fiat has been the only automotive stock to post a negative absolute performance.

We have little doubt that Fiat is in a more solid situation today than it was six months ago although we realise that visibility on the turnaround is still low. Valuing Fiat remains a tricky task: all in all, at current prices we would bet on the stock, whose risk profile is still high but which has attractive potential returns over the short and medium term.

The value of €7.20 that emerges from our SOP is an achievable target based on reasonable assumptions: market share, debt and cash flow will be the main drivers in the coming months, and will determine the stock's performance.

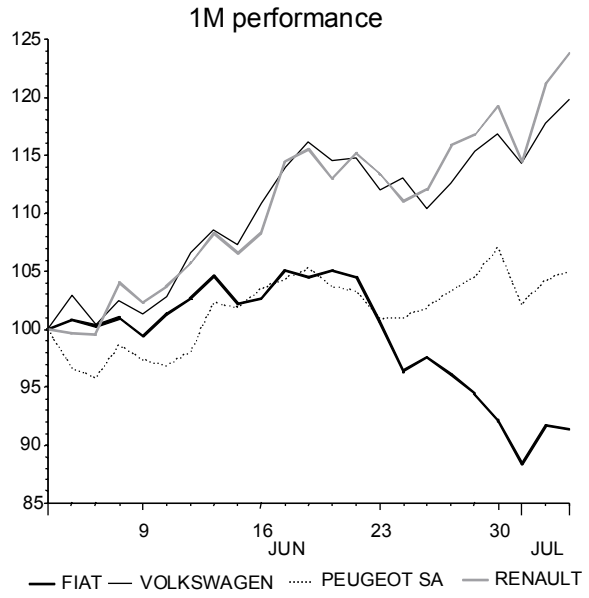
Performance of car sector stocks

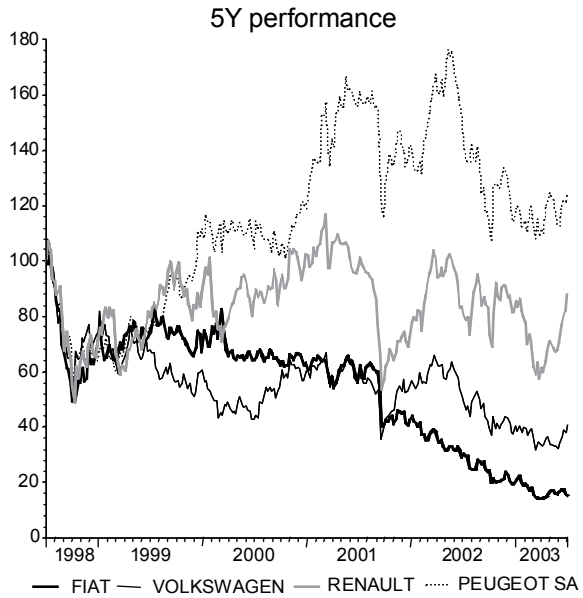
	Absolute perf			Relative to Eurotop 300			Relative to SXAE		
	1m	6m	1y	1m	6m	1y	1m	6m	1y
Fiat	-8.2%	-17.9%	-50.0%	-12.5%	-18.9%	-30.2%	-23.0%	-24.3%	-23.4%
Peugeot	8.9%	10.2%	-19.5%	4.7%	9.2%	0.4%	-5.8%	3.8%	7.1%
Renault	21.9%	5.8%	-2.7%	17.6%	4.8%	17.2%	7.1%	-0.6%	23.9%
Volkswagen	20.6%	6.6%	-24.1%	16.4%	5.6%	-4.3%	5.8%	0.2%	2.5%

Source: Datastream

Note: as of 3/7/03.

Fiat's performance vs. competitors





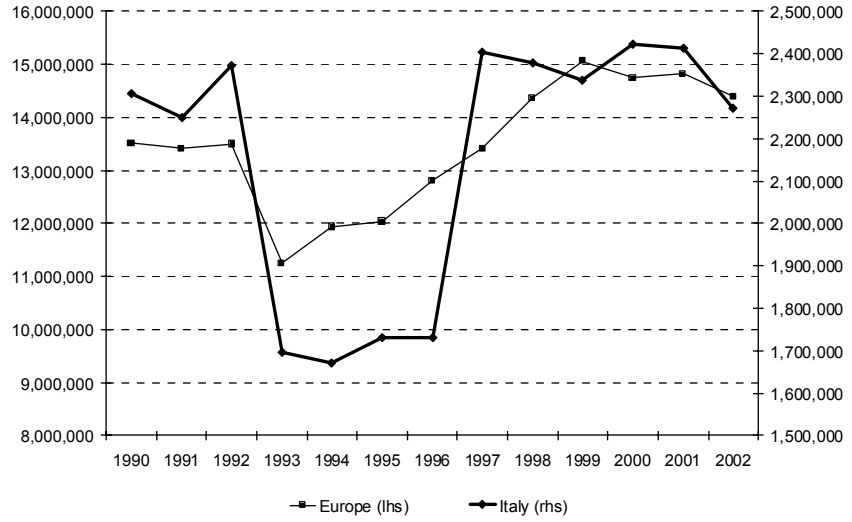
Source: Datastream

Market overview

A demanding gorilla market

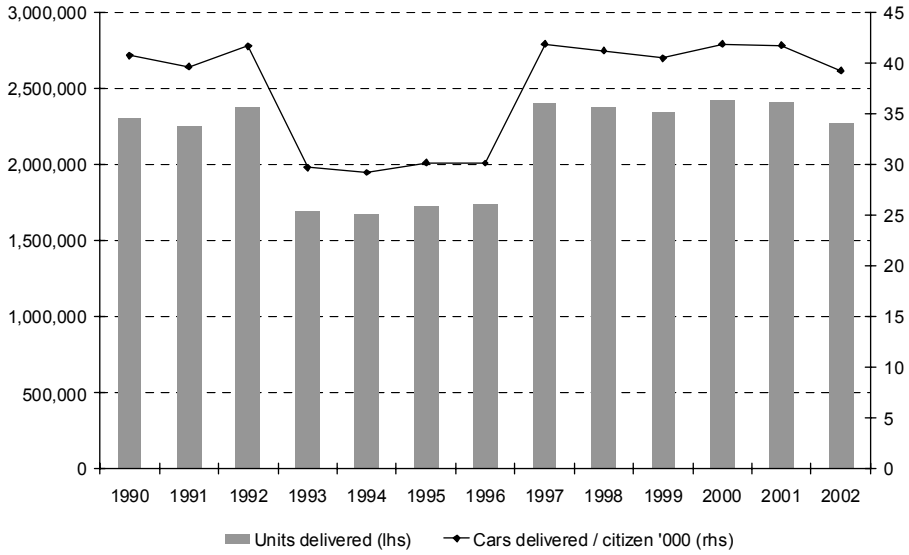
A mature market is by definition near to saturation and the majority of demand is not fed by new customers but by product substitution, with almost flat revenue growth rates. Looking at the performance of car sales in Europe and at the historical number of cars per citizen in Italy, we believe the auto market can easily be considered mature.

EU car registrations 1990-2002



Source: Acea, Anfia, Mediobanca Industry Research

Per capita car deliveries in the EU 1990-2002



Source: Acea, Anfia, Mediobanca Industry Research

Looking in more detail, we believe the main features of the auto market are:

1. *Expert customers.* Since the auto market is a mature one and a car is generally considered the second largest expense for a family (after housing costs), customers tend to have good product knowledge in terms of performance and can easily compare alternative products and evaluate the offers made by the various players. For this reason, products of low quality or that are priced non-competitively are quickly excluded by the market.
2. *Low competitive advantage.* Rapid technological evolution makes it very difficult to maintain competitive advantage without heavy investment and the launch of new products at competitive prices.

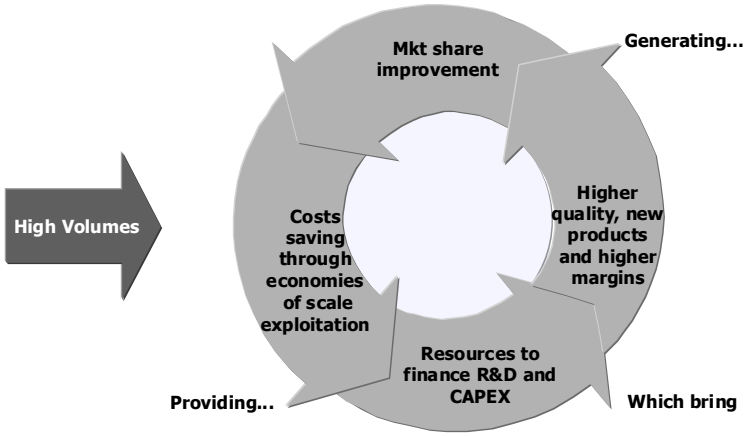
The critical success factor for a car producer is therefore the ability to continuously deliver *high quality* new products sold at *competitive prices*, which it can achieve by investing heavily and generating economies of scale.

Given 1) a flat growth rate and 2) the importance of economies of scale, the auto business looks like a natural *"gorilla market"* in which only the largest competitors can survive by erasing or marginalising the smaller ones.

Few rules to enter the virtuous circle

In light of the above, we believe that the main "musts" for a car manufacturer are those of *defending market share* and *preserving margins and cash flows*, since a company delivering huge volumes is able to enter a kind of virtuous circle, feeding its growth and leading to "gorilla" status.

Virtuous circle in the auto market



Source: Mediobanca Industry Research

The graphic above shows the two main strategies necessary for the creation of a virtuous circle, i.e. making heavy investment in R&D and CAPEX and achieving positioning in highly profitable segments:

a. **Investment in R&D and CAPEX**. Heavy investment in R&D, production and distribution is the right way to deliver models with innovative technologies and appealing design.

In our view, this is the only way a car manufacturer can launch updated and competitive new models, which is very important as a means to reinforce the producer's image and strengthen its medium-term market share.

b. **Highly profitable segments**. Repositioning into more profitable segments in our opinion should help deliver a larger share of the whole market, thereby allowing the company to: 1) be ready to react to potential changes in consumers' habits, 2) reduce exposure to isolated crises or aggressive moves by competitors and 3) focus on higher profitability or potential growth.

These strategies can be executed through organic and external growth. However, considering the low market growth rate, we currently believe that huge volumes and competitive prices cannot be obtained by organic growth alone. Thus we consider also the participation in the consolidation process, through M&A or industrial JV, as an important means of achieving success for car manufacturers.

In fact we would consider any strategy based on an aggressive pricing policy and not supported by a huge investment in quality as a dangerously short-sighted measure. While such a strategy would probably increase short-term sales, it would at the same time erode the company's reputation because of: 1) the lower than expected quality of a durable good, 2) more rapid design obsolescence of an extremely visible status product.

What happened to Fiat?

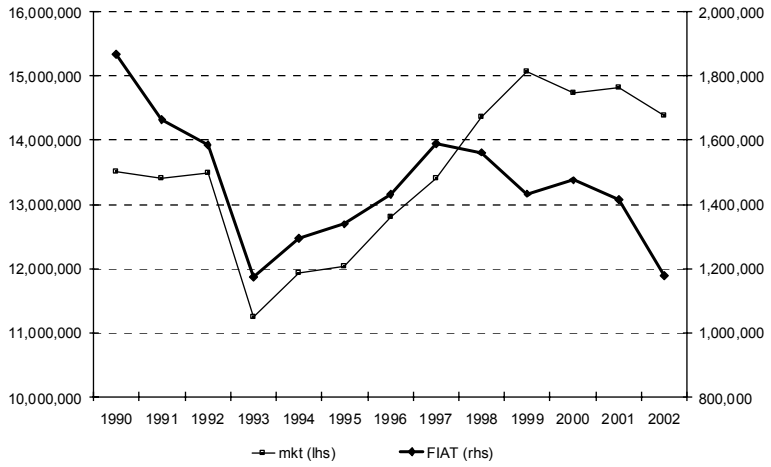
Major crisis

Fiat is currently facing a huge industrial and financial crisis, which is clear from 1) the erosion of its market share, 2) low sales volumes and segments targeted 3) declining EBIT and continual cash burn.

Market share erosion

While deliveries in the EU market grew at a 1% CAGR in 1990-2002 Fiat recorded a negative CAGR of 4%, mainly due to a weak performance in 1997-2002. Note that Fiat has only been able to record a performance in line with its peers during the 1993-1997 period, which we think is due to the ITL devaluation and the launch of the successful Punto model.

EU deliveries – Fiat versus the market 1990-2002



Source: Acea, Anfia, Mediobanca Industry Research

Overall Fiat moved from a European market share of 13.8% in 1990 to 8.2% in 2002 (i.e. from 2nd in Europe after Volkswagen to a weak 7th position), and in recent years the market share gap with VW, PSA and Renault has increased.

EU market share: 1990-2002 snapshot analysis

1990			2002		
Rank	Manufacturer	Mkt share	Rank	Manufacturer	Mkt share
1	VW group	15.7%	1	VW group	18.4%
2	**FIAT**	**13.8%**	2	PSA	15.0%
3	PSA	12.7%	3	JAPAN	11.5%
4	GM	12.0%	4	FORD	11.4%
5	JAPAN	11.8%	5	RENAULT	10.7%
6	FORD	11.5%	6	GM	9.9%
7	RENAULT	9.7%	**7**	**FIAT**	**8.2%**
8	BMW	5.6%	8	Daimler Chrysler	6.6%
9	Mercedes	3.2%	9	BMW	4.3%
10	Volvo	1.7%	10	KOREA	2.7%

Source: Acea, Anfia, Mediobanca Industry Research

Low volumes and segments

The drop in market share is not the only problem Fiat Auto has to address, as the tables below show.

Fiat's sales are largely dependent on the A segment, where it competes with Daimler-Chrysler's premium Smart model in the A segment, and with the heavily discounted Korean models that offer good quality at a lower price. VW and PSA are focused on the more profitable B, C and D segments.

Breakdown of EU deliveries by manufacturer and segment

Producer	SEG	2001		2002	
		Deliveries	%	Deliveries	%
FIAT GROUP	A	243,387	17%	206,385	18%
	B	651,815	46%	496,494	43%
	C	232,760	16%	278,609	24%
	D	175,197	12%	101,637	9%
	E	15,953	1%	11,485	1%
	Other	93,923	7%	72,845	6%
FORD	B	389,981	25%	428,340	28%
	C	542,737	35%	514,901	34%
	D	438,131	28%	406,162	27%
	E	96,941	6%	108,952	7%
	Other	73,367	5%	73,066	5%
PEUGEOT-CITROEN	B	954,065	45%	939,941	44%
	C	516,304	24%	621,533	29%
	D	310,338	15%	261,389	12%
	E	33,942	2%	23,044	1%
	Other	319,021	15%	310,635	14%
RENAULT	B	655,006	42%	639,407	42%
	C	240,168	15%	216,083	14%
	D	227,999	15%	246,358	16%
	E	1,931	0%	23,446	2%
	Other	431,918	28%	394,210	26%
VW-AUDI	B	577,406	21%	607,036	23%
	C	1,174,839	43%	1,021,690	39%
	D	782,237	28%	772,052	30%
	E	104,955	4%	99,089	4%
	Other	106,629	4%	95,090	4%

Source: Acea, Company data, Mediobanca Industry Research

Moreover, Fiat's positioning in the B, D and E segments worsened again in 2002, and while the launch of the Stilo in the C segment allowed Fiat to recover some market share, the gap with the segment leader remains wide. The launches of the new "Audi A3" and "VW Golf" in 2003 are likely to put further pressure on Fiat's market share in the C segment.

EU car sales. - Ranking by segment 2001-2002

2001				2002			
A		495,457	100.0%	A		437,598	100.0%
1	FIAT GROUP	243,387	49.1%	1	FIAT GROUP	206,385	47.2%
2	DAIMLER-CHRYSLER	104,583	21.1%	2	DAIMLER-CHRYSLER	110,113	25.2%
3	DAEWOO	66,657	13.5%	3	DAEWOO	54,340	12.4%
4	HYUNDAI	63,855	12.9%	4	HYUNDAI	41,940	9.6%
5	DAIHATSU	8,474	1.7%	5	SUZUKI	15,738	3.6%
B		4,074,113	100.0%	B		4,045,857	100.0%
1	PEUGEOT-CITROEN	954,065	23.4%	1	PEUGEOT-CITROEN	939,941	23.2%
2	RENAULT	655,006	16.1%	2	RENAULT	639,407	15.8%
3	FIAT GROUP	651,815	16.0%	3	VW-AUDI	607,036	15.0%
4	VW-AUDI	577,406	14.2%	4	FIAT GROUP	496,494	12.3%
5	GM	455,146	11.2%	5	FORD	428,340	10.6%
6	FORD	389,981	9.6%	6	GM	419,192	10.4%
7	TOYOTA	191,789	4.7%	7	TOYOTA	191,134	4.7%
C		3,681,273	100.0%	C		3,541,525	
1	VW-AUDI	1,174,839	31.9%	1	VW-AUDI	1,021,690	28.8%
2	FORD	542,737	14.7%	2	PEUGEOT-CITROEN	621,533	17.5%
3	PEUGEOT-CITROEN	516,304	14.0%	3	FORD	514,901	14.5%
4	GM	483,596	13.1%	4	GM	404,500	11.4%
5	RENAULT	240,168	6.5%	5	FIAT GROUP	278,609	7.9%
6	FIAT GROUP	232,760	6.3%	6	RENAULT	216,083	6.1%
7	NISSAN	109,181	3.0%	7	TOYOTA	134,708	3.8%
D		2,840,689	100.0%	D		2,622,496	100.0%
1	VW-AUDI	782,237	27.5%	1	VW-AUDI	772,052	29.4%
2	FORD	438,131	15.4%	2	FORD	375,323	14.3%
3	BMW-MINI	346,233	12.2%	3	BMW-MINI	350,569	13.4%
4	PEUGEOT-CITROEN	310,338	10.9%	4	PEUGEOT-CITROEN	261,389	10.0%
5	RENAULT	227,999	8.0%	5	RENAULT	246,358	9.4%
6	GM	184,545	6.5%	6	GM	153,428	5.9%
7	FIAT GROUP	175,197	6.2%	7	FIAT GROUP	101,637	3.9%
E		1,013,161	100.0%	E		982,435	100.0%
1	DAIMLER-CHRYSLER	445,692	44.0%	1	DAIMLER-CHRYSLER	449,525	45.8%
2	BMW-MINI	121,748	12.0%	2	GM	99,991	10.2%
3	GM	112,756	11.1%	3	BMW-MINI	99,766	10.2%
4	VW-AUDI	104,955	10.4%	4	VW-AUDI	99,089	10.1%
5	FORD	96,941	9.6%	5	FORD	93,891	9.6%
6	ROVER	36,947	3.6%	6	ROVER	35,475	3.6%
7	PEUGEOT-CITROEN	33,942	3.4%	7	RENAULT	23,446	2.4%
8	HONDA	27,175	2.7%	8	PEUGEOT-CITROEN	23,044	2.3%
9	FIAT GROUP	15,953	1.6%	9	HONDA	16,867	1.7%
10	HYUNDAI	3,530	0.3%	11	FIAT GROUP	11,485	1.2%

Source: Acea, Company data, Mediobanca Industry Research

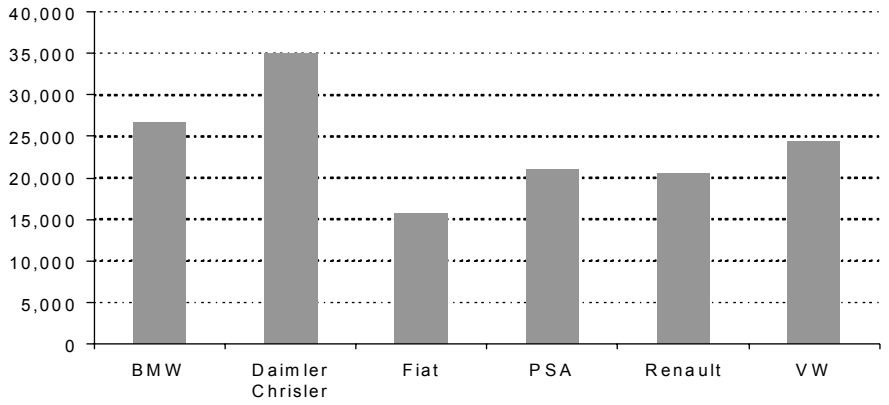
EU car sales -Breakdown by model 2002

	Model	Deliveries	Entry price
A	SMART	110,113	8,900
	FIAT PANDA	**103,747**	**6,600**
	FIAT SEICENTO	**102,625**	**7,900**
	DAEWOO MATIZ	54,340	7,700
	HYUNDAI ATOS	41,940	8,200
	Average price		**7,860**
B	PEUGEOT 206	588,854	10,100
	RENAULT CLIO	500,288	10,400
	OPEL CORSA	419,192	10,500
	FIAT PUNTO	**413,472**	**10,100**
	VW POLO	350,492	11,800
	Average price		**10,580**
C	VW GOLF	589,553	16,300
	FORD FOCUS	514,800	14,600
	PEUGEOT 307	437,465	14,300
	OPEL ASTRA	404,500	15,300
	RENAULT MEGANE	215,279	14,100
	FIAT STILO	**174,070**	**14,400**
	Average price		**14,833**
D	BMW SERIES 3	350,569	23,500
	VW PASSAT	283,916	21,200
	AUDI A4	275,568	26,700
	FORD MONDEO	248,644	20,000
	RENAULT LAGUNA	246,358	20,000
	Average price		**22,280**
E	MERCEDES C-CLASS	206,266	29,800
	MERCEDES E-CLASS	156,528	38,500
	BMW SERIES 5	99,766	38,700
	AUDI A6	89,990	35,600
	VOLVO V70	75,626	40,800
	Average price		**36,680**

Source: Acea, Company data, Mediobanca Industry Research

The table shows not only that Fiat is over-exposed to the A segment, but also that the average price of Fiat models in each segment is, generally speaking, lower than the main competitors. Setting aside sales policies (eg zero-km deals and corporate fleets), this appears to demonstrate that Fiat is forced to keep its prices low because of a lack of effective models. Fiat's positioning across the segments has also led to weak average revenue per unit delivered (ARPU), which is now the lowest of the peer group.

Revenues per unit sold

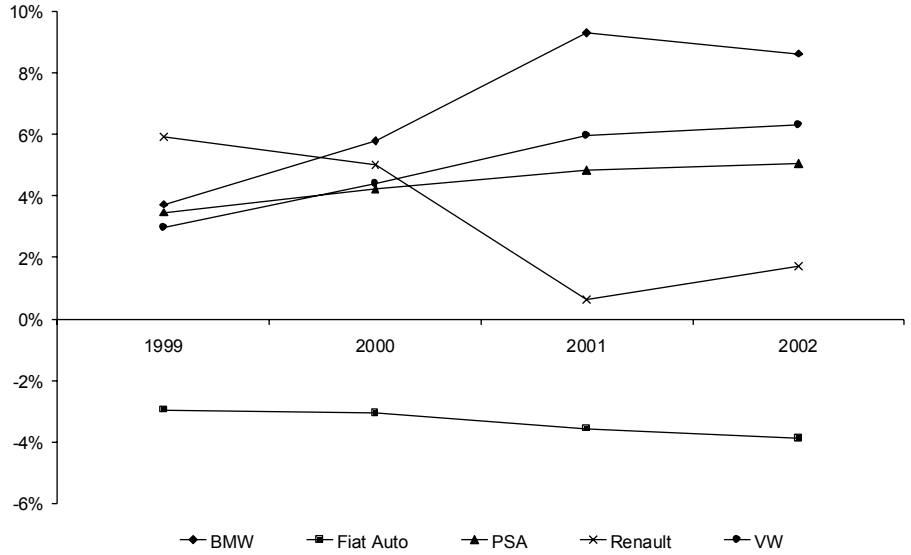


Source: Mediobanca Industry Research, Companies data

Declining EBIT and continual cash burn

In recent years Fiat Auto margins have shrunk to the point where it is the only major car manufacturer recording negative EBIT.

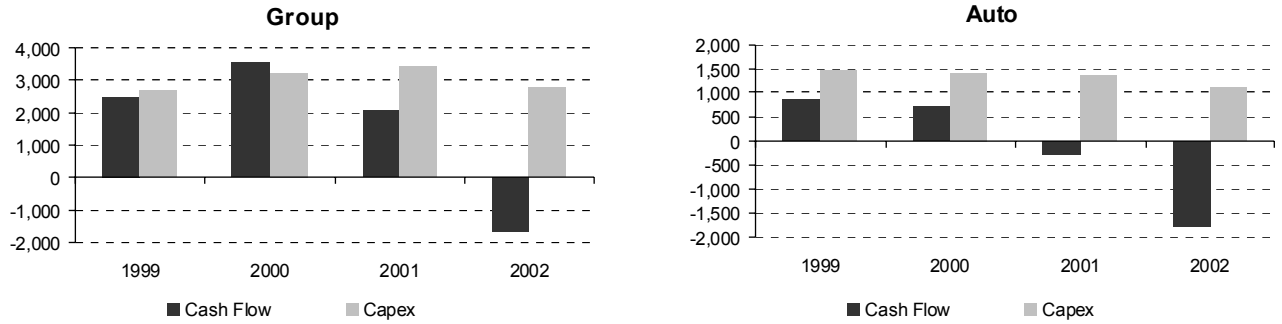
Auto sector operating profit: peer comparison 1999-2002



Source: Mediobanca Industry Research, Companies data

As for cash flow, given that in the auto business capex cannot be reduced below a certain level, we note that Fiat has had to invest a higher amount of money than that generated by operations. This situation has deteriorated significantly during the last couple of years, increasing the company's debt and thus generating an unsustainable trend for the future.

Fiat group and Fiat Auto 1999-2002 cash flow vs capex

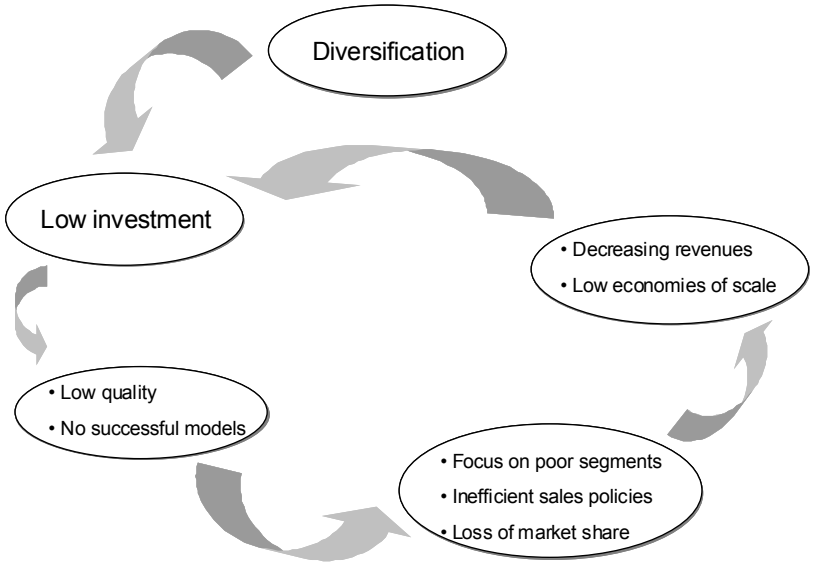


Source: Mediobanca Industry Research, Company data

Reasons behind the crisis

The main reason for the crisis is that Fiat has taken a series of debatable decisions that in our opinion locked the group into a worrying vicious circle. Fiat's diversification strategy adopted in recent years imposed an inadequate level of investment on the core business, which has impacted on the product portfolio and quality, hitting sales and margins.

Breaking the vicious circle



Source: Mediobanca Industry Research

Overall, we believe that the reasons for Fiat's current weaknesses can be summarised as:

- Insufficient focus on the core business.
- Low investment in capex and R&D.
- Weak product portfolio.
- Unsatisfactory sales strategies.
- Low economies of scale.

Insufficient focus on core business

In recent years Fiat has been involved in a number of deals aimed at squeezing out minorities and other non-core investments, which have diverted some €2.0bn from core business investments. This diversification activity accelerated considerably under Paolo Fresco, chairman from 1998 to February 2003.

Diversion of cash from core business

	Pre-deal stake	Deal date	Cost
Toro	36%	1999-2000	1,000
Magneti Marelli	70%	2000	500
Comau	66%	1999	70
Pico	0%	1999	300
Italenergia	n.a.		n.a.

Source: Mediobanca Industry Research

Moreover, even acquisitions in the core business, such as Case in 1999, have proved to be a strategic mistake. The Case acquisition was very costly, as Fiat paid $4.1bn for the company, a hefty 67% premium on the average price of previous months. At the time of the takeover Fiat announced expected savings of $400-500m in 3-4 years. Four years later, however, there has been no real integration between Case and New Holland, and the Morchio plan constitutes the first real effort to rationalise the merged companies.

The failure of this strategy is evident from the recent disposals of Toro, Fidis and Fiat Avio, and the put option on Italenergia, although some of these operations were a financial success:

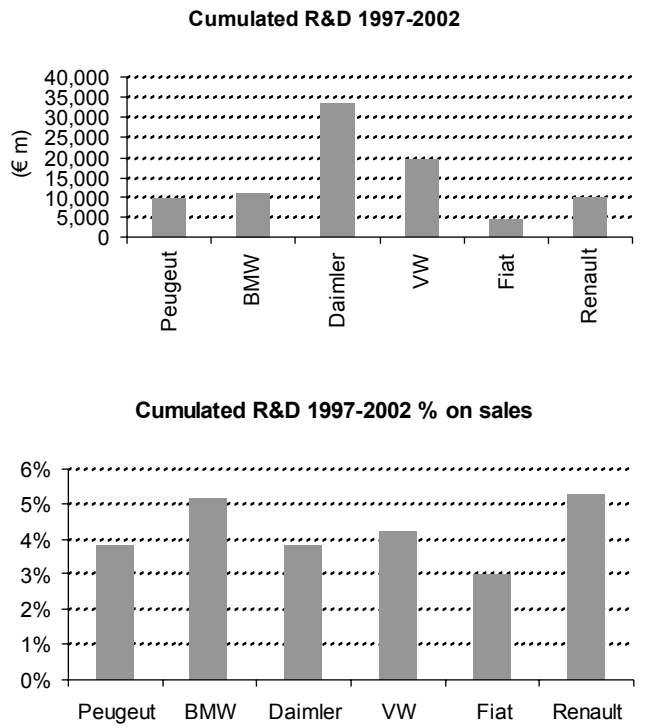
1. the stake in Italenergia, obtained through the transfer of a number of small power plants and booked by Fiat at around €480m, represents an unrealised capital gain of €600m, thanks to the put option floor of €1.1bn;
2. the disposal of Toro for some €2.4bn will realise a capital gain of €400m.

However, we believe that these financial investments and the squeeze out of minorities from Magneti Marelli and Comau (with a view to disposing of them later), are a clear sign that the group has had little interest in the auto sector for some time.

Low investment in R&D and capex

We reckon that the lack of focus on the core business has above all diverted significant resources away from investment in R&D and capex. In fact Fiat has been the lowest spender among its peers in recent years, with cumulative R&D expenses of €4.4bn in 1997-2002: less than half that of PSA and Renault, and around a quarter of VW's spending. The capex situation is similar, with Fiat spending around €8.0bn, that is less than its peers.

Comparative analysis of cumulative R&D and capex in the auto sector 1997-2002



Source: Mediobanca Industry Research, companies data

Weak product portfolio

We believe that insufficient investment is the main reason for the weak product portfolio, exacerbated by: 1) the lack of really successful models after the Punto, 2) the failure to pick up major trends and 3) lower quality than competitors.

Lack of really successful models after the Punto

Another effect of the low level of investment is that Fiat has failed to launch any successful new models since 1997, unlike its main competitors.

European market new models-restyling

	1997	1998	1999	2000	2001	2002
Fiat Group			* Lancia **Lybra** launch (D)	* Alfa **147** launch (B)	* Fiat **Punto** Rest. (B) * Fiat **Stilo** launch (C)	
VW Group	* Audi **A8** launch (E) * Skoda **Octavia** launch (D)	* VW **Lupo** launch (B) * Audi **TT** launch (H)	* Seat **Ibiza** Rest. (B) * VW **Golf** Rest. (C) * Seat **Cordoba** Rest. (C) * VW **New Beetle** launch (C) * VW **Bora** launch (C)	* Audi **A2** launch (B) * Skoda **Fabia** launch (B) * Seat **Leon** launch (D)	* VW **Polo** Rest. (B)	
PSA	* Citroen **Xsara** launch (L1)			* Puegeut **607** launch (E)	* Peugeut **307** launch (C) * Citroen **C5** launch (D)	* Citroen **C3** launch (B) * Puugeut **206** Rest. (B)
Renault		* Renault **Clio** Rest. (B) * Renault **Laguna** launch (D)		* Renault **Espace** Rest. (L2)	* Renault **Clio** Rest. (B) * Renault **Scenic** launch (L1)	* Renault **Vel Satis** launch (E)
GM	* Opel **Corsa** Rest. (B)	* Opel **Astra** Rest. (C)			* Opel **Corsa** Rest. (B)	
Ford		* Ford **Focus** launch (C)				

Source: Mediobanca Industry Research, Companies data

Leaving aside the number of new models, we note that both the restyled Fiat Punto and the new Fiat Stilo have underperformed peer models in terms of units sold.

The situation is serious for the Punto, which ranked third by unit sales in the B segment in 2001-2002, but is even worse for the new Stilo C segment model, which is a long way behind by the extremely successful Peugeot 307, Ford Focus and VW Golf.

Unit sales of new models in the EU in 2001-2002

Units / 000	2001	2002	Total
B Segment			
Peugeot 206	624	588	1,212
Renault Clio	493	500	993
Fiat Punto	**541**	**413**	**954**
Opel Corsa	455	419	874
VW Polo	308	350	658
C Segment			
VW Golf	662	589	1,251
Ford Focus	539	514	1,053
Peugeot 307	188	437	625
Fiat Stilo	**n.m.**	**174**	**n.m.**

Source: Acea, Company data, Mediobanca Industry Research

Failure to pick up major trends

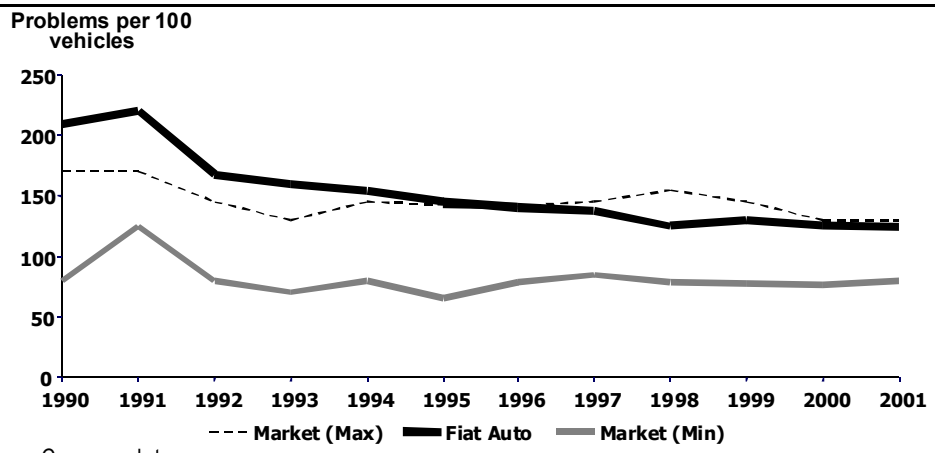
We believe that the lack of focus on the auto sector has also led Fiat to miss out on some important trends in niche sectors, which often offer higher margins.

1. *The city car.* In 1998 the Daimler-Chrysler group launched its Smart model, an innovative city car concept. Although it did not meet the company's targets, it has became a status symbol for young and professionals and is the best-selling car in the European A segment, despite an entry price some 15% higher than the segment average. Fiat, on the other hand, has continued to develop cars with a very low profile, losing market share and potential ARPU.
2. *SUV and 4x4.* This has been a clear success story at both the lower and upper end of the market. Unfortunately Fiat is only now designing the Alfa Romeo Kamal.
3. *Restyling of fashionable historic cars.* In 2000 VW launched the restyling of the Beetle and in 2001 the BMW group launched the restyled Mini, recording significant volumes with higher than average prices for the segment. Fiat has yet to produce any of its legendary models.
4. *Deficiency in diesel engine portfolio.* Demand of diesel engines is growing faster compared to gasoline. Until the recent launch of the new Multijet 1,300 cc, the Fiat Punto was equipped with the 1.9 JTD, engine: too big for a B segment car in terms of fuel consumption and related costs. This is why only 10.5% of Puntos sold are diesel, vs. a segment average of 21% and anything from 28% to 36% for the best competitors. The Toyota Yaris and VW Polo are equipped with 1.4 TDI Common Rail (Common Rail is a technology developed by Fiat and then sold to Bosch; we wonder why). Overall, Fiat aims to increase the percentage of diesel engines sold from 23% to 45% at the end of the plan. It's an ambitious but achievable target thanks to the new Multijet.

Lower quality than competitors

The last important element strongly affected by the low level of investment is the quality perceived by customers. The customer satisfaction data communicated by the group show that Fiat is one of the companies most often associated with defects, and its cars are therefore perceived as low quality, which impacts on volumes and pricing.

Low customer satisfaction



Source: Company data

Unsatisfactory sales strategies

All this considered, Fiat has been forced to develop sales strategies based on price competition, largely based on zero km (where dealers buy new cars and sell them as used), ex-demo and rental deals. Although these strategies have contained the drop in registration volumes, they have also led to oversupply of semi-new cars, resulting in significant price erosion and impacting on both ARPU and margins. Moreover, the sales strategy has suffered from an unsatisfactory dealer network which does not fully cover the main European countries. The new business plan is finally trying to address this weakness, and includes €700m of investment to develop the network.

Low economies of scale

The weaknesses described above have therefore impacted on volumes, reducing opportunities to obtain economies of scale. Moreover while the main automakers have expanded through mergers and acquisitions in recent years, reaching critical mass and enjoying synergies, Fiat has grown only organically—another factor affecting its profitability versus its peers.

For example, because of its lack of successful models Fiat cannot use the same platforms for a large number of units as its competitors do, to generate economies of scale. Take the Lancia Thesis (3,000 units sold in the EU in 2002): Fiat had to develop a dedicated platform for this model, spending some €400m. The company has not shared platforms for models in the lower segments either, such as the Fiat Stilo/Alfa 147 and Fiat Punto/Lancia Y, and now has 15 platforms for 16 models. A new platform costing around €600m was also built for the Fiat Stilo, along with a dedicated plant with a current capacity utilisation of less than 60%.

Platform sharing

		2002 Volumes
Peugeot		
	Citroen C2 = Peugeot 107	n.m.
	Citroen C3 = Peugeot 206	724,009
	Citroen Xsara = Peugeot 307	606,154
	Citroen C5 = Peugeot 407	257,842
VW group		
	VW Polo = Seat Ibiza = Seat Cordoba = Skoda Fabia	639,175
	VW Golf = Audi A3 = Skoda Octavia	795,076
	VW Passat = Audi A4 = Skoda Superb	569,691
Fiat group		
	Fiat Punto	413,472
	Lancia Y	79,665
	Fiat Stilo	174,070
	Alfa 147	95,008

Source: Mediobanca Industry Research, Company data

About to turn the corner?

The Boschetti plan: a step in the right direction but much more to do...

Fiat's doubtful strategic decisions led to a consolidated net loss close to € 4.0 bn in 2002, with net financial debt of € 3.7 bn or €5.2 bn at Q1 03 (excluding some € 6.0 bn of off balance sheet liabilities). Because the Fiat crisis is both industrial and financial it is particularly difficult to achieve a turnaround. After the ineffective January 2002 capital increase, some important steps have been taken in the right direction. While we will not cover the previous business plan in detail here, we note that:

- Some measures to deal with the financial crisis have been taken. We believe these measures will be effective, although they only represent a short-term stop-gap (see sections headed "Convertendo" and "Disposal of non-core activities" below).
- Cost cutting has been effective, but there is still a lot of scope for improvement.
- Revenues remain a tricky area.

"Convertendo": set for renegotiation. In September 2002 a group of major Italian banks (Capitalia, IntesaBCI, San Paolo IMI and Unicredito) agreed a €3.0bn convertible loan ("convertendo") expiring on 10/10/2005, (3m Euribor + 150bp). The original conditions were:

- Between January and July 2004, under certain conditions relating to ratings and debt levels, the banks can request mandatory redemption or (if the company cannot meet its redemption obligations) convert €2.0bn of the 3.0bn into Fiat shares.
- In the event of an early conversion, the strike price will be the average of €15.50 (price to be adjusted to the new right issue) per share and the average market price recorded during the previous three months.
- When the loan expires, if Fiat is unable to (or decides not to) repay it, the debt will be automatically converted into shares at the strike price of the average of €15.50 per share and the average market price recorded during the previous six months (instead of three months).

  Since these conditions are quite tough for the banks, they are in the process of renegotiating the loan. According to rumours, the top of the range could be lowered from €15.50 to €12.50, with the expiry date postponed to 2008 (subject to the approval of a Fiat extraordinary shareholders' meeting). The banks are clearly aiming to avoid a mark to market valuation of Fiat shares. Under the new rumoured conditions, in the (extremely unlikely) event of total conversion, the banks would have a 20-25% stake in Fiat, after the announced capital increase. In exchange, Fiat could obtain a further loan of €2.0bn at better condition than its credit standing would merit.

Disposal of non-core activities. Fiat has finally been forced to dispose of non-core businesses such as Fiat Avio, Toro and Fidis and others, in order to reduce its debt. These deals should generate an overall (already disposed plus Toro, Avio and Fidis) reduction in net debt of some €3.1bn, and confirm Fiat's new commitment to invest in its core industrial activities. The downside is that Toro and Fiat Avio were the only businesses to make a significant positive contribution to EBIT in 2002.

Disposal of non-core assets

(€ m)	Cash-in	Debt/(cash) deconsolidation	Net effect
Toro	2,400	(1,000)	1,400
Fiat Avio	1,500	(100)	1,400
Fidis	370	(800)	(430)
Fraikin	320	80	400
IPI	120	136	256
Fidis Brazil			100
Total	4,710	(1,684)	3,126

Source: Mediobanca Industry Research, Company data

Big room for cost cutting

The previous business plan targeted cost savings of a total of €1 bn, and we believe this is achievable since it is based on reasonable assumptions. In Q1 03 savings of about €250m were obtained on a like for like basis versus Q1 02.

Boschetti plan – expected cost cutting: 2003 vs. 2002

Average 2003 on 2002 P&L impact (€ m)	
Reduce production costs by 3.5%	500
Reduce distribution costs & warranties	200
Reduce overheads	200
Reduce other costs	100
International operations	100
Total cost reductions	1,100
Increase R&D	(100)
Net cost reduction	1,000

Source: Company data

The Morchio plan: another step forward

CEO Giuseppe Morchio's presentation on 26 June was fully based around Fiat Auto, Iveco and CNH: the first positive news.

Fiat's new business plan appears sound, since the targets announced are to be reached mainly through cost efficiencies, and do not incorporate aggressive assumptions on market share and revenue growth.

However, we would have appreciated more details on both financial and industrial issues besides the larger commitment to investment in capex and R&D. Moreover, a bigger rights issue would have been a safer bet, to reduce the risk of a further financial crisis.

Once again we can split the business plan into 2 main areas: financial restructuring and industrial relaunch.

Morchio plan main financial and strategic issues

Right issue	€1.8bn. 3 new shares out of 5 old
Strategic Focus	Core business
2006 market car deliveries /000	
Italy	2,200
Rest of EU	11,450
Mkt share Fiat 2006	
Italy	32.4%
Rest of EU	4.1%
Group EBIT	b/e 2004. 4.1% as of 2006
Fiat Auto EBIT	b/e 2005
Free cash flow	b/e 2005
R&D	2003-2006 cumulated €7.9bn
CAPEX	2003-2006 cumulated €9.1bn
Downsizing	12 plants of which 1 in Italy. Some 12,300 employee of which 2,800 in Italy

Source: Mediobanca Industry Research

Financial restructuring

Here, the major issue is the new €1.85bn capital increase. Investors were perhaps expecting details about the rumoured changes in the conditions of the bond loan and €2bn in new facilities loans from the banks.

We understand that negotiations between Fiat and the banks are still ongoing, and expect to hear something fairly soon.

As regards the put option with GM, and the possibility of GM underwriting Fiat Auto's capital increase, we do not see these as major issues in the short term, since the management is now committed to relaunching the business, and the deadline for GM to decide whether or not to underwrite the capital increase is October 2004.

Capital increase: will €1.8bn be enough to cover the business plan?

A share issue was already largely priced in by the markets, especially since a flurry of press rumours in the last few days has indicated its likelihood and even the size of the deal. Three ordinary shares will be issued at par value of €5 for every five ordinary, preference or savings shares owned.

The total proceeds will be about €1.8bn, and the issue is expected to start on 7 July. However, we are doubtful whether €1.8bn will be enough to support the new business plan, and to prevent Fiat from plunging back into financial crisis in the event of unexpected delays in implementing the plan.

We would have preferred a larger issue, since Fiat's investment programme to 2006 is ambitious, and the company will have to try to claw back market share and profitability in a gloomy scenario for the auto industry.

A higher amount would have diluted the core shareholder's stake, but would at least have placed Fiat on a firmer footing in the event of a further market slowdown or a delay in putting the plan into effect. A simple calculation bears this out.

Cash requirements in 2003-2005

(€ m)		2003E	2004E	2005E	Cumulated
EBIT		-616	-45	776	115
D&A		2,251	2,326	2,399	6,977
EBITDA		1,635	2,281	3,175	7,092
Financial Items		-536	-428	-503	-1468
Restructuring costs		-1000	-600	-100	-1700
Cash Flow		**99**	**1,253**	**2,571**	**3,923**
Capex		2,415	2,454	2,395	7,265
FCF		**-2317**	**-1201**	**176**	**-3341**
Total FCF to be financed	**3,341**				
Current Debt	3,800				
To be financed	**7,141**				
Rights issue	1,800				
Disposals Net effect	2,400				
Net gain on Italenergia put option	1,020				
Debt @ 2005	**1,921**				
Off balance sheet liabilities	6,000				
Total debt @ 2005 after off balance sheet liabilities	**7,921**				

Source: Mediobanca Industry Research

Based on our estimates, we believe the Fiat group should be able to generate total cash flow of some €3.9bn in 2003-2005, and should plough some €7.3m into capex. Taking a simple scenario of zero taxes and working capital absorption/generation, the group needs €3.3bn to finance its operations until 2005.

However, including the €1.8bn rights issue, the net effect of disposals, and the potential disposal of Italenergia at the put floor (minus expenses), we believe the group's debt will be close to €1.9bn by the end of 2005, in addition to off balance sheet trade receivables discounted. According to our estimates the ratio EBIT/Interest charges should be only 1.5x.

This level of debt is based on the assumption that the plan will work well. However, if Fiat auto does not recover as expected, the group could face another financial crisis in 2004-2005, right in the middle of the turnaround period; this will throw its future into serious jeopardy. Conversely, if performance comes out above expectations, rising cash flows will easily enable the company to cope with the transaction.

Industrial relaunch

The industrial aspect of the plan can be summarised as follows:

- total focus on the core business;
- operating income to rise by €4.7bn: two-thirds of this will be generated by cost efficiencies and one-third will come from the revenues side. After the expected price erosion, changes to D&A, the reduction in the consolidation base and forex this is expected to shrink to €2.9bn;
- total investment seen at €9.1bn in 2003-2006, and total R&D at around €7.9bn, broadly in line with our expectations;
- EBIT breakeven to be reached in 2004, while the EBIT margin is expected to rise to 4.1% as of 2006. Fiat Auto is not expected to reach EBIT breakeven until 2005.

What we like: well-focused, reasonable and achievable

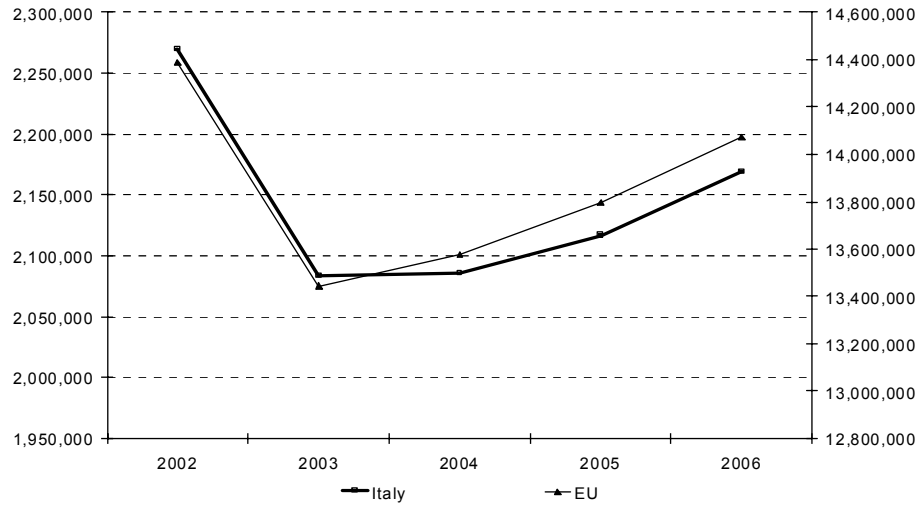
We like the Morchio plan because after several years in which resources have been wasted on non-core activities, the management now seems finally committed to focusing on the core business. Moreover, the plan appears sound and the new targets reasonable, as they do not depend on a buoyant market or a huge rise in revenues, but focus more on cost efficiencies (two-thirds of the improved margins are to come from the costs side and the remaining third from the revenues side).

Conservative market and revenue growth

We believe that one of the plan's main strengths is its conservative view of market and revenue growth.

The plan incorporates a negative 2002-2006 CAGR of 0.8% (to 2.2m units) for deliveries on the Italian market, in line with our estimate of a negative 1.1% growth rate. For the rest of Europe, the plan assumes a negative 2002-2006 CAGR of 1.4% (11.45m units), slightly more conservative than our estimate of –0.4%. We believe that the assumptions on the Italian market may even be conservative from 2H 04 onwards. We understand that the management is rather annoyed about the non-stop speculation over the government's possible re-introduction of fiscal incentives, since it is causing consumers to put off their purchasing decisions. However, we think a renewed incentive policy could benefit Fiat once the new models have been launched.

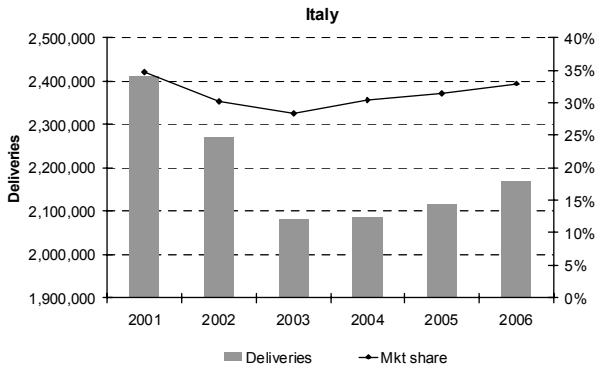
Expected trend in new car registrations: Italy and EU 2002-2006E

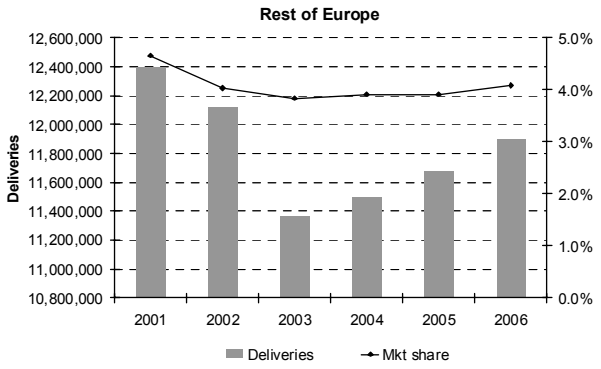


Source: Mediobanca Industry Research

According to the plan, Fiat's market share will stand at 30.2% in 2003 and 32.4% in 2006. Our model is slightly more conservative for this year, owing to a poor first half, which means the company will have the challenging task of gaining a 32% share in the second half to reach the target of 30.2% for the whole of 2003. June saw Fiat's domestic market share drop even further to 26.9%, an all-time low. However, we believe the contraction was due purely to one-off events, i.e. the launch of the New Punto and New Alfa 156 in the second half of June. We will be keeping a close eye on the July figures, and we expect to see the market share recover, since the new models will make a contribution for the full month. As far as 2006 we believe that the Fiat's target are challenging but achievable both for Italy (32.6%) and EU (4.1%).

Expected deliveries and Fiat's market share: Italy and rest of Europe 2001-2006E





Source: Mediobanca Industry Research

However, we do believe that the targets are on the conservative side, and we think there is still room for further growth. Nonetheless, we prefer to maintain our conservative stance as there is still low visibility on the appeal of the new 2005-2006 models—the most important issue for the real turnaround of the business.

Overall revenues are expected to be €52bn in 2006, down 6.2% on 2002. This is due to the combined effect of €6.5bn of disposals and growth in Fiat Auto, CNH and Iveco.

A new push to eliminate inefficiencies—but will it be enough?

On the costs side, we like the fact that the plan takes account of Fiat's two biggest weaknesses: 1) overcapacity, 2) unexploited production platforms. Overall the group plans to make €3.1bn in savings by 2006, by introducing countermeasures:

- it will close 12 plants (only one of which will be in Italy and only one a car plant), mainly relating to CNH and the components business. This will lead to some 12,200 job losses (including 2,800 in Italy), partly replaced by 5,400 new recruits.
- platform sharing will become an important factor: today the group has 15 platforms producing 16 models; by 2006 5-7 platforms out of a total 14 are expected to be shared with GM. This, together with the further development of joint ventures, should bring additional cost savings of about €0.45bn in 2006.

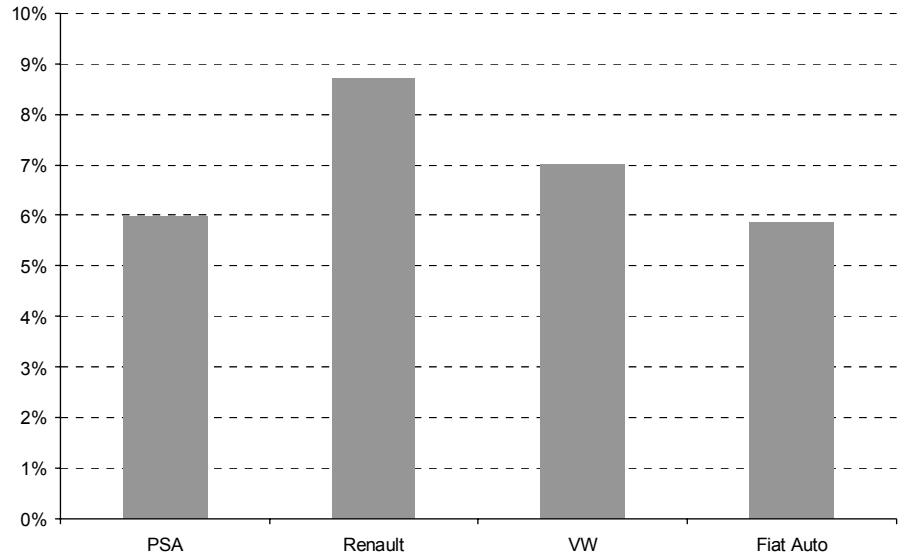
What we don't like: slightly unchallenging

First of all we would have appreciated further details on the financials (especially the company's forecasts of cash burn and cash flow drivers) and industrial factors such as sales mix, retail network optimisation, cost cutting and plant optimisation. Aside from this, we believe the Morchio plan's main weaknesses are: 1) that Fiat's investment is still lower than that of its peers, 2) continuing overcapacity.

Lower investment than its peers

The €9.1bn of capex included in the plan for 2003-2006 is in our view too little when set against the spending of Fiat's peers, both in absolute terms and as a percentage of total sales. This will obviously hamper Fiat in its bid to gain the technological and design excellence needed to drive the turnaround. In R&D too, the company plans to spend only 3.9% of its total revenues between 2003 and 2006, a lower percentage than that of its peers.

Total expected capex as % of sales: 2003-06E



Source: Mediobanca Industry Research

Continuing overcapacity

Overall capacity usage is not expected to improve significantly, growing from 70% to only 78% for Fiat-Lancia. However, a more aggressive downsizing of plants in Italy would have met with huge political and social opposition. We believe there is still room for plant optimisation, and this could be a good place to start clawing back profitability.

Plant utilisation rate: 2002-2006E

	2002	2004	2006
Fiat Lancia	70%	76%	78%
Alfa Romeo	74%	81%	90%
Light	90%	95%	93%
Truck	61%	63%	67%
Powertrain	67%	77%	90%
Agricultural eq.	68%	80%	87%
Construction eq.	47%	52%	65%

Source: Company data

Boosting revenues remains a challenging task

On the revenues side, the outlook is still painful, and a longer time is needed for a real turnaround: we expect Fiat Auto to concentrate on defensive actions by trying to improve its market share slightly and recover profitability. More specifically:

- ***Auto revenues are not expected to rise in 2003-2004***

    1. *The market is flattening off.* We expect new car sales in Italy to shrink by 8.2% YoY to 2m this year, and European sales to fall by 6.6% to 13.4m. This expected negative trend was recently confirmed by profit warnings from Peugeot, Renault and Daimler-Chrysler.

    2. *No launch of real volume-maker models until 2005.* The models set for launch in 2003 are not expected to be real volume makers, although we believe that they will have some positive impact on market share and brand image. We think the Punto Multijet will ease customers' perception of a technology gap between Fiat and the other major carmakers, while the Lancia Y and Alfa GT coupe are likely to appeal in terms of design. We think the real challenge will come in 2005, which will see the launch of 1) the New Fiat Punto, 2) a new D segment model, the Crossover, 3) the Alfa coupe and a supercar, both in the H segment, and 4) an SUV. With these models Fiat should finally have a complete product portfolio, and if their technology is good and their design appealing, the group should definitely see a turnaround.

Fiat's 2003-2006 pipeline

2003	2004	2005	2006
Fiat Gingo (A)	Lancia B-mpv Lancia	Fiat Punto (B)	Fiat Stilo
Fiat Idea (B)		Fiat Large (D)	Alfa Spider
Lancia Y (B)		Fiat Large cross-over (D)	SUV cross-over
Alfa GT coupè		Alfa GT coupè (H)	
		Alfa Supercar (H)	
		SUV	

Source: Mediobanca Industry Research

3. *New models cannot be speeded up*. The launch of a new model generally takes 30-36 months, even for very efficient carmakers, so Fiat's new cars are highly unlikely to be brought forward.

4. *The sales mix still needs restructuring*. In 2002 the zero-km, ex-demo and rental segments still accounted for 16% of total deliveries, so hard work will be required to improve the sales mix and reduce price pressure.

Financials

We have based our model on assumptions very similar to those communicated in the industrial plan, although our EBIT forecasts are more conservative, and see consolidated breakeven coming only in H2 04 rather than in the whole of 2004, as the company believes.

Key financials: MB estimates vs. Fiat business plan: 2006E

(€ bn)	MB estimates	Plan
Consolidated revenues	52.2	53.7
EBIT improvement 2002-2006	2.7	2.9
o/w auto	2.1	n.a.
others	0.6	n.a.
2006 EBIT margin	3.8%	4.1%
Restructuring costs	1.8	1.8
Capital Gains	1.5	1.5
R&D	7.5	7.9
Capex	9.7	9.1
Mkt share auto 2006		
Italy	32.5%	32.4%
Rest of EU	4.1%	4.1%
2006 market car deliveries		
Italy	2,169	2,200
Rest of EU	11,904	11,450

Source: Mediobanca Industry Research, company data

Our main assumptions are:

- A consolidation base encompassing Fiat Auto, CNH, Iveco, Teksid, Magneti Marelli, Comau, Itedi and business services. We expect Toro and Fiat Avio to be consolidated for H1 and Q3 respectively in 2003.
- Auto: we expect a weak performance from the Italian and EU markets overall, together with a slightly increased market share for Fiat. This means that Fiat Auto's revenues should grow by a 1.2% CAGR 2002-2006 to €23.6bn in 2006. Thanks to both revenues growth and cost efficiencies, EBIT is expected to rise from a loss of €1.3bn in 2002 to a positive figure of €790m in 2006.

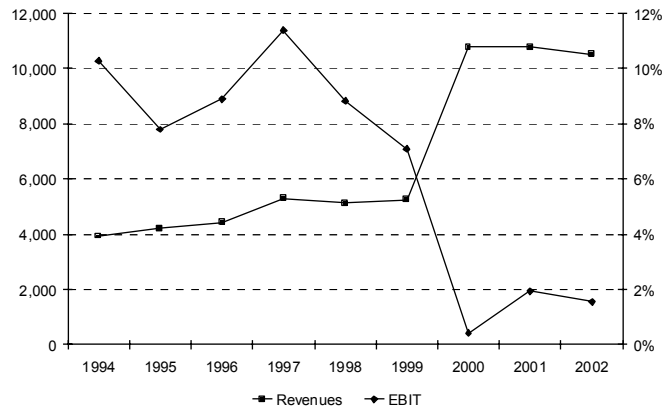
Fiat Auto historical and expected figures

P&L (€ m)	2001	2002	2003E	2004E	2005E	2006E
Italian market deliveries	2,413,455	2,269,535	2,083,593	2,085,677	2,116,962	2,168,827
Rest of Europe mkt deliveries	12,404,264	12,119,129	11,361,390	11,493,756	11,679,742	11,903,811
Fiat mkt share Italy	34.7%	30.3%	28.3%	30.5%	31.5%	32.5%%
Fiat mkt share EU	4.7%	4.0%	3.8%	3.9%	3.9%	4.1%
Revenues	**24,440**	**22,147**	**18,436**	**19,444**	**20,876**	**23,248**
%chg	-3.6%	-9.4%	-16.8%	5.5%	7.4%	11.3%
Cost of sales	-21,550	-19,836	-16,112	-16,819	-17,745	-19,405
As % on sales	-88.2%	-89.6%	-87.4%	-86.5%	-85.0%	-83.5%
R&D	-870	-861	-1,061	-1,031	-1,044	-1,162
As % on sales	-3.6%	-3.9%	-5.8%	-5.3%	-5.0%	-5.0%
Commercial costs	-1,829	-1,882	-1,582	-1,517	-1,503	-1,278
As % on sales	-7.5%	-8.5%	-8.6%	-7.8%	-7.2%	-5.5%
S&G	-740	-911	-761	-681	-626	-604
As % on sales	-3.0%	-4.1%	-4.1%	-3.5%	-3.0%	-2.6%
Other	0					
EBIT	**-549**	**-1,343**	**-1,080**	**-603**	**-42**	**790**
EBIT margin	-2.2%	-6.1%	-5.9%	-3.1%	-0.2%	3.4%

Source: Mediobanca Industry Research

- CNH: A further slight decline in construction and a slight rise in agricultural equipment sales should bring overall revenues to $10bn in 2003, up 1% YoY. Despite this, the weak dollar is likely to hit Fiat's consolidated figures, and we therefore expect CNH's revenues to stand at some €8.5bn, down 19% YoY.

CNH historical and expected figures

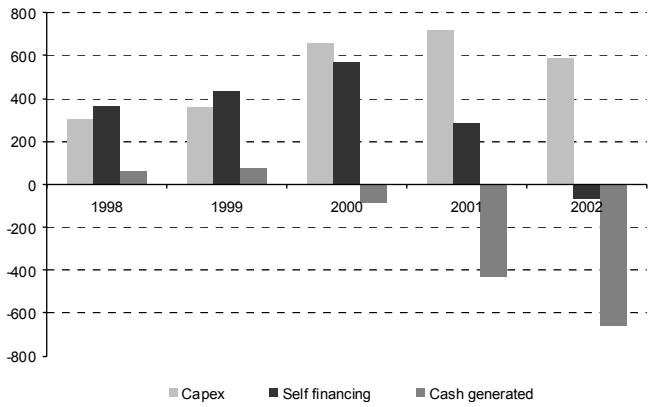


(€m)	2002	2003E	2004E	2005E	2006E
Revenues	**10,513**	**8,471**	**8,808**	**9,199**	**9,659**
Cost of sales	(8,358)	-6,692	-6,870	-7,083	-7,340
As % of sales	-79%	-79%	-78%	-77%	0%
R&D	(299)	-263	-273	-285	-299
As % of sales	-3%	-3%	-3%	-3%	0%
S&G	(1,083)	-847	-881	-920	-966
As % of sales	-10%	-10%	-10%	-10%	0%
Other	(610)	-500	-564	-561	-618
Total costs	(10,350)	-8,302	-8,587	-8,849	-9,224
EBIT	**163**	**169**	**220**	**350**	**435**
EBIT margin	1.6%	2.0%	2.5%	3.8%	3.8%

Source: Mediobanca Industry Research

- Iveco: in 2002 the main contribution to total revenues came from heavy trucks, light trucks and buses, which together represented 73% of total sales. This year we expect total vehicle deliveries to shrink to around 159k units, while ARPU will remain almost steady. Although Iveco is one of the group's main EBIT contributors, its financials have deteriorated over the last few years, and the company has changed from a cash generator to a cash burner.

Iveco historical and expected figures



Source: Mediobanca Industry Research

(€m)	2002	2003E	2004E	2005E	2006E
Revenues	**9,136**	**8,917**	**9,570**	**10,327**	**10,868**
Cost of sales	(7,674)	(7,445)	(7,962)	(8,541)	(8,966)
As % of sales	-84.0%	-83.5%	-83.2%	-82.7%	-82.5%
R&D	(239)	(230)	(225)	(220)	(219)
As % of sales	-2.6%	-2.6%	-2.4%	-2.1%	-2.0%
S&G	(1,121)	(1,148)	(1,182)	(1,298)	(1,226)
As % of sales	-12.3%	-12.9%	-12.3%	-12.6%	-11.3%
EBIT	**102**	**94**	**201**	**269**	**456**
EBIT margin	1.1%	1.1%	2.1%	2.6%	4.2%

Aside from these assumptions, the plan is noteworthy for its focus on the auto sector, and we therefore expect the division to play an ever more important role in 2003-2005, and to increase its contribution to total revenues from 40% in 2002 to 45% in 2005.

Fiat group revenues

	2001	2002	2003E	2004E	2005E	2006E
Fiat Auto	24,440	22,147	18,436	19,444	20,876	23,239
CNH	10,777	10,513	8,471	8,808	9,199	9,659
Iveco	8,650	9,136	8,917	9,570	10,327	10,868
Ferrari	1,058	1,208	1,351	1,654	1,737	2,244
Teksid	1,752	1,539	1,231	1,108	1,053	1,063
Magneti Marelli	4,073	3,288	2,696	2,737	2,778	2,805
Comau	2,218	2,320	2,390	2,473	2,547	2,637
Fiat Avio	1,636	1,534	963	-	-	-
Itedi	347	360	367	375	382	390
Toro	5,461	4,916	2,512	-	-	-
Business Solutions	1,805	1,965	2,053	2,117	2,191	2,263
Eliminations	(4,211)	(3,277)	(2,766)	(2,704)	(2,861)	(2,979)
Total Revenues	**58,006**	**55,649**	**46,622**	**45,581**	**48,229**	**52,189**
YoY change	2.1%	-4.1%	-16.2%	-2.2%	5.8%	8.2%

Source: Mediobanca Industry Research

Fiat group EBIT

	2001	2002	2003	2004	2005	2006
Fiat Auto	(549)	(1,343)	(1,023)	(602)	(42)	789
CNH	209	163	169	220	350	435
Iveco	271	102	94	201	269	456
Ferrari	62	70	77	94	99	135
Teksid	15	27	25	20	19	22
Magneti Marelli	(74)	(16)	3	27	44	65
Comau	60	(101)	(84)	12	38	58
Fiat Avio	186	210	70	-	-	-
Itedi	(2)	7	7	7	11	12
Toro	68	147	84	-	-	-
Business Solutions	73	67	62	74	88	93
Eliminations	(1)	(91)	(100)	(100)	(100)	(100)
Total EBIT	**318**	**(758)**	**(616)**	**(45)**	**776**	**1,964**
EBIT Margin	0.5%	-1.4%	-1.3%	-0.1%	1.6%	3.8%

Source: Mediobanca Industry Research

Moreover, after revenues and margins, we will be keeping a close eye on the group's debt over the next couple of years, as financial charges of over €600m are burdening the P&L.

Debt should fall significantly following 1) the €1.8bn rights issue and 2) the disposal of Toro, Fiat Avio and Fidis, which we estimate will bring in €2.4bn this year. This will bring debt down to about €2.1bn, assuming capex at €2.4bn in 2003.

As we mentioned earlier, our estimates do not differ significantly from those in the plan, although our EBIT forecasts are more conservative, and see consolidated breakeven coming only in H2 04 rather than in the whole of 2004, as the company believes. We expect capex to total €9.7bn between 2003 and 2006, which should put debt at some €1bn in 2006.

Proceeds from disposals

	Cash-in	Debt/(cash) deconsolidation	Net effect
Toro	2,400	(1,000)	1,400
Fiat Avio	1,500	(100)	1,400
Fidis	370	(800)	(430)
Total	4,270	(1,900)	2,370

Source: Mediobanca Industry Research, company data

FIAT

Profit&Loss account(€m)	2001	2002	2003E	2004E	2005E
Turnover	58,006	55,649	46,574	45,546	48,191
Turnover growth %	*2.1*	*-4.1*	*-16.3*	*-2.2*	*5.8*
EBITDA	3,168	1,837	1,635	2,281	3,175
EBITDA margin (%)	*5.5*	*3.3*	*3.5*	*5.0*	*6.6*
EBITDA growth (%)	*-0.3*	*-42.0*	*-11.0*	*39.5*	*39.2*
Depreciation & Amortization	-2,850	-2,595	-2,251	-2,326	-2,399
EBIT	318	-758	-616	-45	776
EBIT margin (%)	*0.5*	*nm*	*nm*	*nm*	*1.6*
EBIT growth (%)	*-60.7*	*-338.4*	*-18.7*	*-92.7*	*-1827.7*
Net Fin.Income (charges)	-1,174	-1,552	-536	-428	-503
Non-Operating Items	0	0	0	0	0
Extraordinary Items	359	-2,503	500	-600	-100
Pre-tax Profit	-497	-4,813	-653	-1,073	173
Tax	-294	554	27	137	-20
Tax rate (%)	*nm*	*11.5*	*4.1*	*12.8*	*11.6*
Minorities	346	315	28	42	-7
Net Profit	-445	-3,944	-598	-894	146
Net Profit growth (%)	*n.m*	*n.m*	*n.m*	*n.m*	*n.m*
Adjusted Net Profit	-804	-1,441	-1,098	-294	246
Adjusted Net Profit growth(%)	n.m	n.m	n.m	n.m	n.m

Balance Sheet (€ m)	2001	2002	2003E	2004E	2005E
Working Capital	-1,392	-2,773	-2,585	-2,041	-2,215
Net Fixed Assets	42,410	36,968	20,886	21,013	21,010
Total Capital Employed	41,018	34,195	18,301	18,973	18,795
Shareholders' Funds	12,170	7,645	10,220	9,326	9,472
Minorities	1,437	1,038	1,010	968	975
Provisions	21,375	21,736	5,195	5,171	5,563
Net Debt (-) Cash (+)	-6,036	-3,776	-1,876	-3,507	-2,785

Cash Flow Model (€ m)	2001	2002	2003E	2004E	2005E
Cash Earnings	2,089	-1,645	126	1,391	2,551
Working Capital Needs	3,022	1,381	-188	-544	174
Capex (-)	-3,438	-2,772	-2,415	-2,454	-2,395
Financial Investments (-)	-1,997	-1,081	0	0	0
Dividends (-)	-380	-228	0	0	0
Other Sources / Uses	1,135	6,605	4,378	-24	392
Ch. in Net Debt (-) Cash (+)	431	2,260	1,900	-1,631	722

Multiples	2001	2002	2003E	2004E	2005E
P/E Adj.	nm	nm	nm	nm	22.8
P/CEPS	6.1	nm	34.7	4.0	2.2
P/BV	1.0	1.0	0.5	0.6	0.6
EV/ Sales	0.3	0.2	0.28	0.32	0.29
EV/EBITDA	5.4	5.8	8.0	6.4	4.4
EV/EBIT	54.0	nm	nm	nm	18.0
EV/Cap. Employed	0.4	0.3	0.7	0.8	0.7
Yield (%)	1.3	2.5	0.0	0.0	0.0

Per Share Data (€)	2001	2002	2003E	2004E	2005E
EPS	-0.808	-6.76	-0.78	-0.91	0.15
EPS growth (%)	n.m	n.m	n.m	n.m	n.m
EPS Adj.	-1.46	-2.47	-1.42	-0.30	0.25
EPS Adj. growth (%)	n.m	n.m	n.m	n.m	n.m
CEPS	3.79	-2.82	0.16	1.41	2.59
BVPS	22.1	12.4	10.4	9.5	9.6
DPS Ord	0.31	0.31	0.00	0.00	0.00

Key Figures & Ratios	2001	2002	2003E	2004E	2005E
Avg. N° of Shares (m)	551	584	771	986	986
EoP N° of Shares (m)	551	616	986	986	986
Avg. Market Cap. (€ m)	11,149	6,834	5,199	5,199	5,199
Enterprise Value (€ m)	17,185	10,610	13,075	14,706	13,984
Labour Costs/Turnover (%)	15%	14%	16%	15%	15%
Depr.&Amort./Turnover (%)	5%	5%	5%	5%	5%
Prod. Ratio (Turn./Op.Costs)	1.0	1.0	1.0	1.0	1.0
Gearing (Debt / Equity) (%)	44%	43%	17%	34%	27%
EBITDA / Fin. Charges	2.7	1.2	3.0	5.3	6.3
Cap.Employed/Turnover (%)	71%	61%	39%	42%	39%
Capex / Turnover (%)	6%	5%	5%	5%	5%
Pay out (%)	-51%	0%	0%	0%	0%
ROE (%)	nm	nm	nm	nm	2%
ROCE (%) (pre tax)	1%	nm	nm	nm	4%
ROCE (%) (after tax)	nm	nm	nm	nm	4%