

LUXOTTICA**BUY****The Short-sighted Shouldn't Panic****PRESENT PRICE: €10.70****TARGET PRICE: €13.50****INITIATION OF COVERAGE**

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Basic Figures, June 11, 2003

Reuters / Bloomberg codes:	LUX.MI / LUX.IM
Market capitalisation (€ mn):	4,825
Number of shares (mn):	452.1
Average daily volume (€ mn):	3.1
52-week range (€):	20.20-9.25
Free float (%):	25.0
2003E ROE (%):	18.4
2003E P/BV (x):	3.1
2002-04F PEG:	Neg

Source: Reuters and SCH Bolsa estimates and forecasts.

Estimates and Fundamental Ratios

	2001	2002	2003E	2004F
Net profit (€ mn):	316.4	372.1	283.4	308.1
% change:	23.9	17.6	-23.8	8.7
Cash flow (€ mn):	528.3	518.1	434.9	466.0
% change:	22.7	-1.9	-16.0	7.1
P/E (x):	24.5	21.3	17.1	15.7
EPS (€):	0.70	0.82	0.63	0.68
% change:	23.6	17.2	-23.3	8.7
P/CF (x):	14.7	15.3	11.1	10.4
CF/S (€):	1.16	1.14	0.96	1.03
EV/EBITDA (x):	12.7	12.2	9.7	8.4
GDY (%):	1.0	1.2	1.5	1.7
DPS (€):	0.17	0.21	0.16	0.18

Source: Company data and SCH Bolsa estimates and forecasts.

Relative Performance (12 Months)

Source: Datastream.

Luxottica is the world's leading manufacturer and retailer of mid- and premium-priced sunglasses and prescription frames, with a turnover of €3bn. 73% of sales are made in the US, where the company controls the two leading retail chains in their respective segments: LensCrafters and Sunglass Hut International. Ray-Ban is Luxottica's most important proprietary brand, while licensed brands include Chanel, Versace, Bvlgari and other luxury brands.

The eyewear market has grown steadily over the past 10-to-15 years, as glasses have gradually come to be considered fashion accessories. Luxottica has been able to outpace market growth thanks to its fully-integrated business model and well executed acquisitions. We believe this will continue in the future.

During the past 12 months the stock has been penalised by the strengthening of the euro against the US dollar, the expiration of the Armani licensing agreements and the slowdown of consumption trends in the US. While there could still be unfavourable news in 2Q03E, the company's share buy-back plans should prevent any further weakness in the share price. Additionally, 2004F looks brighter, with an expected recovery of the US dollar and the US economy, new potential licence agreements and the renovation of Chanel, synergies from the integration of OPSM, and the possible announcement of new acquisitions. The founder and current chairman has recently bought shares in the company.

We initiate coverage on Luxottica with a Buy rating and a target price of €13.50/share for year-end 2003E (and €14.60/share for year-end 2004F), based on a DCF model. At €13.50, the stock would be trading at P/E and EV/EBITDA multiples of 19.7x and 10.2x, respectively, below the company's historical averages.



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EXECUTIVE SUMMARY

A world leader	Founded in Agordo (Belluno) in 1961 by Leonardo Del Vecchio, current chairman and owner of 69% of its share capital, Luxottica is the world leader in the mid- and premium-priced eyewear frame industry, with a turnover of €3,132mn in FY02. The company has a solid track record, with a 25% EPS CAGR during the past 12 years. Luxottica is listed both in the US, where it has appreciated at a 20% CAGR since its IPO in 1990, and in Italy (2.3% of the capital, since the end of 2000).
Glasses as fashion accessories	Since the beginning of the 1990s, Luxottica's reference market has been growing steadily as a result of the increasing use of glasses (both corrective and sunglasses) as fashion accessories. The company expects the demand for prescription frames to grow at rates similar to GDP growth in the western economies, while sunglasses could exceed GDP growth in the medium term, although they are more cyclical. We expect Luxottica to continue outpacing market growth rates thanks to its fully-integrated business model and well-executed acquisitions.
A fully-integrated player	Luxottica is the most integrated player in the industry as it not only controls manufacturing, mainly located in the eyewear cluster of north-eastern Italy, but also distribution, thanks to 29 wholesale distribution branches around the world and the retail chains acquired over the past few years in the US (LensCrafters and Sunglass Hut). The company manufactures and distributes prescription frames and sunglasses under own (eg, Ray-Ban) and licensed brands (eg, Chanel).
Bad 2003E already priced-in	The stock was penalised over the past 12 months by: (1) the strengthening of the euro versus the US dollar, since more than 70% of the company's consolidated sales are made in US dollars; (2) the expiration of the Armani licence agreement, which accounted for 7.2% of Luxottica's revenues in 2002; and (3) the slowdown of consumption in the US, especially in the mid to high segment (luxury goods), in which Luxottica operates. With (1) the €/US\$ likely to reach US\$1.20 between 2Q03E and 3Q03E and (2) US private consumption likely to bottom out in 2Q03E (or 3Q03E at the latest), we believe the risk to the company's €0.69 EPS target for 2003 is still on the downside (our estimate is €0.63). Nevertheless, the company's aggressive share buy-back programme is likely to prevent further weakness in the stock price (15.5mn ADRs can still be purchased, while the stock's average daily trading volume is of 300,000 ADRs).
2004F looks brighter	2004F looks much brighter, as: (1) for 4Q03E we expect the euro to start weakening versus the US dollar up to an average of US\$1.065 in 2004F (versus US\$1.12 in 2003E); (2) private consumption in the US is likely to improve, albeit gradually, towards year-end; (3) new agreements could be reached with leading fashion houses and the agreement with Chanel could be renewed; and (4) synergies from the acquisition of Australia's leading optical retailer, OPSM, could exceed our estimates. Finally, further acquisitions could be announced and, given the company's track record, we believe this should be good news for the stock.
Target price of €13.50/share	From a valuation point of view, we obtain a fair value for the company of €13.50/share for year-end 2003E (€14.60/share for year-end 2004F), using a DCF model. Historical multiples show that the company trades in line with its lowest ratios of 1993 and 1997 while, relative to the market, Luxottica trades at a P/E in line with its historical average of 1.25x (although down versus 2002's 1.43x). A comparison in terms of market multiples with the luxury goods industry shows that Luxottica is around 20%-25% undervalued in terms of P/E. We highlight that the optical industry lacks comparables of a similar market size.

INVESTMENT POSITIVES AND CONCERNS

INVESTMENT POSITIVES

- **Market leader:** Luxottica is the undisputed leader in the manufacture and distribution of mid- to high-price sunglasses and prescription frames. Consequently, it would be the best partner for any luxury brand willing to diversify into eyewear.
- **Best portfolio of own brands:** with the acquisition of Ray-Ban, Luxottica now has the best portfolio of proprietary brands (representing roughly half of its total revenues). Own brands can be more profitable, as they entail no royalty payments and are not exposed to the risk of the non-renewal of licence agreements.
- **Leading optical retailer in the US:** with the acquisition of LensCrafter and Sunglass Hut, Luxottica controls 11% of the US prescription frame market and 35% of the premium sunglasses market (and 5%-6% of the sunglasses market as a whole).
- **Vertical integration:** Luxottica is a vertically integrated player. This allows it to offer high-quality products and a high standard of service to its wholesale clients (opticians). However, it still manages to achieve the highest profitability in the industry.
- **Good track-record in acquisitions:** past acquisitions (LensCrafters, Ray-Ban, Sunglass Hut) have rapidly paid off. Luxottica's strong cash flow generation provides it with substantial scope for future acquisitions.
- **Share buy-backs:** the company currently has two ADR buy-back programmes in operation. Around 15.5mn ADRs could be purchased on the market over the next 18 months.

CONCERNS

- **Exposure to the US dollar:** around 73% of the group's consolidated revenues are in US dollars, compared with less than 70% of its total operating costs. According to Luxottica, a 10% decline in the US dollar versus the euro should have a 12%-13% negative impact on its EPS. Luxottica has no hedging for 2003.
- **Trade down:** at times of economic difficulty, customers tend to either postpone eyewear purchases (especially frames and sunglasses) or trade down towards cheaper options. Larger retailers are stepping up their competition against specialised optical chains in the mid and low segments.
- **Laser surgery:** we expect a certain impact in Europe in the future. However, so far the impact on prescription frames has been limited to the US, where penetration of laser surgery is higher. Furthermore, according to Luxottica, laser surgery penetration leads to increased use of sunglasses.
- **Stock overhang:** Giorgio Armani still has a 5% stake in Luxottica, although he is apparently willing to sell it: the stake was acquired at the time of the IPO, so even at current prices Armani should book a substantial capital gain. We understand that the company's founder and major shareholder has offered to buy Armani's stake, which we believe would be welcomed by the market.

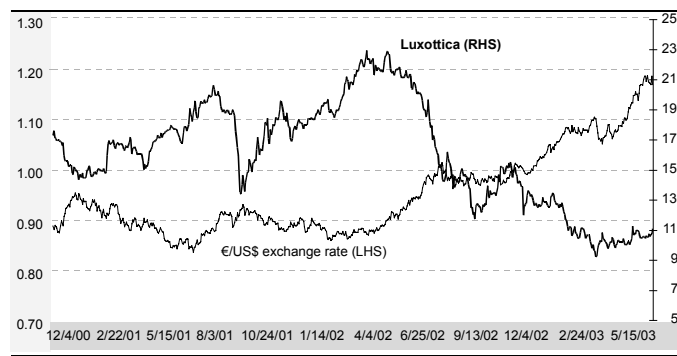


VALUATION

Stock penalised during the past 12 months

The stock has been hit over the last 12 months by: (1) the strengthening of the euro versus the US dollar, with the company making more than 70% of its consolidated sales in the latter currency; (2) the expiration of the Armani licence agreement, which accounted for 7.2% of Luxottica's revenues in 2002; and (3) the slowdown in US consumption, especially in the mid-to high-range (luxury goods) of the sector.

Figure 1. Luxottica – Share Price Correlation with the €/US\$ Exchange Rate, 2000-03



Source: Bloomberg.

Lack of comparables

We have valued Luxottica using a DCF model and market multiples, despite the difficulty in finding a comparable sample of companies.

Luxury goods industry

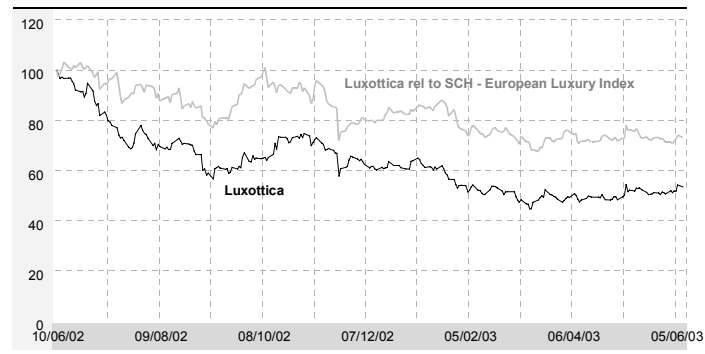
The most used peer group for Luxottica is the luxury goods industry, as it is one of the leading licensees of eyewear for luxury brands. The main difference is Luxottica's licensee status for roughly half of its revenues (according to our estimates) which, in our view, deserves a certain discount.

Figure 2. Luxottica – Multiples Comparison: The Luxury Goods Industry, 2003E-04F

	Mkt Cap (€ mn)	P/E 2003E	P/E 2004F	EV/EBITDA 2003E	EV/EBITDA 2004F
LVMH	21,592	26.5	23.1	12.3	11.0
Christian Dior SA	6,460	13.1	20.8	6.7	6.4
Hermes International	4,709	21.4	20.5	11.9	11.1
Bulgari SpA	1,359	16.6	15.8	10.8	10.0
Gucci Group NV	8,188	27.2	25.2	18.2	14.7
Tod's SpA	806	17.4	16.2	8.0	7.1
Richemont AG	7,625	24.1	18.1	14.7	11.1
Swatch Group AG	4,614	14.6	13.1	8.3	7.1
Burberry Group PLC	1,841	15.6	13.4	8.5	7.3
Hugo Boss AG	917	10.2	9.1	6.4	5.5
Tiffany	4,185	24.8	21.6	12.6	11.9
Avg ex-high & low	–	19.3	18.1	10.4	9.2
Luxottica	4,825	15.2	13.9	9.7	8.4
Luxottica @ €13.50/share	6,043	19.1	17.4	11.6	10.2

Source: JCF and Santander Central Hispano Bolsa estimates and forecasts.

Figure 3. Luxottica – Comparison with the Luxury Goods Industry, 2002-03



Source: Bloomberg and Santander Central Hispano Bolsa.

Optical industry

A comparison between Luxottica and other listed players in the optical industry is not very meaningful. Luxottica is seven times bigger in terms of market capitalisation than its largest 'comparable' (the German retail chain Fielmann AG). Its only comparable player in terms of market capitalisation, Essilor (with a market cap of €3.5bn, versus Luxottica's €4.8bn) is not strictly comparable in terms of operations as it supplies Luxottica with corrective lenses and is not present in the retail business.

Figure 4. Luxottica – Multiples Comparison: The Optical Industry, 2003E-04F

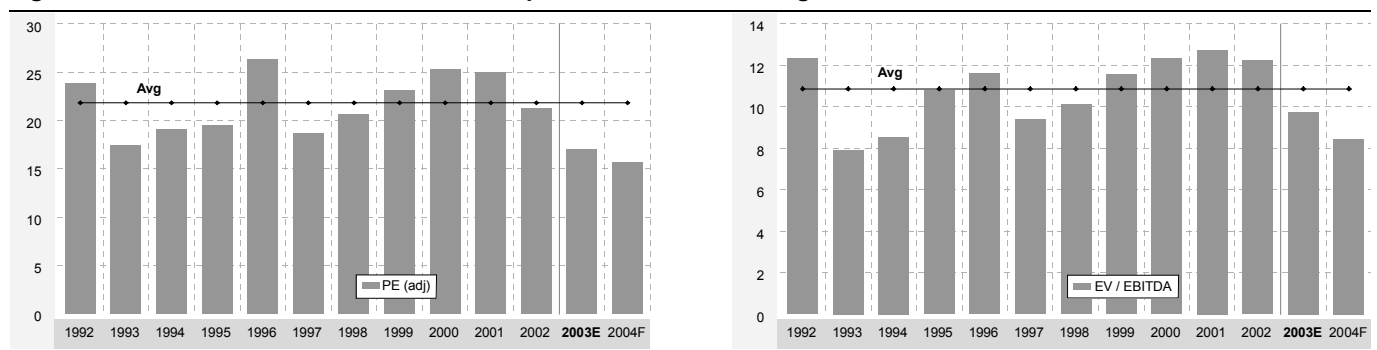
	Mkt Cap (€ mn)	P/E 2003E	P/E 2004F	EV/EBITDA 2003E	EV/EBITDA 2004F
Luxottica	4,825	15.2	13.9	9.7	8.4
Essilor Intl	3,594	16.9	15.0	7.8	6.9
Fielmann AG	728	14.6	13.2	6.2	5.6
Grandvision	411	13.5	11.6	4.8	4.2
Oakley	660	19.6	16.8	NA	NA
De Rigo	144	9.4	8.4	3.8	3.0
Marcolin	47	11.9	8.2	4.0	3.5
Indo	32	NA	NA	NA	NA

Source: JCF and Santander Central Hispano Bolsa estimates and forecasts.

Historical multiples

In terms of historical multiples, Luxottica trades at 2003E P/E and EV/EBITDA ratios which are in line with its lowest levels, reached in 1993 and 1997. Relative to the market (DJ Stoxx 600), Luxottica's current 2003E P/E is in line with its 1.25x historical average, down from 1.43x in 2002. The stock's relative P/E ranges from 0.84x in 1993 to 1.71x in 2003E.

Figure 5. Luxottica – P/E and EV/EBITDA Multiples vs Historical Averages



Source: JCF and Santander Central Hispano Bolsa estimates and forecasts.



DCF model

Using a DCF model, which we consider the most appropriate valuation tool for Luxottica, we obtain fair values of €13.50/share for year-end 2003E and of €14.60 for year-end 2004F, with an upside potential of 26% and 36%, respectively. At €13.50/share, Luxottica would trade at 2004F P/E and EV/EBITDA multiples of 19.7x and 10.2x, respectively, still below its historical averages of 21.8x and 10.9x.

Figure 6. Luxottica – Discounted Cash Flow Model

(€ mn)	% CAGR													% CAGR
	2002	2003E	2004F	2005F	2006F	2007F	2003E-07F	2008F	2009F	2010F	2011F	2012F	2013F	
Sales	3,132	2,818	3,263	3,475	3,726	4,042	9.4	4,184	4,330	4,482	4,639	4,801	4,969	3.5
EBIT	602	491	551	600	655	718	10.0	747	777	808	840	874	909	4.0
Tax rate (%)	30	33	37	40	40	40	–	40	40	40	40	40	40	–
NOPAT	420	329	350	360	393	431	7.0	448	466	485	504	524	545	4.0
Depreciation & amort	146	151	158	170	185	202	–	206	210	214	219	223	227	–
Chg net working cap	-75	-52	-28	-23	-28	-57	–	-25	-26	-27	-28	-29	-30	–
Capex	-71	-437	-127	-152	-182	-219	–	-220	-221	-222	-223	-224	-225	–
Free cash flows	420	-9	353	355	367	357	NM	409	429	450	472	494	517	6.4

	YE 2003E	YE 2004F	
NPV flows	2,547	2,384	
Terminal value	4,981	5,351	
Enterprise value	7,528	7,735	
Net debt	1,420	1,134	
Equity value	6,108	6,600	
Minorities	15	20	
Theoretical mkt cap	6,093	6,580	
Fair value/share (€)	13.5	14.6	
Upside (%)	26.0	36.0	

Sensitivity analysis			
LT-growth rate (%)	WACC (%)		
	7.9	7.4	6.9
1.0	12.1	12.6	13.2
1.5	12.9	13.5	14.1
2.0	13.9	14.6	15.2
2.5	15.1	15.8	16.5
3.0	16.6	17.3	18.1

Source: Santander Central Hispano Bolsa estimates and forecasts.

We believe three further factors should be mentioned, in order of importance:

Insiders are buying shares

- The buying of shares by insiders is always good news. Luxottica's chairman and main shareholder, Leonardo Del Vecchio, acquired 660,992 shares (0.145% of the company's capital) on the market for €7.3mn in the period from February 6 to April 28 (at an average price of €11.00/share).

Luxottica is buying back shares

- On March 20, Luxottica announced a new share buy-back plan of up to 10mn ADRs (one ADR = one ordinary share), representing 2.2% of its share capital, over a period of 18 months. The buy-back plan is additional to the programme covering 11.5mn ADRs (2.5% of the company's capital), announced at the end of September 2002. Only 6mn ADRs have been purchased under the buy-back programme up to the end of May, so that still more than 15mn ADRs (3.4% of the company's capital) can be bought-back on the market. With an average daily trading volume of around 300,000 shares, we expect Luxottica's share price to be sustained in the event of any weakness materialising. No decision has yet been taken as to whether to cancel the company's treasury stock.

The new S&P/Mib Index

- Luxottica has entered the Italian stock market's new S&P/MIB Index and is ranked 28 out of 40 stocks. The new Index began trading for a six-month trial period on June 3. We expect no impact in the short term, although the successful launch of the Index could give the stock an additional boost towards the end of the year.

Armani's 5% stake Finally, Giorgio Armani is rumoured to be willing to sell his 5% stake in the company following the non-renewal of their long-term licence agreements. The possibility is further reinforced by the fact that the stake was acquired at the time of the IPO, so Armani should receive a substantial capital gain even if he sells at currently depressed market prices. We believe the most likely scenario is that of a private placement, while we understand that the company's founder and major shareholder has offered Armani to buy out his stake, which we believe would be well received by the market. Armani's disposal through a private placement would increase Luxottica's free float from 25% to 30%.



COMPANY DESCRIPTION

A BRIEF HISTORY

Founded in 1961...

Leonardo Del Vecchio (68) founded Luxottica in Agordo (Belluno) in 1961 as a contract manufacturer of semi-finished eye-wear parts. In 1967, the company started assembling parts to manufacture complete eyeglass frames to be sold under the Luxottica brand. In 1971, Luxottica's sole activity became the manufacture and distribution of finished eyeglass frames, with the first collection being presented at MIDO (International Exhibition of Optics, Optometry and Ophthalmology) in Milan.

Figure 7. Luxottica – Historical P&L Account, NOPAT/CE and Gearing, 1990-2002

(€ mn)	1990	1991	1992	1993	1994	1995 (LC)	1996	1997	1998	1999 (RB)	2000	2001 (SH)	2002	% CAGR 1990-2002
Sales	193	239	270	340	420	955	1,226	1,431	1,538	1,874	2,417	3,065	3,132	26.1
% change YoY	NA	23.8	13.0	26.0	23.3	127.5	28.3	16.7	7.5	21.8	29.0	26.8	2.2	–
EBIT	37	57	67	93	119	153	180	224	227	239	413	509	602	26.2
% change YoY	NA	54.1	17.2	39.5	27.1	29.4	17.1	24.6	1.4	5.2	73.0	23.4	18.1	–
EBIT margin (%)	19.2	23.8	24.7	27.4	28.2	16.1	14.7	15.6	14.8	12.7	17.1	16.6	19.2	–
Net income	26	31	35	48	65	83	106	129	133	152	255	316	372	24.8
% change YoY	NA	19.2	12.5	36.5	35.5	29.4	27.3	21.9	2.8	14.6	67.4	23.9	17.6	–
Net inc margin (%)	13.5	13.0	12.9	14.0	15.4	8.7	8.7	9.0	8.7	8.1	10.6	10.3	11.9	–
Fd EPS (€)	0.06	0.07	0.08	0.11	0.14	0.19	0.24	0.29	0.30	0.34	0.56	0.70	0.82	24.7
% change YoY	NA	19.2	12.5	37.8	35.5	28.9	26.8	21.9	2.8	14.3	66.4	23.6	17.2	–
NOPAT/CE (%)	NA	NA	25.2	32.0	40.3	10.6	13.2	14.0	13.5	8.7	15.1	13.0	15.7	–
Gearing (%)	NA	NA	4.5	-12.4	-28.8	255.4	167.9	128.2	100.8	142.6	85.7	109.0	87.9	–

Source: Company data and Santander Central Hispano Bolsa.

25% CAGR over the past 12 years

The company has been able to deliver an EPS CAGR of close to 25% over the past 12 years. It has done so through an aggressive leveraged acquisition policy (1995 LensCrafters, 1999 Ray-Ban, and 2001 Sunglass Hut), which had hardly any impact at the EPS level, but impacted the after-tax return on capital employed (down to 15.7%, compared with 25.2% in 1992).

Listed in NY and Milan

Luxottica was listed on the NYSE on January 23, 1990 (at an adjusted price of US\$0.95, corresponding to a market capitalisation of US\$430mn). Since its US listing, the stock has appreciated at a CAGR of over 20%, in line with the group's EPS (in US\$) over the past ten years. On December 4, 2000 Luxottica was listed on the Milan stock exchange (10.39mn shares, or 2.3% of its total shares, at a price of €16.83, corresponding to a market capitalisation of €7.6bn). Each ADS is equivalent to one ordinary share and the stock's average daily trading volume is similar in both stock markets, at around €3.2mn.

Figure 8. Luxottica – Performance vs S&P 500 Index, Since its Listing in January 1990

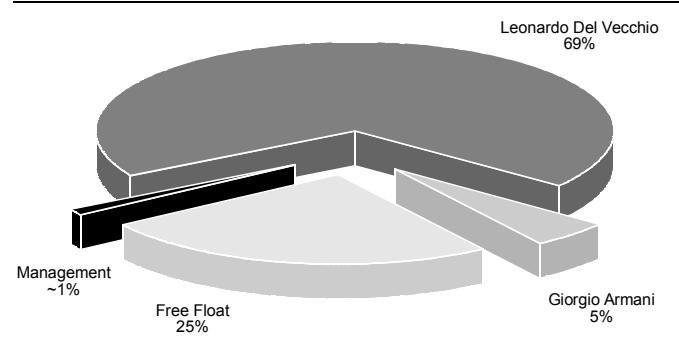


Source: Bloomberg.

Armani owns 5% of the company

Luxottica's main shareholders are its founder, Leonardo Del Vecchio, with a 69% stake, Giorgio Armani, with a 5% stake and management, with approximately 1%. The rest is free float. Around 400 employees have stock options in the company. Options are awarded each year at a price equal to the market price at the date of the award and become exercisable in three equal annual instalments from the date of the award.

Figure 9. Luxottica – Shareholder Structure



Source: Consob and Santander Central Hispano Bolsa estimates.

DESCRIPTION

Market leader

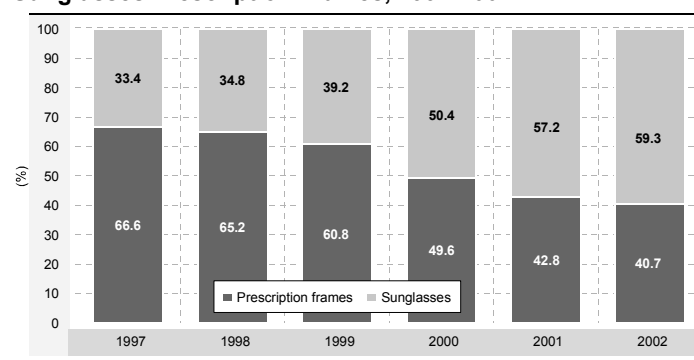
Today, Luxottica is the world leader in the mid- and premium-price eyewear frame industry, with a turnover of €3,132mn in FY02 (with prices from US\$50 to US\$100 per unit, and above US\$100 per unit). According to company sources, the global optical market is estimated to be worth US\$45bn at retail prices. However, this includes not only all market segments (Luxottica operates only in the mid-to-high segment), but also products such as prescription and contact lenses, in which Luxottica is not involved.



Market growth drivers

Luxottica's reference market has grown steadily since the beginning of the 1990s, mainly as a result of the increased perception of glasses (both corrective and sunglasses) as fashion accessories, rather than merely as devices for medical purposes. The sunglasses market benefits from: (1) the increased awareness of the need for protection from UV rays; and (2) the increasing use of contact lenses and the increasing penetration of laser surgery. The prescription frame market benefits from: (1) an ageing population; and (2) the increased exposure to TV screens and PC monitors. Demand for sunglasses tends to be more cyclical than for prescription frames. Nevertheless, management expects growth rates in the sunglasses market to exceed those of prescription frames in the long term. Over the past six years, Luxottica has increased the relative weight of sunglasses from 33% to nearly 60% in volume terms (although also as a result of the acquisition of Ray-Ban and Sunglass Hut).

Figure 10. Luxottica – Breakdown of Units Sold by Sunglasses/Prescription Frames, 1997-2002

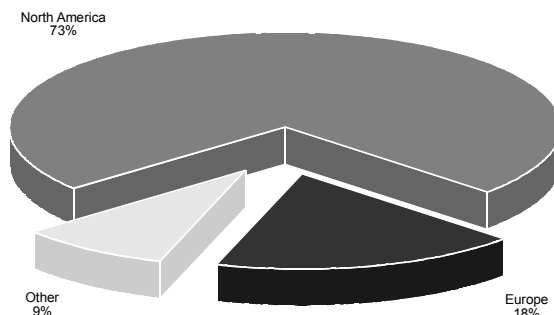


Source: Company data and Santander Central Hispano Bolsa.

73% exposure to the US\$

From a geographical point of view, 73% of Luxottica's consolidated sales are made in North America, where the company operates through its wholesale network and through its fully-owned retail chains LensCrafters, and Sunglass Hut. The company estimates that LensCrafters has an 11% share of the US optical market (from 7% at the time of the acquisition) and that Sunglass Hut has a 35% share in the mid-to-high sunglasses segment (and around 5%-6% of the sunglasses market as a whole). Retail chains have a 50% market share of the US optical market, which is the most concentrated.

Figure 11. Luxottica – Breakdown of Consolidated Revenues by Geographical Area



Source: Company data and Santander Central Hispano Bolsa.

Strategic pillars... The company's strategic pillars are:

- **Vertical integration.** All stages of manufacturing and distribution are currently managed in-house: engineering and design, manufacture of prototypes, product engineering, manufacture of molds and frame parts, manufacture of glass lenses for sunglasses (not prescription lenses) and world-wide distribution. This guarantees higher margins, shorter lead times, a better service to customers and a better understanding of market trends.
- **Manufacturing system.** Luxottica operates through six state-of-the-art manufacturing facilities in northern Italy (each specialising in a specific type of technology) and one in China. The Italian plants are currently working at close to full capacity. According to the company, capacity could be increased by 2%-4%/year through the adoption of new technologies and improved productivity. Currently, the return rate for defective goods is below 1%. The manufacturing site in Tristar (China) provides the group with metal parts and frames for LensCrafters' lower-range products (Luxottica's Chinese facilities produced 4mn, or 12%, of the 32mn units sold in 2002). We expect China to provide a larger proportion of Luxottica's production requirements in the future.
- **Brand portfolio.** Similarly to most of its direct competitors, Luxottica produces eyewear collections under proprietary brand names, such as Ray-Ban, Persol, Revo and Killer-Loop, and brand names under licence such as Chanel, Versace and Bvlgari. Following the addition of Ray-Ban (an estimated 11% of total revenues), we believe Luxottica now has the sector's most prestigious portfolio of own brands. On the other hand, its Italian competitor, Safilo, currently manages the best portfolio of luxury brands produced under licence (following the addition of the Giorgio Armani and Emporio Armani collections). Industry rumours, however, suggest that some of Safilo's licensed brands might become available upon expiration, due to their incompatibility with other brands in the company's portfolio. Luxottica's most important licence is with Chanel, which accounts for close to 5% of consolidated sales and expires at year-end 2004, with renovation normally negotiated 12 months in advance.



Figure 12. Luxottica – The Prescription Frames and Sunglasses Industry¹

Luxottica	Safilo	De Rigo	Oakley ²	Marcolin	Indo ³	Allison	Marchon	Fielman	Grand Vision
2002 sales of €3,132mn	2002 sales of €894mn	2002 sales of €513mn	2002 sales of US\$490mn	2002 sales of €167mn	2002 sales of €123mn	2002 sales of €60mn	NA	2002 sales of €807mn	2002 sales of €603mn
Licensed Brands	Licensed Brands	Licensed Brands	Licensed Brands	Licensed Brands	Licensed Brands	Licensed Brands	Licensed Brands	Licensed Brands	Licensed Brands
Chanel	Bottega Veneta	Prada	–	Dolce & Gabbana	Carolina Herrera	Desil	Calvin Klein	–	–
Versace	Burberry	Fendi		D&G	Paco Rabanne	Anna Sui	CK		
Versus	Christian Dior	Givenchy		Roberto Cavalli	Purificación García	Zerorh+	Donna Karan		
Ferragamo	Diesel	Loewe		Chloé	Chupa Chups	Vivienne Westwood	DKNY		
Bvlgari	Gucci	Celine		Montblanc	(Givenchy) Guess	Les Copains	Flexon		
Byblos	Yves Saint Laurent	Etro		Costume National	Replay		Disney		
Genny	Max Mara	La Perla		Replay	Lacoste		Nautica		
Ungaro	Oliver	Furla		Miss Sixty			Nike Vision		
Tacchini	Pierre Cardin	Fila		Fornarina			(Fendi)		
Moschino	Ralph Lauren	Von Fürstenberg		Mossimo					
Web	Stella McCartney	Martini		Essence					
Anne Klein	Valentino	Martini Racing		Unionbay					
Brooks Brothers	Giorgio Armani	This Week		Bob Mackie					
	Emporio Armani	John L. Cook		Cover Girl					
		Motor Oil		NBA					
				The North Face					
Own Brands	Own Brands	Own Brands	Own Brands	Own Brands	Own Brands	Own Brands	Own Brands	Own Brands	Own Brands
Ray-Ban	Carrera	Police	Oakley	Cébé	Indo	Gianfranco Ferré	Marchon	Fielmann	–
Revo	Smith	Sting		Marcolin	Sting (for Spain)	Exté	Tres Jolie		
Arnette	Safilo	Rolling			Hit	Romeo Gigli	Marchon		
Killer-Loop	Oxydo				James Dean	Try Ultralight	Tanos		
Persol	Blue Bay								
Vogue									
Luxottica									
Sferoflex									
Retail Chains	Retail Chains	Retail Chains	Retail Chains	Retail Chains	Retail Chains	Retail Chains	Retail Chains	Retail Chains	Retail Chains
LensCrafters	Solstice	Dollond & Aitchison	19 DOS	–	–	–	–	Fielmann	Grand Optical
Sunglass Hut		General Optica							Générale d'Optique
OPSM ⁴									Solaris
Laubman & Pank ⁴									Vision Express
Budget Eyewear ⁴									

(1) Essilor, €2,170mn in revenues in 2002, operates in the corrective lens and high-precision optical systems industry.

(2) Sales of sunglasses and prescription glasses amounted to US\$364mn.

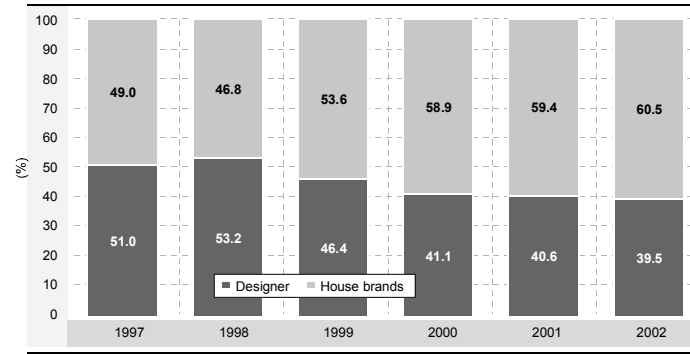
(3) Frames represent less than 25%.

(4) After the acquisition of OPSM.

Source: Santander Central Hispano Bolsa.

Over the course of the past six years, Luxottica has reduced the number of frames sold under third-party brands from 51% to 39.5%. In terms of sales, we believe that third-party brands account for roughly 50% of the total, given their higher average prices. In terms of profitability, we believe that Ray-Ban and Revo are the most profitable brands for Luxottica, as they sell at prices which are similar to those of designer brands, with no royalty fees to be accounted for (which in the industry are in the region of 15%, including a 5% contribution to advertising expenses).

Figure 13. Luxottica – Breakdown of Units Sold by Own/Licensed Brand, 1997-2002

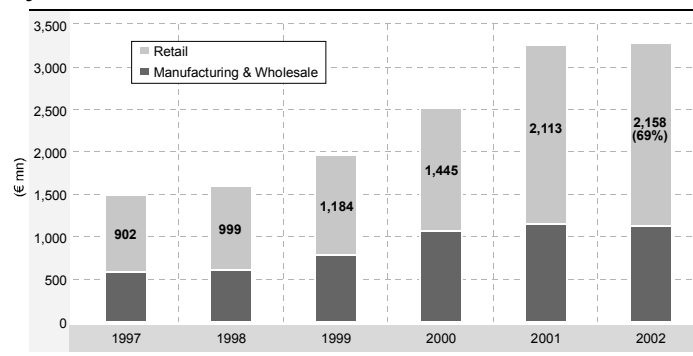


Source: Company data and Santander CeCH Bolsa.

- Distribution network.** Luxottica distributes its products in 120 countries, serving approximately 200,000 points of sale (eyewear stores). In its 29 major markets, Luxottica operates through directly or indirectly controlled wholesale branches, each coordinating a network of sales representatives (1,100 for the whole group). The remaining countries (around 90) in which the company operates are covered by independent distributors. This distribution network ensures high standards of sales and after-sales customer services. An automated order management system shortens the delivery time of goods to 24-48 hours from the time of ordering (if in stock) and therefore reduces retailers' stock requirements. The company's European warehouses are in Sedico (Italy), while in the US it has two distribution centres, one in Atlanta for the retail division and one in New-York (Port Washington) for the wholesale division.
- Presence in the retail business.** Thanks to the acquisition of LensCrafters in 1995, Luxottica has become the market leader in the retailing of eyewear products in North America (882 stores at year-end 2002, with an 11% share of the mid- and premium-price segments). In 2001, Luxottica acquired Sunglass Hut, the world's largest sunglasses retail chain, with 1,663 stores in the US (a 35% market share in the mid- and premium-price segment), 160 in Australasia and 91 in Europe. On April 30, Luxottica launched a take-over bid for OPSM Group Ltd, the largest optical retailer in Australia and New-Zealand, and with a significant presence in Hong Kong, Singapore and Malaysia.



Figure 14. Luxottica – Breakdown of Consolidated Revenues by Distribution Channel, 1997-2002



Source: Company data and Santander Central Hispano Bolsa.

Past EPS growth rates will not be seen in the future, but...

Over the past 12 years, Luxottica delivered sales and EBIT CAGRs in excess of 26% and of close to 25% at the net income level. This has been possible thanks not only to the high growth rates experienced by the market but also to the acquisition in 1995 of LensCrafters, in 1999 of Ray-Ban and in 2001 of Sunglass Hut. While the acquisitions proved barely dilutive at the EPS level, the after-tax return on capital employed fell from 25.2% in 1992 to 15.7% in 2002.

... Luxottica will continue to outpace market growth rates

Going forward, while growth rates are only likely to remain sustained in less developed markets, we expect Luxottica to continue to outpace market growth rates thanks to: (1) its fully-integrated business model, which guarantees better quality standards in terms of sales and after-sales services and lower lead times; and (2) selective acquisition in the retail business, especially in areas where its wholesale network is relatively underdeveloped; and (3) additional licence agreements with luxury brands, with industry rumours suggesting this could be a possibility in the short term.

Acquisitions are likely to focus on retail (a recent suggestion was Grand Vision), especially in areas in which Luxottica is still underdeveloped from a wholesale point of view (eg, the current OPSM acquisition). On the other hand, we believe Oakley fits in well with Luxottica's strategy, as it is the only global brand name in the eyewear industry along with Ray-Ban. A quarter of Oakley's revenues are generated outside the core sunglasses business (prescription eyewear, apparel, footwear and accessories), something which could also happen at Ray-Ban. Apart from the company's current expansion into prescription eyewear, management rules out further diversification into non-core products at Ray-Ban, at least in the short term.

Figure 15. Ray-Ban



Source: Ray-Ban.

PROFIT OUTLOOK

1Q03 RESULTS

1Q03 was poor, and 2Q03E hardly looks better

The 1Q03 results showed YoY declines of 20% in revenues (to €705mn), 28.6% in EBITDA, 31.2% in EBIT and 35.1% in net income (to €66mn). In constant currencies, sales fell 6.6% versus a 2.1% increase in 4Q02, due to: (1) lower sales of the Giorgio Armani and Emporio Armani collections, which plunged some 50% in the quarter; and (2) weakness in the US economy, also affected by poor weather conditions in February. We estimate that Armani accounted for a drop of about 3.6% in revenues. Luxottica retail division sales declined by 3% on a like-for-like basis, versus a 1.5% contraction in 4Q02. Moving into 2Q03E, constant currencies retail sales climbed 3% in the opening weeks of April (from -1.9% in 1Q03), but we understand that May's disappointing store traffic is unlikely to sustain the trend.

Figure 16. Luxottica – Quarterly Results, 1Q02-1Q03

(€ mn)	1Q02	2002	1Q03
Net sales	880	3,132	705
% change YoY	32.6	2.2	-20.0
Cost of goods sold	-258	-878	-208
Gross profit	622	2,254	497
% change YoY	30.8	3.4	-20.2
Gross margin (%)	70.7	72.0	70.5
Operating expenses	-459	-1,653	-385
EBIT	163	602	111
% change YoY	25.4	18.1	-31.8
EBIT margin (%)	18.5	19.2	15.8
Net financial charges	-19	-61	-11
Other, net	3	-1	-5
Pre-tax profit	147	539	96
% change YoY	24.2	22.2	-34.8
Pre-tax margin (%)	16.7	17.2	13.6
Taxes	-44	-163	-29
Tax rate (%)	30.0	30.2	30.0
Net income before min	103	377	67
Minorities	-2	-5	-1
Net income	101	372	66
% change YoY	20.9	17.6	-35.1
Net margin (%)	11.5	11.9	9.3

Source: Company data.

ACQUISITION OF OPSM GROUP LTD

Australia's leading optical retailer

On April 30, Luxottica launched a take-over bid for OPSM Group Ltd. OPSM is the leading optical retailer in Australia (35% market share), with 481 stores and three brands – *OPSM*, *Laubman & Pank* and *Budget Eyewear* – each targeting a defined market segment. OPSM also runs 34 stores in New Zealand, 80 in Hong Kong, 12 in Singapore and 12 in Malaysia. At December 31, 2002 OPSM stores totalled 619. OPSM employs 4,000 people.

Bid of A\$3.90/share

Luxottica's cash offer is for 100% of OPSM's outstanding shares, at A\$3.90/share. This price represents a 21.9% premium to OPSM's pre-announcement closing price of A\$3.20/share. OPSM's board unanimously recommended that the shareholders accept Luxottica's offer, in the absence of a higher one. The A\$3.90/share offer is to be reduced by A\$0.10/share, which will be distributed as a dividend.



- Strategic rationale** From a strategic point of view, the acquisition of OPSM represents a further step in Luxottica's vertical integration strategy. With OPSM, Luxottica would become the leading player in the Australian prescription segment, with limited cannibalisation on its existing operations in the area (one wholesale branch and 153 Sunglass Hut stores). Additionally, Luxottica only accounts for 5% of OPSM sales, so there is clear scope for improvement.
- Multiples paid are similar to Sunglass Hut's** From a financial point of view, Luxottica is valuing OPSM's equity at A\$550mn (€309mn, at a €/A\$ exchange rate of 1.78) on a fully-diluted basis. Including OPSM's estimated A\$30mn net debt, the total consideration is A\$580mn (€327mn). Based on IBES consensus for the year ending June 2004, this implies 1.08x EV/sales, 8.2x EV/EBITDA, 12.0x EV/EBIT and 17.7x P/E. In March 2001, Sunglass Hut was purchased at similar multiples (0.95x EV/sales, 6.0x EV/EBITDA and 13.0x EV/EBIT).
- Luxottica expects no earnings dilution in 2003E** Luxottica calculates an EV/EBITDA of approximately 8x, based on calendar year 2003 EBITDA for Australia and New Zealand's operations. This is excluding potential savings/synergies following the acquisition, but including the negative impact of SARS on OPSM's Hong Kong operations (estimated at A\$3.5-4mn at the EBIT level). Hong Kong represents approximately 15% of OPSM's estimated sales in calendar year 2003E. If the deal goes ahead, OPSM would be consolidated from 2H03E. Assuming no synergies arise before year-end, management estimates a neutral impact on the expected EPS of €0.69 this year.

Figure 17. Luxottica – OPSM Main P&L Items

(€ mn)	YE Jun-02	YE Jun-03E	YE Jun-04F	2H03E	FY04F
Sales	234	268	304	179	318
% change YoY	NA	15	13	NA	NA
EBITDA	29	31	40	21	42
% change YoY	NA	8	28	NA	NA
EBITDA margin (%)	12.3	11.6	13.1	11.6	13.1
EBIT	19	20	27	15	29
% change YoY	NA	4	39	NA	NA
EBIT margin (%)	8.1	7.4	9.0	8.1	9.0
Net income	12	13	17	9	18
% change YoY	NA	10	31	NA	NA
Net margin (%)	5.2	5.0	5.8	4.9	5.7

Source: IBES consensus and Santanter Central Hispano Bolsa estimates.

- Synergies/savings** According to our calculations, the acquisition would be marginally EPS dilutive (1%) in 2003E and EPS enhancing in 2004F, thanks to the expected implementation of savings/synergies. Immediate savings could be achieved by eliminating structural costs, while the clearest synergy in the medium term would be achieved by raising the Luxottica units sold through OPSM's retail chains from the current 5%. We believe that OPSM's operations outside Australia and New Zealand are loss making. Consequently, the disposal of these operations should be earnings enhancing. Other assumptions included in our scenario are: (1) goodwill of €233mn generated on the deal, to be amortised over 20 years (goodwill relating to LensCrafters and Sunglass Hut is amortised over 25 years, while that arising on Ray-Ban is amortised over 20 years); and (2) Luxottica's cost of debt of 3.3% (Libor + 50bp).

OUTLOOK

'2003 year of transition'

Luxottica's Chairman, Mr Del Vecchio, recently reiterated that 2003 would be a year of transition for the company due to: (1) the termination of the licence agreements with Armani (which accounted for some 7.2% of consolidated sales in 2002); (2) unfavourable exchange rates (strong euro versus the US dollar); and (3) the uncertain macroeconomic and geopolitical environment. Luxottica's guidance for FY03E EPS is €0.69, assuming an average 2003 US\$/€ exchange rate of 1.10. The company expects growth in both sales and net income to resume in 2004.

EPS of €0.63 this year

Assuming the OPSM acquisition goes ahead and average €/US\$ rates of 1.12 for 2003E and 1.065 for 2004F, we estimate EPS of €0.63 this year and €0.68 in 2004F.

2003E

For the current year, we expect Luxottica sales to decline by 10% to €2,818mn. Our 2003E sales estimates are built on: (1) a negative 11.7% currency impact (based mainly on an average US\$/€ rate of 1.12); (2) a 6% negative impact from the expiration of the Armani licences (€173mn lower sales) at the end of May; (3) a 5.7% positive contribution from the consolidation of OPSM in 2H03E (€179mn according to our own calculations on IBES consensus estimates); and (4) 1.7% organic growth, calculated assuming a 4.7% contribution from the recently launched Ray-Ban prescription frames and Versace collections (totalling €147mn) and a 3% decline in all other collections still. Management expects Ray-Ban prescription frames and Versace collections to offset the negative Armani impact in the medium term. Nevertheless, we expect demand to remain weak for most of the current year. As a general policy, Luxottica increases prices for new collections in line with inflation (1,000 new models, or re-styling, are launched each year, versus a total of 2,450 models). Luxottica plans to open 25 LensCrafters and 25 Sunglass Hut stores this year. In terms of selling surface, this would represent expansion of roughly a 2.8% for LensCrafters and 1.3% for Sunglass Hut. However, factoring in store closures, selling surface growth is likely to be much lower: at the end of March 2003 there were six LensCrafters stores and 24 Sunglass Hut stores less than at year-end 2002.

2004F

In 2004F, we expect Luxottica's consolidated revenues to grow by 15.8% as:

- (1) The currency impact should be positive (some 3%), mainly because we expect the US\$/€ exchange rate to stand at 1.05 at year-end, with a 2004F average of 1.065. However, the OPSM deal would reduce Luxottica's exposure to the US dollar by 10%-11%.
- (2) Armani should only have a moderately negative impact (€53mn or -1.9%) in 1H04F.
- (3) OPSM should contribute approximately €318mn (SCH Bolsa calculation based on IBES consensus), or 11.3% of 2003E sales.
- (4) We expect Luxottica to achieve organic sales growth of 2.8%.

Weak US\$ should impact EBIT . . .

At the EBIT level, we expect a negative contribution of approximately 120bp (€103mn or -17%) from the euro's appreciation versus the greenback. This should become a 40bp positive impact in 2004F (€30mn, +6%), as we expect the US dollar to appreciate against the euro during the year. In Figure 18 overleaf we set out our sensitivity analysis using the SCH Bolsa US\$/€ exchange rate for 2004F (averaging 1.065) and others. We still do not expect any hedging to be contracted for 2004F.



Figure 18. Luxottica – Sensitivity Analysis Using Varying US\$/€ Exchange Rates, 2004F

	-10%	-5%	Own Est	+5%	+10%
US\$/€	1.01	1.07	1.12	1.17	1.23
Curr eff vs 2003E (@ 1.12)	10.7	5.2	–	-4.6	-9.2
% change YoY					
Revenues	7.8	3.7	–	-3.2	-6.2
Gross profit	9.4	4.5	–	-3.9	-7.6
EBIT	12.5	6.0	–	-5.2	-10.1
Net income	14.0	6.7	–	-5.8	-11.2

Source: Santander Central Hispano Bolsa forecasts.

... and gross profit

We expect the gross margin to drop by 80bp in 2003E, mainly as a consequence of the euro's strength. In fact, we estimate that roughly 60% of costs of goods sold are euro-denominated with the remaining 40% being mainly in US dollars (principally raw materials and the Chinese manufacturing facilities). In 1Q03, the gross margin held up relatively well, at 70.5% versus 70.7% in 1Q02. However, we prefer to adopt a more cautious stance as inventories rose 11% at the end of 1Q03 (on 20% lower sales), so the likelihood of higher markdowns in the remainder of the year is rather high, in our view. In 2004F, we expect the gross margin to recover marginally, mainly on the back of our assumption on the US\$/€ exchange rate.

OPSM should dilute operating margins

The consolidation of OPSM should dilute operational margins in both 2003E and 2004F. We expect Luxottica's consolidated EBITDA margin to drop to 17.4% in 2003E from 23.9% last year, while the EBIT margin should stand at 16.9% at year-end versus 19.2% in 2002. As mentioned on page 17, we expect OPSM to generate an EBITDA margin of 11.6% and an EBIT margin of 8.1% in 2H03E, with 13.1% and 9%, respectively, in 2004F. This compares with our Luxottica ex-OPSM estimates: 2003E EBITDA and EBIT margins of 23.6% and 17.9%, respectively, climbing to 23.7% and 18.1% in 2004F. Note that we are assuming that the savings/synergies arising from the OPSM deal will only reach €12mn in 2004F, which could prove conservative given Luxottica's good track record in recent acquisitions.

Advertising

This year, the advertising expense could decline from the 2002 level of 6.8% of revenues, as the retail division's budget (US\$125mn) could be cut in 2H03E if demand remains weak. Going forward, management believes that advertising should remain at about 7% of revenues.

Balance sheet

On the balance sheet front, the acquisition of OPSM (for €309mn, plus OPSM's net debt of €18mn) would raise the group's net financial debt to €1,347mn, versus the previous guidance of €1.0-1.1bn, excluding the acquisition. At €1,347mn, financial gearing would stand at 83% versus 88% at year-end 2002. Excluding further possible acquisitions, we believe that Luxottica will be able to generate close to €300mn of annual free cash flow, and return to a net liquidity position within four years. Maintenance capex should be around €100mn this year and next year, of which 65% is devoted to the retail division (15% to new openings).

Tax rate

With the tax rate likely to climb gradually to 40% by 2005F (from 30.2% in 2002), as tax credits from previous acquisitions disappear, we expect net income to drop by 23.8% to €283mn this year and to rise to €308mn (+8.7%) in 2004F.

FINANCIAL DATA

Figure 19. Luxottica – Profit & Loss Account, 2001-05F

(€ mn)	2001	2002	2003E	2004F	2005F
Net sales	3,065	3,132	2,818	3,263	3,475
% change YoY	26.8	2.2	-10.0	15.8	6.5
Cost of goods sold	-884	-878	-811	-930	-991
Gross profit	2,181	2,254	2,007	2,333	2,485
% change YoY	26.1	3.4	-11.0	16.3	6.5
Gross margin (%)	71.2	72.0	71.2	71.5	71.5
Selling expenses	-1,034	-1,079	-1,000	-1,168	-1,230
Royalties	-55	-62	-56	-65	-70
Advertising expenses	-214	-214	-186	-222	-244
General & administrative exp	-275	-261	-240	-287	-299
Goodwill amortisation	-94	-36	-34	-39	-42
Operating expenses	-1,671	-1,653	-1,516	-1,782	-1,884
EBIT	509	602	491	551	600
% change YoY	23.4	18.1	-18.4	12.3	8.9
EBIT margin (%)	16.6	19.2	17.4	16.9	17.3
Net financial charges	-77	-61	-60	-57	-49
Other, net	9	-1	0	0	0
Pre-tax profit	441	539	430	494	551
% change YoY	21.9	22.2	-20.2	14.7	11.5
Pre-tax margin (%)	14.4	17.2	15.3	15.1	15.8
Taxes	-123	-163	-142	-180	-220
Tax rate (%)	28.0	30.2	33.0	36.5	40.0
Net income before min	318	377	288	313	330
Minorities	-1	-5	-5	-5	-6
Net income	316	372	283	308	325
% change YoY	23.9	17.6	-23.8	8.7	5.4
Net margin (%)	10.3	11.9	10.1	9.4	9.3
Adjusted net profit	310	373	283	308	325
% change YoY	23.2	20.3	-24.0	8.7	5.4
Cash flow	528	518	435	466	495
% change YoY	22.7	-1.9	-16.0	7.1	6.2
Per Share Data	2001	2002	2003E	2004F	2005F
Weighted avg number of shares	451.0	453.2	451.0	451.0	451.0
Fully diluted number of shares	454.0	455.4	452.1	452.1	452.1
EPS (€)	0.70	0.82	0.63	0.68	0.72
Fd EPS (€)	0.70	0.82	0.63	0.68	0.72
% change YoY	23.6	17.2	-23.3	8.7	5.4
Adjusted EPS (€)	0.68	0.82	0.63	0.68	0.72
% change YoY	23.0	19.9	-23.4	8.7	5.4

Source: Santander Central Hispano Bolsa estimates and forecasts.

Figure 20. Luxottica – Balance Sheet, 2001-05F

(€ mn)	2001	2002	2003E	2004F	2005F
Total fixed assets	2,521	2,446	2,732	2,700	2,682
Net working capital	466	540	592	620	643
Funds	-168	-304	-345	-388	-433
Net capital employed	2,818	2,682	2,978	2,932	2,892
Net debt	1,470	1,254	1,420	1,134	845
Minorities	5	10	15	20	26
Shareholders' equity	1,343	1,418	1,544	1,778	2,021

Source: Santander Central Hispano Bolsa estimates and forecasts.



Figure 21. Luxottica – Cash Flow, 2001-05F

(€ mn)	2001	2002	2003E	2004F	2005F
Net income (losses)	316	372	283	308	325
Depreciation & amortisation	212	146	151	158	170
Change in funds	-93	136	41	43	45
Operating cash flow	436	654	476	509	540
Change in working capital	-102	-75	-52	-28	-23
Maintenance capex	-868	-71	-110	-127	-152
Investments	0	0	-327	0	0
Change in minorities	-5	4	5	5	6
Dividends	-63	-77	-95	-74	-82
Share buy-backs and other	0	-22	-62	0	0
Change in cash	-602	436	-166	286	289

Source: Santander Central Hispano Bolsa estimates and forecasts.

ANALYST CERTIFICATION: I, Carlo Scomazzoni, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject companies and their securities. I also certify that I have not been promised compensation either directly or indirectly for expressing the recommendations in this report.

NOTES



NOTES

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Key to Investment Codes (1)

Buy	Upside of more than 20%.
Hold	Upside of 15%-20%.
Underweight	Upside of less than 15%.

(1) Target prices set from January to June are for December 31 of the current year. Target prices set from July to December are for December 31 of the following year.

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