

# THE LEX COLUMN

## Finmeccanica's US leap

Pier Francesco Guarguaglini, the septuagenarian chairman and chief executive of Finmeccanica, has a plan. He has transformed the Italian industrial holding company into a focused aerospace and defence group by selling non-core assets and making sensible acquisitions. Yesterday's agreed cash offer for US group DRS Technologies for an enterprise value of €3.4bn is the latest step in an evolution that has seen Finmeccanica's market capitalisation triple to €9bn since late 2002.

The strategic rationale for the DRS deal is clear. International expansion ultimately means building a presence in the US – it buys half the world's arms. Recent successes there, notably the contract to supply the president's helicopters, have been encouraging. But an established business, with the Department of Defense relationships it brings, is necessary to progress.

Funding the deal means continuing Finmeccanica's disposals. Selling the last chunk of STMicroelectronics and part of the energy services division should raise about €1bn. The rest of the €3.4bn will be raised from debt and equity – with the amount to come from shareholders depending on the Italian government's willingness to see its 34 per stake diluted.

However, the price paid for DRS is high. On consensus forecasts the deal will make a post-tax return on capital of just 5 per cent in two years time. To justify the purchase requires either significant synergy benefits or another five years of booming US defence spending. The group chose not to disclose the value of the former, but cost savings at DRS, to be run by its existing management, will be few. Cross-selling opportunities will also be hard to find given the difficulties of exporting defence equipment from the US under current regulations.

As for defence spending, two-thirds of DRS's sales go to the US Army. If the post-second world war experience is anything to go by, spending can fall rapidly if the political climate changes. Finmeccanica has made a bold leap into the big league, but could come to regret it if Barack Obama is riding in the helicopter come November.

