

QUARTERLY REPORT
THIRD QUARTER 2005
FINMECCANICA

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MANAGEMENT REPORT AT 30 SEPTEMBER 2005

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Finmeccanica Group

Management report at 30 September 2005

Results for the three quarters of 2005

As of 30 September 2005, the Finmeccanica Group's economic and financial results were up on the figures of the previous period and basically aligned to forecasts made. On the other hand, these results show trends that differ with respect to the indicators taken into consideration. While the Group EBIT margin rose from 4.2% at 30 September 2004 to 5.4%, the return on invested capital and on shareholders' equity dropped (from 15.2%¹ to 12.7% and from 17.0%² to 15.7% respectively).

The analysis of the main trends in the income statement and balance sheet items needs an appropriate introduction:

- the adoption, as from 1 January 2005, of IAS 32 and 39 regarding treatment of financial instruments, figures cannot be compared with those of previous periods, especially those regarding the income statement, as will be further detailed in the Notes to the report for the period in question found below;
- the transfer of a total of 96 million shares in StMicroelectronics NV (STM) made in 2004, either directly or indirectly through the sale of approximately 30.4% of the shares in the investing company STMicroelectronics Holding NV (STH), gave the Group an indirect equity investment in STM of roughly 6.6% and a direct equity investment in STH of roughly 19.6%. Following the adoption of the IFRS standards, in particular IAS 39, Finmeccanica S.p.A. entered this equity investment under the assets held for sale, then valued it at fair value, with a contra-item in shareholders' equity.

¹ Figures at 31 December 2004.

² Figures at 31 December 2004.

- Therefore, the income statement at 30 September 2005 does not include any contribution from the equity investment in STM which, instead, showed an attributable profit of €nil. 62 in the same period of the previous financial year;
- finally, the comparison between the two periods, related in particular to income statement figures, is not always meaningful since, as at 30 September 2004, the Agusta Westland joint venture was still 50% consolidated on a proportional basis, and the joint venture with Alcatel had still not been set up and the transaction with BAE Systems Plc. had not been completed.

* * * * *

The quarter at 30 September 2005 closed with a consolidated net profit of €nil. 180, compared to a profit of €nil. 148 at 30 September 2004.

For a like-for-like comparison of the figures of the two periods taken into consideration, by deducting the contribution of STM (as mentioned in the introduction) from the result of the first half of 2004, the net consolidated result (30 September 2004) would be equal to a profit of €nil. 60.

The overall rise by €nil. 120 is basically due to the €nil. 137 increase in the EBIT. Add to this improvement a lower tax burden of €nil. 13, better adjustments to the equity investments amounting to €nil. 4, mainly attributable to the different consolidation method used for the Fata Group (consolidated on an equity basis and showing a loss of €nil. 15 at 30 September 2004), on the one hand, and to the poor performance for €nil. 16 by Avio S.p.A. (a company owned by Aero Invest 1 S.A.) on the other hand, and less negative effects of discontinuing operations (losses of €nil. 5 relating to BredaMenarinibus S.p.A. at 30 September 2004), which allowed the Group to counter the higher amount of net financial charges totalling €nil. 39, mainly due to the higher average exposure over the period.

Taxes amounted to €nil. 137 as at 30 September 2005, and included €nil. 72 for IRAP (Local Tax on Production Activities) (€nil. 63 as at 30 September 2004); excluding this figure, the theoretical Group tax rate, calculated as against the results before taxes, stood roughly at 21%, showing a decline over the same period of the previous financial year (approximately 29%), partly due to the 1 percentage point drop in the IRES-IRPEG (Corporate Income Tax) rate and to the decision, previously taken when drawing up the first half-year report of 2004, to adopt Group taxation (consolidated tax base), in accordance with the provisions of the Tax Reform.

* * * * *

Value of production rose by 16.9%, in line with the Group's targets, rising from €nil. 6,460 as at 30 September 2004 to €nil. 7,554 as at 30 September 2005, up in absolute terms by €nil. 1,094, substantially attributable to the different contribution from AgustaWestland in the two periods under comparison. Other sectors showed different trends:

Up

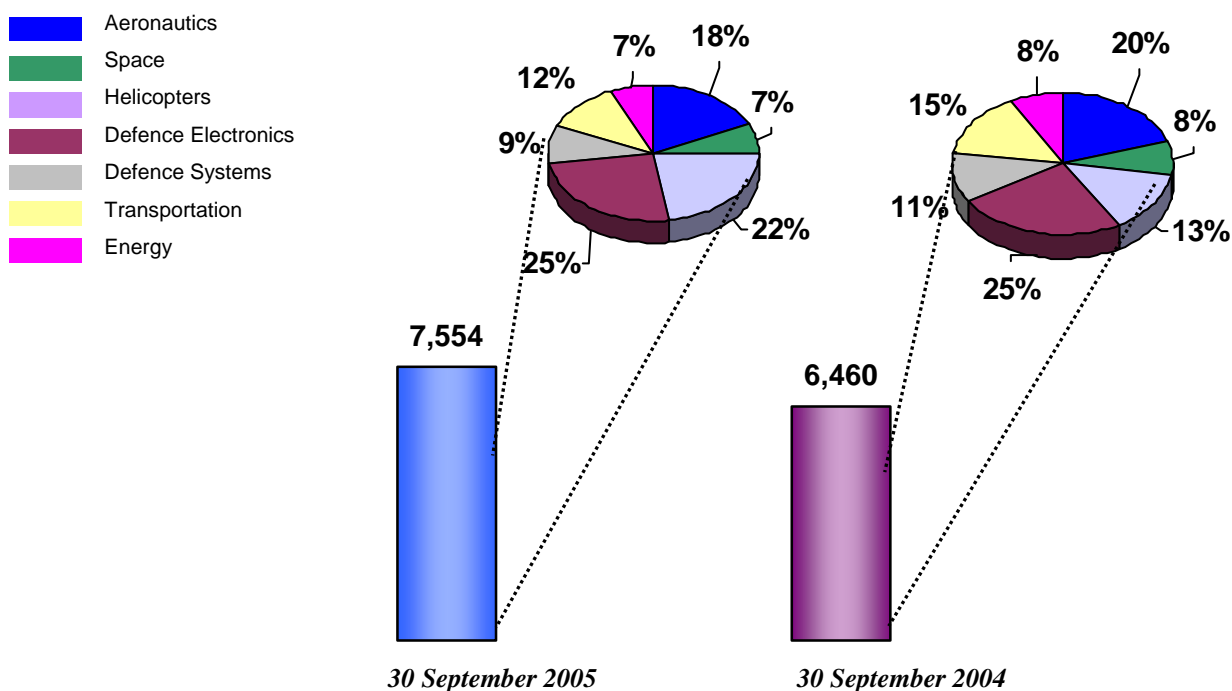
- in Aeronautics, a €nil. 73 rise (+5.5% compared to the same period of the previous financial year), both in the military segment for increased activity on the C27J, in particular for aircraft ordered by Greece, and in the civil segment, which recorded an increase in GIE/ATR and engine nacelles production, offsetting the slight drop in aerostructures and aircraft conversion;
- in Defence Electronics, a €nil. 275 rise, mainly attributable to the acquisition of avionic activities from Bae Systems Plc at the end of April 2005;

Down

- in Defence Systems, a €nil. 44 drop, down 7.5% compared to the same period of the previous financial year, owing to less activities developed;

- in Transportation, a €mil. 73 drop, down 7.5%, ascribable to Ansaldo S.p.A., since both Ansaldo Signal NV and its subsidiaries and Ansaldo Trasporti Sistemi Ferroviari S.p.A. were basically in line with the value of production at 30 September 2004.

Value of production - 30 September 2005 – 2004 (€mil.) and contribution by sector



The **operating income after depreciation and amortisation (EBIT)** came to €mil. 406 as at 30 September 2005, compared to €mil. 269 as at 30 September 2004, up in absolute terms by €mil. 137. The EBIT margin increased from 4.2% in 2004 to 5.4% in 2005. In this case too, the different contribution from AgustaWestland basically represents the main reason for the increase between the two periods under comparison. Other sectors showed growing trends, with the sole exception of the production of rolling-stock (Ansaldo S.p.A.) in the Transportation sector.

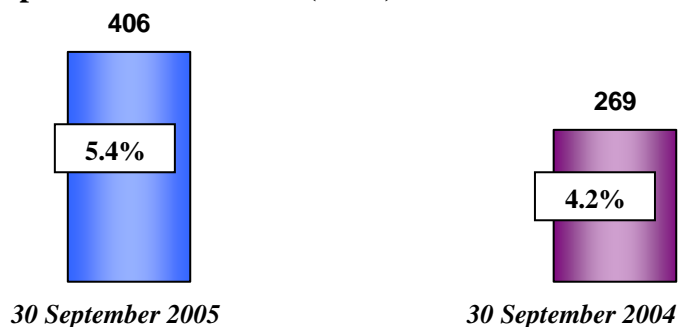
Below are the best main performances:

- in Aeronautics, a €mil. 43 rise, related basically to increased volumes of activity developed as at 30 September 2005, compared to the same period of the previous financial year, as earlier mentioned, and to the effect of the conclusion of negotiations on the Boeing B757 programme;
- in Space, a €mil. 22 rise, since 2004 was already affected by restructuring provisions/writedowns required to identify non-core activities, also in view of the agreements finally reached with Alcatel for the establishment of two Joint Ventures, one operating in manufacturing (Finmeccanica share of 33%) and the other in satellite services (Finmeccanica share of 67%);
- in Defence Electronics, a €mil. 9 rise, benefiting from the effects of the change in the sector's consolidation perimeter, partly eroded by the delays in the Tetra Interpolizie order;
- in Defence Systems, a €mil. 5 rise, thanks to the contribution from more profitable activities;
- in Energy, a €mil. 6 rise, thanks to the different mix of activities, to greater contribution of service and to the benefits produced by the efficiency and productivity plans;
- in Transportation, a €mil. 21 rise, both in Ansaldo Signal NV and its subsidiaries and in Ansaldo Trasporti Sistemi Ferroviari S.p.A., both benefiting from a substantial increase in industrial profitability.

As previously reported, the only significant drop by €mil. 49 is shown by AnsaldoBreda S.p.A.. As delays in expected delivery times intensified, the new management of AnsaldoBreda S.p.A. was tasked with the responsibility of implementing a thorough organisational/operational restructuring process aimed at developing higher levels of efficiency and competitiveness of the segment both on the national market and on foreign markets in particular. This stressed the need to revise the “whole life” estimates

of several orders, with the consequent inclusion of considerable extra costs charged to the income statement.

EBIT and ROS at 30 September 2005 - 2004 (€mil.)



* * * * *

At 30 September 2005 the consolidated **net invested capital** totalled €mil. 6,873 compared to €mil. 4,219 at 31 December 2004. The €mil. 2,654 increase is mainly attributable to:

- €mil. 1,543 for goodwill on new acquisitions;
- €mil. 703 for **working capital**, partly owing to the negative effect of higher net inventories, and partly to the foregoing effects of the adoption of IAS 32 and 39 regarding transactions without recourse;
- €mil. 414, mainly due to the effects of the adoption of the IFRS standards related to the switch in valuation of the equity investment in STMicroelectronics NV from equity to the “fair value” method.

Take note that prudent financial management, with constant control over the financial requirements of the businesses, achieved through management of advances from customers and payments related to both customers and suppliers, allowed the Group and may still allow it to basically curb net invested capital within forecasts made and parameters set.

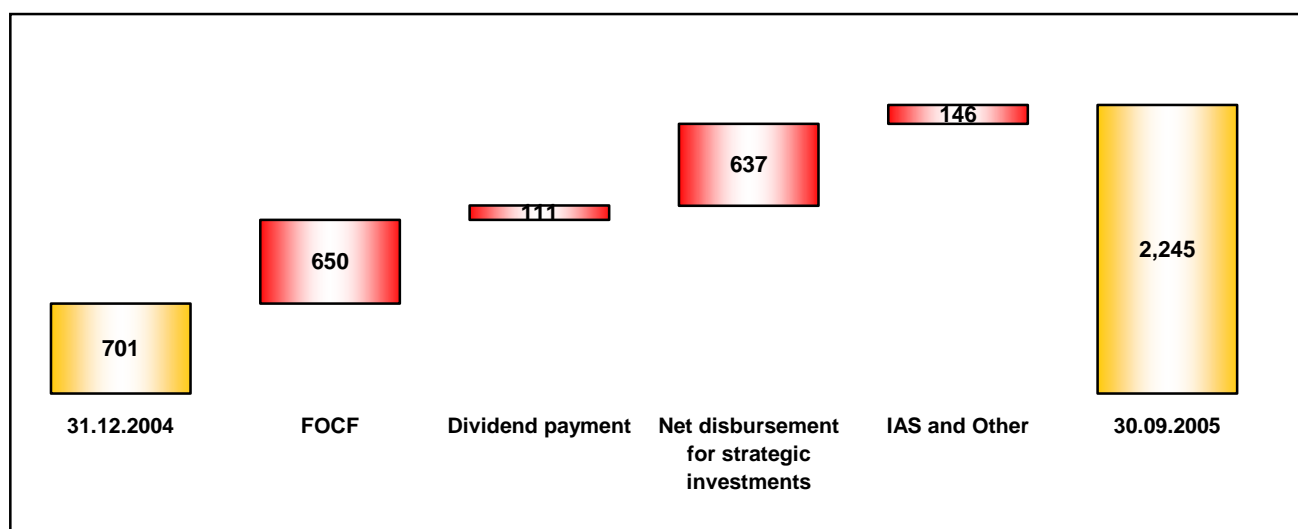
As for the main ratios on the previously mentioned return on Group capital, return on net invested capital (**ROI**) fell from 15.2% at 31 December 2004 to 12.7% at 30 September 2005, dropping by 2.5 percentage points, due mainly to an increase in net

invested capital itself. Return on equity (**ROE**) dropped from 17.0% at 31 December 2004 to 15.7% at 30 September 2005, following the increase in shareholders' equity, due partly to the different method to value STMicroelectronics NV, and partly to the increase in the minority interest share in consideration of the acquisition of activities from Bae Systems. As at 30 September 2005, **EVA**³ slightly dropped by €mil. 7; the figure cannot be compared with the value recorded in the corresponding period of the previous financial year, following adoption of the IFRS standards.

The Group's **net financial debt** (financial payables in excess of financial receivables and cash and cash equivalents), at 30 September 2005, stood at €mil. 2,245, up by €mil. 1,544 on the net debt of €mil. 701 at 31 December 2004 (as further detailed in the explanatory notes); the current financial management was negative, since the free operating cash flow (FOCF) over the period under consideration (as is routine for such a significant seasonal business) saw funding requirements amounting to €mil. 650, up by €mil. 135 compared to the figure at 30 September 2004, which was €mil. 515.

Given the heavy strategic investments made and the significant seasonal nature, net financial debt is still low enough to maintain the Group's conservative financial management, all other conditions being equal.

Net financial debt as at 30 September 2005

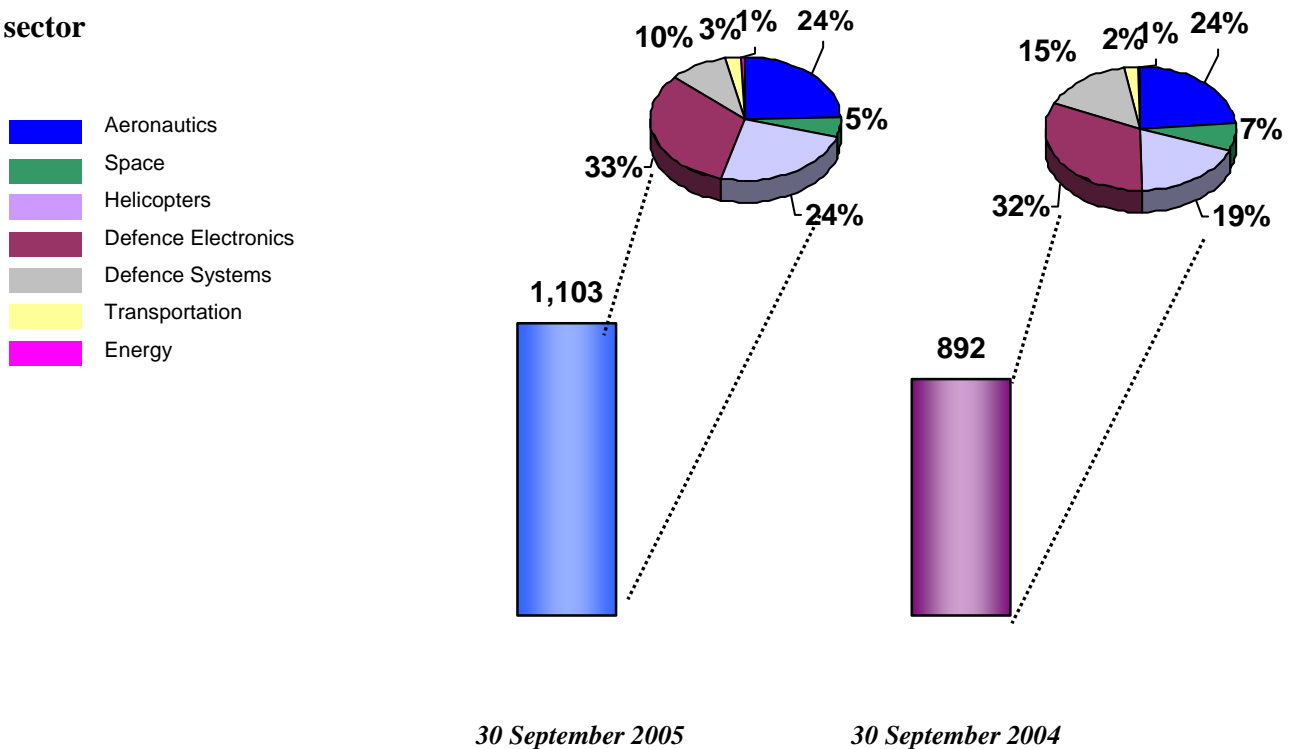


³ EVA[®] is a registered trademark of Stern Stewart & Co..

Research and Development costs as at 30 September 2005 totalled €mil. 1,103, showing an increase of about 24% compared to €mil. 892 as at 30 September 2004, and related mainly to the following programmes:

- Aeronautics: programmes to develop prototypes and technologies for aerostructures and system integration;
- Space: Cosmo, Syracuse, Sicral 1B, Artes 3, EGNOS and Galileo programmes and the International Space Station;
- Helicopters: A149 development, as well as the modifications to the basic models of EH101, NH90 and A109 LOH/LUH;
- Defence Systems: the new Meteor air-to-air missile and the new “guided” munitions;
- Defence Electronics: avionics, command and control systems, communication systems and integrated networks and private mobile communications;
- Energy: start-up and activation of the technological autonomy in the field of steam and gas turbines.

Research & Development as at 30 September 2005-2004 (€mil.) and contribution by sector

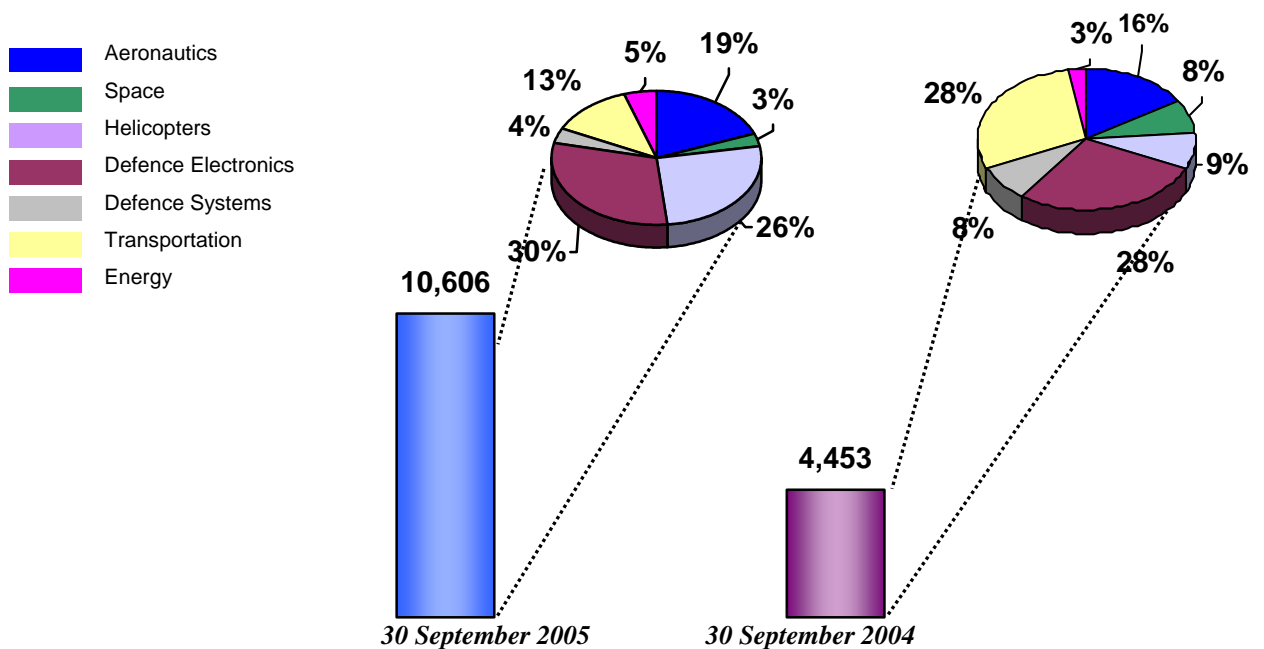


New **orders** acquired as at 30 September 2005 totalled €mil. 10,606, up €mil. 6,153 compared to €mil. 4,453 in the same period of the previous financial year.

Regarding this increase, approximately €mil. 394 are ascribable to the different contribution from AgustaWestland in the two periods under comparison.

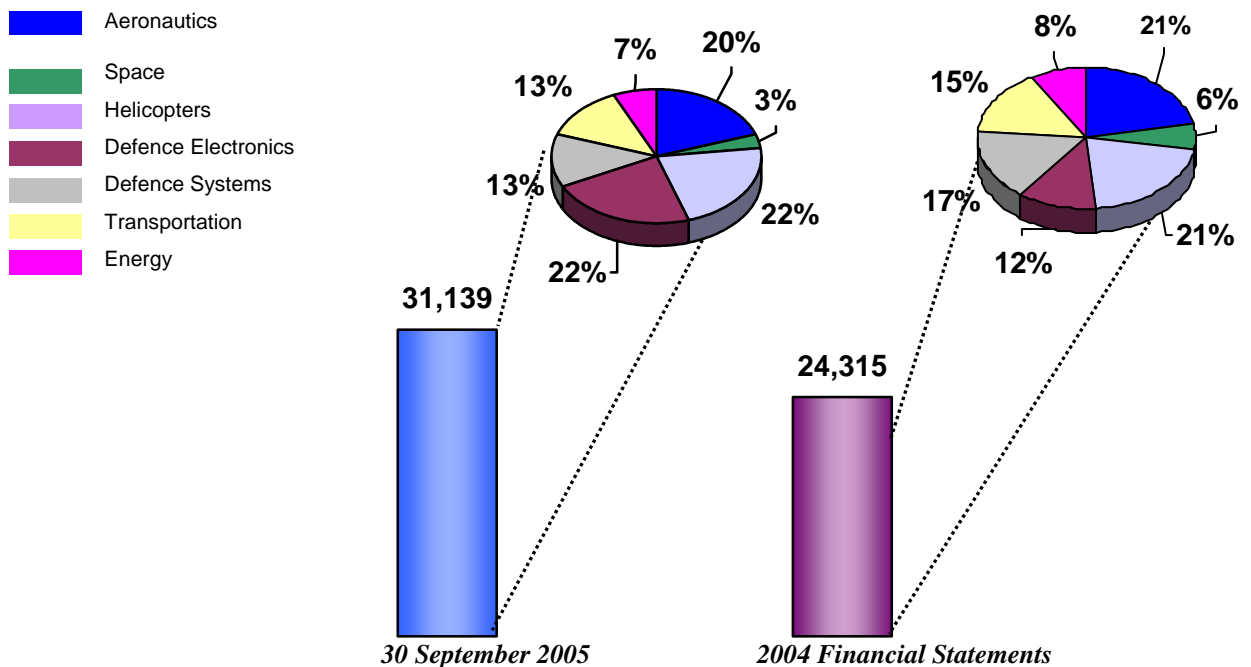
The main orders acquired in the first half of 2005 relate to Aeronautics with a first *tranche* of the B787 aircraft acquired in the third quarter of 2005, to Helicopters with the important acquisition of the first *tranche* of US101 helicopters for the President of the United States and to Defence Electronics with the second *tranche* of the EFA order for the production of the Defensive Aids Sub System (DASS). Approximately 54% of the total orders acquired refer to the military market, compared to 43% recorded in the same period of the previous financial year.

Orders as at 30 September 2005-2004 (€mil.) and contribution by sector



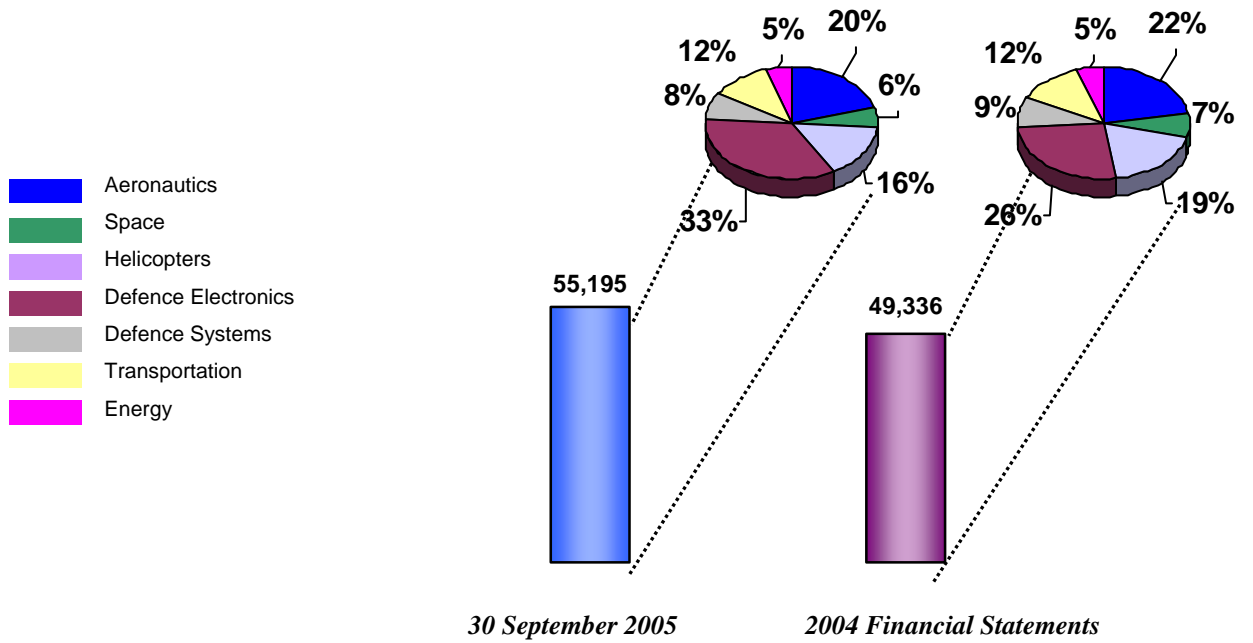
The **order backlog** at 30 September 2005 stood at €nil. 31,139, up by €nil. 6,824 compared to 31 December 2004 (€nil. 24,315), though guaranteeing the Group work for approximately 2.9 years of production. About 28% of the order backlog will undergo production in the 2006 financial year. Regarding the overall increase, roughly €nil. 2,620 relate to the abovementioned agreement with Bae Systems, and the rest to the effects of normal order securing and invoicing of finished products.

Order backlog as at 30 September 2005 (€nil.) and contribution by sector



The **number of employees** in the Group as at 30 September 2005 came to 55,195, up by 5,859 units compared to 49,336 as at 31 December 2004, mainly due to the agreement entered into with Bae Systems, which saw approximately 6,000 units joining the Group.

Number of employees as at 30 September 2005 and contribution by sector



Results for the third quarter of 2005

During the third quarter of 2005, the Finmeccanica Group's production volumes reached €mil. 2,591 (+25% compared to €mil. 2,085 in the third quarter of 2004), while the EBIT stood at €mil. 156 (€mil. 73 in the third quarter of 2004).

Such positive figures reflected on the remarkable result achieved by the ROS (ratio between EBIT and value of production) in the third quarter of 2005, which came to 5.9%, up from 3.5% recorded in the third quarter, and from 5.1% posted in the first half of 2005.

Sectors	1.7 – 30.9.2005		1.7 – 30.9.2004	
	Value of production	EBIT	Value of production	EBIT
Aeronautics	469	51	448	24
Helicopters	551	48	311	25
Space	176	5	185	12
Defence Electronics	712	33	511	18
Defence Systems	236	22	229	4
Transportation	313	18	278	8
Energy	181	7	172	9
Other Activities	40	(28)	19	(27)
Eliminations	(87)	-	(68)	-
	2,591	156	2,085	73

The third quarter of 2005 saw financial charges increase by €mil. 25, owing to the heavy strategic investments made by Finmeccanica S.p.A. and to the operational requirements of Group companies.

Taxes for the period came to €mil. 55, up €mil. 19 compared to the figure recorded in the third quarter of 2004, following a higher taxable income.

Accordingly, net profit for the period reached €mil. 76, up on the figure posted in the third quarter of 2004 (€mil. 57).

Significant transactions during and after quarter

The period at issue and the months following quarter-end saw a series of important strategic and financial initiatives. Group strategies developed into numerous industrial transactions, aimed at streamlining the organization and focusing on certain specific sectors, the aim being to strengthen the Group's technological and commercial leadership role, concurrently cutting down the diversification rate of its offer portfolio. From a financial point of view, Finmeccanica adopted the measures required to enable it to implement the foregoing strategies, building from a strong economic and financial base.

Industrial Transactions

On 29 April 2005, Finmeccanica and BAE Systems Plc (BAE) signed, after obtaining the necessary approvals, the final agreement concerning the *Eurosystems* project, initially signed on 27 January 2005. It provides for the establishment of a new company operating in the Avionics sector owned by Finmeccanica (75%), the acquisition of BAE activities in the military and secure communications field, and the return of Italian business of the AMS NV joint venture under the full control of Finmeccanica. The new perimeter of Selex Sistemi Integrati S.p.A. (former AMS S.p.A.) also includes Air Traffic Management (ATM) and Air Traffic Control (ATC) activities previously controlled by BAE in Great Britain, Germany (Selex Sistemi Integrati GmbH) and the United States (Selex Sistemi Integrati Inc.). The agreement provides for Finmeccanica to be entitled to exercise a call option for the acquisition of the remaining 25%, and for BAE to be entitled to exercise a put option, once two years have lapsed from the date of the transaction.

Through this agreement, Finmeccanica becomes the second-largest European group and the sixth on a global scale in the Defence Electronics sector, with a turnover in excess of €bil. 3, thus helping the Group to achieve its growth targets in Aerospace and Defence and to focus on some specific sectors of this industry, such as helicopters, aeronautics

and defence electronics and security, where it has acquired significant systems development skills.

On 28 January 2005, Finmeccanica and Alcatel SA (Alcatel) signed an agreement of similar strategic significance to the abovementioned, but of a different nature. It is the agreement for the creation of an alliance in the space sector with the establishment of two companies dedicated to industrial production and satellite service businesses, respectively. The first company, **Alcatel Alenia Space S.A.S.**, 33% owned by Finmeccanica, will group together the industrial business of Alenia Spazio (now Alcatel Alenia Space Italia S.p.A.) and Alcatel Space, and will specialise in the design, development and production of satellites, payload and other space equipment and systems. The second company, **Telespazio Holding S.r.l.**, 67% owned by Finmeccanica, will group together the activities of Telespazio and of Alcatel Space Services and Operations S.A.S. and will specialise in activities and services for satellite solutions, the supply of high value-added networks and services, multimedia applications and Earth observation.

On 28 April 2005, the European Commission authorized the formation of the two new companies. The contribution of the companies to the new foregoing parent companies took place on July 1.

The agreement is intended to further significant operating synergies and economies of scale, which will improve profitability and the Group's position at worldwide level in the Space sector, reaching a co-leadership status in Europe.

On 1 March 2005, the Eurely consortium, formed by Finmeccanica S.p.A., Alcatel SA, AENA (Spanish public air navigation board) and by the Spanish group Hispasat, was selected, together with the competing consortium iNavSat (formed by EADS and Thales), for the final phase of the talks involving the license for the **European Galileo satellite system**. Finmeccanica's participation in the foregoing consortium is a golden opportunity for the satellite service business, since it allows the Group to operate as a leading actor in the frame of a project which is extremely important at worldwide level

and particularly strategic for the new value-added applications (PRS - Public Regulated Services, info-mobility, Security, etc.). In June, after examining a joint proposal submitted by the two bidding consortia, Eurely (AENA, Alcatel, Finmeccanica and Hispasat) and iNavSat (Eads, Inmarsat and Thales), stressing how the entire programme would have significantly benefited from their merger, Galileo Joint Undertaking (GJU) gave its approval and started negotiations. This phase should lead, among other things, to the signing of the concession contract by the end of 2005. Another key element of the development of Galileo was the appointment of the Supervisory Authority's Executive Director, who should also be tasked with awarding the concession contract.

With a view to the development of protection and security strategies, the Group set in motion the establishment of a centre of excellence in this field, by contributing and restructuring the **Secure Communications** Division, including some investments, from Selenia Communications to Elsag, the aim being to reposition IT activities within the Group's Defence Electronics business.

On 27 July 2005, Finmeccanica announced the acquisition of a 52.7% stake in the share capital of **Datamat S.p.A.**, an IT company specialized in the development and design of avionic and naval mission systems and integrated solutions in the Defence, Space, Public Administration, Health, Banking, Finance and Telecommunications sectors. After obtaining all the necessary antitrust authorizations, the acquisition was completed for a value of about €mil. 151 on 5 October 2005. During November, the Group will launch a takeover bid on the whole remaining Datamat outstanding shares, at a price of €9.65 per share. The acquisition of Datamat strengthens the Group skills in the IT systems for applications linked to the Aerospace, Defence and Security core business.

On 18 August 2005, Finmeccanica signed a memorandum of understanding with the Federal Agency for Industry of the Russian Federation involving Alenia Aeronautica and the aeronautical company **Sukhoi**, to cooperate in the development of a new family of civil aircraft, with jet propulsion, for regional transport. The new family of aircraft, which is named RRJ (Russian Regional Jet) and is composed of two aircraft, 78 and 98-seat respectively, will target both the Russian domestic market and the world market,

thus accessing a strongly developing demand market. According to the agreement, Alenia Aeronautica should acquire an equity investment in SCAC (Sukhoi Civil Aircraft Company) and provide its own technical and operational know-how in various programme stages. On the same date, Finmeccanica and Rosoboroexport signed three preliminary agreements to start cooperating in the industrial fields of aeronautical design, unmanned aircraft and advanced trainer aircraft. Specifically, Alenia Aeronautica and the Russian company Irkut should cooperate to manage engineering activities applied to civil aeronautics; Aermacchi and Yakovlev (a company owned by Irkut) should continue cooperating in the field of advanced trainer aircraft; Alenia Aeronautica, Aermacchi, Irkut and Yakovlev should start programmes of joint experiments on new technologies to be applied to unmanned aircraft being developed.

On the whole, the agreements signed considerably extend the cooperation relationships existing between the Group and Russia, a country provided with great potentials and good industrial capacities.

On 10 September 2005, Finmeccanica signed a cooperation agreement with the Greek company **Hellenic Aerospace Industry (HAI)** to identify business areas within which cooperation programmes may be started within the current year. The main application fields already identified are the structural components of civil aircraft, modifications and updating of civil and military aircrafts, satellite systems, electronic systems, surveillance systems.

During the period under consideration, Finmeccanica also conducted a series of additional activities involving the logistics and security businesses, signing, among other things, a Memorandum of Understanding with the Civil Protection Department to identify and assess a system for the prevention of risks and management of emergencies.

In frame of a broader plan to bring value to its civil businesses, on 29 September the Board of Directors of Finmeccanica approved to extend the project for the listing of **Ansaldo Signal N.V.** on the Italian Stock Exchange, to **Ansaldo Trasporti Sistemi Ferroviari S.p.A. (ATSF)**, a project already approved in July. The transaction, which is likely to be completed within the first half of 2006, provides for the establishment of a

new industrial company capable of fully benefiting from the strongly complementary skills of the two companies. In fact, ATSF will have greater opportunities to access foreign markets thanks to the commercial network and the international level of Ansaldo Signal, one of the top names in world railway signalling, while Ansaldo Signal will be able to enhance its capacity to compete in the integrated systems field thanks to the design and system capabilities of ATSF.

Finally, in the frame of a broader plan to bring value to business outside the Aerospace and Defence core business, on 2 March 2005, Finmeccanica signed the preliminary agreement with Dipiudì Ambiente, a company in the De Luca Group, for the transfer of BredaMenariniBus S.p.A., Italy's second-largest producer of city buses.

Take note that, on 1 July, Alenia Spazio S.p.A. changed its name to Alcatel Alenia Space Italia S.p.A. and that, on 1 August, Selenia Communications S.p.A. changed its name to Selex Communications S.p.A..

Financial transactions

In March 2005, Finmeccanica S.p.A. launched a new €mil. 500 20-year bond issue bearing a 4.875% coupon, due March 2025, placed entirely on the European institutional market. Besides adding flexibility to the Group's financial structure, this transaction, thanks also to the combined effect of the repayment of the Finmeccanica debenture loan effected in June, also allowed to extend the average life of the debt from 5 to 10.4 years.

Below is a table summarising the outstanding debenture loans at 30 September 2005, including the transactions placed on the market by the related concern Finmeccanica Finance S.A., through guarantee of the Parent Company.

Issuer		Year of Issue	Maturity date	Counter-value Amount (€000)	Annual Coupon	Type of offering
Finmeccanica Finance S.A.		1997	16 Jan. 2007	6,664	3.30%	Japanese institutional
Finmeccanica Finance S.A.	(1)	2002	30 Dec. 2008	297,000	variable	Italian Retail
Finmeccanica Finance S.A.	(2)	2003	8 Aug. 2010	501,400	0.375%	European institutional
Finmeccanica Finance S.A.	(3)	2003	12 Dec. 2018	500,000	5.75%	European institutional
Finmeccanica S.p.A.	(4)	2005	24 Mar. 2025	500,000	4.875%	European institutional

- (1) Bonds offered solely to the mass public in Italy and listed on the TLX market, managed by Trading Lab Banca SpA – Gruppo Unicredito Italiano. Although they were issued within the framework of a Euro Medium Term Notes programme (“EMTN”) for maximum €bil. 2, the bonds are governed by specific regulations of Italian law. Transaction authorised pursuant to Article 129 of Legislative Decree No. 385/93. Prospectus filed with Consob on 4 December 2002 (authorisation notified with note No. 2079342 of 3 December 2002).
- (2) Bonds exchangeable with a maximum number of 20,000,000 shares of STMicroelectronics NV (STM) at a conversion price of €25.07 per share. Beginning three years after issue, Finmeccanica Finance may require that the loan be converted if the mean price recorded for the 30 business days prior to the date bondholders were notified is more than 125% of the conversion price. Upon expiration, Finmeccanica Finance may refund the loans by cash or, upon receiving a prior notice of no less than 15 business days, for a combination of STM shares valued at the mean price recorded for the 5 previous business days and of cash for the difference. Transaction authorised pursuant to Article 129 of Legislative Decree No. 385/93. The bonds are listed on the Luxembourg Stock Exchange.
- (3) Bonds issued within the EMTN programme for maximum €bil. 2. The entire issue has been converted from fixed rate to variable rate for the first two years of the loan term. Transaction authorised pursuant to Article 129 of Legislative Decree No. 385/93. The bonds are listed on the Luxembourg Stock Exchange.
- Some transactions were effected on these bonds on interest rates that have allowed the Company to benefit from the low prices of variable rates for all 2005, with an actual cost around 3.25%. Starting in the financial year 2006, the actual cost of the loan will revert back to an interest rate equal to an average value of 5.80%.
- (4) Bonds issued within the EMTN programme for maximum €bil. 2. Transaction authorised pursuant to Article 129 of Legislative Decree No. 385/93. The bonds are listed on the Luxembourg Stock Exchange. Some transactions on interest rates have been effected to optimise the loan costs.

All Finmeccanica Finance SA bond issues are irrevocably backed by Finmeccanica S.p.A..

All of the above debenture loans are governed by regulations containing standard law provisions for these kinds of transactions implemented by corporate subjects. The aforementioned Finmeccanica issues contain clauses that do not require any commitment regarding specific financial covenants, while they do include the so-called negative pledge and cross default clauses.

All bonds issued by Finmeccanica S.p.A. and Finmeccanica Finance SA have been assigned a medium-term credit rating by the three international rating agencies, Moody's Investors Service, Fitch and Standard and Poor's. Specifically, at the date of this Half-year Report, such credit ratings were A3 (Moody's) and BBB (Fitch and Standard and Poor's), all showing a stable outlook. Tale note that the Moody's credit rating in the month of June improved two levels advancing from Baa2 to A3, which came pursuant to a methodological revision made by the Agency itself with regard to the level of correlation existing in the relationships between companies and the State in which the latter holds shareholdings.

On 16 August, the EMTN bond issue programme was renewed for a further period of 12 months, for a maximum amount of €bil. 2, under which all the issues currently outstanding were effected, except solely for the issue referred to in note (2) above. The programme has been renewed in accordance with the new European Directive on prospectuses (Prospectus Directive).

Conclusion of the previously illustrated agreement with which the Eurosystem transaction was completed has had substantial repercussions on Group net financial debt in the second quarter of 2005. More specifically, according to the agreements entered into with the counterpart BAE, through the companies involved in the transaction, on April 29 Finmeccanica has disbursed a total of €nil. 528 (equal to approximately 355 million sterling) net of the amounts paid by BAE for its share; Finmeccanica made the payment using its own available funds.

In July, new agreements were executed:

- an alliance was reached with the French company Alcatel, operating in the Space sector, resulting in formation of the two aforementioned companies, whose related net financial cost was €mil.109; over the year, it could be necessary to make adjustments to the purchase price, as provided by the agreements;
- acquisition of 52.7% of Datamat S.p.A., operating in the ICT solutions sector, with a cash outlay of about €mil. 151 in October. A takeover bid will subsequently be launched on the company. If the takeover bid enables acquisition of the entire outstanding share package, it would imply a maximum disbursement of an additional €mil. 119 for a total amount of approximately €mil. 270.

Finally, the decision by Finmeccanica to list on the stock market, through a company incorporated under Italian law, the equity investment held in its subsidiary Ansaldo Signal NV, and the other company in the railway sector, Ansaldo Sistemi Ferroviari, should lead to significant benefits regarding the Group's financial position and the deconsolidation of the company; the transaction is expected to be completed in the first quarter of 2006.

Analysis of the consolidated economic and financial position

<i>Income statement at 30.09.05</i> (€mil.)	<u>Three quarters ended 30 September</u>		<u>Quarter ended 30 September</u>		<u>1st half</u>
	<u>2005</u>	<u>2004</u>	<u>2005</u>	<u>2004</u>	<u>2005</u>
Revenues	7,298	6,191	2,572	1,989	4,721
Changes in inventories of work in progress, finished and semi-finished goods	256	269	19	96	237
Other operating revenues	242	201	42	77	203
Costs for purchases	(2,572)	(2,230)	(906)	(711)	(1,668)
Costs for services	(2,195)	(1,857)	(705)	(651)	(1,488)
Costs for personnel	(2,162)	(1,835)	(721)	(574)	(1,440)
Amortisation, depreciation and writedowns	(257)	(230)	(90)	(69)	(165)
Other operating costs	(224)	(267)	(60)	(90)	(164)
(-) Capitalisation of internal construction costs	20	27	5	6	15
	<u>406</u>	<u>269</u>	<u>156</u>	<u>73</u>	<u>251</u>
Net financial income (charges)	(65)	(26)	(24)	1	(41)
Effect of accounting for equity investments with equity method	(24)	60	(1)	17	(23)
Profit (loss) before taxes and the effect of discontinued operations	<u>317</u>	<u>303</u>	<u>131</u>	<u>91</u>	<u>187</u>
Income taxes	(137)	(150)	(55)	(36)	(82)
(Profit) Loss associated with discontinued operations		(5)		2	-
Net profit (loss)	<u>180</u>	<u>148</u>	<u>76</u>	<u>57</u>	<u>105</u>
. Group	172	147	73	56	101
. Minority interests	8	1	3	1	4
Earnings per share (*)					
Basic	0.43	0.35	0.18	0.13	0.25
Diluted	0.49	0.38	0.17	0.14	0.32
Earnings per share net of discontinued operations (*)					
Basic	0.43	0.36	0.18	0.13	0.25
Diluted	0.49	0.39	0.17	0.14	0.32

(*) For a better comparison, earnings per share was determined by considering, also when calculating the comparative figures, the effects arising from the grouping of ordinary shares made by the Parent Company on 18 July 2005.

Balance sheet at 30.09.05 (€mil.)	<u>30 Sept. 2005</u>	<u>31 Dec. 2004</u>	<u>30 Sept. 2004</u>	<u>30 June 2005</u>
<i>Non-current assets</i>				
Intangible assets	3,765	2,225	1,189	3,553
Property, plant and equipment	2,415	2,300	1,994	2,479
Real estate investments	2	2	2	2
Equity investments	137	639	1,339	128
Financial assets at fair value	856	-	-	793
Securities held to maturity	1	1	1	-
Receivables	117	106	146	119
Deferred tax assets	321	250	182	305
Other assets	10	17	18	18
	<u>7,624</u>	<u>5,540</u>	<u>4,871</u>	<u>7,397</u>
<i>Current assets</i>				
Inventories	5,281	4,589	3,872	5,161
Contract work in progress	2,909	2,169	2,308	2,671
Trade receivables	3,623	3,353	2,956	3,610
Financial assets at fair value	19	-	-	33
Securities held to maturity	-	33	22	-
Tax receivables	442	372	404	419
Financial receivables	375	514	505	398
Other assets	674	508	528	646
Cash and cash equivalents	438	2,055	1,422	588
	<u>13,761</u>	<u>13,593</u>	<u>12,017</u>	<u>13,526</u>
<i>Non-current assets held for sale</i>	<u>10</u>	<u>513</u>	<u>94</u>	<u>10</u>
Total assets	<u>21,395</u>	<u>19,646</u>	<u>16,982</u>	<u>20,933</u>
<i>Shareholders' equity</i>				
Share capital	1,856	1,856	1,856	1,855
Other reserves	2,339	1,771	1,366	2,245
Group shareholders' equity	<u>4,195</u>	<u>3,627</u>	<u>3,222</u>	<u>4,100</u>
<i>Minority interests</i>	<u>443</u>	<u>22</u>	<u>(1)</u>	<u>449</u>
Total shareholders' equity	<u>4,638</u>	<u>3,649</u>	<u>3,221</u>	<u>4,549</u>
<i>Non-current liabilities</i>				
Financial payables	2,050	1,654	1,552	1,982
Severance pay and other employee liabilities	1,116	983	832	1,126
Provisions for risks and charges	472	587	774	445
Deferred tax liabilities	96	87	70	100
Other liabilities	346	220	244	337
	<u>4,080</u>	<u>3,531</u>	<u>3,472</u>	<u>3,990</u>
<i>Current liabilities</i>				
Advances from customers	3,957	3,214	2,713	3,713
Trade payables	2,930	2,832	2,460	3,024
Financial payables	1,027	1,669	1,605	989
Tax payables	246	173	122	227
Provisions for risks and charges	588	514	333	573
Other liabilities	3,929	3,682	2,982	3,868
	<u>12,677</u>	<u>12,084</u>	<u>10,215</u>	<u>12,394</u>
<i>Liabilities directly correlated with assets held for sale</i>	<u>0</u>	<u>382</u>	<u>74</u>	<u>0</u>
Total liabilities	<u>16,757</u>	<u>15,997</u>	<u>13,761</u>	<u>16,384</u>
Total liabilities and shareholders' equity	<u>21,395</u>	<u>19,646</u>	<u>16,982</u>	<u>20,933</u>

Cash flow

	For the three quarters ended 30 September	
	2005	2004
<i>Cash-flow from operating activities:</i>		
Gross cash-flow from operating activities	812	615
Changes in working capital	(887)	(889)
Changes in other operating assets and liabilities, taxes and interest	(430)	(373)
Cash-flow used for operating activities	(505)	(647)
<i>Cash-flow from investing activities:</i>		
Acquisitions of companies, net of cash acquired	(637)	(96)
Investments in property, plant and equipment and intangible assets	(240)	(230)
Disposals of property, plant and equipment and intangible assets	32	5
Net investments in unconsolidated equity investments	(5)	-
Other investing activities	68	357
Cash-flow used for investing activities	(782)	36
<i>Cash-flow from financing activities:</i>		
Issues of debenture loans	500	-
Repayments of debenture loans	(953)	(19)
Net change in other financial payables	226	(107)
Dividends paid	(110)	(84)
Dividends paid to minority shareholders	(1)	(4)
Cash-flow used for financing activities	(338)	(214)
Net decrease in cash and cash equivalents	(1,625)	(825)
Translation differences	8	(12)
Cash and cash equivalents at 1 January	2,055	2,259
Cash and cash equivalents at 30 June	438	1,422

Shareholders' Equity

(€mil.)	Share capital	Retained earnings and consolidation reserves	Other reserves	Total Group Shareholders' Equity	Minority Interests	Total Shareholders' Equity
Shareholders' equity at 1 January 2004	1,856	1,308	(16)	3,148	7	3,155
Translation differences			16	16		16
Income (charges) directly through shareholders' equity				0		0
Net profit (loss) at 30 September 2004		147		147	1	148
	1,856	1,455	0	3,311	8	3,319
Dividends		(84)		(84)	(4)	(88)
Capital increases				0		0
Change in consolidation area and other minor changes		(5)		(5)	(5)	(10)
Shareholders' equity at 30 September 2004	1,856	1,366	0	3,222	(1)	3,221
Shareholders' equity at 31 December 2004	1,856	1,798	(27)	3,627	22	3,649
Adoption of IAS32: treasury stock	(1)			(1)		(1)
Adoption of IAS32 and IAS39: other effects		109	417	526		526
Adoption of IFRS2		(5)	5	0		0
	(1)	104	422	525	0	525
Change in fair value of assets available for sale			6	6		6
Change in fair value of cash-flow hedge instruments and transfers through profit and loss			(21)	(21)		(21)
Translation differences			24	24		24
	0	0	9	9	0	9
Dividends		(110)		(110)	(1)	(111)
Net profit (loss) at 30 September 2005		172		172	8	180
Capital increases	1		3	4		4
Change in consolidation area and other minor changes		(32)		(32)	414	382
Shareholders' equity at 30 September 2005	1,856	1,932	407	4,195	443	4,638

General Information

The Finmeccanica Group is a major Italian high technology organisation. Finmeccanica S.p.A., the holding company responsible for guiding and controlling operations and strategy, coordinates its operating subsidiaries (the Finmeccanica Group or, simply, the Group), which are especially concentrated in the fields of aeronautics and helicopters, space and defence. The Group also has important businesses in the energy and transportation industries.

Finmeccanica is a company limited by shares based in Rome (Italy), at Piazza Monte Grappa 4, and is listed on the Milan stock market (MIB 30).

Basis of preparation

In application of Regulation (EC) no. 1606/2002 of 19 July 2002, the consolidated accounts of Finmeccanica Group for the financial year ending 31 December 2005 are, for the first time, to be prepared in accordance with the international accounting standards (IFRSs) endorsed by the European Commission. Pursuant to Article 82 of the modified regulations implementing Legislative Decree 58/98 as amended (CONSOB resolution no. 14990/05), the consolidated accounts at 30 September 2005 have been prepared in accordance with the international accounting standards (IFRSs), as endorsed at the date of presentation of this half-year report. Specifically, the quarterly report at 30 September 2005 was prepared on the basis of the references indicated in Annex 3D to the abovementioned “regulation”.

The accounting policies used by the Group in preparing the consolidated accounts for the year ended 31 December 2004 complied with the relevant provisions of the Italian Civil Code, interpreted and supplemented, as necessary, by the accounting standards issued by the National Councils of the Italian accounting profession and by the interpretation document OIC 1 prepared by the Italian Accounting Board regarding the main effects of the reform of corporate law on financial reporting. First-time adoption of IFRSs was effected to prepare the consolidated accounts for the first half of 2005. To this end, it was necessary, for the purposes of comparison, to modify the figures for 2004 to reflect any changes resulting from the introduction of the new accounting standards.

The main IFRSs used in the preparation of the financial statements to be consolidated have been supplemented with the IFRIC interpretations available at September 2005. At the date of preparation of this quarterly report, certain aspects of adaptation and interpretation by the relevant official bodies, as well as the process of endorsement by the European Commission, have yet to be completed. As a result, there may be further changes or supplements to such standards and interpretations which could result in Finmeccanica Group being required or opting to alter the accounting policies adopted in preparing these quarterly consolidated accounts.

The accounting standards specified below have been applied consistently for the comparative periods, with the exception of those related to the measurement of financial instruments. For these, the Group has elected the exemption allowed by IFRS 1, which permits the adoption of IAS 32 and IAS 39 at 1 January 2005 without presenting comparative figures for the previous financial year. Accordingly, the standards adopted for the valuation of financial instruments for the opening balances at 1 January 2004 and the subsequent interim and annual IFRS reports for 2004 are the same as those used in previous periods (Italian GAAP).

All figures are shown in millions of euros unless otherwise indicated.

Preparation of the quarterly report at 30 September 2005 required management to make certain estimates. The main areas affected by estimates or assumptions of particular importance or that have significant effects on the balances shown are described below.

These consolidated accounts at 30 September, which have been prepared in accordance with IFRSs, have not been audited.

Accounting policies

Standards and scope of consolidation at 30 September 2005

The Group's consolidated accounts for the quarter ended 30 September 2005 include the statements of the companies/entities included in the scope of consolidation ("consolidated entities"), which have been prepared in accordance with the IFRSs adopted by Finmeccanica Group. Below is a list of the main changes in the Group's scope of consolidation over the periods under comparison.

Subsidiaries and entities controlled jointly

In particular, the entities over which Finmeccanica exercises a controlling influence, either by directly or indirectly holding a majority of shares with voting rights or by exercising a dominant influence through the power to govern the financial and operating policies of an entity and obtain the related benefits regardless of the nature of the shareholding, have been consolidated on a line-by-line basis.

Not consolidated on a line-by-line basis are those entities which, because of the dynamics of their operations (e.g. consortia without shares and controlling interests in equity consortia which, by charging costs to their members, do not have their own financial results and the financial statements of which do not, net of intercompany assets and liabilities, have material balances) or their current status (e.g. companies that are no longer operational, have no assets or personnel, or for which the liquidation process appears to be essentially concluded), would be immaterial to the Group's situation in both quantitative and qualitative terms. These holdings have been consolidated using the equity method.

Participating interests in entities (including special-purpose entities) over which control is exercised jointly with other parties are consolidated proportionally (so as to incorporate only the value of the assets, liabilities, costs and income proportional to the percentage held without, therefore, including the holdings of the other parties).

All controlled entities are consolidated at the date on which control was acquired by the Group. The entities are removed from the consolidated financial statements at the date on which the Group relinquishes control.

Business combinations are recognised using the purchase method, whereby the acquirer purchases the equity and recognises all assets and liabilities, even if merely potential, of the acquired company. The cost of the transaction includes the fair value at the date of purchase of the assets sold, the liabilities assumed, the capital instruments issued, and all other incidental charges. Any difference between the cost of the transaction and the fair value at the date of purchase of the assets and liabilities is allocated to goodwill. In the event the process of allocating the purchase price should result in a negative difference, this difference is recorded as an expense immediately at the purchase date.

Amounts resulting from transactions with consolidated entities have been eliminated, particularly where related to receivables and payables outstanding at the end of the period, as well as interest and other income and expenses recorded on the income statements of these enterprises. Also eliminated are the net profits or losses posted between the consolidated entities along with their related tax adjustments.

The financial years of the consolidated entities, as specified below, all end on 31 December. The quarterly financial statements at 30 September 2005 have been prepared based on the ending balances at 30 September.

Other equity investments

Investments in entities over which significant influence is exercised, which generally corresponds to a holding of between 20% (10% for listed companies) and 50%, are accounted for either using the equity method or at fair value. In the case of the equity method, the value of the investment is in line with shareholders' equity adjusted, when necessary, to reflect the application of IFRSs, and includes the recognition of goodwill (net of impairments) calculated at the time of purchase, and to account for the adjustments required by the standards governing the preparation of consolidated financial statements. Accordingly, the profits and losses recorded between the entities

consolidated using the equity method and the other consolidated entities of the Group have been eliminated.

Any value losses in excess of book value are recorded in the provision for risks on equity investments.

The fair value of equity investments, in the event this method applies, is calculated based on the bid price of the last trading day of the month for which the IFRS report was prepared (in this case 30 September 2005).

Segment information

The Group considers the organization by industry to be “primary”, as company risks and benefits are influenced significantly by differences in the products and services provided, with the organization by geographic area being “secondary”, as company risks and benefits are also significantly influenced by operating in different countries or different geographic areas.

Currency translation

Identification of the functional currency

The balances of the quarterly financial statements of each Group entity are presented recorded in the currency of the primary economy in which each enterprise operates (the functional currency). The consolidated quarterly financial statements for the Finmeccanica Group have been prepared in euros, which is the functional currency of the Group Parent.

Translation of transactions denominated in a foreign currency

Items expressed in a currency other than the functional currency, whether monetary (cash and cash equivalents, receivables or payables due in pre-set or measurable amounts, etc.) or non-monetary (advances to suppliers of goods and services, goodwill, intangible assets, etc.), are initially recognised at the exchange rate prevailing at the date on which the transaction takes place. Subsequently, the monetary items are translated into the functional currency based on the exchange rate at the reporting date, and any

differences resulting from this conversion are recognised in the income statement. Non-monetary items continue to be carried at the exchange rate on the date of the transaction, except in situations where there is a persistent unfavourable trend in the exchange rate concerned. The differences receive the accounting treatment (income statement or translation reserve) required of adjustments of these items.

Translation of financial statements expressed in a currency other than the functional currency

The rules for translating financial statements expressed in a foreign currency into the functional currency (with where the currency is that of a hyper-inflationary economy) are as follows:

- the assets and liabilities presented, even if solely for comparative purposes, are translated at the end-period exchange rate;
- costs and revenues, charges and income presented, even if solely for comparative purposes, are translated at the average exchange rate for the period in question, or at the exchange rate on the date of the transaction in the event this is significantly different from the average rate;
- the “translation reserve” includes both the exchange rate differences generated by the translation of balances at a rate different from that at the close of the period and those that are generated by the translation of opening balances of shareholders’ equity at a rate different from that at the close of the period.

Differences resulting from the translation of net investments in foreign operations and of financing or other currency instruments designated as hedges of such investments are recognised in the consolidated accounts in the translation reserve and only taken to the income statement following the disposal of the net investment.

Goodwill and adjustments to fair value related to the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the end-period exchange rate.

Intangible assets

Intangible assets are non-monetary items without physical form, but which can be clearly identified and generate future economic benefits for the company. They are carried at purchase and/or production cost, included directly related expenses allocated to them when preparing the asset for operations and net of accumulated amortisation (with the exception of intangibles with an indefinite useful life) and any impairments of value. Amortisation begins when the asset is available for use and is recognised systematically over its remaining useful life. In the period in which the intangible asset is recognised for the first time, the amortisation rate applied takes into account the period of actual use of the asset.

Development costs

This account includes costs related to the application of the results of research or other knowledge in a plan or a project for the production of materials, devices, processes, systems or services that are new or significantly advanced, prior to the start of commercial production or use, for which the generation of future economic benefits can be demonstrated. These costs are amortised over the entire period in which the future earnings are expected to be realised for the project itself. If such costs are reimbursed in whole or in part by the customer or fall within the scope of costs defined by Group standards as “non-recurring costs”, they are recognised under inventories (see the following section).

Research costs, on the other hand, are expensed in the period in which they are incurred.

Patents and intellectual property rights

Patents and intellectual property rights are carried at acquisition cost net of amortisation and accumulated impairment losses. Amortisation begins in the period in which the rights acquired are available for use and is calculated based on the shorter of the period of expected use and that of ownership of the rights.

Concessions, licenses and trademarks

This category includes: concessions, i.e. government measures that grant private parties the right to exclusive use of public assets or to manage public services under regulated

conditions; licenses that grant the right to use patents or other intangible assets for a determinate or determinable period of time; trademarks that establish the origin of the products of a given company; and licenses for the know-how or software owned by others. The costs, including the direct and indirect costs incurred to obtain such rights, can be capitalised after receiving title to the rights themselves and are amortised systematically over the shorter of the period of expected use and that of ownership of the rights.

Goodwill

Goodwill recognised as an intangible asset is associated with business combinations and represents the difference between the cost incurred to acquire a company or division and the sum of the values assigned, based on current values at the time of the acquisition, to the individual assets and liabilities of the given company or division. As it does not have a definite useful life, goodwill is not amortized but is subject to impairment tests conducted at least once a year, unless market and operational factors identified by the Group indicate that an impairment test is also necessary in the preparation of interim financial statements. In conducting an impairment test, goodwill is allocated to the individual cash-generating units (CGUs), i.e. the smallest financially independent business units through which the Group operates in its various market segments.

Goodwill related to the acquisition of consolidated companies is recognised under intangible assets. Goodwill related to associated companies or subsidiaries not consolidated on a line-by-line basis is included in the value of the investments.

Property, plant and equipment

Property, plant and equipment is measured at purchase or production cost net of accumulated depreciation and any impairment losses. The cost includes all direct costs incurred to prepare the assets for use, as well as any charges for dismantlement and disposal that will be incurred to return the site to its original condition.

Charges incurred for routine and/or cyclical maintenance and repairs are expensed in full in the period in which they are incurred. Costs related to the expansion, modernization or improvement of owned or leased structural assets are only capitalised to the extent that such costs meet the requirements for being classified separately as an asset or part of an asset. Any public capital grants related to property, plant and equipment are recognised as a direct deduction from the value of the asset to which they refer.

The value of an asset is adjusted by systematic depreciation calculated based on the residual useful life of the asset itself. In the period in which the asset is recognised for the first time, the depreciation rate applied takes into account the period of actual use of the asset. The estimated useful lives adopted by the Group for the various asset classes are as follows:

	Years
Land	indefinite
Buildings	20-33
Plant and machinery	5-10
Equipment	3-5
Other assets	5-8

In the event the asset to be depreciated is composed of distinct elements with useful lives that are significantly different from those of the other constituent parts, each individual part that makes up the asset is depreciated separately, in application of the component approach to depreciation.

This item also includes equipment intended for specific programs (tooling), although it is depreciated, as with other non-recurring costs (see the following section), on the basis of units manufactured in relation to those expected to be produced.

The gains and losses from the sale of assets or groups of assets are calculated by comparing the sales price with the related net book value.

Investment properties

Investments that generate income independent from company operations are classified as “investment properties”. These investments are measured at purchase or production cost, increased by any related incidental expenses and reduced by accumulated depreciation and any impairment losses.

Impairment of intangible assets and property, plant and equipment

Assets with indefinite lives are not depreciated or amortised, but are rather subject to impairment tests at least once a year to ascertain the recoverability of their book value.

For assets that are depreciated or amortised, an assessment is made to determine whether there is any indication of a loss in value. If so, the recoverable value of the asset is estimated, with any excess being recognised in the income statement.

If the reasons for such writedowns should cease to obtain, the asset’s book value is restored within the limits of its net book value; the writeback is also taken to the income statement. Under no circumstances, however, is the value of goodwill that has been written down restored to its previous level.

Equity investments

The Group classifies its equity investments as follows:

- “subsidiaries” in which the owner of the interest has the power to determine the financial and operating decisions and to receive the related benefits;

- “associated companies” in which the owner of the interest exercises significant influence (which is assumed to exist when owner can exercise at least 20% of the votes in the ordinary shareholders’ meeting). This also includes companies subject to joint control (joint ventures);
- “parent companies”, when the company held holds shares in its own parent;
- “other companies” that do not fall under any of the categories above.

Equity investments due to be sold and those purchased for the sole purpose of being sold within twelve months are classified separately under “assets held for sale”.

Subsidiaries (including those subject to joint control), associates and other companies, with the exception of those that are held for sale, are recognised at the cost of purchase or start-up posted in the separate accounts of the companies of the Group. The cost value is maintained in subsequent financial statements except in the event of a loss of value, or any writeback, following a change in its economic use or capital transactions. Equity investments held for sale are carried at the lower of cost and fair value net of sales costs.

Inventories

Inventories are recorded at the lower of cost and net realisable value. The Group used the *weighted average cost method*. The net realisable value is the sales price in the course of normal operations net of estimated costs to finish the goods and those needed to make the sale. Any writedowns are eliminated in future periods if the reason for the writedown should cease to obtain.

The Group classifies inventories as follows:

- raw materials, secondary materials and consumables
- work in progress and semi-finished goods
- contract work in progress
- finished products
- goods

In particular, work in progress and semi-finished goods, as specified in the relevant section, include non-recurring costs. They represent costs related to studies, specific research, and pre-definition, definition and design activities for a clearly defined and

measurable product within the company's operating plans, including the difference between the higher costs of labour incurred in the various stages of the start-up of production and those in the standard stage as determined on the basis of the expected learning curve. This item also includes pre-operating costs incurred after a contract has been awarded, but before production has begun.

Work in progress is recognised at production cost excluding financial charges and general overheads. Pre-operating costs pending in inventory are absorbed as part of the valuation of work in progress. This is done on the basis of production and sales plans in relation to the type of product concerned.

Contract work in progress

Work in progress is recognised on the basis of progress (or percentage of completion), whereby costs, revenues and margins are recognised based on the progress of production. The Group has adopted the cost-to-cost percentage-of-completion method.

The valuation reflects the best estimate of the schedules prepared at the reporting date. The assumptions upon which the valuations are made are periodically updated. Any impact on profit or loss are recognised in the period in which the updates are made.

In the event the completion of a contract is expected to result in a loss at the gross margin level, the loss is recognised in its entirety in the period in which it becomes reasonably foreseeable.

Contract work in progress is recorded net of any writedowns, as well as pre-payments and advances related to the contract being performed.

This analysis is carried out contract by contract: in the event of positive differences (where the value of work in progress that is greater than total pre-payments), the difference is recorded as an asset; negative differences, on the other hand, are recorded as a liability under "advances from customers". If it has not been collected at the date of preparation of the annual or interim accounts, the amount recorded among advance payments will have a directly contra-item in trade receivables.

Contracts with payments in a currency other than the functional currency (the euro for the Group) are measured by converting the portion of payments due, calculated using the percentage-of-completion method, at the exchange rate prevailing at the close of the period in question. However, the Group's policy for exchange-rate risk calls for all

contracts in which cash inflows and outflows are significantly exposed to exchange rate fluctuations to be hedged specifically. In such cases, the recognition methods described in the specific section below.

Financial assets

From 1 January to 31 December 2004

Financial assets were recognised as current and non-current assets with reference to their maturity and/or use at the date of the preparation of the financial statements. Securities and equity investments carried under current assets were recognised at the lower of their specific purchase cost or market value. Securities classified under non-current assets were recognised at purchase cost, adjusted to take account of lasting value impairments (for equity investments, see specific section).

From 1 January 2005

The Group classifies its financial assets into the following categories:

- financial assets at fair value through profit or loss;
- loans and receivables;
- held-to-maturity financial assets;
- available-for-sale financial assets.

Management classifies assets at the time they are first recognised.

Financial assets at fair value through profit or loss

This category includes financial assets acquired for the purpose of short-term trading transactions, or designated for this use by management, as well as derivatives, which are discussed in the next section. The fair value of these instruments is determined with reference to their end-period bid price. For unlisted instruments, the fair value is calculated using commonly adopted valuation techniques. Changes in the fair value of instruments in this category are recognised immediately in the income statement.

The classification of assets as current or non-current reflects management expectations regarding their trading. Current assets include those that are planned to be sold within 12 months or those designated as held for trading purposes.

Loans and receivables

This category includes non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. They are measured at their amortised cost using the effective interest method. Should objective evidence of impairment emerge, the value of the asset is reduced to the value obtained by discounting the expected cash flows from the asset; the loss ascertained in the impairment test is recognised in profit or loss. If the reasons for the writedown should cease to obtain, the value of the asset is restored up to the amortised cost value it would have if no impairment had been recognised. Loans and receivables are posted under current assets except for the portion falling due beyond 12 months, which is carried under non-current assets.

Financial assets held to maturity

These are non-derivative assets with fixed maturities that the Group has the intention and ability to hold to maturity. Those maturing within 12 months are carried as current assets. Should objective evidence of impairment emerge, the value of the asset is reduced to the value obtained by discounting the expected cash flows from the asset; the loss ascertained in the impairment test is recognised in profit or loss. If the reasons for the writedown should cease to obtain, the value of the asset is restored up to the amortised cost value it would have if no impairment had been recognised.

Financial assets available for sale

This category encompasses non-derivative financial assets specifically designated as available for sale or are not classified in any of the previous items. They are recognised at fair value, which is calculated with reference to their market price at the reporting date or using financial valuation techniques and models. Changes in value are recognised in a specific equity item (“Reserve for assets available for sale”)

The reserve is taken to the income statement only when the financial asset is effectively sold or, in cases of a loss of value, when it become evident that the impairment in value already recognised in equity is unrecoverable. Classification as current or non-current depends on the intentions of management and the effective marketability of the security itself. Assets that are expected to be sold within 12 months are carried under current assets.

Should objective evidence of impairment emerge, the value of the asset is reduced to the value obtained by discounting the expected cash flows from the asset; reductions in value previously recognised in equity are reversed to profit or loss. If the reasons for the writedown should cease to obtain, the value of the asset is restored.

Derivatives

From 1 January to 31 December 2004

Derivatives were not recognised in the financial statements if the characteristics of the instruments and their degree of correlation with the underlying assets were such that they could be defined as a hedging instrument. For derivatives not defined as hedges, any reductions in value were recognised under costs and liabilities, while positive variations in market value were not recognised.

With respect to forward transactions, the difference attributable to premiums or discounts was recognised in financial income and charges and in other current assets and liabilities on a *pro rata temporis* basis.

From 1 January 2005

Derivatives are still regarded as assets held for trading and stated at fair value through profit and loss unless, in the light of the new standards and current interpretation, they are deemed eligible for hedge accounting and effective in offsetting the risk in respect of underlying assets, liabilities or commitments undertaken by the Group.

In particular, the Group uses derivatives as part of its hedging strategies to offset the risk of changes in the fair value of assets or liabilities on its balance sheet or the risk associated with contractual commitments (fair value hedges) and the risk of changes in expected cash flows in contractually defined or highly probable operations (cash flow hedges). For details regarding the methodology for recognising hedges of the exchange rate risk on long-term contracts, see the relevant section.

The effectiveness of hedges is documented both at the start of the transaction and periodically thereafter (at least every time an annual or interim report is published) and measured by comparing changes in the fair value of the hedging instrument against

changes in the hedged item (“dollar offset ratio”). For more complex instruments, the measurement involves statistical analysis based on the variation of the risk.

Fair value hedges

Changes in the value of derivatives that have been designated and qualify as fair value hedges are recognised in profit or loss, similarly to the treatment of changes in the fair value of the hedged assets or liabilities that are attributable to the risk that has been offset with the hedge.

Cash flow hedges

Changes in the fair value of derivatives that have been designated and qualify as cash flow hedges are recognised - with reference to the “effective” component of the hedge only - in a specific equity reserve (“cash flow hedge reserve”), which is subsequently recognised in profit or loss when the underlying transaction affects profit or loss. Changes in fair value attributable to the non-effective component are immediately recognised in profit or loss for the period. If the derivative is sold, or ceases to function as an effective hedge against the risk for which it was originated, or the occurrence of the underlying operation ceases to be highly probable, the relevant portion of the cash flow hedge reserve is immediately recognised in the income statement.

Determining fair value

The fair value of instruments quoted on public markets is determined with reference to the bid price for the instrument in question at the reference date. The fair value of unquoted instruments is determined with financial valuation techniques. Specifically, the fair value of interest rate swaps is measured by discounting the expected cash flows, while the fair value of foreign exchange forwards is determined on the basis of the market exchange rate at the reference date and the rate differentials among the currencies involved.

Cash and cash equivalents

The item includes cash, deposits with banks or other institutions providing current account services, post office accounts and other cash equivalents, as well as investments maturing in less than three months from the date of acquisition. Cash and cash equivalents are recognised at their fair value.

Shareholders' equity

Share capital

Share capital consists of the capital subscribed and paid up by the Group Parent. Costs directly associated with the issue of shares are recognised as a decrease in share capital when they are directly attributable to capital operations.

Treasury stock

From 1 January to 31 December 2004.

Treasury stock was recognised as a current asset with a contra-item in an equity reserve.

From 1 January 2005

Treasury stock is recognised as a decrease in Group shareholders' equity. The costs incurred in the issue of new shares by the Group Parent are recognised as decreases in shareholders' equity, net of any deferred tax effect. Gains or losses realised in the acquisition, sale, issue or cancellation of treasury stock are not recognised.

Retained earnings

These include net profits or losses for the financial period in question and previous financial periods that are not distributed or allocated to reserves (for profits) or covered (for losses). The item also includes transfers from other equity reserves when the

restrictions on their release cease to apply, as well as the effects of changes in accounting policies and significant errors.

Other reserves

Other reserves consist of specific-purpose equity reserves of the Group Parent. They include the fair value reserve relating to items accounted for using the fair value method recognised in equity and the cash flow hedge reserve in respect of the effective portion of such hedges.

Payables and other liabilities

From 1 January to 31 December 2004

Payables defined as obligations to pay an amount in respect of the purchase of products, goods and services at a set date as well as other financial liabilities were recognised at nominal value.

From 1 January 2005

Payables and other liabilities are initially recognised at fair value net of transaction costs. They are subsequently valued at their amortised cost using the effective interest rate method.

Payables and other liabilities are defined as current liabilities unless the Group has the contractual right to settle its debts at least 12 months after the reporting date.

Deferred taxes

Deferred taxes are calculated with reference to the temporary differences between the value of assets and liabilities recognised in the company financial statements and the value attributed to them for tax purposes. Deferred tax assets and liabilities are calculated by applying the tax rate in force at the time the temporary differences will be reversed. Deferred tax assets are recognised to the extent that it is probable the company will post taxable income at least equal to the temporary differences in the financial periods in which such assets will be reversed.

Employee benefits

Post-employment benefit plans

Group companies use several types of pension and supplementary benefit plans, which can be classified as follows:

- *Defined contribution plans* in which the company pays fixed amounts to a distinct entity (e.g. a fund) but has no legal or constructive obligation to make further payments if the fund does not have sufficient assets to pay the benefits accrued by employees during their period of employment with the company. The company recognises the contributions to the plan only if employees rendered their services to the company specifically in exchange for these contributions;
- *Defined benefit plans* in which the company undertakes to provide agreed benefits for current and former employees and incur the actuarial and investment risks associated with the plan. The cost of the plan is therefore not determined by the amount of the contributions payable in the financial period but, rather, is redetermined with reference to demographic and statistical assumptions and wage trends. The methodology used is the projected unit credit method. The “*trattamento di fine rapporto*”, a staff severance pay mechanism peculiar to Italy, belongs to this category.

In compliance with IAS 19, the Finmeccanica Group uses the so-called “corridor” approach in recognising actuarial losses and gains relating to defined benefit plans. This method makes it possible to dilute the effects of changes in the valuation parameters over a number of financial years. Consequently, net actuarial losses and gains at the end of the prior period that exceed the greater of 10% of the present value of the obligation and 10% of the fair value of the benefit plan assets divided by the remaining working life of employees are recognised in each period.

Other long-term benefits

Group companies grant employees with other benefits (such as seniority bonuses after a given period of service with the company) that, in some cases, continue to be provided after retirement (for example, medical care). These receive the same accounting

treatment as defined benefit plans, using the projected unit credit method. However, the corridor approach cannot be used for “other long-term benefits”. Consequently, net actuarial gains and losses are recognised both immediately and in full as they occur.

Benefits payable for the termination of employment and incentive plans

Termination benefits are recognised as liabilities and expenses when the enterprise is demonstrably committed to terminating the employment of an employee or group of employees before the normal retirement date or to providing termination benefits as a result of an offer made in order to encourage voluntary redundancy. The benefits payable to employees for the termination of employment do not bring any future economic benefit to the enterprise and are therefore recognised immediately as expenses.

Equity compensation benefits

The Group uses stock option plans as part of its compensation of senior management. In these cases, the theoretical benefit attributable to the recipients is charged to the income statement in the financial periods for which the plan is operative with a contra-item in an equity reserve. The benefit is quantified by measuring the fair value of the assigned instrument using financial valuation techniques that take account of market conditions and, at the date of each annual or interim report, an updated estimate of the number of instruments expected to be distributed.

Provisions for risks and charges

Provisions for risks and charges cover certain or probable losses and charges whose timing or amount was uncertain at the reporting date.

The provision is recognised only when a current obligation (legal or constructive) exists as a result of past events and it is probable that an outflow of economic resources will be required to settle the obligation. The amount reflects the best current estimate of the cost of fulfilling the obligation. The interest rate used to determine the present value of the liability reflects current market rates and includes the additional effects relating the specific risk associated with each liability.

Risks for which the emergence of a liability is merely a possibility are reported in the section in the notes on commitments and risks and no provision is recognised.

Leasing

Group entities as lessees in a finance lease

At the date on which a lease is first recognised, the lessee records a non-current asset and a financial liability at the lower of the fair value of the asset and the present value of the minimum lease payments at the date of the inception of the lease, using the interest rate implicit in the lease or the incremental borrowing rate. Subsequently, an amount equal to the depreciation expense and the finance charge separated from principal component of the lease payment made in the period is recognised in the income statement.

Group entities as lessors in a finance lease

At the date on which a lease is first recognised, the value of the leased asset is eliminated from the balance sheet and a receivable equal to the net investment in the lease is recognised. The net investment is the sum of the minimum payments plus the residual unguaranteed value discounted at the interest rate implicit in the lease contract. Subsequently, financial income is recognised in the income statement for the duration of the contract in an amount providing a constant periodic rate of return on the lessor's net investment.

The unsecured residual value is reviewed periodically for possible impairment.

Operating leases

Receipts and payments in respect of contracts qualifying as operating leases are recognised in the income statement over the duration of the contract.

Revenues

Revenues generated by an operation are recognised at the fair value of the amount received, inclusive of volume discounts and reductions.

Revenues also include changes in work in process, the accounting policies for which were described in the relevant section above.

Revenues generated from the sale of goods are recognised when the enterprise has transferred to the buyer substantially all of the significant risks and rewards of ownership of the goods, which, in many cases, will coincide with the transfer of title or possession to the buyer; or when the value of the revenues can be reliably determined.

Revenues from services are recognised on a percentage-of-completion method when they can be reliably estimated.

Grants

Once formal authorisation for their assignment has been issued, grants are recognised on an accruals basis in direct correlation with the costs incurred. Specifically, capital grants are taken to the income statement in direct relation to the depreciation of the relevant goods or projects, and are recognised as a direct reduction in the value of the depreciation expense.

Financial income and expense

Interest is recognised on an accruals basis using the effective interest rate method, i.e. the interest rate that results in the financial equivalence of all inflows and outflows (including any premiums, discounts, commissions etc) that make up a given operation.

Finance charges are never capitalised within assets.

Dividends

Dividends are recognised as soon as shareholders obtain the right to receive payment, which is normally when the shareholders' meeting approves the distribution of dividends.

Dividends distributed to Finmeccanica shareholders are recognised as liabilities for the period in which their distribution is approved by the shareholders' meeting.

Costs

Costs are recognised on an accruals basis in the expectation that the Group companies will continue operations.

Accounting policies applied in the preparation of interim reports and the seasonality of operations

Current taxes

In the interim financial statements of Group companies, income taxes are estimated by applying the expected effective annual tax rate to the interim pre-tax result.

Cash flows relating to operations

The businesses in which the Group is primarily active are characterized by a high concentration of cash flows from customers in the closing months of the year. This pattern affects both the interim cash flow statements and the debt situation of the Group, which shows a marked improvement in the final months of the calendar year.

Critical accounting judgements and estimates

Non-recurring costs

The Group classifies costs incurred for design activities, prototype development and customization to the technical and operating specifications of clearly identified customers under inventories at the item *work in progress and semi-finished goods* even if there is no contractual relationship if it believes that the contract is highly likely to be awarded on the basis of actions by potential customers to conclude a contract or the

correspondence of the Group's projects with the business and financial plans of potential customers. The item also includes the difference between the increased labour costs in the initial manufacturing stage and those considered standard on the basis of the expected learning curve. Such costs are recognised until the contract is formally awarded without recognition of any margin; subsequently, they are allocated to the relevant contract (under the item *contract work in progress*) and amortized against the margin on the contract on the basis of units manufactured in relation to those expected to be produced.

If the prospects for being awarded a contract should change as a result of changes in the conditions noted above or are delayed to the extent that the time horizon for award is less clearly specified, the suspended costs are immediately recognised in the income statement.

Financing for GIE ATR aircraft

In order to enhance its competitive position, in certain cases GIE ATR facilitates access to financing by its customers by providing specific guarantees to third parties (an approach taken by its direct competitors), an activity that in the past it also conducted through special purpose entities.

Where, due to the effect of the guarantees provided or the content of other contractual provisions, it is felt that substantially all risks and benefits attaching to aircraft sale contracts have not transferred to customers, the sale is not recognised as such in the accounts. Rather, the entire operation is recognised as a lease, postponing the recognition of profits until such time as the risks no longer obtain by way of recognition under deferred income and carrying the aircraft among the Group's assets, undergoing normal depreciation. If, however, the operation is structured in a manner in which substantially all risks and benefits are transferred to the customer, it is booked as a loan or a finance lease, with the sale being recognised upon delivery and the financial component being recognised under financial income on an accruals basis. If contracts envisage a buy-back clause or a residual value guarantee, the operation is recognised as a sale only if the present value of the guarantees can be considered immaterial with respect to the overall value of the transaction; otherwise, the aircraft is carried under the

Group's assets and depreciated. All likely risks associated with operations carried out by GIE ATR are measured on the basis of a prudent valuation conducted by management and are either deducted directly from the carrying value of the asset or are recognised under provisions for risks and charges.

Hedging long-term commercial contracts against foreign exchange risk

In order to hedge exposure to changes in flows of receipts and payments associated with long-term construction contracts denominated in currencies other than the functional currency, the Group enters into specific hedges for the expected individual cash flows in respect of the contracts. The hedges are entered into at the moment the commercial contracts are finalised, except where the award of the contracts is felt to be highly likely as a result of existing framework contracts. Exchange-rate risk is normally hedged with plain vanilla instruments (forward contracts); in some cases, however, in order to protect the Group against the persistent adverse trend in the US dollar, we have entered into more highly structured operations that, while substantively hedging the positions, do not qualify for hedge accounting under IAS 39. In these cases, as in all cases where hedges prove to be ineffective, changes in the fair value of such instruments are taken immediately to the income statement as financial items, while the underlying is valued as if it were exposed to exchange rate variations. Hedges in the former case are carried as cash flow hedges, considering as ineffective the part relating to the premium or discount in the case of forwards or the time value in the case of options, which is recognised under financial items.

Recognition of the equity investment in STMicroelectronics (STM)

The indirect investment in STM was designated at the date of adoption of IAS 32 and IAS 39 (1 January 2005) as *available for sale*. Accordingly, the carrying value is adjusted at each balance-sheet date to market value (bid price), recognising the differential with respect to the carrying value determined in accordance with previous GAAP, as well as subsequent changes in fair value, in a specific equity reserve (*reserve*

for assets available for sale), which will be reversed to profit or loss only if and when the equity investment is sold.

Provisions for risks and estimates of final costs of long-term contracts

The Group operates in sectors and with contractual arrangements that are especially complex. They are recognised on a percentage-of-completion basis. Margins recognised in the income statement are a function of both the state of progress on contracts and the margins that are expected to be recognised for the completed contract. Accordingly, correct recognition of work in progress and margins on contracts that have not yet been completed requires management to make a careful estimate of the final costs and expected increases as well as delays, extra costs and penalties that could reduce the expected margin. In order to enhance support for this activity, the Group has adopted contract management and risk analysis tools designed to identify, monitor and quantify the risks associated with such contracts. The amounts posted in the financial statements represent management's best estimate at the reporting date.

In addition, the Group's operations regard sectors and markets where many disputes are settled only after a considerable period of time, especially in cases where the customer is a government entity, making it necessary for management to estimate the outcome of such disputes. The main potential loss situations classified as "probable" or "possible" (no provision is recognised for the latter) are reported in the notes to the figures for the period.

Estimates

The estimates used in restating comparative information are consistent with those used in preparing the financial statements drawn up under previous GAAP.

Segment information

Primary frame of reference

The Group operates in a variety of industry segments: aeronautics, space, helicopters, defence electronics, defence systems, transport, energy and other businesses.

For a more detailed analysis of the main programmes, outlooks and operating indicators for each segment, see the Report on Operations in the business areas. The results for each segment at 30 September 2005, as compared with those of the same period of the previous year, are as follows:

30 September 2005										
	Aero- nautics	Space	Heli- copters	Defence Electron- ics	Defence Systems	Transport ation	Energy	Other Activities	Elimin- ations	Total
Revenue from external customers	817	539	1,696	1,511	634	893	516	141		6,747
Revenue from other segments	416	8	7	318	59	-	3	23	-283	551
Operating result	99	24	174	114	42	5	20	(72)		406
Financial expense – net										(65)
Share of result of associates				1				(25)		(24)
Tax expense										(137)
Profit (loss) from discontinued operations										-
Profit (loss) for the period										180
Group share of net result										172
Minority share										8
Capital expenditure	90	125	35	984	28	18	8	4	-	1,292
30 September 2004										
	Aero- nautics	Space	Heli- copters	Defence Electron- ics	Defence Systems	Transport ation	Energy	Other Activities	Elimin- ations	Total
Revenue from external customers	755	500	850	1,88	725	962	504	28		5,612
Revenue from other segments	426	8	3	324	19	-	-	10	(211)	579
Operating result	56	2	97	105	37	33	14	(75)		269
Financial expense – net										(26)
Share of result of associates				(2)				62		60
Tax expense										(150)
Profit (loss) from discontinued operations								(5)		(5)
Profit (loss) for the period										148
Group share of net result										147
Minority share										1
Capital expenditure	96	13	10	107	18	8	9	17		278

The assets and liabilities attributable to the segments at 30 September 2005 and at 31 December 2004 are as follows:

30 September 2005										
	Aero- nautics	Space	Heli- copters	Defence Electron- ics	Defence Systems	Transport ation	Energy	Other Activities	Elimin- ations	Total
Assets	4,189	872	5,308	5,390	1,986	1,894	986	4,395	(3,635)	21,385
Liabilities	3,991	523	3,473	3,328	1,367	1,755	968	4,691	(3,339)	16,757

31 December 2004										
	Aero- nautics	Space	Heli- copters	Defence Electron- ics	Defence Systems	Transport ation	Energy	Other Activities	Elimin- ations	Total
Assets	3,965	724	4,835	3,189	2,021	1,686	853	4,723	(2,863)	19,133
Liabilities	3,669	750	3,075	2,418	1,324	1,592	839	3,805	(1,857)	15,615

Secondary frame of reference

Group revenue can also be broken down geographically as follows (based on the customer's home country):

	30 September 2005	30 September 2004
Europe	5,941	4,885
North America	558	478
Other	799	828
	<u>7,298</u>	<u>6,191</u>

Assets are geographically distributed as follows:

	30 September 2005	31 December 2004
Europe	20,900	18,803
North America	405	250
Other	80	80
	<u>21,385</u>	<u>19,133</u>

Capital expenditure is distributed as follows (based on the location in which it is made):

	<u>30 September 2005</u>	<u>30 September 2004</u>
Europe	1,280	274
North America	6	1
Other	6	3
	<u>1,292</u>	<u>278</u>

Notes to the quarterly report at 30 September 2005

To provide further information on the Group's financial position, the following statements "Reclassified Consolidated Income Statement", "Reclassified Consolidated Balance Sheet", "Reclassified Net Financial Debt" and "Reclassified Consolidated Cash-Flow Statement" have been prepared.

For a better understanding and comparison of the data below, please take note of the main changes in the scope of consolidation:

- Oto Melara Iberica SA was consolidated on a line-by-line basis beginning 1 January 2005;
- Seicos S.p.A. was consolidated on a line-by-line basis beginning 1 January 2005;
- IGS S.p.A. was consolidated on an equity basis beginning 1 January 2005, following its liquidation;
- Elsig Security S.r.l., established on 25 February 2005, was consolidated on a line-by-line basis as from that date;
- on 24 March 2005, the demerger deed of branches of business of Galileo Avionica S.p.A. was completed, leading to the establishment of the companies Trimprobe S.p.A. and G.A. Immobiliare S.p.A.. Both companies were consolidated on a line-by-line basis as from that date;
- on 29 April 2005, following the agreements reached with BAE Systems (Eurosystems transaction), Selex Sensors and Airborne Systems S.p.A., established in March 2005, was the object of a capital increase through contributions of Galileo Avionica S.p.A. and its related concerns by Finmeccanica S.p.A., and of BAE

Systems Avionics Ltd (subsequently Selex Sensors and Airborn Systems Ltd) and its related concerns by BAE Systems Electronics Ltd.. Selex Sensors and Airborne and Systems Ltd and S.p.A were consolidated on a line-by-line basis as from that date;

- on April 29, once again, following the agreements reached with BAE Systems, Finmeccanica acquired control of the remaining 50% in Alenia Marconi Systems S.p.A. (subsequently Selex Sistemi Integrati S.p.A.), previously consolidated on a proportional basis. The agreement also envisaged the acquisition of a number of companies, in particular Selex Sistemi Integrati GmbH, Selex Sistemi Integrati Ltd. and Selex Sistemi Integrati Inc.. As from such date, the foregoing companies have been consolidated on a line-by-line basis. As from the same date, and again as a result of the foregoing agreements, the indirect equity investment of the British company AMS Ltd. was transferred to BAE Systems. Accordingly, the company was deconsolidated;
- on July 1, Finmeccanica and Alcatel Participations SAS set up two unequal joint ventures operating in the Space sector: Alcatel Alenia Space SAS (33% owned by Finmeccanica), to which Alcatel Alenia Space Italia S.p.A. (former Alenia Spazio) was contributed and Telespazio Holding S.r.l. (67% owned by Finmeccanica) to which the companies in the Telespazio S.p.A. groups were contributed. The two companies, and their subsidiaries, were consolidated on a proportional basis as from the abovementioned date;
- the AgustaWestland group, 50% consolidated on a proportional basis until 30 November 2004 (the date of acquisition of the further 50%) was consolidated on a line-by-line basis as from that date;
- Fata Group S.p.A. and Fata Automation S.p.A., two companies in liquidation which were previously consolidated on an equity basis, were consolidated on a line-by-line basis as from the last quarter of 2004;
- Consult Data S.r.l. was deconsolidated beginning 29 July 2005, following the transfer of the relevant equity investment to third parties;
- Elsig Solution was deconsolidated beginning 4 August 2005 following the transfer of the relevant equity investment to third parties;

- Elsag Back-Office S.p.A. was deconsolidated beginning 29 August 2005 following the transfer of the relevant equity investment to third parties.

The “Reclassified Consolidated Income Statement” contains the values for both the period from 1 January to 30 September and from 1 July to 30 September, 2005, and for the periods under comparison, only from the acquisition (or effective) date.

The “Reclassified Consolidated Balance Sheet” at 31 December 2004 does not include values for the groups and companies consolidated beginning in 2005.

In reference to the comparability of figures, take also note that the three quarters of 2005 was marked by changes in the Euro against the main currencies concerning the Group. In particular, period-end (30 September 2005) and average conversion ratios showed the following changes in the currencies particularly significant to the Group, compared to 2004: final period-end exchange rates (Euro/US Dollar -13.1% and Euro/Pound Sterling -2.9%); average exchange rates for the period (Euro/US Dollar +3.0% and Euro/Pound Sterling +1.7%).

The Table below shows the Reclassified Consolidated Income Statement in the three quarters of 2005 and in the third quarter of the 2005 financial year.

€mil.	For the three quarters ended 30 September		For the quarter ended 30 September		1st half- year
	2005	2004	2005	2004	2005
	Revenues	7,298	6,191	2,572	1,989
Change in work in progress, semi-finished goods and finished products	256	269	19	96	237
	<u>7,554</u>	<u>6,460</u>	<u>2,591</u>	<u>2,085</u>	<u>4,958</u>
Costs for purchases and personnel	(6,902)	(5,885)	(2,320)	(1,930)	(4,578)
Amortisation and depreciation	(246)	(211)	(90)	(67)	(155)
Writedowns	(11)	(19)	(1)	(1)	(10)
Restructuring costs	(17)	(47)	(7)	(8)	(10)
Other net operating revenues (costs)	28	(29)	(17)	(6)	46
EBIT	<u>406</u>	<u>269</u>	<u>156</u>	<u>73</u>	<u>251</u>
Net financial income (charges)	(89)	34	(25)	18	(64)
Income taxes	(137)	(150)	(55)	(36)	(82)
NET PROFIT (LOSS) BEFORE DISCONTINUED OPERATIONS	<u>180</u>	<u>153</u>	<u>76</u>	<u>55</u>	<u>105</u>
Result of the discontinued operations	-	(5)	-	2	-
NET PROFIT (LOSS)	<u>180</u>	<u>148</u>	<u>76</u>	<u>57</u>	<u>105</u>
<i>of which:</i>					
. Group	172	147	73	56	104
. Minority interests	8	1	3	1	1

- “Value of production”, equal to €mil. 7,554, showed a 17% rise on the previous period’s figure (€mil. 6,460). This increase is due to the different contribution from AgustaWestland in the helicopters sector (50% consolidated on a proportional basis in the same period of 2004), to the increased activity in the Aeronautics, Defence Electronics (also thanks to the acquisition of Selex Sensors and Airborne Systems Ltd at the end of April 2005) and Space sectors. This increase was contrasted by a drop in the Defence Systems and Transportation (AnsaldoBreda). “Value of production” was equal to €mil. 2,591 in the third quarter of 2005 compared to €mil. 2,085 in the 2004 quarter, showing an increase of €mil. 506;
- “Costs for purchases and personnel” rose from €mil. 5,885 in the same period of 2004 up to €mil. 6,902 in 2005. Specifically, values are broken down as follows:

	<u>30 September 2005</u>	<u>30 September 2004</u>
Purchases of materials	2,752	2,296
Change in inventories	(180)	(66)
Purchases of services	2,012	1,728
Costs of rents and operating leases	183	129
Total costs for purchases and services	<u>4,767</u>	<u>4,087</u>
Wages and salaries	1,604	1,442
Social security contributions	424	297
Severance pay costs	65	50
Costs related to other defined-benefit plans	25	11
Employee disputes	3	3
Other costs	34	22
Total personnel costs	<u>2,155</u>	<u>1,825</u>
Capitalised costs for internal construction	<u>(20)</u>	<u>(27)</u>
Total	<u>6,902</u>	<u>5,885</u>

The trend in net costs for purchases (approximately +17%), as “value of production”, is attributable, in addition to the different contribution from AgustaWestland to the scope of consolidation, to the foregoing trend recorded in the sectors’ activity. In regard to the quarter, “net costs for purchases” amounted to €nil. 1,606 compared to €nil. 1,356 in the 2004 quarter.

“Personnel costs”, equal to €nil. 2,155 compared to €nil. 1,825 in the 2004 period under comparison, show an increase due to the increase in both the number of paid employees and the average unit cost.

The average headcount was 52,066, compared to 45,656 in the same period of the previous financial year, with an increase due to the increased number of employees correlated to the new companies included in the scope of consolidation, to the different contribution from AgustaWestland, 50% consolidated on a proportional basis in the 2004 period under comparison.

The final headcount at 30 September 2005 was 55,195, 5,859 more than the 49,336 at 31 December 2004, substantially due to the effect of acquisitions of companies (in particular, Selex Sensors and Airborne Systems Ltd) and a slightly positive turnover.

Average unit cost per employee showed an increase for Italy, essentially due to changes in the scope of consolidation and renewed collective agreements. The increase abroad is attributable to the net effect of the rise deriving from the change in the scope of consolidation, to the composition of job categories and the drop of the Pound Sterling and Dollar against the Euro, as mentioned earlier;

“Costs for personnel” were equal to €mil. 714 in the quarter compared to €mil. 566 in the 2004 quarter. Costs relating to personnel reorganisations/restructurings are recorded under “restructuring costs”;

- “Amortisation and depreciation” showed an increase with respect to the same period of the previous financial year, substantially due to the change in the scope of consolidation (a greater contribution from AgustaWestland and acquisitions of Selex Sensors and Airborne Systems Ltd. and Alcatel Alenia Space SAS). Amortisation and depreciation for the period amounted to €mil. 246 (€mil. 211 in the same period of 2004), of which €mil. 207 related to property, plant and equipment (€mil. 178 in the same period of 2004) and €mil. 39 to intangible assets (€mil. 33 in the same period of 2004). Amortisation and depreciation for the quarter amounted to €mil. 90 compared to €mil. 67 in the 2004 quarter;
- “Writedowns”, amounting to €mil. 11, show a decrease compared to the same period in the previous financial year (€mil. 19) and relate to receivables (€mil. 18 in the same period of 2004). In 2004, this item included €mil.1 of goodwill. Writedowns in the quarter totalled €mil. 1 (€mil. 1 in the 2004 quarter);
- “Restructuring costs” amounted to €mil. 17 compared to €mil. 47 in the same period of 2004. Restructuring costs amounted to €mil. 7 in the quarter compared to €mil. 8 in the third quarter of 2004;
- “Other net operating revenues (costs)” amounted to €mil. 28 of net revenues (€mil. 29 of net costs in the same period of 2004); specifically, these are broken down as follows:

	<u>30 September 2005</u>	<u>30 September 2004</u>
Grants for training and research and development	16	20
Net exchange rate differences on operating items	(5)	(6)
Indirect taxes	(15)	(12)
Net adjustment of receivables and liabilities in foreign currency at the end-period exchange rate	10	3
Capital gains on disposal of fixed assets	9	3
Insurance reimbursements	13	7
Reversals from (allocations of) provisions	34	-
Other operating income (costs)	(34)	(44)
Total	<u>28</u>	<u>(29)</u>

“Other net operating revenues and costs” totalled €mil. 17 of net costs in the quarter, compared to €mil. 6 in the third quarter of 2004;

- “EBIT” came to €mil. 406, showing an increase of €mil. 137 (approximately +51%) compared to the same period in the previous financial year (€mil. 269). This rise is due to the net effect of an increase attributable to the Helicopters sector, which benefited from the different contribution from AgustaWestland, to a growth in the sectors Aeronautics, Space, Defence Electronics, Defence Systems, Energy and Transportation for the railway signalling components. Such positive results were offset by the drop in the vehicles segment in the Transportation sector, as more broadly detailed above. EBIT came to €mil. 156 in the quarter compared to €mil. 73 in the 2004 quarter, showing an increase of €mil. 83;
- “Net financial income and charges”, equal to €mil. 89 of net charges, showed a decrease of €mil. 123 compared to the same period of the previous financial year (€mil. 34 of net income) and a decrease of €mil. 43 in the quarter, from €mil. 18 of net income in 2004 to €mil. 25 of net charges in 2005. Note that the item is made up of the balance of “net financial income and charges”, equal to €mil. 65

of net charges in the three quarters of 2005 compared to €nil. 26 of net charges in the same period of 2004 and of the effect of the equity investments valued at equity, equal to €nil. 24 in the 2005 period under comparison compared to a positive effect of €nil. 60 in the same period of 2004. Specifically:

	30 September 2005	30 September 2004
Dividends and gains on investments and securities	7	5
Net discounting of receivables, liabilities and provisions	(2)	(3)
Net interest	(82)	(48)
Premiums/discounts on interest rate hedging	(8)	(10)
Net results from financial instruments valued at fair value through profit or loss	15	-
Net exchange rate differences	(8)	1
Other net financial income (charges)	13	29
Total	<u>(65)</u>	<u>(26)</u>

As already discussed when preparing the Half-year Report, the Group has decided to adopt IAS 39 at 1 January 2005. As such, the income statement presented for the purposes of comparison does not include the effects of the application of this standard.

In particular:

- gains and losses through fair value measurement are not recognized;
- premiums and discounts on hedging transactions were recognized as interest on an accruals basis, whereas in 2005 they are measured at fair value as an ineffective component of the hedging instruments;
- the premiums/discounts on interest rate hedges include only those gains and charges actually realized, while the component previously recognized on an accruals basis is now recognized in accordance with the new standards under fair value through profit or loss;
- financial expense is now measured based on the effective interest rate rather than on the nominal rate. With regard solely to exchangeable and convertible bonds, this method of recognition led to higher levels of imputed interest, i.e. for which there is no actually cash outlay, of €nil. 22 compared with the same period of the previous year.

Net gains resulting from the recognition at fair value through profit or loss include the effects of derivative instruments which, although they meet the objective of limiting the fluctuations of the underlying position within a specific range, do not meet the particularly restrictive conditions of IAS 39, either because of the nature of the instruments themselves or the inability to mathematically demonstrate their effectiveness. In detail, these gains are as follows:

	<u>Income</u>	<u>Cost</u>	<u>Net</u>
Exchange rate derivatives	11	(35)	(24)
Interest rate swap	17	-	17
Options on STM	1	-	1
Option embedded in the exchangeable bond	21	-	21
	<u>50</u>	<u>(35)</u>	<u>15</u>

The gains on the option embedded in the exchangeable bond are related to the fluctuations in the fair value of the embedded option in the exchangeable bond with STM shares as the underlying asset. On 1 June 2005, the Group purchased an offsetting option with the same underlying and same key parameters as that embedded in the bonds. The recognized gain (€mil. 21) represents the difference in fair value from the date of first-time application of IAS 39 and that of the purchase of the call option. As a result of this transaction, the Group is in an essentially neutral position with regard to further variations in the fair value of the call option sold.

The other financial income includes (€mil. 18) the positive effects of the closure of previous transactions in options to hedge the investment in STM.

The effects of recognition using the equity method specifically refer to:

	<u>30 September 2005</u>	<u>30 September 2004</u>
STM results	-	88
Aero Invest 1 S.A. results	(28)	(12)
Net results of other holdings	4	(16)
	<u>(24)</u>	<u>60</u>

- “income taxes” amounted to €nil. 137 compared to the corresponding period in 2004 (€nil. 150). Taxes totalled €nil. 55 in the third quarter compared to €nil. 36 in the third quarter of 2004.

Specifically, this item represents the algebraic sum of:

	<u>30 September 2005</u>	<u>30 September 2004</u>
Corporate income tax (IRES)	69	54
Regional business tax (IRAP)	72	63
Benefit under consolidated tax mechanism	(68)	(17)
Other income taxes	33	25
Tax related to previous periods	(1)	3
Provisions for tax disputes	7	8
Deferred tax – net	25	14
	<u>137</u>	<u>150</u>

With regard to the Group Parent, the consolidated income statement includes neither current taxes (as there was no taxable income during the period under consideration) nor net deferred tax assets, as there is a lack of reasonable certainty as to the future realization of taxable income that would allow them to be recognized and a lack, with specific regard to past tax losses, of the prerequisites established by the applicable accounting standard.

- the “results of the operations identified as discontinued” have been shown separately on the income statements. Accordingly, the item includes the result for the period on the operations sold through the date of the sale:
 - for the three quarters of 2005, the result on the U.K. operations in the radar-devices segment through the sale date (29 April 2005);

- for the three quarters of 2004, the loss on the operations being sold as held by the Group in the bus manufacturing industry.

	30 September 2005	30 September 2004
	<hr/>	<hr/>
Revenues	93	58
Costs	(94)	(63)
Financial income - net	1	-
Taxes	-	-
	<hr/>	<hr/>
	-	(5)
	<hr/>	<hr/>

The Table below shows the Reclassified Consolidated Balance Sheet at 30 September 2005.

€mil.	30.09.2005	31.12.2004	30.09.2004	30.06.2005
Non-current assets	7,624	5,520	4,871	7,397
Non-current liabilities	(2,030)	(1,877)	(1,920)	(2,008)
	<u>5,594</u>	<u>3,643</u>	<u>2,951</u>	<u>5,389</u>
Inventories	5,281	4,589	3,872	5,161
Contract work in progress	2,909	2,169	2,308	2,671
Trade receivables	3,623	3,353	2,956	3,610
Trade payables	(2,930)	(2,832)	(2,460)	(3,024)
Advances from customers	(3,957)	(3,214)	(2,713)	(3,713)
Short-term provisions for risks and charges	(588)	(514)	(333)	(573)
Other net current assets (liabilities)	(3,059)	(2,975)	(2,172)	(3,030)
Net working capital	<u>1,279</u>	<u>576</u>	<u>1,458</u>	<u>1,102</u>
Net invested capital	<u>6,873</u>	<u>4,219</u>	<u>4,409</u>	<u>6,491</u>
Group shareholders' equity	4,195	3,627	3,222	4,100
Minority interests	443	22	(1)	449
Shareholders' Equity	<u>4,638</u>	<u>3,649</u>	<u>3,221</u>	<u>4,549</u>
Net financial debt (cash and cash equivalents)	<u>2,245</u>	<u>701</u>	<u>1,208</u>	<u>1,952</u>
Net (assets) liabilities held for sale	<u>(10)</u>	<u>(131)</u>	<u>(20)</u>	<u>(10)</u>

“Non-current assets” (€mil. 7,624 at 30 September 2005 compared to €mil. 5,520 at 31 December 2004) show a net increase of €mil. 2,104.

	30 September 2005	31 December 2004
Intangible Assets	3,765	2,225
Property, plant and equipment	2,415	2,300
Investment properties	2	2
Equity investments	137	639
Financial assets at fair value	856	-
Securities held to maturity	1	1
Receivables	117	86
Deferred tax assets	321	250
Other assets	10	17
	<u>7,624</u>	<u>5,520</u>

Specifically:

- due to the net increase of €nil. 1,521 in goodwill, mainly due to the acquisition, within the scope of the broader reorganization of the Group's assets in the Defence Electronics segment, of a majority stake (75%) in Selex Sensors and Airborne Systems S.p.A. (the parent of the avionics business that includes Galileo Avionica S.p.A. and the U.K. firm Selex Sensors and Airborne Systems Ltd.) and to the acquisition of the equity investments held by Alcatel Alenia Space SAS and Telespazio Holding S.r.l. joint ventures. The remaining increases are essentially related to the full consolidation of Selex Sistemi Integrati S.p.A., which was previously consolidated on a proportional basis at 50%, as the remaining share returned to the Group following the dissolution of the AMS NV joint venture;
- due to the net effect of the decrease of €nil.502 in equity investments, attributable to both the reclassification made following the recognition of the interest held indirectly in STM (€nil. 442) under the "financial assets at fair value" and the partial repayment of capital by Aero Invest 1 S.A. (€nil. 68);
- due to the effect of the indirect interest in STM (equal to 6.6% at 30 September 2005) valued under "financial assets held at fair value"; below is the breakdown over the period:

<i>1 January 2005</i>	-
Reclassification from investments in associates	442
Fair value adjustment at 1 January 2005	408
Fair value adjustment at 30 September 2005	6
<i>30 September 2005</i>	<u>856</u>

The increase in value from 1 January 2005 to 30 September 2005, as well as the fair value adjustment at 1 January 2005, was also recognized in the specific equity reserve.

- due to investment, opening of loans and repayments and amortisation activities in the period;
- due to a net decrease in values deriving from exchange rate differences consequent to the translation of the financial statements in foreign currency (mainly dollars and sterling).

“Non-current liabilities”, equal to €mil. 2,030 at 30 September 2005 compared to €mil. 1,877 at 31 December 2004, showed a net increase of €mil. 153.

	30 September 2005	31 December 2004
Severance pay and other employee liabilities	1,116	983
Provisions for risks and charges	472	587
Deferred tax liabilities	96	87
Other liabilities	346	220
	<u>2,030</u>	<u>1,877</u>

Specifically:

- due to the net increase of €mil. 133 in the item “Severance pay and other employee liabilities” following the reviews of the “defined benefit plans” made by the British companies of AgustaWestland and to the entry of Selex Sensors and Airborne System Ltd. and Alcatel Alenia Space SAS in the scope of consolidation;
- due to the net decrease of €mil. 115 in the “provisions for risks and charges”, in particular for uses and reclassifications of the short-term portions of the provisions for product guarantees and of the reorganisation and restructuring fund;
- due to the net increase of €mil. 126 in the “other liabilities”, attributable in particular to deferred income, payables to personnel and other payables.

“Net working capital” shows a net value equal to €mil. 1,279 compared to a net value of €mil. 576. at 31 December 2004. More specifically:

- “inventories” are equal to €mil. 5,281 compared to €mil. 4,589 in the previous financial year:

	30 September 2005	31 December 2004
Raw materials and consumables	1,256	1,075
Work in progress and semi-finished goods	3,315	2,970
Finished goods and merchandise	165	132
Advances to suppliers	545	412
	<u>5,281</u>	<u>4,589</u>

- Work in progress includes assets defined according to Group practice as non-recurring costs (€mil. 2,523 at 30 September 2005), which are largely related to programs in the aeronautics (€mil. 1,311) and helicopter (€mil. 732) segments. Inventories are shown net of impairment charges of €mil. 400 (€mil. 414 at 31 December 2004);
- “Contract work in progress” are equal to €mil. 2,909 compared to €mil. 2,169 at 31 December 2004); “advances received” are equal to €mil. 3,957 compared to €mil. 3,214 at 31 December 2004:

	30 September 2005	31 December 2004
Contract work in progress (gross)	6,080	4,742
Advances from customers	(3,171)	(2,573)
Contract work in progress (net)	<u>2,909</u>	<u>2,169</u>
Advances from customers (gross)	10,684	9,874
Contract work in progress	(6,727)	(6,660)
Advances from customers (net)	<u>3,957</u>	<u>3,214</u>

- “Trade receivables and payables”, equal to €nil. 3,623 and €nil. 2,930 respectively, compared to €nil. 3,353 and €nil. 2,832 , show a positive net balance equal to €nil. 172:

	30 September 2005		31 December 2004	
	Receivables	Payables	Receivables	Payables
Receivable from associates and subsidiaries not fully consolidated	206	23	228	35
Receivable from consortia	-	-	78	3
Receivable from other partners of the MBDA JV	36	14	38	-
Other third parties	3,381	2,893	3,009	2,794
	<u>3,623</u>	<u>2,930</u>	<u>3,353</u>	<u>2,832</u>

- “Provisions for risks and charges”, equal to €nil. 588, showed a net increase of €nil. 74 compared to €nil. 514 at 31 December 2004. The most significant allocations were for product guarantees and contractual penalties. The most significant uses and overuses were for contractual risks, guarantees given and for the cost of restructuring begun in the previous financial years.

With regard to the risk provisions, note that the Finmeccanica Group’s business regards industries and markets where many disputes (connected with credit and debit positions) are settled only after a considerable period of time, especially in cases where the customer is a government entity.

Based on the information currently available, it is believed that the various issues that could result in an outflow of resources, and which are not covered by a specific provision, can be resolved in a satisfactory manner without a significant impact on earnings.

Of course, in application of related accounting standards, provisions have been made for any obligations related to probable and quantifiable risks. The situations below do not fall under this category, but are mentioned here solely for the purposes of full disclosure.

Of particular note:

- the dispute in which Finmeccanica has been asked to cover the contractual commitments assumed upon the sale of the former subsidiary Finmilano S.p.A. to Banca di Roma (now Capitalia) originated from the assessment ordered by the Rome Office of Direct Taxes of Finmilano S.p.A. regarding the disallowance of the tax deductibility of the capital loss originating in 1987 on the sale of a non-recourse “deferred” receivable as a price below the nominal value. In essence, the Italian tax authorities felt that this sale was actually a financing transaction and that the loss, in the same manner as a finance cost, should not have been deducted in its entirety in 1987, but should have been recognized over subsequent years as implicit interest in the transaction.

After the Court of Cassation (the supreme court of appeal) – in allowing the appeal filed by the tax authorities – had returned the parties to the court of first instance, the latter once again upheld the company’s complaint. This ruling was once again appealed to the Court of Cassation. It should be noted that substantial charges to be paid by Finmeccanica are not currently foreseeable. In agreement with the bank, it has been deemed that there is insufficient justification to accept the settlement of pending disputes pursuant to Article 16 of Law 289/2002, partly light of the fact that the significant financial outlay that this would have required does not make sense from a cost-benefit point of view;

- in July 2001, the company received the notice to settle the registry fee of about €mil. 10 due on the capital increase approved in 1998. Although the tax liability had already been recognized in the related financial year, the company felt it was unnecessary to meet the tax demand because it was unjustified both in law and in fact. In fact, in addition to being received after statutory deadline, the notice contained a request for a tax related to a tax base that was partially inconsistent with applicable laws. The Tax Commission for the Province of Rome upheld the company’s dispute in its ruling filed in December 2002. The ruling was appealed by the company in relation to the failure to order the tax authorities to reimburse costs. In the first half of 2004, the tax authorities in turn filed a cross appeal of the same ruling, but only with regard to the decision that confirmed the

termination of the office's assessment power in the matter. No objection was raised, however, with regard to the substance of the original ruling establishing the partial lack of justification of the amount requested by the revenue office. In a ruling filed in October 2004, the appeal court rejected the company's primary appeal regarding the lack of reimbursement of costs, but at the same time declared that the cross appeal filed by the tax authorities was inadmissible in that it was filed after the ordinary statutory deadlines. In particular, the Regional Tax Commission in Rome upheld the complaint filed by the company regarding the fact that the tax authorities had erroneously deemed the suspension of the procedural deadlines defined by Article 16 of Law 289/02 (facilitated settlement of pending disputes) to be applicable, given that the case did not fall within the scope of this law. The sentence of the court of second instance has been appealed to the Court of Cassation by the tax authorities.

- the appeal, together with ENEL and other parties, filed with the Regional Administrative Court of Lombardy of the resolution of the Italian Electricity and Gas Authority regarding the method of calculating interest due on amounts to be paid, as compensation, in relation to the termination of the Italian national nuclear energy programme.

The amount of interest that would result from a different calculation method amounts to roughly €mil. 13. Previous rulings by the Lombardy Regional Administrative Court do not support the resolutions of the Authority. Accordingly, it is reasonable to expect a favourable outcome for Finmeccanica;

- on 6 July 2001, Finmeccanica and its subsidiary Alenia Spazio (now ALS S.p.A.) received notice of a summons to appear before the Texas Federal Court to respond to a request for damages resulting from the alleged violation of agreements as part of the Gorizont program, which is related to the events of 1998-1999 when Alenia Spazio operated as a division of Finmeccanica (on 9 July 2001, Alenia Spazio alone received a second summons to appear before the court for the same issue).

Four years after they began, the two cases are still addressing the preliminary matter of jurisdiction.

Based on an examination of the case files by U.S. lawyers, the company feels there are valid reasons to contest the substance of the demands of the plaintiffs;

- arbitration is under way to settle a dispute between Consorzio Trevi – of which the subsidiary AnsaldoBreda S.p.A. is a member with a 40% stake – and Trenitalia S.p.A. in relation to the application of penalties for the late delivery of ETR 500 trains. Consorzio Trevi has contested the penalties and has requested reimbursement of the significant additional costs incurred. The arbitration board arranged for the issues involved in the arbitration to be examined by an independent expert. The expert's report was filed on 10 January 2005. Consorzio Trevi feels that the results of this investigation support its position. However, on 19 October 2005, the Arbitration Board arranged, at the request of Trenitalia, additional consultancy which shall be concluded by 30 January 2006;

- on 1 October 2003, the European Commission notified the Ministry of Foreign Affairs of the formal proceedings initiated for an investigation of the Italian State, pursuant to Article 11 of the EU Treaty, in relation to subsidies granted by the Italian Government to the companies Alenia Aeronautica S.p.A., Aermacchi S.p.A., and Agusta S.p.A., based on Law 808/85, for six research and development projects. The Commission considers the subsidies to be state aid. The preliminary assessment of the Commission was that these subsidies were not reported to the Commission at the time, even though they were each in excess of the ECU 20 million threshold (1 ECU being equal to 1 euro). On 22 January 2004, the decision to open proceedings was published in the EU *Official Journal*. The Italian authorities submitted their own observations to the Commission on 30 January 2004.

In response to requests of third parties, the Commission requested further information from the Italian Government, which was provided in the latter part of May 2004. Further exchanges of requests and information between the Commission and the Italian Government continued in the second half of the year. With its letter of 22 June 2005 C(2005)1813, received by the Permanent Representation of Italy in the EU on 24 June, the European Commission

informed the Italian Government of its decision to extend the scope of the current proceedings to an additional six projects of the aforementioned companies that had initially been excluded by the Commission itself. The Italian authorities are currently preparing a reply.

- “other net current assets (liabilities)”, equal to €nil. 3,059 of net liabilities showed an increase of €nil. 84 compared to €nil. 2,975 of net liabilities at 31 December 2004:

	30 September 2005		31 December 2004	
	Assets	Liabilities	Assets	Liabilities
Employee obligations	22	296	28	241
Deferred income	159	160	109	187
For direct taxes and other taxes	442	246	372	173
Social security payable	15	142	-	177
Payable to Min. of Prod. Act. - Law 808/1985	-	2,762	-	2,589
Payable to associates, consortia and subsidiaries not fully consolidated	70	53	49	41
Derivatives	84	122	-	-
Other payables	324	394	322	447
	<u>1,116</u>	<u>4,175</u>	<u>880</u>	<u>3,855</u>

The table below provides a detail of the asset and liability positions related to derivative instruments:

	30 September 2005		1 January 2005		31 December 2004	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Forex instruments	36	88	80	24	-	-
Interest rate swaps	17	16	-	18	-	-
Options on STM	13	-	39	-	-	-
Exchangeable bond option	18	18	-	39	-	-
	<u>84</u>	<u>122</u>	<u>119</u>	<u>81</u>	<u>-</u>	<u>-</u>

Forex instruments

The Group hedges its own exposure to exchange rate risk by utilising forward instruments and forex options.

The notional value of the forward transactions totalled €mil. 1,992, €mil. 1,061 of which is related to contracts to sell and €mil. 931 to contracts to buy, primarily US dollars. Under Group procedures, forward instruments are purchased with the intent to hedge certain or highly probably commitments and, as such, are designated as hedging instruments at the time of purchase. The effectiveness of the hedge is tested at least at each interim or year-end reporting date using mathematical and statistical methods. In the event that, due to its nature or following such tests, a derivative instrument held should be found to no longer be an effective hedge, the fair value of the instrument is immediately recognized through profit or loss (income of €mil. 10 at 30 September 2005). In the event the designation of the instrument as a hedge should continue to be supported by the tests of actual and future effectiveness, the cash-flow hedge accounting method of recognition is adopted (see the specific note in the section of the accounting policies).

In consideration of the persistent unfavourable trend in the euro-dollar exchange rate in recent years, the Group has hedged a portion of its order portfolio by systematically hedging cash inflows and payments through the use of options that - in accordance with the objective of not exposing the Group to risks in excess of those that are already implicit to its lines of business- have made it possible to minimize the cost of the transaction, allowing the exchange rate in question to fluctuate within a specified range (and in any event more advantageous than that in which the contract is measured). Given their nature and the particularly restrictive requirements of IAS 39, these instruments do not qualify for hedge accounting. Accordingly, both the derivative and the underlying position are measured at fair value calculated based on the forward exchange rate at the balance sheet date. This method of recognition produced net financial expense of €mil. 34. The distortional effect on the income statement is due to the fact that the fair value of the derivative is measured based on the entire notional, whereas the recognition through profit or loss of the hedged orders is limited to the portion of the contract work in progress that has been recognized in the financial statements. The notional value of

these transactions at 30 September 2005 is €mil. 1,432 and is almost exclusively related to the sale of US dollars.

Interest rate swap

At 30 September 2005, the Group held interest rate swaps totalling €mil. 790. A detail of the main instruments is as follows:

Description	Notional	Underlying position	
Fixed/floating/fixed swap	€500m	Bonds – 2003	(a)
Fixed/floating /fixed swap	€100m	Bonds – 2005	(b)
Floating/fixed swap	€190m	Bonds – 2002	(c)
Interest rate options	€200m	Bonds – 2005	(a)

- (a) The transaction was carried out to benefit from low short-term interest rates without, however, exposing the Group to the risk of any subsequent increases. As such, the exposure was converted to a floating rate through 19 December 2005 and back to fixed (5.80% average) after that date.

The instruments purchased also include a number of interest rate options that enable the company to protect portion of the debt portfolio exposed to floating rates and to switch to floating for additional portions of the debt.

In application of IAS 39, the transaction was measured at fair value through profit or loss, thereby generating a profit of approximately €mil. 7. At 30 September 2005, the fair value of the instrument was approximately €mil. 6.

- (b) The transaction was carried out in order to earn short-term benefits from low interest rates. In application of IAS 39, the transaction was measured at fair value through profit or loss, thereby generating a profit of approximately €mil. 10.
- (c) The transaction makes it possible to limit exposure to future changes in the reference interest rate (6-month Euribor) and has been recognized as a cash-flow hedge. At 30 September 2005, the fair value of the instrument was a negative €mil. 6.

This item also includes other minor transactions with a total negative fair value of €mil. 1 and a floating/fixed interest rate swap carried out by the helicopter-related joint venture ATIL, the fair value of which was a negative €mil. 9 at 30 September 2005, and recognized as a cash-flow hedge.

The transactions implemented by the Parent Company and by the ATIL JV and recognized as cash-flow hedges have resulted in a negative reserve at 30 September 2005 in the amount of €mil. 15 (€mil. 13 at 1 January 2005), whereas those that have been recognized at fair value through profit or loss as a result of the particularly restrictive conditions defined by IAS 39 have produced financial income totalling approximately €mil. 17.

Options on STM

This item includes transactions to hedge a portion of the remaining portfolio of STM securities, which numbered 35,000,000 at 31 December 2004. These instruments have been measured at fair value through profit or loss. A portion of the transactions (for a total of 15,000,000 securities) came to a close during the first half and generated an inflow of €mil. 45 and a gain of €mil. 18, in addition to the recognition of the fair value previously recognized as an increase to equity (€mil. 27), while the remaining portion resulted in a recognized gain on the increase in the fair value of the securities totalling €mil. 1.

Exchangeable bond options

This item includes the liability related to the call option embedded in the exchangeable bonds. On 1 June 2005, the Group purchased a call option with the same key parameters in order to hedge future changes in the value of the option sold. This transaction led to a gain of €mil. 21.

equal to €mil. 6,873 (€mil. 4,095 at 31 December 2004) is covered by the shareholders' equity for €mil. 3,717 (€mil. 3,724 at 31 December 2004), and by the net financial debt for €mil. 901 (€mil. 371 at 31 December 2004).

“Net invested capital” and “assets held for sale”, equal to €mil. 6,873 (€mil. 4,219 at 31 December 2004) and €mil. 10 (€mil. 131 at 31 December 2004) respectively, are covered by the shareholders' equity for €mil. 4,638 (€mil. 3,649 at 31 December 2004) and by the net financial debt for €mil. 2,245 (€mil. 701 at 31 December 2004).

The Table below shows the consolidated net financial debt at 30 September 2005, together with the corresponding figure at 30 June 2005, at 1 January 2005, at 31 December 2004 and at 30 September 2004 for comparison purposes.

	30.09.05	01.01.05	30.06.05	31.12.04	30.09.04
Short-term financial payables	504	1,079	385	1,083	1,097
Medium/long-term financial payables	1,954	1,443	1,884	1,551	1,438
Cash and cash equivalents	(438)	(2,055)	(588)	(2,055)	(1,422)
BANK AND BONDED					
DEBT	2,020	467	1,681	579	1,113
Securities	(20)	(33)	(33)	(33)	(22)
Financial receivables from Group companies	(38)	(89)	(40)	(89)	(118)
Other financial receivables	(337)	(445)	(358)	(445)	(409)
FINANCIAL RECEIVABLES AND	(395)	(567)	(431)	(567)	(549)
SECURITIES					
Financial payables to Group companies	304	456	325	456	340
Other short-term financial payables	221	647	279	130	168
Other medium/long-term financial payables	95	103	98	103	115
OTHER FINANCIAL PAYABLES	620	1,206	702	689	623
NET FINANCIAL DEBT					
(CASH)	2,245	1,106	1,952	701	1,187
Net debt attributable to discontinued operations	-	(61)	-	(61)	17

The Group's net financial debt totalled €mil. 2,245 at 30 September 2005, compared to a debt of €mil. 701 at 31 December 2004, after recording a net debt of €mil. 1,952 in June.

From a structural point of view, the trend confirms the dynamics of the Group's payments and receipts, the latter usually squeezed in the final part of the financial year, particularly from the Public Administration. There are quite a few doubts as to whether such sums will be actually collected in full at this time.

The three quarters figures are also influenced by the effects related to the following non-current transactions:

- the agreement with Bae Systems for the reorganisation of the Defence Electronics sector (as commented above) whose overall net impact on the Group financial position, at the date the agreements were signed (29 April 2005) was

€nil. 718. This value is reduced to a net cash outlay of €nil. 528 as a result of the balance paid by BAE for its portion;

- the disbursement of €nil. 109 relating to the establishment, within the completion of the understanding with Alcatel in the Space sector, of the following JVs:
Alcatel Alenia Space, 33% owned by Finmeccanica and 67% owned by Alcatel, to which the satellite production activities were contributed, and TeleSpazio Holdings, 67% owned by Finmeccanica and 33% owned by Alcatel, to which ground satellite activities were contributed;
- the dividends related to the 2004 financial year paid by Finmeccanica for an amount of €nil. 110, growing with respect to the dividend previously distributed, which was €nil. 84 per year in the last three years;
- the collection of €nil. 68 realized in the month of April related to the proportional repayment of part of the share capital to shareholders Finmeccanica and Carlyle by the company Aero Invest 1 SA (the company holding the share capital of Avio S.p.A.).

Finally, take note that the financial position also benefited for the first time from the offset mechanism originating from application of the consolidated tax base which the Finmeccanica Group joined in 2004; this has entailed a lower expense of approximately €nil. 63 in the three quarters.

As regards the composition of debt, with reference to bank debt in particular, there has been a decrease in bank and bonded debts from €nil. 2,522 (at 1 January 2005) and €nil. 2,634 (at 31 December 2004) to €nil. 2,458, essentially due to the combined effect of the following transactions:

- completion of the new €nil. 500 bond issue of Finmeccanica S.p.A.. This transaction, thanks also to the combined effect of the repayment of the Finmeccanica as commented below, also allowed to extend the average life of the debt from 5 to 10.4 years;

- repayment of the debenture loan exchangeable in shares, issued in June 2000 by Finmeccanica S.p.A. which, having reached its natural maturity date, was settled on 8 June 2005 for an amount of approximately €mil. 953, of which €mil. 878 related to principal.

Cash and cash equivalents amounted to €mil. 438 at 30 September 2005, compared to €mil. 2,055 at 31 December 2004. The reduction of available cash contributed to covering the financial requirements for the period, both strategic and operational. The outstanding liquidity at that date is mostly available to the Parent Company and partly to the subsidiaries. Furthermore, take note that process is underway to centralise the cash and signature activities and foreign currency operations of the recently-acquired foreign companies, which should be concluded within the current year, thus also allowing a better financial supervision and control of these companies.

As regards the composition of the remaining debt items, in particular, note that the item *other financial receivables* includes approximately €mil. 288, equal to the unconsolidated portion of financial receivables that the joint venture MBDA holds vis-à-vis other shareholders in implementation of the treasury agreements entered into at that time. In compliance with the consolidation method used, these receivables are included in the Group's scope of consolidation on a proportional basis, as well as all the other data. The item *financial payables to Group companies* includes the debt of €mil. 288 of a Group company toward the joint venture, for the unconsolidated portion.

Moreover, the financial debt includes the residual effects of transactions related to the assignment of receivables which, though legally classified as “without recourse”, with no repurchase clause upon the Group, for accounting purposes, entail (pursuant to IAS 39) keeping the transferred asset under the assets side of the balance sheet, until collection by the factor of the amount due from the assigned debtor. The residual amount of these transactions was equal to €mil. 167 at 30 September 2005 (€mil. 526 at 1 January 2005).

	For the three quarters ended 30 September	
	2005	2004
Cash and cash equivalents at 1 January	2,055	2,259
Cash flow from operating activities	812	615
Changes in working capital	(887)	(889)
Changes in other operating assets and liabilities	(430)	(373)
Cash flow generated from (used in) operating activities	(505)	(647)
Cash flow from ordinary investing activities	(145)	132
Free operating cash flow	(650)	(515)
Strategic investments	(637)	(96)
Cash flow generated from (used in) investing activities	(782)	36
Dividends paid	(111)	(88)
Cash flow from financing activities	(227)	(126)
Cash flow generated from (used in) financing activities	(338)	(214)
Translation difference	8	(12)
Cash and cash equivalents at 30 September	438	1,422

The three quarters of the 2005 financial year closed with a net decrease of cash and cash equivalents equal to €nil. 1,617, attributable to the following factors:

- operating cash flow negative for €nil. 505, despite being in considerable progress with respect to the corresponding period of the previous financial year (showing a negative operating cash flow of €nil. 647), essentially due to the seasonality of collections of the reference business, usually concentrated in the last months of the financial year;
- cash flow from investing activities negative for €nil. 782 (€nil. 36 at 30 September 2004), due mainly to the effects of redefining Group business in the Defence Electronics and Space sectors, which has led to a net outlay for acquisitions of a total of €nil. 637;

- cash flow from financing activities negative for €mil. 338 (€mil. 214 at 30 September 2004), mainly due to repayment of the convertible debenture loan which matured in June 2005 (€mil. 953, including interest related to the last coupon and the additional interest recognised upon settlement of the debt) and payment of dividends related to the 2004 financial year (€mil. 110 relating to the Parent Company and €mil. 1 relating to minority interests), partly offset by the placement in March 2005 of a new €mil. 500 bond issue.

Financial risk management

Within the scope of the policies of the Group Parent aimed at centralizing the financial management of the Group, this section describes the operating criteria adopted to manage foreign exchange risk, interest rate risk and price risk.

Finmeccanica's adoption of the International Financial Reporting Standards (IFRS) has led to substantial differences in the management of and exposure to derivatives.

Some of the main changes from the previous Italian accounting standards include the adoption of the fair value method of measuring the total portfolio of derivative instruments. Whereas in the past derivative transactions intended to hedge specific underlying positions were not valued at market prices, but merely reported in memorandum accounts, the new standards call for their measurement at fair value with entries on the balance sheet or income statement depending on whether a given derivative is classified as being for hedging or trading purposes.

The *management of foreign exchange risk* is governed by the directive issued by Finmeccanica in December 2002, which is being updated in order to ensure its compatibility with the new standards. The goal of the directive remains that of creating uniformity in management criteria based on industrial - not speculative - strategies so as to contain risks within specific limits by carefully and constantly assessing all foreign currency positions. The methodology adopted calls for the systematic hedging of commercial cash flows resulting from the assumption of contractual commitments of a specific nature as either buyer or seller, thereby ensuring current exchange rates at the date of acquisition of multi-year contracts and neutralizing the effects of exchange rate fluctuations. Therefore, at the moment of receiving payment from a customer (or making payment to a vendor), which takes place at the current exchange rate on that day, the related hedging transactions are extinguished in order to offset the effects of the difference between the current exchange rate and the rate of the hedging instrument. These transactions are carried out exclusively with banks by Finmeccanica's Finance Department and then matched with the companies of the Group. The companies that have the greatest need for such hedging transactions are: Alenia Aeronautica and its subsidiaries, Ansaldo Energia, Oto Melara, Alcatel Alenia Space Italia, Galileo

Avionica, AnsaldoBreda, AgustaWestland and its subsidiaries, and Selex Communications and its subsidiaries. At 30 September 2005, Finmeccanica had outstanding foreign exchange transactions with banks in the interest of other Group companies totalling €mil. 3,424, €mil. 1,992 of which for swaps and forwards and €mil. 1,432 for foreign exchange options. The total fair value of these transactions was a negative €mil. 52. Change compared to 1 January 2005 is due to the downturn in the €/\$ exchange ratios, in addition to the entry of the Alcatel Alenia Space joint venture, consolidated on a proportional basis, in the scope of consolidation (€mil. 27).

The IFRS and the related interpretations effectively make a distinction between derivatives considered to be held for hedging purposes, and for which it is possible to apply hedge accounting, and those that are not eligible for hedge accounting and which must be recognized at fair value through profit or loss.

With regard to commercial contracts that under previous GAAP were considered to be hedged by options, the fair value is calculated for the portion of commercial activities already invoiced and for work in progress. The portion of the commercial portfolio subject to fair value measurement will always be nominally less than that of the derivatives, which are used to hedge risk throughout the entire life of the contracts. These distortional effects on the income statement are described in the section relating to derivative instruments. The same concept also applies to the portion of the commercial portfolio hedged with foreign exchange transactions that qualify for hedge accounting, with the difference being that the volatility experienced will be reflected in equity.

In any event, the Finmeccanica Group does not have financial transactions of a speculative nature, in the sense that none of its transactions add risk to that which is already implicit in its operations. On the contrary, in compliance with the Group directive, all existing financial transactions have the specific objective of eliminating or minimizing such risks.

The *management of interest rate risk* is consistent with the longstanding practice of reducing the risk of fluctuations in interest rates while seeking to minimize related financial expense. To that end, at 30 September Finmeccanica had outstanding interest rate swaps for medium and long-term financing with highly rated financial counterparties totalling €mil. 790. These transactions are focused on benefiting from the

low level of short-term floating interest rates while protecting the company against any increases that are more likely take place beyond 2005 by returning the debt structure to fixed rates. At 30 September 2005, the total fair value of the interest rate derivatives portfolio was a positive €nil. 1, as compared with the negative €nil. 18 at 1 January 2005. At 30 September 2005, the transactions for which it was possible to adopt hedge accounting had a negative fair value of €nil. 15, compared with the negative €nil. 13 at 1 January 2005, a deterioration of €nil. 2 during the period. At the same date, transactions not eligible for hedge accounting had a positive net fair value of €nil. 16, compared with the negative €nil. 5 at 1 January 2005, an improvement of €nil. 21. The restrictive IFRS standards and related interpretations make it necessary to consider certain transactions as speculative even when they are essentially intended to contain finance costs without exposing the Group to excessive risk in the event of rising interest rates.

During the first half of the year, taking advantage of the opportunities offered interest rate developments, transactions were closed that led to gains of about €nil. 6.

The *management of price risk* on equity concerns the management of the indirect investment held in STMicroelectronics NV (STM). At the date of the adoption of IAS 32 and 39 (1 January 2005), the Group had outstanding hedges for a total of 35 million STM shares in order to protect a portion of the remaining portfolio of STM stock immediately available to Finmeccanica (totalling 39.7 million shares, in addition to the further 20 million shares backing the bond that can be converted into STM shares in the amount of €nil. 501 with a maturity of 2010: these additional shares are therefore unavailable to the Group). In response to the declining stock price during the period, hedging transactions were concluded for 15 million STM shares, resulting in an inflow of €nil. 45 and a gain of €nil. 18. The options on the remaining 20 million STM shares have been classified as trading securities, and the recognition of the fair value through profit or loss of these instruments led to a gain for the period of €nil. 1.

At the beginning of June, a call option was purchased for STM stock for €nil. 17, which duplicates and neutralizes the option sold with the convertible STM bond, expiring in 2010. The purpose of the transaction was to sterilize the effects of the separation, under IFRS, of the debt component from the option, thereby allowing Finmeccanica to

recognize consolidated revenue of roughly €nil. 21, which is the difference between the value of the option sold in the exchangeable bond at 1 January 2005 and the purchase price of the new option. Finmeccanica also finalized negotiations that make it possible to free up the 20 million STM shares used to guarantee the bond and replace them with the option purchased, thereby making these shares available to the Group.

Transactions with related parties

In general, commercial relations with related parties are carried out at arm's length, as is settlement of the interest-bearing receivables and payables when not governed by specific contractual conditions. Below is a table of the most significant amounts:

<i>(millions of euros)</i> RECEIVABLES AT 30.09.2005	Non- current receivables	Current financial receivables	Trade receivables	Other current receivables	Total
<u>Subsidiaries</u>					
Bredamenarinibus S.p.A.			1	26	27
Gieinter A.G.		11			11
Ansaldo Argentina S.A.		3	1		4
E-Geos S.p.A.			4		4
Lumiq S.p.A.			3		3
CLC S.r.l. (in liq.)				3	3
Ansaldo Invest Denmark A/S (in liq.)				3	3
Finmeccanica Inc.		2			2
IGS S.p.A. (in liq.)		2			2
Finmeccanica UK Ltd		2			2
Alifana Due S.c.r.l.			1		1
S.I.C.A. S.p.A. (in liq.)		1			1
Oto Melara North America Inc.		1			1
<u>Associates</u>					
Eurofighter Jagdflugzeug Gmbh			74		74
Iveco Fiat/Oto Melara S.c.r.l.			46		46
Macchi Hurel Dubios S.A.S.			17		17
Bell/Agusta Aer. Co. LLC			12		12
Eurosynav S.A.S.			6		6
Euromids S.A.S.			6		6
Eurofighter Simulation System Gmbh			4		4
Elettronica S.p.A.		1	2		3
Sostar GMBH			3		3
Orizzonte - Sistemi Navali S.p.A.			2		2
Nicco Communications S.A.S.			2		2
Iniziativa Industriali Milano S.r.l. (in liq.)				2	2
I.M. Intermetro S.p.A.			2		2
NH Industries S.a.r.l.			1		1
Advanced air traffic Systems (M) SDN BHD			1		1
Ind. Aer. Meccaniche Piaggio S.p.A. (Am. Str.)			1		1
Comlenia (M) SDN BHD			1		1
Consorzio Start S.p.A.			1		1
Remington Elsas Low Enforcement Sys. LLC			1		1
<u>J.V. (*)</u>					
GIE ATR				36	36
MBDA S.A.S.			36		36
Alcatel Alenia Space S.A.S.			16		16
Aviation Training Int. Ltd	12	1			13

(*) Amounts refer to the portion not eliminated for consolidation.

(millions of euros)

LIABILITIES AT 30.09.2005

	Non-current liabilities	Current borrowings	Trade payables	Other current payables	Total
<u>Subsidiaries</u>					
S.I.C.A. S.p.A. (in liq.)		3			3
CLC S.r.l. (in liq.)		2			2
Bredamenarinibus S.p.A.			2		2
Finmeccanica Inc.			1		1
Alifana Due S.c.r.l.			1		1
Fata Handling S.p.A. (in liq.)				1	1
Selex Sensor Airborne Syst. El (Overseas) Ltd			1		1
Alifana S.c.r.l.			1		1
<u>Associates</u>					
Bell Agusta Aer. Co LLC				46	46
Eurofighter Jagdflugzeug Gmbh			7		7
Iveco Fiat/Oto Melara S.c.r.l.				5	5
Pegaso S.c.r.l.			3		3
Jiangxi Ch'ange Agusta Helicopter Co Ltd	2				2
Dataspazio S.p.A.			1		1
Europea Microfusioni Aerospaziali S.p.A.	1				1
Elettronica S.p.A.			1		1
Macchi Hurel Dubois S.A.S.			1		1
Orizzonte Sistemi Navali S.p.A.				1	1
Eurofighter International Ltd	1				1
<u>J.V. (*)</u>					
MBDA S.A.S.		288	14		302
Telespazio S.p.A.		4			4
Eurimage S.p.A.		1			1
Alcatel Alenia Space S.A.S.			3		3

(*) Amounts refer to the portion not eliminated for consolidation.

(millions of euros)

RECEIVABLES AT 31.12.2004

	Non-current receivables	Current financial receivables	Trade receivables	Other current receivables	Total
<u>Subsidiaries</u>					
SIAl Marchetti S.r.l. (in liq.)				14	14
CLC S.r.l (in liq.)				3	3
Advanced Logistic Techn. Eng. Center S.p.A.			1		1
GIEINTER AG		9			9
<u>Associates</u>					
Eurofighter Jagdflugzeug Gmbh			125		125
Alenia Marconi Systems Holdings NV		47			47
Macchi Hurel Dubios S.A.S.			12		12
Eurofighter Simulation System Gmbh			2		2
Bell Agusta Aer. Co			11		11
Euromids S.A.S.			10		10
Eurosynav S.A.S.			31		31
Orizzonte - Sistemi Navali S.p.A.			2		2
Elettronica S.p.A.			4		4
Iniziativa Industriali Milano S.r.l. (in liq.)				2	2
Intermetro S.p.A.			2		2
Sostar GMBH			2		2
<u>J.V. (*)</u>					
MBDA S.A.S.			38	1	39
Alenia Marconi Systems S.p.A.			24		24
Alenia Marconi Systems Ltd			2		2
GIE ATR				27	27
Aviation Training Int. Ltd	12				12

(millions of euros)

LIABILITIES AT 31.12.2004

	Non-current liabilities	Current borrowings	Trade payables	Other current payables	Total
<u>Subsidiaries</u>					
S.I.C.A. S.p.A. (in liq.)		3			3
Alifana Due S.c.r.l.			2		2
<u>Associates</u>					
Bell Agusta Aer. Co				41	41
Eurofighter Jagdflugzeug Gmbh			7		7
Pegaso Scrl			5		5
Europea Microfusioni Aerospaziali S.p.A.		3			3
Dataspazio S.p.A.			2		2
Elettronica S.p.A.			1		1
<u>J.V. (*)</u>					
MBDA S.A.S.			8		8
Alenia Marconi Systems S.p.A.			15		15

(*) (*) Amounts refer to the portion not eliminated for consolidation.

(millions of euros) 30.09.2005

	Revenue	Financial income	Purchases and costs	Financial expense
<u>Subsidiaries</u>				
Finmeccanica Inc.			2	
Oto Melara North America Inc.			1	
<u>Associates</u>				
Eurofighter Jagdflugzeug GMBH	398			
Iveco Fiat/Oto Melara S.c.r.l.	40			2
Eurosynnav S.A.S.	24			
Eurofighter Simulation Systems GMBH	11			
Euromids S.A.S.	11			
Dataspazio S.p.A.			7	
NH Industries S.A.R.L.	5			
Nicco Communications S.A.S.	4			
Orizzonte Sistemi Navali S.p.A.	2		2	
Consorzio Start S.p.A.	1			
Elettronica S.p.A.	1		1	
Lockheed Martin Alenia Tactical Transport Systems LLC	1			
Sostar GMBH	3			
<u>J. V. (*)</u>				
MBDA S.A.S.	37			5
GIE ATR	17			
Alenia Marconi Systems S.p.A. (++)	4			
AMS LTD (++)				1
Telespazio S.p.A. (+)			1	
Alcatel Alenia Space S.A.S. (+)	4		3	

(*) Amounts refer to the portion not eliminated for consolidation

(+) Beginning 1 July 2005

(++) Until 29 April 2005

(millions of euros) 30.09.2004

	Revenue	Financial income	Purchases and costs	Financial expense
<u>Subsidiaries</u>				
Finmeccanica Inc.			1	
Fata Group S.p.A.		1		
Seicos S.r.l.	1			
<u>Associates</u>				
Eurofighter Jagdflugzeug GMBH	407		4	
Eurosynnav S.A.S.	30			
Euromids S.A.S.	13			
Eurofighter Simulation Systems GMBH	10			
Macchi Hurel Dubios S.A.S.	10			
Galileo Industries S.A.	3			
Elettronica S.p.A.	3			
Orizzonte Sistemi Navali S.p.A.	3		1	
Nicco Communications S.A.S.	2			
NH Industries S.A.R.L.	1			
Dataspazio S.p.A.			1	
<u>J. V. (*)</u>				
MBDA S.A.S.	48			5
Agusta S.p.A.	28		1	
GIE ATR	17			
Alenia Marconi Systems S.p.A.	13		10	
Westland Helicopters LTd	2			
AMS LTD	1			1
AMS NV		1		
Aviation Training Int. Ltd				1

(*) Amounts refer to the portion not eliminated for consolidation

Performance by sector

AERONAUTICS

€million	30.09.2005	30.09.2004	3rd Quarter 2005	3rd Quarter 2004	31.12.2004
New orders	2,116	723	1,049	123	3,316
Order backlog	6,302	3,640	n.a.	n.a.	5,375
Value of production	1,405	1,332	469	448	1,898
EBIT	99	56	51	24	117
R.O.S.	7.0%	4.2%	10.7%	5.4%	6.2%
Working capital	(398)	(310)	n.a.	n.a.	(585)
Net Invested Capital	43	125	n.a.	n.a.	(149)
R.O.I (*)	n.s.	n.s.	n.a.	n.a.	n.s.
Research and Development costs	269	210	89	72	358
Employees (No.)	10,974	10,682	n.a.	n.a.	10,704

(*) calculated on Invested Capital at period-end

Aeronautics sector includes Alenia Aeronautica (production of military combat, transport and special mission aircraft, as well as civil productions including aerostructures and regional turboprop aircraft) and the subsidiaries Aermacchi (production of military training aircraft and engine nacelles for civil aeronautics), Officine Aeronavali Venezia (aircraft conversions and maintenance) and the GIE-ATR consortium, 50% owned (marketing and assembly of ATR aircraft).

As far as the military market is concerned, latest-generation multi-role aircraft, designed both in Europe and in the United States, will continue to account for the largest portion of the demand. Moreover, the new operating requirements for international transactions

and the demands for protection and security, are spurring the request for transport aircraft, for special missions (air space and battlefield surveillance, sea patrol, tankers, etc.) and for a new generation of advanced training aircraft. Growing interest is being focused on the long-term introduction of unmanned aircraft, for which major programmes have been started in the United States and Europe.

In the three quarters of 2005, Alenia Aeronautica achieved important results in the military segment, as it was chosen by the Bulgarian Government to supply 8 C27J aircraft and by the Turkish Government to supply its Navy with 10 ATR72 ASW (Anti Sub Marine) aircraft for sea patrol and anti-submarine purposes. In January, Aermacchi signed a Memorandum of Understanding with the Greek Ministry of Defence for the new trainer M346, identifying the guidelines for Greece's future participation in the programme, which represents the first step in the internationalisation process.

As far as the C27J is concerned, in order to back the aircraft's promotion on the North American market, on 31 March 2005, Alenia Aeronautica and L-3 Communications set up a jointly held JV - named Global Military Systems (GMAS) - which will act as prime contractor in the production and logistic support to the C27J aircraft, which will take part in the tender to supply the US Army with about 130 transport aircraft, in view of the forthcoming start of the process to award the first order of 33 aircraft. Further promotional initiatives are in progress in a number of countries, such as Canada and Finland and the Czech Republic.

On 21 April 2005, Alenia Aeronautica signed the contract with Dassault to participate in the development of the UCAV demonstrator in the UAV/UCAV (Unmanned Aerial Vehicle / Unmanned Combat Aerial Vehicle - remote-controlled vehicles) sector. Furthermore, talks are still underway on the participation in further European ventures in this sector with other Group companies.

Activities in the military sector in the three quarters of 2005 mainly involved: EFA development, production and logistics, with the delivery of 5 one-seat aircraft to the Italian Air Force; production of the C27J aircraft, upgrades to the Tornado aircraft

(retrofit Pre-Mid Life Upgrade) and to the AMX. For AerMacchi: production and logistical support for the MB339 and SF260 training aircraft, further development of the new M346 training aircraft. For Officine Aeronavali Venezia: development and production for the B767 Tanker programme, overhaul and logistical support for the Atlantic, B707 and G222 aircraft.

As for the civil world market, new models of aircraft are in the pipeline, all featuring cutting-edge performances and new technological solutions, with significant growth opportunities also in store for the companies involved in the design and development of structural components. Finmeccanica, through the companies in the Aeronautics sector, takes part in the new developing programmes, either by Boeing or Airbus, holding major responsibilities, and is involved in talks to also take part in future programmes. The civil market also achieved significant commercial results in the three quarters of 2005.

In regard to the new B787 aircraft, at the end of July, the final contract was signed with Boeing involving Alenia Aeronautica's participation in the programme, followed by the first order to develop components for 150 aircraft.

In regard to the new B787 aircraft, which sees Alenia Aeronautica involved in activities related to the development and production of important fuselage segments in composite materials (such as the central section and the horizontal stabilizer), design activities went ahead. Thanks to its high-tech features, the aircraft will become the medium/long range flagship of commercial aircraft.

In reference again to B787, following the agreement signed between Alenia Aeronautica and Vought Aircraft Industries Inc. in December 2004, to set up a programme joint venture, based in Charleston, South Carolina, work started on the construction of the plant in February 2005. The plant's activities will regard integration of the fitted subassemblies and, in particular, of the various fuselage sections of the B787 produced by the two partners which overall realise 26% of the fuselage value. The main benefits of the joint venture for Alenia Aeronautica regard the acquisition of high value-added volumes of activity, and its role as small prime, enhancing its competitive positioning and becoming the candidate supplier of integration services for future programmes too.

In regard to regional aircraft, the GIE-ATR consortium posted a significant increase in sales of ATR aircraft in the three quarters of 2005, which have been favoured by both the growing demand by the low cost companies and the increased oil price.

On 18 August 2005, Finmeccanica signed a memorandum of understanding with the Federal Agency for Industry of the Russian Federation involving Alenia Aeronautica and the aeronautical company Sukhoi, to cooperate in the development of a new family of civil aircraft for regional transport. On the same date, Finmeccanica also nailed down three different agreements with other Russian industrial partners in the fields of aeronautical design, trainer aircraft and unmanned aircraft technologies.

As to Airbus, the agreement signed in December 2004 strengthens the industrial partnership of Alenia Aeronautica in the frame of the A380 programme, with the granting of new segments of business for the cargo version. Furthermore, talks are underway to seek new opportunities to collaborate (additional activities on aircraft currently in production and participation in the new A350 aircraft).

In the three quarters of 2005, Alenia Aeronautica civil productions were still affected by lower production volumes and continued its co-supply activities for the leading world producers, which specifically regarded:

- Boeing: production of fuselage components and of control surfaces for the B767 and B777 aircraft and the fuselage for the B717;
- Airbus, with the design of the components of the central section of the fuselage of the A380, of the Tail Cone for the A300, of mechanical wing components for the A340 aircraft and of a fuselage section for the A321;
- GIE ATR, in partnership with EADS-ATR, with the production of the ATR 42 and 72 turboprop;
- Dassault Aviation, with the fuselage section for the Falcon 2000 Extended Range, and the engine nacelles for the Falcon 900EX.

As for Officine Aeronavali Venezia, activities worth mentioning regarded passenger-to-cargo aircraft conversions, and for Aermacchi, the civil production of engine nacelles.

New orders at 30 September 2005 were worth €nil. 2,116, showing an increase compared to both the forecasts and €nil. 723 posted at 30 September 2004. The growth was achieved thanks to the first B787 order (approximately €nil. 850) acquired in the third quarter, to a higher amount of orders for EFA equipment and to the GIE-ATR consortium, which acquired orders for 53 aircraft during the three quarters (30 aircraft acquired from the Indian company Air Deccan). The amount pertaining to the sector is approximately €nil. 300. Other orders include those related to the AMX, Tornado, F35 Joint Strike Fighter, and in the civil segment those related to the Falcon, engine nacelles and MD-11 cargo conversion.

The **order backlog** at 30 September 2005 stood at €nil. 6,302, mostly relating to the EFA (59%), B787 (14%), C27J (7%) and AMX (5%) programmes. The backlog is expected to develop in the medium and long term.

The **value of production** posted at 30 September 2005, amounting to €nil. 1,405, went up by €nil. 73 (+5.5%) compared to the same period in the previous financial year (€nil. 1,332 at 30 September 2004). Such a forecasted growth is ascribable to the higher volumes of activity on the C27J and, in particular, to the aircraft ordered by Greece, to which the first aircraft was delivered in September, while further deliveries are expected in the fourth quarter of 2005. The civil segment still holds its ground and records an increase in ATR productions and engine nacelles, offsetting the slight drop in aerostructures and aircraft conversion.

EBIT amounted to €nil. 99 at 30 September 2005, showing a significant growth compared to €nil. 56 posted at 30 September of the previous financial year. The increase is basically due to the higher contribution of the GIE-ATR consortium, owing to greater sales positively affecting both volumes of activity and income prospects of the programme, and to closing negotiations which have allowed to acquire the expected orders by Boeing in the third quarter, to close the B757 programme. Furthermore contribution of the military programmes AMX, JSF and C27J also improves. Such a positive trend lifted profitability, with the sector **ROS** going up from 4.2% at 30 November 2004 to 7% at 30 September 2005.

Working capital shows a negative value of €mil. 398 at 30 September, up by €mil. 187 compared to 31 December 2004 (€mil. -585). The increase, which is typical in the first part of the year, is ascribable to higher net inventories, partly offset by the drop in trade receivables. More in detail, the higher levels in inventories mainly reflect the increase in the work in progress on the C27J, as earlier mentioned, and in the non-recurring work in progress related to development activities carried out over the period on programmes underway.

Net invested capital at 30 September 2005, equal to €mil. 43, increased by €mil. 192 compared to 31 December 2004 (€mil. -149). Such an increase is basically due to the dynamics of working capital earlier mentioned.

Research and Development costs, amounting to €mil. 269 at 30 September 2005, showed an increase compared to €mil. 210 at 30 September 2004. Such a performance reflects the greater commitment, especially by Alenia Aeronautica and Aermacchi, in the non-recurring activities of the B787, C27J, M346, EFA programmes with increased activities on the second *tranche*, Tornado, AMX, UAV (Unmanned Air Vehicles), A380, engine nacelles and B767 Tanker. Technological research and development also continued along two main strands, Aerostructures and System Integration.

At 30 September 2005, there were 10,974 **employees**, up by 270 compared to 10,704 at 31 December 2004, due mainly to recruitments associated with higher loads, and associated in particular with engineering work loads for programmes undergoing development.

HELICOPTERS

€million	30.09 2005 100%	30.09 2004 100%	30.09 2004 50%	3rd Quarter 2005 100%	3rd Quarter 2004 100%	3rd Quarter 2004 50%	31.12 2004 100%	31.12. 2004 **Consolidated share
New orders	2,892	800	400	472	258	129	1,808	1,252
Order backlog	7,039	5,420	2,710	n.a.	n.a.	n.a.	5,238	5,238
Value of production	1,721	1,780	890	551	622	311	2,590	1,453
EBIT	174	184	97	48	46	25	245	130
R.O.S	10.1%	10.3%	10.9%	8.7%	7.4%	8.1%	9.4%	8.9%
Working capital	472	316	158	n.a.	n.a.	n.a.	322	322
Net Invested Capital	2,085	1,038	331	n.a.	n.a.	n.a.	1,947	1,947
R.O.I (*)	11.1%	23.6%	39.0 %	n.a.	n.a.	n.a.	12.5%	6.7%
Research and Development costs	267	338	169	81	120	60	551	349
Employees (No.)	8,545	8,926	4,463	n.a.	n.a.	n.a.	8,968	8,968

(*) calculated on Invested Capital at period-end

(**) For P&L values only: consolidation on a proportional basis (50%) until November and consolidation on a line-by-line basis in December; therefore, balance sheet indicators are not much significant

Finmeccanica is, together with EADS (Eurocopter) and United Technologies (Sikorsky), leader in the extremely tight circle of systems designers in the world helicopter industry with AgustaWestland NV and its related concerns, wholly-owned as from 30 November 2004.

To convey the true extent of the business, total figures at 30 September 2004 for AgustaWestland are also given and, in order to allow a comparison between homogeneous figures, the notes below refer to 100% of the group.

The world helicopter market confirmed a strong growth trend, although the cyclic nature of business typical of the military sector (representing approximately 75% of the overall demand) may affect the correct definition of values. The main growth drivers may be recognized in the need for fleet renewal in several countries with high expenditure budgets, including the United States and Great Britain, in the new demands for security and civil defence, in the general trend towards the acquisition of solutions and services rather than operating platforms only.

A stronger growth is expected in the military sector, where the US market, spurred by the programmes for new acquisitions, which will tend to replace the traditional upgrade requirements, will account for almost half the world market in the next 10 years. The presence of new advanced operating requirements and the availability of latest-generation products, open up an interesting window of opportunities for the European industry to increase its share of the US market, engendering positive effects on the overall competitiveness in the export market. The system of systems multi-platform approach, with the introduction of the helicopter platform in broader battlefield surveillance and control programmes, together with the request for more services over the machine's life cycle (mainly for integrated logistics services and training services), will further contribute to enhancing and increasing the demand in the sector.

In this frame, AgustaWestland further strengthened the strong foothold gained and concurrently demonstrated the effectiveness of its strategic presence on the US and British markets through a number of important acquisitions made during the three quarters of 2005:

- the supply of the first *tranche* of 8 out of a total of 23 units of the helicopter, named US 101, designed for use by the President of the United States;
- the order by the British Ministry of defence to upgrade the Apache combat helicopters sighting and targeting system (M-TADS).

In this frame, mention must be made of the British Ministry of Defence's intention to develop a long-standing partnership with AgustaWestland, since it reputes the latter as

being a preferred supplier, and to award it the Future Lynx programme for the BLUH (battlefield light utility helicopters)/SCMR (surface combatant maritime rotorcraft) requirements.

This string of successes allows the Group to have more odds to win the future tenders for modifications in the products involved (USAF CSAR and Special Forces, UK Medium Lift, Royal Navy SAR) and to have interesting prospects also for other requirements such as:

- in the USA the LUH (light utility helicopters) programme for the supply of approximately 350 AB139 machines, named US 139, to the U.S. Army in partnership with the Texan company L-3 Communications Integrated Systems, which shall complete the final assembly and the customisation of specific avionic systems, in addition to supply logistic support to the entire fleet;
- in Great Britain the Future Rotorcraft Capability requirement, the helicopter component of the MFTS (military flying training system) military training system, as well as the Future Heavy Lift - the successor of the CH-47 -, which may converge in a programme of widespread, general interest.

The civil sector, which confirmed its extreme competitiveness, especially in the medium-low range, shows milder growth prospects. The launch of new models will contribute to expanding the overall value of the market, although forecasts show that the amount of machines delivered will keep stable over the years. The segments basically related to government clients, spurred by increasingly pressing demands for security, civil defence and medical emergency services, show a positive trend, while other more typically commercial segments (VIP /Corporate transport) are affected by the overall unsteady economic climate.

In this frame too, AgustaWestland, given the unique and virtually exhaustive range of modern and competitive products, proved its ability to seize increasingly broad market segments; in this connection, mention must be made of:

- the order of 20 AB139 helicopters for the Seacor client and of 16 units for the CHC New Fond Land, as a helicopter for support and link to the oil platforms; AB 139 order backlog is constantly on the rise, as demonstrated by the 105 machines ordered to date;
- the order related to a further 20 “Grand” helicopters, the new light twin-engine helicopter, which gained certification also from the European EASA body; the company is currently scoring widespread acclaim for this version of helicopter, as demonstrated by the constant increase in its order backlog, reaching 27 machines to date.

In addition to the foregoing orders acquired, mention must also be made of the excellent trend in product support related to integrated support services; in this regard, mention must be made of the order named SKIOS (Sea King Integrated Operational Support) awarded by the British Ministry of Defence to support the Sea King helicopter fleet in order to ensure high reliability levels.

The total volumes of **new orders** acquired at 30 September 2005 amounted to €mil. 2,892, showing a strong increase compared to 30 September 2004 (€mil. 800).

Other significant events marking the three quarters of 2005 include the favourable opinion issued by the Council of State on litigation related to the Nexus programme, entailing the supply of 28 A109 Power and 7 AB412 to the police forces and the State corps of forest rangers.

The **order backlog** at 30 September 2005, equal to €mil. 7,039, showed a strong increase of about 34% compared to 31 December 2004 (€mil. 5,238); this rise is basically due to some important orders acquired in the first months of 2005. These include the first *tranche* of the supply of the US Presidential helicopter acquired on 28 January 2005, whose value amounts to approximately €mil. 800.

Such is the size of the backlog that forecasts see the same production volumes of the

previous financial year, thanks mainly to the activities on EH101, Super Lynx 300, AB 139, A109 Power and “Grand”, A129, besides the start of production of the NH90 helicopter.

Value of production at 30 September 2005 amounted to €mil. 1,721, down compared to the value posted at 30 September 2004 (€mil. 1,780).

The main programmes relating to AgustaWestland’s production included:

- EH 101 for the Italian Navy, completing the first lot with the delivery of the sixteenth unit; for the Danish and Portuguese governments, of which the seven units out of 12 were delivered; furthermore, note that an important milestone was marked for the supply of the EH101 to the Japanese Navy: the delivery of the first helicopter;
- Super Lynx 300 helicopter, for which activities for the supply contracts with the Oman and South Africa Air Forces and Thai Navy were continued;
- AB139 helicopter, with fifteen units delivered in the three quarters of 2005;
- A109 Power helicopter for the civil-government market, with 20 units delivered;
- A109 “GRAND” helicopter, with the first delivery effected during the Le Bourget air show;
- A129 helicopter in the CBT (Combat) configuration and upgrade in this configuration of the A129 Mangusta, currently in service with the Italian Army;
- AB412 helicopter for Italian and foreign government agencies, with 5 units delivered in the three quarters of 2005;
- production work on the A109E Power variant for the supply contracts with the South African Air Force and Swedish Armed Forces; take note of the

acknowledgement by the local authorities for military purposes and the delivery of the first two units;

- industrialisation and production programmes for the NH90 helicopter.

EBIT, amounting to €nil. 174 at 30 September 2005, even if higher than forecasts, dropped by €nil. 10 compared to the same period of the previous financial year (€nil. 184). This fall was ascribable to both lower production volumes and the different mix of programmes in progress, where main activities involved programmes acquired in the export market. In fact, the comparison of the two periods shows a smaller contribution of a number of important domestic contracts (Apache) that had greatly contributed to the economic result of the three quarters of the previous financial year. **ROS**, expressed as impact on the production value, came to 10.1% at 30 September 2005, in any case in line with that in the same period of the previous financial year (10.3%).

Take note, however, that thanks also to the efficiency measures previously adopted in the frame of the integration of Italian and UK activities, economic results for the whole year will witness a sharp rise with respect to those of the previous financial year.

Invested capital, at 30 September 2005, came to €nil. 2,085, up by €nil. 138 compared to 31 December 2004 (€nil. 1,947), partly attributable to the increase in **working capital**, amounting to €nil. 472 at 30 September 2005 (€nil. 322 at 31 December 2004), due to the increase of work in progress, consequent to the start of production on the new AB139 and A109 “Grand” helicopters, and partly to the increased value of goodwill because of the different exchange ratios between the currencies in the reference periods.

Return on invested capital (**ROI**), amounting to 11.1% at 30 September 2005, was down by 1.4% compared to the value posted at 31 December 2004 (12.5%). This decrease is attributable to the abovementioned increase in the invested capital.

Research and Development costs, equal to €nil. 267 at 30 September 2005 (€nil. 338 at 30 September 2004) included:

- research in the frame of the programmes financed through Law 808/85, which

include the development of technologies, mainly for military purposes, for a new helicopter of the 6-7 ton class named A149;

- research on the upgrade of products, where activities continued on the personalization of the AB139 helicopter and of the new A 109S “Agusta Grand” helicopter;
- research and development for variations on base models, in connection with government/military contracts, which include the helicopter EH101, NH90, A109 LOH/LUH.

Employees of AgustaWestland were 8,545 at 30 September 2005, down by 423 compared to 31 December 2004 (8,968). Take note that, at the end of 2004, AgustaWestland started a restructuring/integration plan with the aim of improving its profitability. To date, it has set the following courses of action:

- start of restructuring in the British sites of Westland Helicopters Ltd and Westland Transmissions Ltd, with completion expected by the end of the financial year;
- definition and start-up of the new organisational model of AgustaWestland as an integrated company;
- standardisation of procurement activities;
- identification of certain in-house activities and gradual outsourcing.

SPACE

€million	30.09.2005	30.09.2004	3rd	3rd	31.12.2004
			Quarter	Quarter	
			2005	2004	
New orders	330	353	63	105	1,050
Order backlog	1,042	978	n.a.	n.a.	1,413
Value of production	547	519	176	185	775
EBIT	24	2	5	12	23
R.O.S	4.4%	0.4%	2.8%	6.5%	3.0%
Working capital	53	120	n.a.	n.a.	117
Net Invested Capital	357	182	n.a.	n.a.	177
R.O.I (*)	9.0%	1.5%	n.a.	n.a.	13.0%
Research and Development costs	60	64	6	17	98
Employees (No.)	3,125	3,535	n.a.	n.a.	3,260

(*) calculated on Invested Capital at period-end

Until 30 June 2005, Finmeccanica has been operating in the space industry through Alenia Spazio and its related concerns (manufacturing activity) and Telespazio and its related concerns (satellite services).

1 July 2005 marked the start of operations of the two companies established by Finmeccanica and Alcatel on 28 January 2005, with the purpose of integrating the respective space activities to which the two Groups have contributed their respective industrial segments in the industrial production (Alcatel Alenia Space, a company with registered office in France and industrial plants in France, Italy, Belgium and Spain, 33% owned by Finmeccanica) and in the satellite services field (Telespazio Holding, a company with registered office in Italy and industrial plants in Italy, France and Germany, 67% owned by Finmeccanica).

Specifically, Alcatel Alenia Space is focused on design, development and production of space systems, satellites, orbital infrastructures, space transportation systems, payload, earth devices, instruments and systems for civil and military applications.

Telespazio is focused on the management and control of satellites into orbit, earth centres management, supply of telecommunication networks and services, multimedia and high value-added applications, satellite navigation and Earth observation services.

The establishment of these companies represents an opportunity for growth, the aim being to strengthen the leadership position in satellite systems and services for telecommunications, placing a solid footprint in major European programmes such as Galileo and GMES (Global Monitoring for Environment and Security) and strengthening activity in the field of space applications related to defence and security, and in space observation and exploration. Furthermore, by integrating their respective space activities, the two Groups intend to create important operating synergies and scale economies.

As to the foregoing, figures at 30 September 2005 include the first 6 months of activity of the companies Alenia Spazio and Telespazio, 100% consolidated, and the subsequent 3 months of activity relating to the two new companies (Alcatel Alenia Space and Telespazio Holding), consolidated on a proportional basis. Therefore, figures for the current financial year are not reported on a like-for-like basis with respect to those for the previous financial year.

Following overcapacity in the offer of satellite connections and stagnation in the demand for new systems witnessed over the past years, the commercial market showed recent signs of recovery. Greater developments are expected to arise especially in broadband systems and services.

Despite the slow recovery in the short term in EU countries, owing to budget constraints, it is expected that the institutional demand may truly fuel space industry activities in the coming years. In fact, both the European Union and the European Space Agency (ESA) deem the space sector to be strategic: the priority applications regard satellite navigation

(Galileo programme), territorial defence and control (GMES programme) and broadband communications. Special attention will also be devoted to the development of launching services, required to assure Europe independent access to space.

The whole sector will also benefit from the effects of the Galileo programme, the European global navigation satellite system. The project develops along two basic lines: building of the infrastructure (space and earth segments); management of the system and signal supply. Plans are to position a constellation of 30 MEO (Medium Earth Orbit) satellites, with full deployment expected by around 2010. Such a constellation will guarantee high-precision localisation services. The current development stage of the system, worth approximately €bil. 1.5, is managed by Galileo Joint Undertaking (GJU) on behalf of ESA and the EU, and is conducted by Galileo Industries GmbH, based in Germany, and its subsidiary Galileo Industries S.p.A., based in Italy, which are responsible for launching and testing the first four satellites (In-Orbit Validation stage, 2005-2008) and plan to gain responsibility for the implementation of the complete infrastructure.

Within Galileo Industries, Alcatel Alenia Space participates in producing satellites and is responsible for system engineering, including the assembly and validation stages. Telespazio takes part in the design and building the Galileo system's ground infrastructure plus relevant operations.

The completion of the system (Fully Operational Capability – 2008-2010), worth approximately €bil. 2, management of the system and signal supply, will be granted in concession through tender. The two competing consortia, Eurely (formed by Finmeccanica, Alcatel, AENA, Hispasat and others) and iNavSat (formed by Eads, Inmarsat and Thales) submitted a joint proposal stressing, *inter alia*, how the entire programme would have significantly benefited from their merger. At the end of June, GJU gave its approval and started negotiations. This phase should lead to the signing of the concession contract by the end of 2005. Another key element of the development of Galileo was the appointment of the Supervisory Authority's Executive Director, who should also be tasked with awarding the concession contract.

On a domestic level, the Ministry of Defence is appearing to show an increasingly keen interest in the use of space systems. Following contribution to the Cosmo-SkyMed programme, for which the order relating to the 4th satellite is expected within the year, activity continues on the implementation of the Sicral 1-B satellite for telecommunications, which should be boosted by the assignment of a further *tranche* by December.

On the commercial side, in the three quarters of 2005, the Group acquired **new orders** worth €nil. 330, down by €nil. 23 compared to the same period of 2004 (€nil. 353). The major orders in the period regarded: completion of the order for the Node 3 involving the International Space Station, the orders for the AMOS, Galileo programmes and a further *tranche* for the Herschel/Plank scientific satellite, plus renewal of the contracts for long-term TV broadcasting services (to be supplied in particular to RAI and MEDIASET) and the collection of new orders for the supply of telecommunication satellite services and Earth observation.

The **order backlog**, at 30 September 2005, amounted to €nil. 1,042, decreasing by approximately 26% compared to 31 December 2004 (€nil. 1,413).

Value of production at 30 September 2005 was equal to €nil. 547, increasing by approximately 5% compared to the same period of 2004 (€nil. 519). The production mainly regarded activities relating to the Earth observation Cosmo-SkyMed programme, StarOne C2 satellites for civil applications, Thaicom 5, Chinasat 9, Galaxy 17, Hot Bird 7A, Rascom, Koreasat 5 and Herschel/Plank and GOCE scientific satellites, the programmes involving the International Space Station (Node 3 and ATV vehicle), Syracuse and Sicral 1B satellites for military communications, Galileo and EGNOS navigation programmes; progress in the Express MD Kazakhstan, Meteosat Second Generation and Diana programmes; the implementation of the devices for EQS France and for the Koreasat 5 satellite, payload for Arabsat 4A/4B and Express AM 33/34; furthermore, the supply of satellite telecommunication services, Earth observation, and for the TV sector, resale of satellite capabilities and the supply of broadcasting services.

EBIT stood at €mil. 24 at 30 September 2005, up by €mil. 22 compared to the value posted at 30 September 2004 (€mil. 2), affected by provisions for restructurings and writedowns. The three quarters of 2005 also benefits from the furtherance and consolidation of the restructuring and efficiency measures adopted in the past, both in Alenia Spazio (now Alcatel Alenia Space Italia) and in Telespazio, in addition to lower structure costs. Accordingly, the **ROS** went up from 0.4% at 30 September 2004 to 4.4% at 30 September 2005.

Net invested capital was €mil. 357 at 30 September 2005, showing a significant increase compared to 31 December 2004 (€mil. 177), essentially attributable to the goodwill arising from the establishment of the two new companies, while **working capital** at 30 September 2005 (€mil. 53) shows a net reduction compared to the value posted at December 2004 (€mil. 117), thanks to a careful policy of expense containment.

Research and Development costs amounted to €mil. 60 at 30 September 2005, decreasing by 6% compared to the value posted in the corresponding period of 2004 (€mil. 64). The activities mainly referred to the study and development of various programmes; specifically: Cosmo (SAR radar, developments and qualifications related to the security segment), Syracuse, Sicral 1B (studies on antenna nulling), Artes 3 (EPS subsystem demonstrator for broadband telecommunications), EGNOS and Galileo (the GSTB V1 stages regarding algorithm development and testing, and the GSTB V2 stages related to construction of the prototype satellite). Moreover, studies continued on the experiments conducted on board the International Space Station, as well as studies on capsules, orbital infrastructures and manned re-entry vehicles, on scientific satellites (Alma, Spirale/Melissa, Gaia, BepiColombo, Exomars, Goce and Plank and Agile tests) and on the Mars Express space probe.

Employees at 30 September 2005 were 3,125, decreasing by 135 against 3,260 at 31 December 2004, essentially due to the new consolidation perimeter.

DEFENCE ELECTRONICS

€million	30.09.2005	30.09.2004	3rd Quarter 2005	3rd Quarter 2004	31.12.2004
New orders	3,367	1,283	518	205	1,925
Order backlog	7,114	3,448	n.a.	n.a.	2,857
Value of production	1,932	1,657	712	511	2,082
EBIT	114	105	33	18	155
R.O.S.	5.9%	6.2%	4.6%	3.5%	7.4%
Working capital	1,194	928	n.a.	n.a.	824
Net Invested Capital	2,712	1,412	n.a.	n.a.	1,008
R.O.I (*)	5.6%	9.9%	n.a.	n.a.	15.4%
Research and Development costs	361	288	165	74	344
Employees (No.)	18,593	14,640	n.a.	n.a.	12,596

(*) calculated on Invested Capital at period-end

As already detailed above, the agreement signed with Bae Systems Plc at the end of April 2005 deeply changed the structure of the Defence Electronics sector of Finmeccanica. This agreement entailed:

- the establishment of a new company, Selex Sensors and Airborne Systems S.p.A., 75% owned by Finmeccanica and 25% owned by BAE, grouping together the activities of Galileo Avionica S.p.A. and Selex Sensors and Airborne Systems Ltd (former Bae Systems Avionics Ltd, a British company of Bae Systems operating in the field of electro-optics, airborne radar and electronic warfare);
- the transfer by Bae Systems to Finmeccanica S.p.A. of its military and secure communications business, contributed to Selex Communications S.p.A. (former Selenia Communications);

- the dissolution of the AMS joint venture and the return of Italian businesses, now Selex Sistemi Integrati S.p.A., under the full control of Finmeccanica, which has also acquired the Air Traffic Management (ATM) and Air Traffic Control (ATC) activities of Bae Systems in the United Kingdom, in Germany (Gematronik) and in the United States (ASI).

This sector then includes activities regarding the manufacture of avionic equipment and systems, unmanned aircraft, radar systems, land and naval command and control systems, air traffic control systems, integrated communications systems and networks for land, naval, satellite and avionic applications and private mobile radio communication systems. This division also includes the operative division International Naval Systems of Finmeccanica, which manages relations with Eurosysnav SAS to develop the combat system within the framework of the contract with Horizon SAS to build 4 Orizzonte class frigates for the Italian and French Navies.

Defence Electronics also comprise activities integrated from Elsag, which include the development and maintenance of systems for the automation of postal processes and the design, integration and supply of IT systems and services, with a growing commitment towards the Security market. In fact, in the first half of 2005, the Group started up the process aimed at steering the development of Elsag towards activities more consistent with the Finmeccanica Group's core business, following a reshaping of the mission of the company, whose strategic guidelines may be summed up as follows:

- activities and resources steered towards the defence, aerospace, security markets, and towards the large-scale automation systems clients;
- steady divestment of activities carried out so far on the traditional IT market.

In the frame of this process, in the second quarter of 2005, the Group formalised the acquisition by Elsag S.p.A. of the Security branch of business from Selex Communications S.p.A. and of Space Software Italia S.p.A. from Alenia Spazio S.p.A., while the third quarter of 2005 saw the formalisation of the transfer of Elsag Solution A.G., Elsag Backoffice Services S.p.A. and Consult Data s.r.l..

Take note that the figures in the table are not like-for-like, owing to a change in the consolidation area between September 2005 and the corresponding period in 2004, due to the:

- the consolidation, as from 1 May 2005, of 100% of Selex Sensors and Airborne Systems Spa and 100% of Selex Sistemi Integrati Spa;
- deconsolidation of AMS Ltd, as from 31 December 2004, with the recognition of the economic effects under “discontinuing operations” and of the financial effects under assets/liabilities held for sale;
- consolidation, as from 1 January 2005, of 100% of Seicos, Servizi Integrati di Comunicazione per la Sicurezza, a newly-formed company whose mission is the outsourcing management and maintenance coordination of telecommunication networks in service with the Italian Police Forces.

Defence Electronics accounts for roughly 20% of the world demand in the Aerospace and Defence industry (worth around €bil. 300), with a 6% annual growth rate until 2009. Such a rise is justified from the increasing importance attached to electronic systems related to new operative requirements, based on complex and “networked” architectures formed by sensors, platforms and weapons systems.

Land Surface Systems reported a growing demand for secure communication systems, information superiority, data/sensor fusion techniques and surveillance and protection systems.

The world demand for Naval and Avionic Systems is closely related to the trend in development programmes of new naval platforms (Europe: FREMM, Horizon, *Nuova Unità Maggiore*; USA: DD(X), LCF) and of new aeronautical platforms (Europe: Eurofighter, Rafale, and, in perspective, Eurotrainer; United States: F/A18, F/A22, and, in perspective, JSF) respectively.

Other key drivers of the sector are represented by the development of multi-platform integrated systems, of airborne surveillance systems (air space and battlefield), and by the growing demand in Solution Solving systems and the supply of services and

products.

The new Homeland Security requirements, including protection of national critical infrastructures, and coast and border control, are gradually diversifying the military business and steering it towards civil applications. This opportunity will allow Finmeccanica companies operating in the sector to gain access to any future allocation of national and international funds capable of offsetting the stagnation in European defence budgets.

New orders amounted to €mil. 3,367 at 30 September 2005, up €mil. 2,084 compared to the same period of the previous financial year (€mil. 1,283), such an improvement due mostly to the order acquired by Selex Sensors and Airborne Systems for the production of the DASS (Defensive Aids Sub System) system for all the Eurofighter Typhoon in the second *tranche* related to production of the aircraft, and thanks to an exhaustive range of sensors for self-defence and countermeasures, capable of tracking, assessing and automatically and effectively countering potential threats coming from both the surface and from other aircraft. Among the other acquisitions, take note of the following:

- avionics: further orders relating to the second *tranche* of the EFA programme, the supply of Mirach 100/5 targets to the United Kingdom, three radars for deck-landing to the United Kingdom and to Korea, and two PAR to Pakistan, as well as various orders in the space component, in addition to logistics activities;
- land and naval command and control systems: particularly significant was the acquisition by Selex Sistemi Integrati from MBDA Italia for activities related to the multifunctional radar (Multifunctional Fire Control Radar) and to surveillance activities in the frame of the programme to develop the MEADS medium-range antimissile and antiaircraft mobile defence system (Medium Extended Air Defence System); furthermore, note the orders for the supply of two mobile systems of DADR radar surveillance to the German Ministry of Defence and, for air-traffic control systems, the acquisition of an order from ENVA for the National Surveillance System, as well as the contract, in the frame of an international tender, awarded by the authority managing Ukraine air

navigation services involving the supply of a modern infrastructure for domestic air-traffic control;

- systems and integrated communication networks: orders for the integrated control panels on the A400M, for the development (2nd *tranche*) and production (1st *tranche*) of CNI systems for the Typhoon EF2000 aircraft (Interrogator, V/UHF, MIU, CAMU-T2, Transponder and New Generation IFF interrogator), for the lighting system on the A400M aircraft and for the Personal Role Radio (mainly from Great Britain, the United States and Jordan) and orders for devices and services for the evolution of the strategic network Permanent Telecommunication Network for the Romanian Ministry of Defence and the relevant management system;
- in regard to activities contributed by Elsas, the order involving Security related to the Telecom sites, while for Automation, take note of the contract for technical assistance on the Poste Italiane facilities.

The **order backlog**, net of work in progress, totalled €mil. 7,114 at 30 September 2005, increasing by €mil. 4,257 compared to 31 December 2004, due to the inclusion of the British company Selex Sensors and Airborne Systems Ltd in the scope of consolidation, which brings assets in the Avionics area to 60% of the total order backlog of the sector, as well as the change by Elsas in the method of posting long-term orders, introduced in 2005.

Value of production, amounting to €mil. 1,932 at 30 September 2005, shows an increase in absolute values of €mil. 275 and a percentage of 16% compared to the same period of the previous financial year, due to the acquisition of the English avionics business, to the increase in communication activities and to the establishment of Seicos, which more than offset the effects of the change in the scope of consolidation of Selex Sistemi Integrati. Most of the revenues came from:

- avionics: continuation of activities related to the production of radars, avionic devices and systems for the first *tranche* of EFA aircraft and start of those involving the second *tranche*, to the NH90 programme and to the production of Grifo and PAR radars, in addition to the supply of Mirach 100/5 targets;
- radar and command and control systems: activities related to contracts with the Italian Navy for naval systems on the Nuova Unità Maggiore, to upgrades on the Class Maestrale and De La Penne frigates, national and coast VTS programmes, to international cooperation contracts FSAF and Horizon, for NATO land-based FADR radars (D and S bands) and to air-traffic control programmes;
- systems and integrated communication networks: activities related to the supply of V/UHF radio systems on NATO AWACS aircraft, to the development and production of devices for the EF2000 aircraft (V/UHF, MIDS interface, Interrogator, Transponder), to the production of Personal Role Radio (among which Great Britain, the United States, Jordan and Saudi Arabia) and to the development of the tactical network formed by shelters fitted with digital switching and ATM exchanges, Radio links and Supervision System for Teledife;
- Eltag: activities related to Security and Automation Systems and Services.

EBIT, even if affected by the delay in acquisition of the Tetra Interpolizie, benefited from the effects of changes in the scope of consolidation, reaching €nil. 114 at 30 September 2005 (€nil. +9 compared to 30 September 2004).

ROS declined from 6.2% at 30 September 2004 to 5.9%, also due to the effect of the consolidation of the English avionics business, whose profitability is lower than the average recorded in the sector.

Net invested capital, equal to €mil. 2,712 at 30 September 2005, increased by €mil. 1,704 compared to 31 December 2004 (€mil. 1,008), essentially due to the change in the scope of consolidation and includes approximately €mil. 1,130 in fixed assets related to goodwill of the new Selex Sensors and Airborne Systems. Despite benefiting from the English avionics business, which shows a negative working capital mainly due to advances from customers, **working capital** increased by €mil. 370 compared to 31 December 2004, due to increased inventories and the shift of some collections, which are expected to be recovered in the last part of the year, totalling €mil. 1,194.

Research and Development costs amounted to €mil. 361 at 30 September 2005, compared to €mil. 288 at 30 September 2004 and mainly relate to:

- avionics: continuation of activities related to sales contracts and to projects funded by the Ministry of Production Activities, such as those for the development of the Falco tactical surveillance UAV system, which gained flight certification in June from ENAC (Italian Civil Aviation Authority), the first case for an UAV system;
- command-and-control systems: continuation of activities on 3D land-based radars and on naval combat systems, of activities related to system-type developments, of software technologies in the frame of air-traffic control systems and of technological research in the field of active arrays;
- systems and integrated communication networks: continuation of the developments in VoIP gateways for IPV4, MH544 and MH502 radio links, Software Radio, Future Soldier, *ad-hoc* network, Sicral, Radio BUR for JSF, V/UHF radio for the EFA 2nd *tranche*, NGIFF M 4126 and 422/5 interrogators, RALM/V3 and LOAM Laser Warning;
- private mobile radio communication systems: in regard to the TETRA technology, the Group completed integration of the devices and developed the functional aspects required to start up the network for the Turin 2006 Winter

Olympics; for developments in ARC technology, refer to the SATS programme (Small Aircraft Transportation System) and DTR100 in UHF band.

At 30 September 2005, there were 18,593 **employees**, up by 5,997 compared to 31 December 2004, mainly due to the acquisition of Selex Sensors and Airborne Systems Ltd and the effect of the 100% consolidation of Selex Sistemi Integrati.

DEFENCE SYSTEMS

€million	30.09.2005	30.09.2004	3rd Quarter 2005	3rd Quarter 2004	31.12.2004
New orders	403	382	71	99	810
Order backlog	4,098	4,352	n.a.	n.a.	4,115
Value of production	706	750	236	229	1,145
EBIT	42	37	22	4	97
R.O.S.	5.9%	4.9%	9.3%	1.7%	8.5%
Working capital	(193)	(133)	n.a.	n.a.	(265)
Net Invested Capital	242	257	n.a.	n.a.	129
R.O.I (*)	23.1%	19.0%	n.a.	n.a.	n.a.
Research and Development costs	109	135	36	38	199
Employees (No.)	4,130	4,140	n.a.	n.a.	4,147

(*) calculated on Invested Capital at period-end

Defence Systems include MBDA for missile systems, the JV with BAE Systems and EADS in which Finmeccanica holds an equity investment equal to 25%, Oto Melara S.p.A. for land, naval, and air weapons systems, and WASS S.p.A. for underwater weapons (torpedoes and counter-measures) and sonar systems.

The world demand for missile systems confirms a substantial growth trend already in the short and medium term, especially regarding general air defence (extended to ballistic and cruise missiles) and airborne systems (latest-generation air-to-air missiles and air-to-surface homing systems with target detection capabilities, both to be mounted on multi-role aircraft currently being produced or developed). In particular, air defence systems will become the most dynamic segment in the forthcoming years (around 40% of the world demand), with the continuation of important international collaboration programmes both in Europe (FSAF/PAAMS) and abroad (MEADS, National Missile

Defence). Take note that this segment is strongly focused on the European and US markets and is now gearing up to further strengthen operations there.

Both the land and naval weapons systems market shows interesting growth prospects in the medium term. Despite the sector's overall maturity, the recent military and security operations have required to deeply rethink the need to protect forces and physically occupy battlefields, with the consequent start-up, in the United States too, of programmes for the production of additional quantities of armoured vehicles. In the longer term, the market will require flexible, airborne systems, swift to operate and extremely protected, with strong technological challenges for the sector industries. As for naval weapons systems, both in the medium and, future-wise, small calibre, the segment will witness the growing demand for integrated cannon/smart munitions systems, to be used in littoral operations and in protection from general threats.

Underwater systems, marked by a generally stable demand, also show new interesting operating requirements, both in surveillance and in countermeasures and anti-torpedo defence. New defence and security requirements underlie the important needs for protection of port areas, which tend to represent an innovative segment in the demand for sonar systems. The more traditional market related to torpedoes and surveillance systems for surface vessels and submarines shows a moderate growth cycle, thanks to the launch of new construction programmes (including the fundamental role played by the new Italian-French multi-mission frigates) and to continuation of the upgrading programmes on existing vessels.

Against this background, as at 30 September 2005 **new orders** acquired were worth a total of €nil. 403, up by €nil. 21 compared to 30 September 2004. Noteworthy was the order acquired by MEADS International (the consortium formed by MBDA, the European Group EADS, the German Group Lfk and the US Group Lockheed Martin), for the design and development of the MEADS medium-range antimissile and anti-aircraft mobile defence system (Medium Extended Air Defence System), which is expected to replace the current Patriot systems in the United States and in Germany, and the Nike Hercules systems in Italy. The system incorporates the PAC-3 missile in a system including 360-degree fire control and surveillance sensors, combat

communication/management networked centres and launchers with extreme firepower. The awarding of the contract follows the decision adopted on April 20 last by the German Government to enter the design and development stage of MEADS, as previously was the case for the US and the Italian Governments. Other major orders secured in the missiles segment include the order for the supply of a further *tranche* of MICA air-to-air missiles for the French Ministry of Defence, and the orders for PAAMS surface-to-air missile systems for naval platforms, in addition to customer support activities.

As far as underwater systems are concerned, mention must be made, also for its strategic importance, of the order acquired for the supply of 24 Black Shark heavy torpedoes to be mounted on submarines ordered last year from the DHW German consortium by the Portuguese Navy, won after a neck and neck race with the German rival torpedo. Other noteworthy orders included the order for the supply by WASS again, of countermeasures for the submarines of the Indian Navy.

The **order backlog**, net of work in progress, totalling €mil. 4,098 at 30 September 2005, of which approximately two-thirds relate to activities in the missile systems, is substantially in line with the value posted at 31 December 2004.

Value of production, amounting to €mil. 706 at 30 September 2005, shows a drop in absolute values of €mil. 44 and a percentage of 6% compared to the same period of the previous financial year. Most of the half-year revenues came from:

- activities regarding the PAAMS surface-to-air missile systems for naval platforms, the production of the Storm Shadow air-to-surface missile systems for the British Ministry of Defence and SCALP EG for the French Ministry of Defence, the MICA air-to-air missiles and the Brimstone anti-tank missile, in addition to customer support activities;

- land, naval and aeronautical weapons systems, the production of the turrets for the Centauro armoured car for the second *tranche* in the supply of 62 vehicles to the Spanish Army and of the “Hitfist” turrets with 30-mm weapons for the Polish Army, the supply programmes for the Italian Armed Forces of the Dardo armoured vehicle and PZH2000 howitzer, as well as the production of 76/62 naval cannons;
- underwater systems: activities relating to the new Black Shark heavy torpedo and to the production of MU90 light torpedoes.

EBIT, which stood at €nil. 42 at 30 September 2005, increased by €nil. 5 compared to the same period of the previous financial year, of which €nil. 5 due to more profitable activities than in the past.

Accordingly, **ROS** increased by 1 percentage point, compared to the same period of the previous year.

Working capital, which stood at €nil. -193 at 30 September 2005 mainly due to the advance from customers of MBDA, increased by €nil. 72 compared to the value posted at 31 December 2004 (€nil. -265), due to the shift of some collections and the increase in inventories in the sector of land systems, whose partial recovery is expected to take place in the last part of the year. Accordingly, **net invested capital** stood at €nil. 242 at 30 September 2005 (€nil. 129 at 31 December 2004).

Research and Development costs, totalling €nil. 109 at 30 September 2005 (€nil. 135 at 30 September 2004), mainly refer to missile activities, in particular those related to the development of the new Meteor air-to-air missile, while for land-based and naval weapons, activities worth mentioning involve the new “guided” munitions system for the Italian Navy. The drop with respect to September 2004 (-19%) is ascribable to the switch from the development to the production phase for many programmes involving missile systems.

At 30 September 2005, there were 4,130 **employees**, dropping by 17 compared to 31 December 2004.

TRANSPORTATION

€million	30.09.2005	30.09.2004	3rd Quarter 2005	3rd Quarter 2004	31.12.2004
New orders	1,394	1,332	558	245	1,645
Order backlog	4,182	3,846	n.a.	n.a.	3,656
Value of production	899	972	313	278	1,369
EBIT	5	33	18	8	63
R.O.S.	0.6%	3.4%	5.8%	2.9%	4.6%
Working capital	350	350	n.a.	n.a.	272
Net Invested Capital	498	517	n.a.	n.a.	417
R.O.I (*)	1.3%	8.5%	n.a.	n.a.	15.1%
Research and Development costs	29	21	12	5	26
Employees (No.)	6,260	5,955	n.a.	n.a.	6,005

(*) calculated on Invested Capital at period-end

The Transportation division includes the companies Ansaldo Trasporti - Sistemi Ferroviari S.p.A. (Systems), Ansaldo Signal NV and its related concerns (Signalling) and AnsaldoBreda S.p.A. and its related concerns (Vehicles). They operate in all segments of the rail and mass transit business mainly on the European market, with a sizeable presence in North America and on the Asia-Pacific market for Signalling activities. Through the three companies, Finmeccanica offers its clients complete solutions to satisfy the most exacting transportation demands.

The demand for guided transport systems, both in the urban/suburban and railway segments (passengers and cargo), confirms the interesting growth prospects in the medium term. The drivers of the demand include the need to relieve traffic congestion in the large urban and metropolitan areas, the request for an abatement of the environmental impact of transport systems, the demands for the renewal of a large part of the fleet of

“mature” vehicles, and the growing trend towards the outsourcing of management and maintenance services by the main players.

Europe confirms its leadership post as the major world market, both in terms of size of the demand and for its nature and innovative features. In this frame, Italy shows important growth prospects, especially in urban systems and *Alta Velocità* (High Speed) trains. The Asia-Pacific countries, India in particular, continue to show extremely interesting growth rates related to the demand and are destined to play an increasingly important role on the international scenario. The United States show signs of a gradual upswing in the urban segment, while expectations regard the launch, in the longer-term, of important *Alta Velocità* (High Speed) programmes.

Despite such an extremely positive scenario in the medium and long-term, the demand is currently discontinuous, with a particular slowdown in investments in the United States and in some countries of Western Europe, owing to economic pressure related to the need to restrain public expenditure. The belief is, however, that the unassigned orders should only be slightly put off and will become effective soon.

Against this background, in the three quarters of 2005, the Transportation segment witnessed, compared to the corresponding period of 2004, a strong fall in economic results, fully ascribable to the Vehicles business. In particular, the three businesses performed as follows:

- Vehicles: a sharp fall in operating profits, affected by the first consequences of a thorough revision of order estimates in the light of the negative industrial trend over the year, in the frame of the corporate reorganisation plan started concurrent to the change in management;
- Systems: a sharp rise in profitability, thanks also to the release of funds made available following the settlement of legal disputes and by the mitigation of risks for penalties;

- Signalling: a good commercial performance and a positive operational trend, firstly thanks to the Italian subsidiary Ansaldo Segnalamento Ferroviario, with important financial and economic effects.

New orders acquired at 30 September 2005 were worth €nil. 1,394, up by €nil. 62 compared to the same period of the previous financial year (€nil. 1,332), due to the higher amount of orders in Signalling and Systems business, partly offset by fewer acquisitions in the Vehicles business. The major orders for the period include:

- Vehicles: the second Supply Contract for Circumvesuviana, 29 Sirio trams for Florence; first supply contract for 3 line of the Milan subway, options relating to the contract for the Holland-Belgium *Alta Velocità* (High Speed) trains and to the contract for high volume passengers traffic trains for Morocco;
- Systems: De Ferrari-Brignole stretch of the Genoa subway, tramway for the Municipality of Florence, variants for Italy's High-Speed trains;
- Signalling: orders for the supplies to Rete Ferroviaria Italiana of ground systems related to the 2b phase of the "automatic train control systems" (SCMT) master agreement; orders acquired from Trenitalia concerning the third supply contract of the on-board SCMT devices; the order regarding maintenance on the Madrid-Lerida high-speed rail link; the Union Pacific order acquired in the United States.

At 30 September 2005, the **order backlog** stood at €nil. 4,182, up by €nil. 526 compared to the value posted at 31 December 2004 (€nil. 3,656), guaranteeing the Group work for approximately 3 years of production.

Value of production stood at €nil. 899 at 30 September 2005, down by €nil. 73 compared to 30 September 2004 (€nil. 972), showing a decline due to the problems in the Vehicles business.

The main orders for the Transportation division included:

- Vehicles: DMU trains for the Danish railways, new ETR500 *Polensione* locomotives for Trenitalia, trains for the Madrid subway, high volume passengers traffic trains for Morocco, orders for Sirio trams for various municipalities;
- Systems: *Alta Velocità* (High-Speed) activities for Rome-Naples rail link, and the Copenhagen, Genoa, Brescia and Naples subways; as to *Alta Velocità* (High-Speed) activities, note the positive conclusion of the partial testing of the Rome-Naples rail link, which took place on 7 September, with consequential starting of the pre-operation stage;
- Signalling: *Alta Velocità* (High-Speed) contracts for Italy and France, automatic train control systems (SCMT), both ground and aboard, for Italy, 2 phase of the Channel Tunnel Rail Link, production of components.

EBIT came to €mil. 5 at 30 September 2005, down by €mil. 28 compared to the three quarters of 2004 (€mil. 33), because of the abovementioned decline in Vehicles business (ROS -14.1%), only partly offset by an improvement in Systems (ROS 8.3%) and Signalling (ROS 8.9%), which benefited from a substantial increase in profitability. **ROS** fell as a result, reaching 0.6%, against a value of 3.4% recorded at 30 September 2004.

Working capital, totalling €mil. 350 at 30 September 2005, showed an increase by €mil. 78 compared to the value posted at 31 December 2004 (€mil. 272), also as a consequence of the adoption of IAS 32 and 39 accounting standards. In fact, according to a conservative interpretation by the Parent Company, these standards would lead to a reinstatement of the non-recourse transactions effected by the Vehicles business, which are still the subject of interpretative uncertainty. Net of this effect, there is the positive financial performance of the Systems business and, above all, of the Signalling business, which offsets the critical areas posted by Vehicles.

Net invested capital, amounting to €nil. 498 at 30 September 2005, reflects the performance of the working capital, showing an increase by €nil. 81 compared to the value posted at 31 December 2004 (€nil. 417).

Research and development costs amounted to €nil. 29 at 30 September 2005, showing an increase by €nil. 8 compared to the value posted at 30 September 2004 (€nil. 21) due to higher activities developed by the Signalling business.

Employees at 30 September 2005 came to 6,260, up by 255 compared to 31 December 2004 (6,005), mainly due to the increased personnel in the Signalling business.

ENERGY

€million	30.09.2005	30.09.2004	3rd Quarter 2005	3rd Quarter 2004	31.12.2004
New orders	557	128	121	37	937
Order backlog	2,130	1,454	n.a.	n.a.	2,089
Value of production	519	513	181	172	727
EBIT	20	14	7	9	20
R.O.S.	3.8%	3.0%	3.9%	5.2%	2.7%
Working capital	(247)	(74)	n.a.	n.a.	(63)
Net Invested Capital	(240)	(54)	n.a.	n.a.	(56)
R.O.I (*)	n.a.	n.a.	n.a.	n.a.	n.a.
Research and Development costs	8	5	3	2	8
Employees (No.)	2,527	2,492	n.a.	n.a.	2,588

(*) calculated on Invested Capital at period-end

This segment comprises Ansaldo Energia S.p.A., 100% owned, and by some smaller companies directly owned by Ansaldo Energia itself.

The trend of the world power generation market confirms the slow growth at global level in the demand for plants and machinery for the production of electrical energy, which is expected to gradually strengthen in the short and medium term. The development of the Indian market continues (which however appears to remain in the hands of domestic contractors), as well as the revival of the North American market and the development in the Far East market. Specifically, the Chinese market is witnessing the collapse of the bubble of orders reported in 2003, involving steam plants, while note the first signs of an opening to foreign contractors for turbogas plants. In any case, forecasts on the continuously prevailing demands on the Eastern markets, in particular China and India,

also for this year, show most of the orders relating to the traditional cycles fed with fossil fuels. As far as the size of the plants is concerned, the trend appears to steer towards the medium-large size for both the traditional cycles and for turbogas.

The Italian market has kept up the levels in the demand recorded last year, even if it is likely that this trend is expected to slow, owing to protraction in the demands. In this scenario, Ansaldo Energia also confirms its leadership position on the domestic market in the third quarter, concurrently maintaining its foothold on the Middle East and European markets. As far as service is concerned, which represents a segment of considerable interest for possible expansions and in accordance with the developments in the Company's strategic plan, contacts are being established with international operators in order to create structural cooperation relationships. In this context, 45% of ESG - Energy Service Group AG -, with registered office in Switzerland, was acquired in the third quarter, including the option to acquire the residual 55% by 2006. ESG is a service company operating in the field of energy production plants specialised in the on-site services.

Orders maintain a positive trend compared to the previous financial year. In fact, the higher amount of acquisitions is also confirmed in the third quarter compared to the third quarter of 2004 (€mil. 121 compared to €mil. 37 in the third quarter of 2004). This way, orders acquired at 30 September 2005 increased up to €mil. 557 compared to €mil. 128 in the corresponding period of the previous financial year, 60% involving the plant engineering-manufacturing area, 35% involving service activities and 5% involving the nuclear division. The major orders include:

- a 380 MW combined cycle plant for the Leinì power station located in Piedmont, ordered by Piemonte Energia of the Electrabel Group;
- a power island for the 800 MW combined cycle power station of Escatron (Spain), ordered by Enelpower;
- engineering activities on the Rizziconi power plant (located in Calabria) for the EGL Group prior to the supply of the plant;
- the supply of two 90MW steam turbines for the plant of ERG in Priolo;

- service activities such as the scheduled maintenance (long-term service agreement) on the above mentioned Leinì power plant and the Moncalieri and Lublin (Poland) plants.

Thanks to these acquisitions, the **order backlog** came to €mil. 2,130 at 30 September 2005, compared to €mil. 2,089 at 31 December 2004.

Value of production, amounting to €mil. 519 at 30 September 2005, was substantially in line with the value posted at 30 September 2004. Regarding this figure, 73% came from the plant engineering-manufacturing area, for activities conducted on the new orders of Vado Ligure, Leinì and Sparanise, in addition to continuation of the works on Enipower and Iranian orders, 20% from service and 7% from nuclear division activities.

EBIT, amounting to €mil. 20 at 30 September 2005, compared to €mil. 14 in the corresponding period of the previous financial year, despite higher R&D costs over the period (€mil. 8 against €mil. 5 in the three quarters of 2004). This was due to a different mix of activities, with greater contribution from service and the constant improvement of efficiency and production plans. Accordingly, **ROS** rose to reach 3.8%, against 3% of September 2004, while an higher ROS (5.2%) recorded in the third quarter of 2004 benefited of the major progress of orders with higher margins over the period.

A further improvement was posted in **working capital**, showing a negative value of €mil. 247, against a negative value of €mil. 63 at 31 December 2004, thanks to the collection of advances on new activities and to the performance of the outstanding jobs. Concurrently, **net invested capital** also continues to post a negative value of €mil. 240 at 30 September 2005, against a negative value of €mil. 56 at 31 December 2004, though with further improvements.

Research and Development costs, amounting to €mil. 8 at 30 September 2005, refer to the development of the technological autonomy plan in the steam and gas turbines

sector, launched in the previous financial year and whose results are in line with the pre-established programmes.

At 30 September 2005, **employees** were 2,527, dropping by 61 compared to 31 December 2004, against 183 new hires and 244 leavers, consistently with the predetermined corporate development plans.

OTHER ACTIVITIES

€million	30.09.2005	30.09.2004	3rd Quarter 2005	3rd Quarter 2004	31.12.2004
New orders	96	14	12	5	33
Order backlog	164	57	n.a.	n.a.	106
Value of production	108	38	40	19	79
EBIT	(72)	(75)	(28)	(27)	(140)
R.O.S.	n.s.	n.s.	n.s.	n.s.	n.s.
Working capital	48	419	n.a.	n.a.	(44)
Net Invested Capital	1,834	3,373	n.a.	n.a.	914
R.O.I (*)	n.s.	n.s.	n.a.	n.a.	n.s.
Research and Development costs	-	-	-	-	-
Employees (No.)	1,041	535	n.a.	n.a.	1,068

(*) calculated on Invested Capital at period-end

The sector includes: the Elsacom NV Group, which manages satellite telephony services; Mecfin - Meccanica Finanziaria S.p.A., a real-estate and service management company; Iritech S.p.A., holding the equity investment in Ansaldo Ricerche, to carry out spin offs of branches of business to be managed with other synergic partners, such as, for example, the production of energy through fuel cells with the Ansaldo Fuel Cells S.p.A. subsidiary; Finmeccanica Finance SA, responsible for financially supporting the Group; SO.GE.PA. - Società Generale di Partecipazioni S.p.A., responsible for directly managing the pre-winding-up/winding-up and rationalisation processes of companies falling outside the business sectors through transfer/replacement transactions and other smaller companies, including ALS S.p.A., a company contributing the branch of business to the Space sector. This company left a number of doubtful assets, deemed no longer functional to the development of the Space sector.

Following the adoption of the IFRS accounting standards, the equity investments in Ansaldo Industria S.p.A., Fata Group S.p.A. and Fata Automation S.p.A. in liquidation have been included in the scope of consolidation as from 31 December 2004.

BredaMenarinibus S.p.A., for which a preliminary sale agreement had been signed at the end of March 2005, was deconsolidated from the sector as from 1 January 2004, with the recognition of the economic effects under “discontinuing operations” and of the financial effects under assets/liabilities held for sale.

This sector’s figures also include those of the Corporate division of Finmeccanica SpA. In March 2005, the Corporate division, whose activities mainly involve policy, control and support to Group companies, reshaped its own organisational structure, including, *inter alia*, the following departments: External Relations, Human Resources, Marketing & Commercial Affairs, USA/UK Operations, Chief Technical Officer, Administration & Control, Group Finance, Strategy and Legal & Corporate Affairs.

Some of the Group’s major strategic projects include:

- continuation of the development of the Group Purchasing Programme (“P-180”), which aims at achieving important benefits from purchases by exploiting innovative computing tools such as e-procurement;
- the Life Cycle Management Project and Project Control initiative, conceived for the adoption, at Group-wide level, of a common model on project management, planning and control applied to the entire life cycle of an order.

Outlook

As earlier mentioned, the Group's outlook appears to be currently free from any events that may engender trends and results basically inconsistent with those forecasted.

More in detail, forecasts see an exceeding 20% rise in production volumes in 2005, compared to 2004, with a resulting improvement in operating profit (EBIT) in absolute terms.

Besides the abovementioned results, the integration of recently acquired activities, especially the avionic business of BAE, and consolidation of those about to be acquired, will entail high integration costs required to allow implementation of the significant synergies expected, which are a priority commitment for the Management in the short-medium term.

The constant monitoring of working capital trends, given the heavy investments made necessary for the development of new productions, will contribute to creating a fairly positive cash flow, which should allow the Group's net financial debt not exceeding the value posted at 30 June 2005.

For the Board of Directors
Chairman and Managing Director
(Pier Francesco Guarguaglini)