CAZENOVE
&CO.

FIDIA
Initial Coverage- 20/12/00
Price €12.70
Market Cap. € 61 m (28.2% floating)
Long Term Buy
Target Price €15.8

Recommendation:
Fidia has strongly improved its profitability during the last 2 years thanks to:

- Higher post-sales activity
- Improvements in the product mix
- More financial contribution from Government institutions (EU and Italian) for the R&D activity

We expect sales to strongly increase in the high speed milling systems division. We also expect CAM (Computer Aided Manufacturing) software sales to become consistent given the good reception of the product among its customers.
The company is very small and we already anticipate no interest from a large number of institutions because of the size. However we consider Fidia a good Long-Term Buy opportunity given the very high ROCE and good prospects in terms of sales and EPS growth.

We have compared Fidia to other small mechanical engineering & electronics companies listed on the Milan Stock Exchange:
Sabaf, PrimaIndustrie, Targetti Sankey, Brembo, Interpump, IMA, Saes Getters, Gewiss and Manuli Rubber. We have excluded Vemer and Beghelli whose multiples are artificially high.

Their multiples varies between the one mentioned below:

	High (Gewiss)	**Low(Manuli Rubber)**
EV/Ebitda 2001	9.5x	3.5x
P/E 2001	25x	12x

We have also compared Fidia to the above mentioned sample in respect of some fundamental indicators:

Expectations 2000-2002

Organic Sales Growth	*Possible growth through acquisition*	*Referring market sales growth*	*Ciclicality of the business*
+	++	+	+

Liquidity of the Stock	*Cash flow generation*	*ROCE*	*EPS Growth*
-	++	+	=

++ Much higher than the average
+ higher than the average
= in line with the average
- lower than the average

We understand Fidia has no track record as a public company and the size of the stock is very limited however we believe that Fidia is good buying opportunity for long term investors interested to diversify in a small and very profitable high tech company. **Target price €15.8**

Business Overview

1) Fidia is world leader in the design, construction and marketing of integrated systems for the machining of complex forms for the moulds and dies industry.

2) Fidia activity is divided in 3 divisions:

- Numerical controls for milling systems
- High-Speed milling systems
- CAM software for the milling of complex shapes

3) Fidia exports more than 60% of its production. The company has set up subsidiaries in Germany, France, Spain, USA, China and Brazil.

History

The company was founded in 1974, by the current Chairman and controlling shareholder (Ing. Morfino), to design and build sophisticated numerical controls.

Fidia started developing control numerical systems for the machining of complex forms for the moulds and dies industry
First products released on the market were:

- CNC11 Copymill
- CNC12 Compact

During the 80s Fidia started its internalisation process, setting up subsidiaries in USA, Germany, France and Spain.

New products were put on the market at the end of the 80s: CNC 10/20/30. These latest versions had installed Micro-Processors Digital Equipment (DEC).

In 1988 the company acquired 50% (later increased to 100%) of Meccanica Fortini, company specialised in the production of large milling systems.
In 1990 the company started developing CAM software (Computer Aided Manufacturing).
In 1993 the company set up a JV in China. The company has later increased its stake form 52% to 92%. In 1994 the company set up an office in Brasil.
In 1994 the company buys 36% (increased in 1996 to 73%) Sitra, company with a long know how set up in the 60s by various Engineering Professors based in Turin.
In 1996 the company buys 37.5% of Simav (increased later to 100%) in 1998. Simav is a manufacturer of high frequency converters for electrosplindles.
In 1997 the company started developing Hill Mill software packages together with a research centre based in Switzerland. Fidia later bought the entire stake of the company. The company is now the sole proprietor of that technology.
A large of new products has been put on the market during the last 2 years, both in the high speed milling division and numerical control systems division.

Divisions of the group

Numerical controls

Fidia numerical controls are designed to control milling systems for machining of complex forms. Accuracy and quality of the finished product are their most important characteristics.

The software incorporated in the numerical control "reads" the static mathematical data and transform these data into dynamic electrical data, i.e. into commands for making the tool execute the sequence of movements required in order to produce the desired shape by milling the part.

Numerical controls can be either:	% on total sales (1999 data)
sold directly to OEM customers	70%
Installed in Fidia high speed milling machine	13%
Installed in third party's milling machines	17%

The company has sold 479 numerical controls in 1999.

High Speed Milling Systems

Fidia high-speed technology virtually eliminates manual finishing. Customers are therefore able to manufacturer more complex form with improved quality and significantly reduced amount of time.

Fidia started selling high speed milling machines after the acquisition of Meccanica Cortini in 1988.

- Meccanica Fortini manufacturers large machines.
- Simav manufacturers small/medium machines

The company manufacturers five types of high-speed systems. They differ according to the size, features and applications.

The K165 high speed milling machines has been one of the best performers during the last few years. More recently the company has launched two new machines: K211 and K411. These two machines represent Fidia's new line of high –speed 5- axis milling centres.

Some features of the K211 and K411:

- High penetration and excellent removal capacity
- Optimum visibility of the part being machined
- Wide range of possibilities for customisation
- Easy to install

Thanks to the quality of the final product these machines can be used to manufacturer a large number of sophisticated products (like undercarriage and turbines for aeroplanes).

Fidia High Speed Milling Systems have all installed a Fidia Numerical control system.

CAM

Cam is a software package for the automatic generation of machine tool control programs. Starting from the mathematical data, the software generates the subsequent phases of the milling process. The HI-MILL CAM developed by Fidia represents an increasingly important business segment.

CAM software enables the blue collar to partially modify the set up of the final print without requesting the support from the engineers in the Technical department.

CAM software has been completed in 1999. Since than the company has started marketing the product among its current customers experiencing a very good response.

The company doesn't outsource any software part of the business. A limited part of the electronics is outsourced to third parties. A more important contribution from third parties is seen in the mechanical side of the business.

R&D expenses
The sustained growth of the company is based on high R&D costs. Fidia employs more than 40 people in the R&D department. The company enjoys a very good reputation in the academic and scientific world; as a result it was able to receive contribution for the development of a large number of projects.

- 12 Projects were financed by the EU
- 4 Projects were financed by MURST (Italian Minister of Research)

€m	1998	1999	1stH 00
R%D expenses	2.5	2.9	1.5
% of sales	7.4%	7.7%	7.7%
Other Income	1.8	2.4	1.6

Most of other income (around 80%) is represented by contributions from the EU and MURST.

The company has patented a large number of products and processes (mainly related to the electronic part of its products) both in Italy and abroad. Fidia has preferred not to patent its software as secrecy was considered more important.

Post Sales activity
The increased level of post-sales activity has pushed the up the marginality of the group. During the first half of the current year 18% of total sales, marginally higher than during the 1stH 99 (17%) and much higher than in the past.
In Italy post sales assistance is supported by a service centre based in Padoa (NE of Italy) and some agents.
Outside Italy post sales assistance is either provided by the subsidiaries of the company or by service centers. Rarely the company uses local agents.

Customers and Market issues
Fidia High Speed Milling machines are sold to final customers (i.e. GM or Nike) while numerical control systems can be sold either to the final customer or the machine tool manufacturer.

In 1999 2/3 of the total turnover was generated by sales in the automotive sector. Fidia is highly exposed to the automotive sector both in the high-speed milling division and numerical control system division.

Fidia total sales to the automotive sector are related to the ***number of models*** put on the market by each car manufacturer. The life-cycle of each single model is expected to further decrease in the near future (from 8-10 years in the 80s to 2-4 years in few years time). As a consequence the expected number of "face- lift" on already set-up platforms is expected to increase. Fidia works with all the main players in the automotive market (GM, Ford, Nissan and mainly all European players).

Fidia is also highly successful in the wheel (e.g. Good Year and Continental) and shoe sector (e.g. Nike and Bata).
High technology is easily applicable to a large number of industries.
No customer accounts for a significant percentage of total sales.

The company estimates *(Source: Modello STEP*) the 2000 world market for milling machines to reach €7.5bn-€10bn in 2000. Around 10% of the market is represented by high speed milling systems sales that are expected to increase their market share during the next 3 years.

The same source expects high speed sales milling systems sales to increase in between **13%-17% per year until 2003** (overall market expected to increase between 4.5-9%).

Competitors

Fidia position itself at the top of the range. Its machines can cost up to 2x the competition. The company will concentrate its attention on new machines with better quality standard. However more recently the company has developed machines slightly less performing in order to keep a market share also in the low end of the segment.

Fidia main competitors are very large groups:

Fanuc (part of GE Fanuc)	mainly in North America
Siemens	World player
Heidenhain	Germany, Spain and Italy (through Selca)

SWOT

Strength
Very good R&D department
High number of patents
Constant change of new products
High Brand recognition
Good contacts with various Government Institutions
International exposure (6 subsidiaries around the world)
Ability to customise products
High customer loyalty
High level of customer service
Very limited amount of capitalised costs

Opportunities
Expansion outside Europe
Small acquisitions in the software and electronics market
High speed milling to increase market share on total milling machines
Increase marketing efforts

Weakness
Working Capital still high
Business is slightly cyclical
Exposed to the auto sector
Business is slightly seasonal

Threats
R&D contribution may decrease in the forthcoming future

P&L 1999 – 9m results 2000

€m	**1998**	**1999**	**9m 2000**
Numerical Control (incl. CAM)	16.5	17.3	12.7
High Speed Milling Systems	18.1	20.2	15.5
Total Fidia Sales	34.6	37.5	28.2
Ebitda	3.6	6.6	5.4
Ebitda Margin	**10.5%**	**17.6%**	**19.1%**

During the last 3 years the company has been able to capitalise the large efforts made in the past in R&D.
Sales have increase in particular in the High Speed Milling Division. The company has experienced very good results thanks to the DIGIT product line (the average price per machine has strongly increased).
Numerical control systems sales have increased during last 2 years thanks to higher units sold (+18% in 1999). During the first six months of the year the number of units sold has slightly decreased. Furthermore in 1999 the company has started selling CAM software. CAM sales also today represent a very small part of the entire business (€0.3m) but we expect them to increase strongly since 2001.

Sales during the IVQ of the year represent around 30-35% of total sales.
Around 12% of total sales (nearly all sales outside Europe) are in US$. The company has already covered next year exposure (2001) at a fix rate 1US$=L.2140

Order backlog has increase 84% to €12.1m thanks to very good orders received in the high speeding mills division. The order backlog in the High speed milling division accounts for 5 months, the one in the numerical control division for 1-2 months.

Cost of Raw materials: Has decrease its weight in % of total sales thanks to the increased level of post sales activity and increased productivity of the group

Cost of labour has also decreased marginally has number of employees has increased less that total sales. The average salary has increased as the company has remunerated its personnel also through productivity bonus.

Financials have increased following the close of some expensive financial lines.

Forecasts 2000-2002
During the next 3 years we expect sales to increase strongly in the high-speed milling division. We also expect good order inflow for the recently launched CAM software.
We don't expect major increase in the numerical system division, apart from an increased level of intra-group activity.
The company has the capacity to sustain the growth for at least one more year. In 2002 accordingly to the results achieved and eventual J/V and acquisitions the company could decide to increase its production capacity.

The company is planning to expand both geographically and in terms of products. Fidia is interested to increase its presence in markets where it's already present (USA, Brasil and China) and to set up JV or subsidiaries in other emerging markets.
The company is also committed to further increase its portfolio of products, not only through R&D expenses but also through external acquisitions. Fidia is in particular interested in small software houses specialised programs within CAD environment. Fidia is also looking at opportunities to further enhance its electronics capabilities.

Profitability of the group is expected to decrease as:

- R&D costs will be less supported by contribution from Government institutions
- Increase its international network

Below the Ebit line we expect financials to turn positive given the positive net financial position.
We expect the company to charge all the IPO expenses (€1.9m) in the 2000 P&L.
Finally we expect the current tax rate (46%) to slowly decrease to 42% tax rate thanks to a more favourable fiscal legislation (Dual Income Tax) and other fiscal advantages stemming from the listing of the company.

Cash flow
We forecast the company to continue to generate cash flow it has done in the past. Capital expenditure is fairly limited (4-5% of total sales), excluding R&D expenses that are anyway included in the P&L.
Fidia has been working in order to decrease the payment period and stock ratio. This has contributed to further increase the cash flow of the company.
In 2001 and 2002 we expect the company to further increase its cash flow, excluding acquisitions or joint ventures. In 2002 Capex might increase if the company decide to increase its capacity. Given that at the moment no decision has been taken we prefer not to include them in our cash flow statement.
The company is expected to pay dividend from the year 2000 onwards.