

Finmeccanica has the world in its sights

Once close to bankruptcy, this Italian aerospace group now owns swathes of Britain's defence industry and is continuing to expand in the US, writes **Sylvia Pfeifer**



Jetsetter
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 Finmeccanica is working on BAE's Eurofighter radar, equivalent to the Spitfire gun sights

During the Second World War, Ferranti, a Manchester-based company, moved production of its gun sights to Edinburgh to escape enemy bombing. The sights, for the RAF's Spitfire, were described at the end of the war as "the single most important equipment" introduced during the hostilities.

Today, Ferranti has changed sides – it has been bought by Finmeccanica, the Italian aerospace and defence group. Engineers at its Crewe Toll site, near Edinburgh, are working on a modern equivalent of the Spitfire gun sights, a powerful and top secret airborne radar for Eurofighter.

But the Italian group's invasion of Britain goes far beyond radars. In the past two years it has quietly put together a string of deals taking it from nowhere to be by some measure the second-largest player in the British defence industry, with

revenues

of £1.6bn a year, 10,000 employees and control of some of Britain's most sensitive technology. In addition to the avionics business – Selex Sensors and Airborne Systems in which BAE Systems retains a 25 per cent stake – Finmeccanica owns AgustaWestland, the helicopter company that will produce the Future Lynx for the Ministry of Defence. It was also part of the winning consortium that will fly the US president in the next few years.

How did this Italian conglomerate, that just a few years ago was close to bankruptcy, come to own large swathes of Britain's defence industry? At a time when Britain's largest defence contractor, BAE, is focusing its attentions on the more lucrative US defence market, Finmeccanica has been following in the footsteps of Thales, the French defence group, which has become a player in Britain after buying the defence interests of Racal six years ago.

The architect behind Finmeccanica's rapid rise is Pier Francesco Guarguaglini, the company's 69-year-old chairman

and chief executive and a veteran of Europe's defence industry. An engineer from Tuscany, Guarguaglini has masterminded a series of bold, often complex, restructurings and acquisitions, particularly in the UK where the company has spent more than £1.6bn over the past two years.

The Italian state may still own a 32.4 per cent stake in Finmeccanica, but Guarguaglini makes no secret of his global ambitions, which in the UK means being regarded as nothing short of British.

"We want to be seen as British," he says in an interview at Finmeccanica's Rome headquarters. "We want to increase our activities in the UK and expect to maintain a good relationship with our UK Ministry of Defence customer, giving them confidence in us as an important element of their industrial and technology base."

Although its UK business is headed by an Italian, Alberto de Benedictis, the individual operations are all run by British nationals. In a bid to cement its ties with the UK MoD, the company

recently appointed Lord Bach, the former defence procurement minister, as non-executive chairman of Selex Sensors and Airborne Systems.

Advice is also on hand from veterans

of Britain's defence industry; Guarguaglini says he still gets advice from Sir Richard Evans, the former chairman of BAE Systems, on how to operate in the UK environment.

While Finmeccanica has forged strong relations with the MoD in a relatively short time, BAE's relationship with its main customer has been through some rocky periods. Relations were pushed to breaking point over cost overruns on two UK military programmes – the Nimrod maritime spy plane and the Astute nuclear submarine. The overruns led to a painful £750m writedown in BAE's 2003 figures. But they also pushed the MoD to recognise that fixed-price contracts secured through competition did not always provide realistic cost targets or value for money.

Relations have improved since then and BAE recently appointed a new chief operating officer with sole responsibility

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for running its UK operations. Nevertheless, Mike Turner, BAE's chief executive, has made no secret of his desire to grow on the other side of the Atlantic. The company broke into the top tier of Pentagon suppliers last year with the £2.4bn purchase of United Defense Industries. The recent sale of its holding in Airbus, the Franco-German aerospace group, which netted BAE £1.9bn, has increased speculation that the company is sizing up acquisitions in the US.

Alison Wood, BAE's head of strategy, says while the company is positioning itself globally, it still recognises that it has a "significant footprint" in the UK and one that it wants to retain. Focusing on the US market is a no-brainer; the US defence market is ten to 12 times larger than the UK one.

"The group is interested in growing... there is a finite capacity for the UK market and the US market still remains the largest and one of the most attractive market-places," says Wood.

For Finmeccanica, meanwhile, growing

overseas – both in the UK and the US – is crucial if it wants to maintain its growth in the longer-term. Italian defence spending, which had been on a

downward trend over the past two years, has recently turned positive, but the real opportunities remain overseas.

The company has changed radically since Guarguaglini took the helm in April 2002. At the time, it was still a sprawling conglomerate whose operations reflected its history as a company set up after the Second World War by the Italian government to resurrect its shipbuilding,

automotive and rail industries.

It had begun slimming down in the 1980s and in the late 1990s began to build up its defence portfolio through a series of joint ventures with BAE and Matra in missiles, BAE in avionics and with GKN in helicopters. By the time the financial crisis struck in 1997 – debts had soared to €6bn – Guarguaglini, who had first worked in Finmeccanica's radar and defence electronics subsidiaries, had become head of the defence business.

He left in 1999 to run Italy's main shipbuilding group, Fincantieri, but was called back to take the top job four years ago. He decided to focus operations on aerospace and defence and reduce its reliance on the Italian government.

But if the company really wanted to become a global player, it needed to take full control of its destiny – which meant control of joint ventures. He opened talks with BAE and agreed to pay the British company £633m in return for control of Selex (BAE retains a 25 per cent stake) and an air-traffic control business.

Says Guarguaglini: "What was important to me was that I had complete control of the two legs (systems integration capability and electronics) which underpin our defence electronics business so that we could design a large system based on those two legs."

Discussions followed with GKN to buy their stake in AgustaWestland and the Italian company eventually agreed to pay £1.1bn for the 50 per cent stake.

The deal with BAE in particular raised eyebrows in some circles – it would leave a foreign company in charge of sensitive British technology, including radar. But

unlike its European partners, Britain is no stranger to foreign involvement in defence programmes. The MoD buys kit from companies around the world to the extent that American and European players have built up large presences here. Thales, for example, is a key partner in one of Britain's most important defence programmes, the design and construction of two new aircraft carriers for the Royal Navy.

Both de Benedictis and Alex Dorrian, his opposite number at Thales UK, say what is relevant to the British Government is not the shareholding of the assets but how they are managed in Britain. "What is relevant is how the assets are managed and developed in country so that you are continuing to invest, your asset base continues to grow," says de Benedictis from his Westminster office.

Consideration, adds Dorrian, is "given to the benefit a company brings to the UK economy, through investment and employment".

Finmeccanica's decision to focus on defence electronics and helicopters has proved to be key in building a strong relationship with the MoD. Although the defence industry is known for its big, eye-catching "platforms" – fighters, tanks and ships – it is the equipment that runs these platforms – the radar, software and electronics – that command a big slice of defence budgets. "We believed it would be difficult to justify building new platforms over and over in the future because of the cost, but electronics was going to be at the heart of the systems," says de Benedictis. "Electronic content on aircraft has grown from 15 per cent 30

years ago to over 50 per cent in a modern platform, and closer to 60 per cent in the fourth generation platforms," he adds.

This summer, Finmeccanica signed a ground-breaking deal with the MoD to provide it with Future Lynx helicopters. The £1bn deal was announced alongside the signing of a strategic partnership agreement with the MoD. The first of its kind, it fits in with government's Defence Industrial Strategy (DIS) whose aim is to create long-term partnership deals with industry to provide fighter jets, helicopters, armoured vehicles, missiles and warships.

Lord Drayson, the defence procurement minister, describes the signature of strategic partnership with AgustaWestland as "a major step forward for the DIS and gave a clear signal to the UK's defence industry that change is both necessary and achievable".

Finmeccanica's ambitions do not end there and the company is already bidding for more work with the MoD, including supplying the RAF with a new trainer jet. It is also keen to supply other platforms with its electronic systems.

At its Crewe Toll site in Scotland, engineers are working on the newest generation of radar – which works digitally. Analysts say this electronically scanned radar, dubbed E-scan, is key to winning more export orders for Eurofighter and it could eventually be deployed on the third tranche of planes.

"If you look at where the UK is going to put its money in terms of requirement, we are certainly in some of the sweet spots," says de Benedictis.

The company's globalisation effort has paid off. Last year it boasted revenues of €11.5bn (£7.8bn), compared with €7.7bn in 2002. Guarguaglini expects this to rise to about €15bn by 2008. Italy's contribution in terms of order intake has fallen from just over 80 per cent in 2004 to 40 per cent this year.

On the civil side, the company is present on both the new aerospace programmes, Boeing's 787 and Airbus A380. It is trying to increase its share of the work on the upcoming A350 XWB.

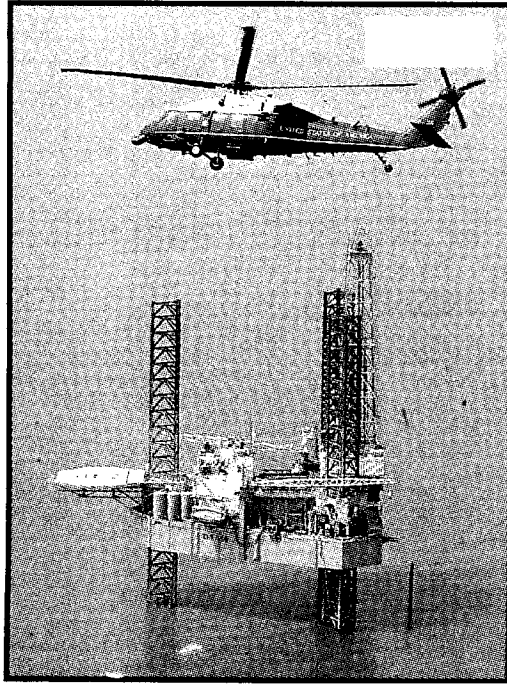
Future plans, says Guarguaglini, are to continue to penetrate the US market and enlarge activities in the UK and keep reducing the percentage of revenues from the Italian market.

Does he think the current turmoil at EADS will make integration of the European industry more or less likely?

"First they have to fix the problems inside Airbus," he says. "This means, not only putting the A380 on the right path but also they have to find a good path for the A350... So this will reduce the possibility [of more integration]."

A tie-up with France's Thales is also on the agenda. Finmeccanica last year signalled its interest when the French government mooted a restructuring of the company. The two companies are co-operating in a number of areas and this will be reinforced when the space assets of Alcatel move to Thales, creating a joint venture with the Italian company. Guarguaglini says further talks about a possible combination will have to wait until May after the French election but adds he is "ready to discuss this".

"In time, we have to think about how to reinforce Finmeccanica."



Italians hover over White House

THE US President's personal helicopter transport has been provided by one company, the all-American Sikorsky, for 50 years. But last year, in a decision that shocked Washington, the Pentagon chose an Anglo-Italian design for Marine One, the name given to the President's fleet. Marine One is so sensitive that the Sikorskys that currently supply the President are built behind green screens and barbed wire.

Finmeccanica, the Italian company that will supply Marine One, overcame these sensitivities by forging a bid with Lockheed Martin, the prime contractor, and using a design based on Britain's Merlin. It also enlisted the help of Tony Blair and Silvio Berlusconi, the then Italian premier, to convince the Americans its proposition was the best.

The deal, for 23 helicopters, brought the Finmeccanica name to the attention of the British public for the first time. The planes, dubbed US101s, are modified versions of the EH101 helicopter which is in service with the Royal Navy and others around the world. The structure will be made at Yeovil in Somerset, the UK site of AgustaWestland, Finmeccanica's helicopter subsidiary – and the same Westland helicopter plant that caused the famous rift in Margaret Thatcher's cabinet in the 1980s. They are then shipped to the US for final assembly at Lockheed's Owego plant in New York. Flights from the White House lawn are due to begin in late 2009.

As part of its integration of AgustaWestland, Finmeccanica intends to focus production at Yeovil on military helicopters while its sites in Italy, including Vergiate, near Milan, will be devoted more to civil helicopters such as the AW139s whose customers recently included the Nigerian government and Nicky Oppenheimer, the South African diamond magnate.

Defence facts

How the largest defence companies match up in Britain

	UK employees	UK sales/yr	Key Programmes
BAE Systems	32,400	£6.5bn	Aircraft carriers, Eurofighter, JSF, Nimrod, Astute
Boeing (defence only)	150	not available	Apache, Chinook
EADS (defence only)	5,000	£700m	Eurofighter, A400m
Finmeccanica	10,000	£1.6bn	Eurofighter, Future Lynx
General Dynamics	1,500	£500m-£700m	Bowman, Eurofighter
Lockheed Martin	1,500	£400m-£600m	Merlin, Javelin
Thales UK	9,000	£1.1bn	Aircraft carriers, Watchkeeper

Source: Company estimates