Trevi-Finanziaria Industriale SPA

Initial Opinion BUY

Equity | Italy | Engineering & Construction
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Solid foundations for further growth

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A specialist for all times: we initiate at Buy, PO €13.0

We believe the industry's short/mid-term prospects bode well for a niche specialist like Trevi, as the quality of its order backlog proves. Its core capabilities, global presence and product portfolio should ensure its continued prosperity. At today's low valuation, we see +30% potential on a DCF basis (10% WACC, 1.5% TGR). We initiate at Buy with a PO of €13.0 (10x 2009E P/E and 5x EV/EBITDA).

First of four pillars: in-demand infrastructure specialist

As the world's top-4 special foundation, soil consolidation and tunnel excavation specialist (no residential/commercial exposure), Trevi has a global reputation for quality/diligence in complex underground works. Its upfront payment schemes and 'first-in' position (first to start works and to cash in) strengthen its model.

Equipment & Services, synergies and differentiation

Its Soilmec arm is the second-largest producer of special foundation equipment globally. By operating in both services & equipment, it benefits from important commercial and technological synergies. Experience gained in services helps add value for clients via innovative new machinery and best advice on field work. Also, many machinery clients become partners in large, complex commissions.

Oil/gas/water Drilling Equipment & Services coming of age

Drillmec and Petreven offer drilling rigs and drilling services through the in-house developed, highly automated HH rigs, which will gain in appeal as oil prices drop. Its product portfolio is expanding and endorsed by prestigious industry players.

Quality order backlog up 40%, up 50% in emerging markets

Sales visibility stands at 1.2 years with a backlog of €1.2bn: >50% in emerging markets (the Middle East and oil-rich Africa) and US$300mn of dam/dyke repairs in the US. Thereafter, prospects look good due to its niche expertise and appealing products (more HHs, offshore rigs, offshore wind & geothermal energy).

Estimates (Dec)

(EUR)	2006A IFRS	2007A IFRS	2008E IFRS	2009E IFRS	2010E IFRS
EPS (Reported Diluted)	0.38	0.82	1.05	1.27	1.43
EPS Change (YoY)	88.2%	114.5%	28.2%	21.0%	12.6%
Dividend / Share	0.05	0.10	0.15	0.19	0.21

Valuation (Dec)

	2006A	2007A	2008E	2009E	2010E
P/E	25.8x	12.0x	9.40x	7.76x	6.89x
Dividend Yield	0.55%	1.01%	1.56%	1.90%	2.14%
EV / EBITDA*	10.1x	6.65x	5.17x	4.35x	4.18x
Free Cash Flow Yield*	-7.42%	9.48%	-6.50%	8.38%	13.3%

* For full definitions of *iQmethod*℠ measures, see page 28.

Stock Data

Price	EUR9.85
Price Objective	EUR13.00
Date Established	22-Oct-2008
Investment Opinion	B-1-7
Volatility Risk	MEDIUM
52-Week Range	EUR8.36-EUR17.65
Mrkt Val / Shares Out (mn)	EUR630 / 64.0
Average Daily Volume	413,910
ML Symbol / Exchange	TVFZF / MIL
Bloomberg / Reuters	TFI IM / TFI.MI
ROE (2008E)	38.0%
Net Dbt to Eqty (Dec-2007A)	87.3%
Est. 5-Yr EPS / DPS Growth	13.5% / 17.9%
Free Float	100.0%

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Refer to important disclosures on page 29 to 30. Analyst Certification on Page 26. Price Objective Basis/Risk on page 26.

iQprofile℠ Trevi-Finanziaria Industriale SPA

Key Income Statement Data (Dec)	2006A	2007A	2008E	2009E	2010E
(EUR Millions)	IFRS	IFRS	IFRS	IFRS	IFRS
Sales	643	837	1,030	1,201	1,269
EBITDA Adjusted	85.6	129	167	198	206
Depreciation & Amortization	(27.6)	(30.1)	(37.9)	(44.1)	(41.4)
EBIT Adjusted	58.1	99.4	129	154	164
Net Interest & Other Income	(15.5)	(13.5)	(16.1)	(15.4)	(6.27)
Tax Expense / Benefit	(14.7)	(28.1)	(37.8)	(48.5)	(55.3)
Net Income (Adjusted)	26.8	55.8	72.0	87.4	98.7
Average Fully Diluted Shares Outstanding	70.2	70.2	70.2	70.2	70.2
Key Cash Flow Statement Data					
Net Income (Reported)	26.8	55.8	72.0	87.4	98.7
Depreciation & Amortization	27.6	30.1	37.9	44.1	41.4
Change in Working Capital	(55.8)	(3.36)	(65.5)	(23.8)	(4.62)
Deferred Taxation Charge	0	0	0	0	0
Other Adjustments, Net	3.79	15.7	3.00	2.70	4.11
Cash Flow from Operations	2.32	98.2	47.4	110	140
Capital Expenditure	(49.2)	(38.7)	(88.1)	(58.1)	(56.8)
(Acquisition) / Disposal of Investments	0	0	0	0	0
Other Cash Inflow / (Outflow)	(0.09)	(4.73)	(3.09)	(3.60)	(3.81)
Cash Flow from Investing	(49.2)	(43.4)	(91.2)	(61.7)	(60.6)
Share Issue / (Repurchase)	0	(0.18)	(0.12)	0	0
Cost of Dividends Paid	(1.66)	(3.47)	(6.40)	(10.8)	(13.1)
Cash Flow from Financing	(2.61)	(21.7)	(14.5)	(10.8)	(13.1)
Non Cash Changes to Debt	NA	NA	NA	NA	NA
Change in Net Debt	49.5	(33.1)	58.3	(38.0)	(65.9)
Net Debt	176	143	201	163	97.1
Key Balance Sheet Data					
Property, Plant & Equipment	192	207	264	285	308
Goodwill	0	0	0	0	0
Other Intangibles	4.92	5.39	5.78	7.07	8.76
Other Non-Current Assets	20.8	22.9	26.4	26.4	26.4
Trade Receivables	187	188	254	288	298
Cash & Equivalents	89.9	90.8	70.3	113	287
Other Current Assets	175	247	325	357	370
Total Assets	671	762	946	1,076	1,298
Long-Term Debt	197	172	176	185	269
Other Non-Current Liabilities	46.9	44.6	50.4	46.9	51.3
Short-Term Debt	68.7	61.2	95.0	91.0	115
Other Current Liabilities	231	320	393	446	470
Total Liabilities	543	598	715	769	905
Total Equity	127	163	231	308	393
Total Equity & Liabilities	671	762	946	1,076	1,298
Key Metrics					
iQmethod*℠ - Bus Performance					
Return On Capital Employed	10.3%	15.7%	17.6%	17.2%	15.0%
Return On Equity	24.4%	40.1%	38.0%	33.6%	28.9%
Operating Margin	9.03%	11.9%	12.5%	12.8%	13.0%
Free Cash Flow (MM)	(46.8)	59.5	(40.7)	52.4	82.9
iQmethod*℠ - Quality of Earnings					
Cash Realization Ratio	0.09x	1.76x	0.66x	1.26x	1.41x
Asset Replacement Ratio	2.21x	1.61x	2.83x	1.57x	1.66x
Tax Rate	34.4%	32.7%	33.5%	35.0%	35.0%
Net Debt/Equity	138%	87.3%	87.0%	53.0%	24.7%
Interest Cover	4.62x	5.86x	7.88x	9.96x	17.0x

* For full definitions of *iQmethod*℠ measures, see page 28.

Company Description

Trevi Group is the global top-4 specialist in foundation services (40% of sales) and second-largest foundation equipment producer through Soilmec (33%). Its arm Drillmec also manufactures drilling rigs (22% of sales) and Petreven offers drilling services (5%). It operates in over 80 countries with direct presence in 27 of them. Its reliance on the domestic market is limited to 13%, and the Middle East generates 29% of revenues, with the rest well diversified across all continents.

Investment Thesis

Trevi's well-balanced business rests on four pillars, diversified across 80 countries. With a solid balance sheet, a quality order backlog of EUR1.2bn (1.2 years of sales) driven by State-backed infrastructure in emerging markets (64%, 23% in the Middle East) and a product portfolio in constant expansion, appealing even with falling oil prices, Trevi is well positioned to continue leveraging on its niche expertise and flexible/efficient business model in coming years.

Stock Data

Price to Book Value	2.8x

Executive summary

A specialist for all times: we initiate at Buy, PO €13.0

We believe that the industry's short/mid-term prospects bode well for a 'niche' specialist like Trevi, as the quality of its order backlog proves. Longer-term, its core capabilities, global presence and appealing product portfolio should allow Trevi to continue to prosper. At the current low valuation, we think there is potential upside of +30% based on our DCF (10% WACC, 1.5% TGR) and we rate Trevi a Buy with a PO of €13.0, or 10x 2009E P/E and 5x EV/EBITDA.

Success founded on four pillars

Italian Trevi Group is the world's fourth-largest specialist in Foundation Services for civil infrastructure such as bridges, railways, underground lines, dams, industrial systems and tunnels, rather than residential/commercial construction. Soon after its foundation, its core portfolio expanded into the production of Foundation Equipment through its Soilmec subsidiary, the world's second-largest.

Since 2004, the group's two newest subsidiaries – Drillmec, specialised in drilling rigs and related drilling equipment for oil, gas, geothermal and water; and Petreven, a supplier of oil drilling services – have come of age and constitute the third and fourth pillars of Trevi's success story. Through its newest fifth arm (Trevi Energy) it aims to develop renewable energy projects, not before 2010.

Trevi Group has three main production facilities in Italy, one in Houston (Texas) for Drillmec, and is currently building a new plant in Dubai (operating by H209) for both Soilmec/Drillmec. Through a network of over 50 exclusive agents and distributors in 80 countries, including local presence through 32 branches and subsidiaries in 27 countries where its services arm operates, the group has successfully accomplished a vast number of projects worldwide.

Drivers

- Supply of Services & Equipment, leading to important commercial and know-how synergies.
- Considerable synergies and diversification via Foundation and Drilling.
- Leading specialist in special foundation 'niche': #4 in services, #2 in equipment globally, with no residential/commercial construction exposure.
- Strong position in emerging markets: 60% of sales, 29% in Middle East.
- Strong order backlog (now at c.€1.2bn): 1.2 years of sales visibility.
- Promising 'life' beyond the order backlog.
- Good prospects for the US programme of reconstruction of 1,000 dams.
- Appealing drilling equipment portfolio: innovative automated HH series.
- Flexible business model and M&A programme for small acquisitions.

Risks

- Political instability or lower funding/budgeting (as growth can be dependent on government policy and initiatives); currency fluctuations.
- A long-lasting, global recession and other potential credit crunch-related problems: project delays, cash flow and NWC risks, higher competition.
- Execution risk in sizeable project commissions and potential liquidity or funding difficulties faced by clients.
- A scarcity of skilled labour should demand remain strong.
- Oil companies slashing capex if oil price prospects head down.

Table 1: Trevi – sensitivity analysis

	WACC				
TGR	9.00%	9.50%	10.00%	10.50%	11.00%
1.00%	14.22	13.34	12.55	11.84	11.20
1.25%	14.51	13.59	12.77	12.03	11.37
1.50%	14.82	13.85	13.00	12.23	11.54
1.75%	15.16	14.14	13.24	12.44	11.73
2.00%	15.52	14.44	13.50	12.67	11.92

Source: Merrill Lynch estimates

Valuation

Our valuation is based on a three-stage DCF: 1) two years with a +20% sales CAGR; 2) four years of a +3% sales CAGR, gradually converging to the final stage; 3) stable 1.5% EBIT growth. We forecast an EBITDA margin of 16.2% in 2008, 16.5% in 2009, and stable thereafter at 16.2%. We use a WACC of 10%, which reflects an 8.5% equity and country risk premium and a tax rate of 35%. We have also subtracted the estimated advanced cash payments for WIP (c.€50mn in 2008) and the debt portion of the convertible, €64mn, from the net debt, while taking full account of the dilution (an additional 6.2 million shares).

Table 2: Trevi – cash flow model

(€mn)	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E
EBITDA	167	198	206	212	217	221	224	227	231
D+A	-38	-44	-41	-45	-46	-47	-47	-48	-49
EBIT	129	154	164	167	171	174	177	179	182
cash taxes	-43	-54	-58	-59	-60	-61	-62	-63	-64
NOPLAT	86	100	107	109	111	113	115	117	118
Gross Cash Flow	124	144	148	153	157	160	162	165	167
Other non-cash items	-4	-5	-5	-5	-5	-5	-6	-6	0
Capex	-88	-58	-57	-56	-57	-57	-56	-56	-57
WC	-65	-24	-5	0	1	-4	-3	-3	-3
FCF	-26	67	92	102	107	104	108	111	106

Source: Merrill Lynch estimates

Our model results in a **price objective of €13.0/share** (equity value of €912mn, EV of €1,076mn), or a 2009E P/E of 10.2x, **EV/EBITDA of 5.1x**, EV/EBIT 6.6x.

Sum-of-the-parts comps analysis confirms our DCF

The **sum-of-the-parts analysis** of Trevi's two activities (foundations and drilling) that we carry out in this section **yields a figure of €13.2 /share**.

Table 3: Trevi – valuation ratios

Price p/share	€13.00	2008E	2009E	2010E
EV/Sales (†)		1.03	0.84	0.74
EV/EBITDA (†)		6.4	5.1	4.6
EV/EBIT (†)		8.2	6.6	5.7
P/E		12.4	10.2	9.1
P/CE		8.3	6.9	6.5
FCF yield (%)		-4.8	5.3	8.7
PEG (*)		0.2	0.4	0.5
EEG (**)		0.2	0.2	0.4

Source: Merrill Lynch estimates; (†) EV adjusted for convertible bond and estimated advanced payments; (*) 2007E P/E divided by average of 2006E-07E and 2007E-08E EPS CAGRs; (**) 2007E EV/EBITDA divided by average of 2006E-07E and 2007E-08E EBITDA CAGRs

Note: In the current negative global economic environment, our strategists and economists have highlighted several times that consensus earnings estimates for 2009, 11% higher than in 2008 for Europe, are still too high (see our European Equity Strategy note, *Q3: Expectations still too high*, 21 October 2008). For this reason, we have limited our peer analysis to Merrill Lynch's coverage universe, which does not include competitors Bauer and Keller Group (see page 12). Also, we have decided to focus on EV/EBITDA, as it is a more accurate ratio when comparing business models and capital structures that may differ notably, despite operating in the same industry and being affected by similar drivers.

Foundation equipment/services: an above-average player

A comparison with our broad EMEA Construction & Engineering coverage universe gives a pretty heterogeneous picture in terms of trading multiples (see Table 5). We believe that in addition to growth and profitability, the following three issues determine how far below or above the average a stock should trade: (1) balance sheet strength and refinancing needs; (2) quality/nature of revenue streams, eg, geographical and residential exposure; and (3) reliability of the order backlog (financial health of the client base).

Trevi looks financially solid and its growth and investment programme appears well funded; the quality of its revenues and order backlog is high, given its specialisation in infrastructure works (85-90% state-backed; only 10-15% PPP) and lack of residential/commercial exposure; its strong presence in the most attractive emerging markets (eg, the Middle East); and its apparently sustainable payment/receivables balance due to its advanced payment scheme and its

relative position in the supply chain. We conclude that Trevi's foundations business deserves to trade **at a 20% premium to the average EV/EBITDA** of our broad EMEA Construction & Engineering coverage universe, ie, **5.8x 2009E**.

Drilling equipment/services: in line with industry

We believe Trevi has an edge with its focus on HH rig products (see pages 10 and 16), especially on the drilling services side. However, given its small size relative to the industry, we are not going to build a case for a premium versus its peers. Nevertheless, given the successful coming-of-age of its drilling business, the quality of its client base, and the recognition of its innovation efforts by reputable clients, we argue that Trevi should trade at least in line with the industry average. A look at our broad EMEA Oil & Gas Equipment & Services coverage universe (see Table 5) results **in an average 2009E EV/EBITDA of 3.9x.**

Conclusion: price objective derived from DCF

Based on the 2009E EBITDA mix of the different business units, our conservative sum-of-the-parts (see Table 4) arrives at: 2009E EV/EBITDA of 5.2x, or **€13.2/share.** We therefore conclude that our DCF price objective of €13.0/share, or 5.1x EV/EBITDA, is supported by broad industry multiples.

Table 4: Sum-of-the-parts 2009E EV/EBITDA

	2009E Sales % mix	2009E EBITDA margin	2009E EBITDA % mix	2009E EV/EBITDA	Implied share price
Foundation services	40.4	17.2	42.2	5.8	€ 14.90
Foundation equipment	26.8	15.0	24.4	5.8	€ 14.90
Drilling equipment	26.5	14.7	23.6	3.9	€ 8.20
Drilling services	6.3	26.0	9.9	3.9	€ 8.20
Total				5.2	€ 13.20

Source: Merrill Lynch estimates; EV and price per share adjusted for convertible bond and estimated advanced payments

Table 5: Trevi – peer group

Name	ML ticker	Curr.	Share price 20.10.08	Market Cap (mn)	Q-R-Q Rating	Sales (mn) 2007	Sales (mn) 2008E	Sales (mn) 2009E	EBIT % 2007	EBIT % 2008E	EBIT % 2009E	EPS CAGR % 2007-08E	EPS CAGR % 2008E-09E	P/E 2008E	P/E 2009E	EV/EBITDA 2008E	EV/EBITDA 2009E	EV/EBIT 2008E	EV/EBIT 2009E	EV/Sales 2008E	EV/Sales 2009E
Trevi	TVFZF	EUR	10.30	659	B-1-7	837	1,030	1,201	11.9	12.5	12.8	28.2	21.0	9.8	8.1	5.5	4.5	7.2	5.8	0.9	0.7
EMEA Construction and Engineering																					
ACS	ACSAF	EUR	27.60	9739	A-1-8	21,312	23,094	23,870	11.7	11.7	11.8	-1.7	5.7	8.8	8.3	10.3	9.6	14.3	13.7	1.7	1.6
Aveng	AVEPF	ZAR	41.56	14160	C-1-7	25,858	34,213	43,703	20.0	8.8	9.1	-50.5	16.9	6.7	5.7	2.2	1.7	2.7	2.0	0.2	0.2
Balfour Beatty	BAFBF	GBP	260.00	1126	A-3-7	6,466	7,046	7,236	2.6	2.0	2.0	-7.1	3.3	7.1	6.9	7.0	6.8	9.6	9.3	0.2	0.2
Bilfinger & Berger	BFLBF	EUR	26.96	1003	B-2-7	9,222	10,304	10,718	2.6	2.4	3.0	-4.1	32.2	7.8	5.9	5.4	4.5	8.4	6.5	0.2	0.2
Bouygues	BOUYF	EUR	29.06	10098	A-1-7	29,613	32,354	33,932	7.4	6.9	6.9	1.3	6.3	7.4	6.9	4.8	4.6	8.1	7.7	0.6	0.5
Eiffage	FGLLF	EUR	29.15	2716	C-3-7	12,596	12,959	13,077	9.1	9.0	9.0	-64.0	1.1	6.8	6.8	7.2	7.2	11.8	11.8	1.1	1.1
FCC	FMOCF	EUR	31.01	4049	A-3-7	13,881	14,222	14,282	9.4	9.0	8.5	-38.9	-2.4	9.0	9.2	7.4	7.6	11.9	12.5	1.1	1.1
Ferrovial	GRFRF	EUR	25.78	3616	A-2-7	14,630	14,316	14,901	13.1	11.1	12.8	-79.1	-74.8	23.6	93.7	12.8	11.2	24.1	20.1	2.7	2.6
Galliford Try	GLLDF	GBP	41.00	153	B-3-7	1,621	1,707	1,586	4.6	4.3	3.3	-26.7	-19.1	4.4	5.4	2.5	3.3	2.6	3.7	0.1	0.1
Hochtief AG	HOCFF	EUR	23.22	1625	B-2-7	16,452	16,854	16,888	0.7	1.5	1.8	5.7	20.3	10.6	8.8	3.8	3.4	8.5	7.1	0.1	0.1
Kier Group	XKEIF	GBP	710.50	256	B-3-7	2,199	2,365	2,372	4.2	3.4	2.2	-22.4	27.7	8.5	6.6	1.2	1.7	1.5	2.2	0.0	0.0
Sacyr	SYRVF	EUR	8.64	2635	B-3-7	5,760	5,820	5,815	16.0	14.3	13.7	-85.5	322.9	19.3	4.6	18.8	18.9	27.6	28.9	3.9	4.0
Strabag SE	XSTBF	EUR	17.40	1984	C-2-7	9,879	11,416	13,179	3.0	3.4	4.0	-1.4	36.4	8.6	6.3	1.5	1.2	2.8	2.1	0.1	0.1
Vinci	VCISF	EUR	26.04	12655	A-1-7	30,428	32,980	33,876	10.2	9.9	10.1	5.1	5.5	8.1	7.7	6.5	6.3	9.9	9.5	1.0	1.0
Wavin	WAVNF	EUR	2.73	215	C-3-7	1,619	1,609	1,609	9.4	7.0	6.9	-47.7	11.4	4.5	4.0	5.5	5.5	8.5	8.6	0.6	0.6
YIT OYJ	YITYF	EUR	6.03	767	B-1-7	3,706	3,968	4,462	8.7	8.8	8.5	6.3	9.4	3.4	3.1	3.7	3.4	4.1	3.7	0.4	0.3
Average (excluding outlyers Ferrovial and Sacyr)														*7.3*	*6.5*	*4.9*	*4.8*	*7.5*	*7.2*	*0.5*	*0.5*
EMEA Oil & Gas Equipment & Services																					
Acergy SA	ACGYF	NOK	37.20	1036	C-3-7	2,682	2,890	2,950	11.9	13.6	12.2	104.8	-8.5	4.0	4.4	2.4	2.4	3.1	3.4	0.4	0.4
Aker Solutions	AKKVF	NOK	53.50	14398	C-1-7	57,957	59,236	62,266	6.1	6.8	7.8	12.9	22.3	5.3	4.3	3.4	2.9	3.9	3.2	0.3	0.2
AMEC	AMCBF	GBP	468.25	1563	B-1-7	2,356	2,676	2,872	4.5	6.6	8.4	62.6	25.7	11.0	8.8	5.9	4.4	6.5	4.8	0.4	0.4
Bourbon	BOUBF	EUR	23.76	1319	B-2-7	770	920	1,071	27.8	20.9	22.0	-4.2	12.7	8.8	7.8	10.4	8.5	15.7	12.8	3.3	2.8
CGG-Veritas	CGPVF	EUR	13.24	1820	B-2-9	2,374	2,361	2,662	20.6	19.5	19.6	-9.0	16.7	7.5	6.4	4.2	3.7	8.6	7.6	1.7	1.5
Integra	XNITF	USD	1.00	124	C-1-9	1,177	1,617	1,892	4.0	5.9	8.8	-164.1	326.5	5.4	1.3	1.9	1.3	5.6	3.2	0.3	0.3
Petrofac Ltd	POFCF	GBP	428.25	2496	C-3-7	2,440	3,379	4,001	10.2	10.1	10.2	40.3	6.7	9.7	9.1	5.1	4.1	6.0	5.0	0.6	0.5
Petroleum Geo	PGEJF	NOK	38.20	1016	C-2-9	1,519	1,870	2,098	32.5	34.3	34.4	21.8	17.4	2.6	2.2	2.3	2.0	3.5	3.1	1.2	1.1
Saipem	SAPMF	EUR	13.02	5747	A-1-7	9,530	9,767	10,731	9.1	10.4	11.2	15.0	18.5	8.6	7.3	5.7	4.6	7.7	6.5	0.8	0.7
SBM Offshore	SBFFF	EUR	10.94	2093	B-1-7	2,886	3,124	3,453	10.4	8.6	10.6	-15.0	16.5	9.4	8.1	8.0	5.6	15.8	11.6	1.4	1.2
SBO	SBOEF	EUR	31.50	503	C-2-7	317	364	433	23.4	22.5	21.6	9.4	15.7	9.2	8.0	5.3	4.7	6.9	6.0	1.6	1.3
Subsea 7 Inc	SBEAF	NOK	42.90	953	C-1-9	2,187	2,540	3,132	14.6	18.2	17.1	8.6	23.8	3.6	2.9	2.8	2.3	3.3	2.9	0.6	0.5
Average														*7.1*	*5.9*	*4.8*	*3.9*	*7.2*	*5.8*	*1.0*	*0.9*

Source: Merrill Lynch estimates

Company overview

Founded in 1957 and headquartered in Cesena (Italy), the Trevi Group is one of the main global players in the underground engineering field. It initially started offering foundation engineering (Foundation Services), now integrated within the subsidiary Trevi. It is focused on special foundations and soil consolidation for infrastructures, such as bridges, railways, underground lines, dams, industrial systems and tunnels. Soon after its foundation, its core portfolio expanded into the production of Foundation Equipment, now assimilated in its Soilmec arm.

In 2004, the group established two new subsidiaries: Drillmec, specialised in drilling rigs and related equipment (Drilling Equipment) for oil, gas, geothermal and water; and Petreven, a supplier of oil drilling services (Drilling Services). Through Trevi Energy, a fifth leg established in September 2007, the group aims at engineering and developing renewable energy projects, mainly wind and geothermal energy. The venture is still in an early development phase, with the first 600MW of offshore wind farm projects in Southern Italy currently undergoing the administrative authorisation process and could get the green light in 2010/11.

The group has three main production facilities in Italy (two for Soilmec, the second one under construction, and one for Drillmec), one in Houston (Texas) for Drillmec, and is currently building a new plant in Dubai (operating by H209) for both Soilmec/Drillmec. With all plants running at full capacity on one shift, total annual output amounts to c.700 foundation machines and 50 rigs (40 for oil). Management expects capacity of c.800 machines and 70 rigs (of which 60 for oil) by 2009YE. The equipment manufacturing absorbs only c.10% of total capex.

Through a network of over 50 exclusive agents and distributors in 80 countries, including local presence through 32 branches and subsidiaries in 27 countries where its services arm operates, the group has successfully accomplished a vast number of relevant projects worldwide.

A global expert in special foundations, NOT in residential/commercial

Its specialisation in infrastructures that require sophisticated foundation works makes Trevi a 'niche' player. It has practically no exposure to residential construction, where both small local players and large construction and equipment conglomerates dominate. Its only 'commercial' exposure is limited to some recent projects in Dubai (eg, Pentominium Tower), which differ both in scale and level of skill required to most commercial projects elsewhere, as well as the sale of a few foundation equipments totalling < 5% of Soilmec's output. Thus, the group is not affected by the residential construction weakness in the US (or elsewhere). In fact, it currently holds a record order backlog of US$300mn in the US, which we think offers further significant upside potential (see page 19).

A record order backlog and an impressive list of works accomplished

A record order backlog of €970mn was reported in H108 (see page 14) - we think it could now be closer to c.€1.2bn, allowing for a sales visibility of c.1.2 years, owing to a range of new projects awarded recently. Such projects include foundation works for the Barwa Financial District (Qatar), the Wolf Creek, Tuttle Creek and Herbert Hoovert dams (US), the underground rail network extension (Algiers); oil drilling equipment orders by the Ministry of Oil in Iraq and the JV with the Shoula Group (linked to the Saudi Royal Family) to supply drilling to Aramco.

2004 marked the beginning of a new era of growth and profitability

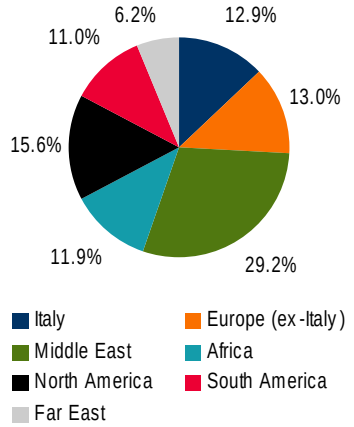
The fatal combination of the OPEC's oil production cut in January 2001 (oil prices had dropped to US$10/bl), infrastructure capex cuts in oil-driven economies, the

Table 6: Trevi's historical development

1957	*Pali Trevisani* is founded by Davide Trevisani and soon focuses on special foundation works and the development of adequate equipment technology
1962	First self-moving equipment for driven piles is patented; founder's brother Gianluigi joins Trevi
1967	First Rotary machine for large diameter bored piles is patented; First large commission abroad is awarded: foundations for Apapa road, in Lagos, Nigeria
1969	Soilmec subsidiary for foundation equipment founded
1970-79	Creation of international subsidiaries to execute works abroad, eg. in Argentina, Nigeria and Thailand
1980-89	*Pali Trevisani* becomes TREVI; diversification in small diameter drilling technology and abroad carries on, eg. with branches in Honk Kong, Philippines Thailand
1990-99	Further international/technological (tunnel) expansion; TREVI acquires Swissboring, a foundation works leader in many Middle Eastern markets, and several oil drilling rig makers in Italy (Massarenti, S. Ballerini and Comas Due) and the US (Branham); TREVI is listed on July 15, 1999 in the Milan Stock Exchange
2000-08	Further expansion of (oil) drilling equipment business with in-house developed hydraulic rigs (HH series) and a dedicated subsidiary, Drillmec; creation of drilling services arm, Petreven, focused on HH technology.

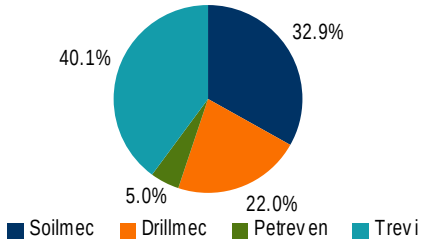
Source: Company data

Chart 1: H108 sales - geographical mix



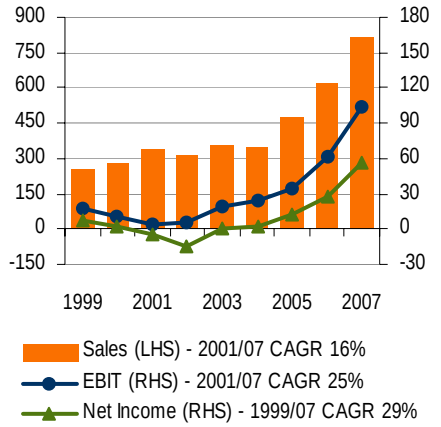
Source: Company data

Chart 2: H108 sales - divisional mix



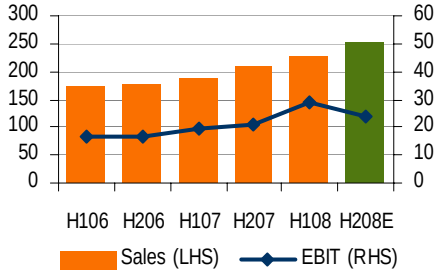
Source: Company data

Chart 3: Sales, EBIT and NI track record (€mn)



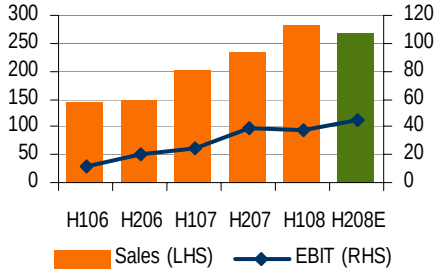
Source: Company data, 1999-2003 GAAP and 2004-2007 IFRS

Chart 4: Services division (Trevi+Petreven) Sales and EBIT per semester (€mn)



Source: Company data, Merrill Lynch

Chart 5: Equipment division (Soilmec+Drillmec) sales and EBIT per semester (€mn)



Source: Company data, Merrill Lynch

Argentinean currency crisis, the US construction sector downturn, the Iraq war and September 11 marked a very difficult period for the Trevi Group. This prompted the group to take action, resulting in a new path of robust growth and profitability since 2003, characterised by strong diversification.

- **Product expansion:** Drillmec spins off from Soilmec to better focus on growing its activities globally, including water and geothermal drilling; more powerful rigs (both conventional and HH), as well as new foundation machines are developed to complete the portfolio.
- **Internationalisation:** Drillmec and Petreven, which is no longer a start-up, increase the number of clients and geo exposure, moving from 4% of group's sales in 2003 to 27% in H108. The Foundation-related divisions also expand internationally.
- **More special infrastructure 'niche' works:** Foundation works intensify their presence in highly specialised foundations in infrastructure, moving away from residential works.
- **Flexibility and optimisation** of the business model – by outsourcing low value-added production of equipment (we estimate c.800 people are working in the group's outsourced activities versus none in 2003), by optimising inventory management and expanding production abroad.

Consequently, we believe the group has strengthened its position and is now better placed to maximise/offset demand upturns/downturns across business segments and geographies, while its margins appear much more sustainable.

Since 2004, CAGR in sales of 32% and in EBIT of 62%

Such strong growth rates since 2004 have been driven by a strong performance of core markets, the accelerated infrastructure investments in emerging countries (generating 59% of sales from both equipment and services in H108), especially in the Middle East and the Gulf area, where revenues in H108 accounted for 29.3% of the total (vs 18.3% in 2003). The increasing contribution of the new oil-related divisions (from c.14% of total EBIT in 2004 to c.27% in 2007) has also supported this recent success - $100mn worth of rigs were sold in Egypt and Oman in the last 4 years. The momentum of these positive trends appears to be strong in 2008-09.

Gearing has also strengthened from a quite stretched net debt/EBITDA of 3.5x in 2003 to 1.1x in 2007. Cash generation in the period benefited also from a NWC improvement (from 32% of sales in 2004 to 15% in 2007), owing to a much stricter advanced payment policy and inventory management.

Sales in H108 were up 29% to €490mn and EBIT up 50% to €60mn

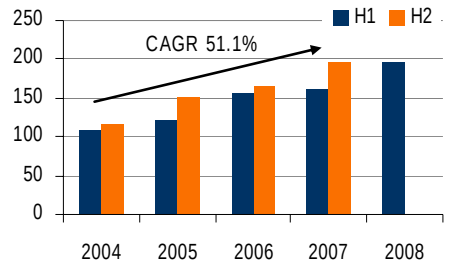
The H1 increase in sales and EBIT was driven by a strong performance from all areas, with the sale of drilling rigs growing fastest. The economies of scale in the Equipment units are gaining momentum and have raised group profitability: the EBIT margin was 560bp higher vs H106 as sales more than doubled. The Services units also raised profitability (280bp increase in the EBIT margin vs H106) helped by the coming-of-age of the Drilling division.

The regions showing the most remarkable growth are the Middle East and North America, where the group generated 45% of total sales in H108 vs 30% in H107, in line with their 41% share of the H108 order backlog. Projects accomplished though the Swissboring subsidiary, such as the foundation works for the Ferrari Experience in Abu Dhabi and the Pentominium Tower in Dubai, are positively contributing to the 2008 results, as well as adding prestige and visibility to an already solid record in a region with enormous potential.

Success founded on four pillars

1) Trevi: Foundation Services, 40% of H108 sales

Chart 6: Foundation Services (Trevi) sales (€mn)



Source: Company data

The historical core business, Trevi, operates in the execution of specialised works in the underground engineering field (special foundations, tunnel excavation and soil consolidation). It is the fourth-largest player worldwide (see page 12) and can work both standalone or in partnership with other international operators, should the size and scope of works require so. The very positive performance experienced in recent years was due to the following.

- **Exclusive focus on especial foundation works**, including more and more complex projects, where know-how and execution experience are crucial, strengthen the group as a 'niche' player and enhance its margins. Trevi has practically no exposure to the residential or commercial construction markets. This specialist know-how also increases barriers to entry vs other players that are exposed to the more commoditised residential sector (ie, small, local players or local arms of larger construction giants).
- **Wide geographical diversification** (c.25 countries) vs its competitors, which tend to be less geographically diversified and more dependant on its domestic markets (eg, Bauer generates 23% of sales in Germany and 40% in non-infrastructure; Keller Group generates 51% of sales in he UK/US, and has an important US residential exposure after a series of small acquisitions in recent years). Soletanche-Bachy is has the widest geo-exposure.
- **Highest reputation and market position in the Middle East**, especially in the Emirates, Qatar and Oman, where it is the market leader through the 100% subsidiary Swissboring (acquired in 1999). These oil-driven countries are experiencing a booming commercial/civil construction cycle that is due to continue for the foreseeable future. Trevi's presence in Saudi Arabia, Kuwait, Bahrain, Iran, Iraq and Egypt is increasing, supported also by its drilling business. Recent works include foundation works for the Barwa Financial District (Qatar), the extension of an underground metropolitan line (Algiers), the Pentominium Tower (Dubai) and the Ferrari Experience (Abu Dhabi).

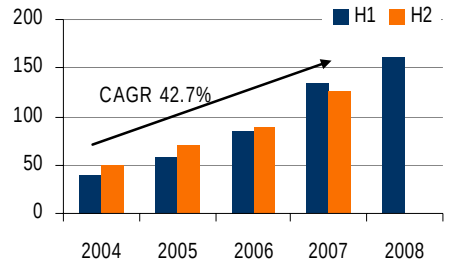
The **order backlog** currently offers around a year of sales visibility (see page 14).

Supply chain and timing: Its client base includes a large number of general contractors (none is > 5% of sales). Typical foundation works last on average 5-6 months. All labour is carried out by Trevi's highly specialised teams (with ad-hoc subcontracting of specific parts of a project). Foundation works are usually first to start in an infrastructure project, and therefore first to finish and cash in, thus minimising impacts from project delays due to third parties.

Project award and pricing: Works are usually awarded in bidding processes. Pricing is fixed for each specific project and calculated considering contingencies for external risk factors – projected budgets are subject to escalation, if significant events, such as geotechnical difficulties not reflected in the preliminary surveys, do occur. Trevi's price positioning is similar to Bauer's, its closest competitor, and relies on its track record, experience in complex works, quality and after-sales service to justify a premium vs other less sophisticated competitors.

Payment terms and risks: An upfront payment of 10-15% is usually requested before works start, the rest is cashed in gradually as works progress – 90-95% is usually cashed in by completion. 85-90% of works are State backed, and only 10-15% related to PPP schemes. Trevi's relative position in the supply chain (see above) provides relative power, ie Trevi can paralyse works in the critical early stage of a project if payments are delayed. Currency risk during the start and completion of a project is not usually hedged; yet, both revenues and cost base in most works are in the same currency (except for some € contracts in the US).

Chart 7: Foundation Equipment (Soilmec) sales (€mn)



Source: Company data

2) Soilmec: Foundation Equipment, 33% of H108 sales

Soilmec manufactures machinery, plants, rigs, grabs, cranes and other equipment tools used in foundation engineering. It was founded in 1969 and is now the second-largest player in the world (see page 12), and the global leader in the middle-high (€0.5-1mn of ASP) equipment building for subsoil engineering. With c.400 employees and an output of c.700 machines pa (5% of which is for Trevi), it is the global leader by number of machines produced.

The **order backlog** offers 5-6 months of sales visibility (see page 14).

With an EBITDA margin of 13-14% (vs c.9% in 2004), it has impressively grown its top and bottom lines over the last four years owing to the following:

- **A successful international expansion** resulting in a 43% CAGR in sales in 2004-07, supported by a positive construction upturn globally. It has a network of agents and distributors in 90 countries.

- **Lack of exposure to the commercial/residential construction** market, apart from the sale of a few machines used in commercial works, which account for less than 5% of total sales.

- **A complete product portfolio with a constant improvement of mix**. Over the years, new in-house developed equipment has gradually been added to its portfolio, which now offers a complete assortment of products, ranging from smaller ones (priced at c.€200K) to larger, more complex ones (priced at up to €1.5mn) – the ASP is c.€600-700K. This year alone, over 20 new products, to be launched next year, have been prototyped.

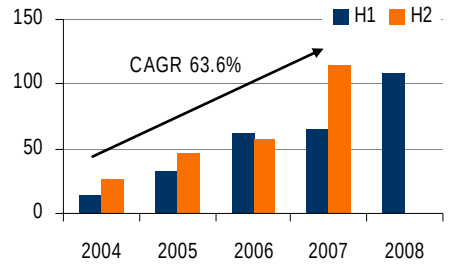
  The machines offered by Soilmec have hydraulic technology (most of its European peers do too), which is in contrast to many US players who still use mechanical technology. The machines tend to be 'standard' (especially when the sector is booming), with ad-hoc adjustments that enhance margins. The new Hydromill series for applications requiring deeper diaphragm and walls, and the optional electronics for remote diagnostics of machine/tool parameters offered with all equipment sold are under the most recent developments.

- **The gradual outsourcing of least critical, value-added phases** (including most metal working and pre-assembly) of the production process to a vast network of local third parties that offer great flexibility to expand or contract output and a more convenient cost structure.

  We estimate as many as c.400 people could be employed in Soilmec's outsourced activities versus none in 2003. Thus, Soilmec can focus on carefully planning and coordinating outsourced works in order to guarantee the quality and timing of the in-house final assembly. It currently produces three machines every day, of which c.5% are sold to Trevi, 90% are exports and 5% are sold in Italy.

- **The successful development of tool sales**, which now make up c.5% of divisional total revenues. Spare parts account for an additional c.5%.

Chart 8: Drilling Equipment (Drillmec) sales (€mn)



Source: Company data

3) Drillmec: Drilling Equipment, 22% of H108 sales

Drillmec was founded in 2004 as a spin-off of Soilmec and aimed at applying Trevi's underground engineering experience in the drilling field (so far only onshore). However, its origins go back to the 1980s, when low oil prices forced oil companies to search for more efficient, cheaper ways of drilling. In this context, Italian oil companies ENI/SAIPEM contracted Trevi to develop hydraulic drilling technology, giving birth to an internally designed and manufactured first hydraulic rig (precursor of current HH series, see page 16).

The **order backlog** currently offers 1.5 years of sales visibility (see page 14).

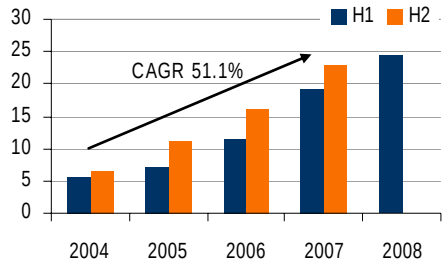
Drillmec can now offer solutions to satisfy almost the entire spectrum of its clients' onshore drilling needs (ie, up to 10,000m of depth in various extreme environmental conditions). Here are the main highlights of Drillmec's success:

- **The four manufacturers acquired during the 1990s** (Massarenti, Silvio Ballerini and Comas Due in Italy and Branham in Houston, Texas) and integrated within Drillmec, allowed for quickly setting a solid foothold in an industry where reputation and experience are as important as technology and value on offer. All these manufacture traditional (mechanical) drilling rigs.
- **The in-house developed HH rigs series** (c.50% of total production output) successfully introduced greater efficiency and lower running costs (vie higher process automation), a good example of Drillmec's innovative capacities (see page 16). It has sold 60-70 HH rigs so far; although other peers are developing similar automated hydraulic rigs, few can yet be found on offer.
- **The EDRA (European Drilling Rig Alliance) JV** with Wirth and Bentec aimed at full-package drilling system tenders worth over €20mn with high technology content proved a successful way to expand operations. Now that Drillmec can stand, walk and even run on its own feet, EDRA plays no role.
- **By replicating Soilmec's efficient and flexible business model**, as well as by leveraging Trevi's experience in underground engineering, Drillmec has been able to grow fast, reaching EBITDA margins of 13-14% (vs 8% in 2004). With c.350 employees (plus an estimated 400 in outsourced production activities), the company is structured to emulate Soilmec's successful outsourcing model. In addition, the group can easily switch resources from one business unit to the other, thus minimising the impact of a potential demand downturn in any one business.
- **Increasing volumes and rapidly improving mix:** in 2007 it supplied 50-60 rigs across all continents. In 2008, it expects to deliver 60-70 rigs, and a similar number in 2009 (yet closer to 70), but with a superior average turnover per unit. The price range for rigs is very wide: from €700k-1.5mn for a small water rig to €10-40mn for an oil rig, depending on its size and power. But the key for Drillmec's ASP is the amount of the full system that is actually supplied. In its origins, Drillmec could not supply the full package of a large rig, whereas now it can assemble 80-90% of it in-house – yet 60-70% of it is the real focus of the company. We believe first offshore rigs and HH rigs for deeper drilling are part of Drillmec's very ambitious new product pipeline.

Strong reputation among a large client base: In an industry that tends to be very conservative when it comes to new technologies and new suppliers, Drillmec has been able to establish a strong reputation and valuable relationships with clients across the globe, such as Saipem, Weatherford, Repsol, Aramco, Total, ENI, Chevron, Petrobras, TNK/BP, and many more, as well as Petreven itself.

Payment terms require the upfront payment of 30% of the order, 5% when the rig is installed and tested on site, and the rest during the manufacturing. Delivery times are currently 9-12 months, due to large demand (vs an industry average of 12-18 months). The lifespan of the rigs is usually 20-30 years, depending on the intensity of the activity and the working conditions. Clients are increasingly asking Drillmec to provide staff training and testing/rig-up services, which tend to be quite profitable as these are perceived as value-added by the clients.

Chart 9: Drilling Services (Petreven) sales (€mn)



Source: Company data

4) Petreven: Drilling Services, 5% of H108 sales

Petreven was incorporated in Venezuela in 2004 and provides onshore perforation services for the oil and gas industry, using only hydraulic hoist (HH) rigs manufactured by its sister company, Drillmec. It has successfully expanded operations from two rigs in operation in 2004 (in Colombia and Argentina) to nine in 2008 (plus one more in December 2008, operating from Q1 2009):

- 5x HH100 rigs in Argentina, 2x HH100 rigs in Peru, 1x HH300 rigs in Venezuela and 1x HH100 rigs in Colombia;
- under contracts with Petrobras (six rigs in operation), Chevron-Texaco (one rig) and Repsol (two rigs).

Current unit day rates amount to c.US$20,000/day, ie, US$7.3mn pa per rig. Around 100% of all revenues and 75% of all costs in this division are in US$, a mix that should be stable in the near future.

Petreven's market positioning is based on the exclusive use of HH rigs, which offers, in our opinion, great growth opportunities (see page 16).

The company expects to add 4-5 more operating rigs to its portfolio in H109.

Industry and market snapshots

A leader in non-residential construction niche

Trevi is the **world's fourth-largest special foundation engineering player,** ie, foundation work in civil infrastructure, not residential/commercial construction. It follows 1) British Keller Group (listed on the LSE); 2) French Soletanche-Bachy (a subsidiary of the French construction giant Vinci); and 3) German Bauer (closest direct competitor, listed on the Frankfurt Stock Exchange since mid-2006).

It is the leader in Italy with c.10% share of the total foundation works market, followed by 3-4 other companies with around half of Trevi's turnover and then up to 250 smaller local players operating mainly in the residential sector.

Soilmec is currently the second-largest player in the world after Bauer AG, the only other player that offers both Foundation Services and Equipment, and is now attempting to enter the Drilling sector, following Trevi's successful steps. The third manufacturer is Italian Casagrande, followed by a few other smaller, but relevant German, Italian, Scandinavian and Chinese players (eg. ABI/Delmag, Wirth, Junttan, Sany). The booming construction industry in China and the saturation of global capacity have led to the proliferation of many small domestic players, which still lack the experience and product quality and compete solely on price. However, for most relevant public infrastructure European equipment is still preferred. Large conglomerates such as Atlas Copco, Sandvik and Caterpillar do not operate in Soilmec's segment, but rather supply all players with components.

Geo-diversification and flexibility as the key strengths: The group claims to have achieved a higher level of flexibility through outsourcing (Bauer has grown through acquisition and internalised production), a more diversified presence (in c.80 countries, in 25 with Trevi foundation services, vs Bauer in c.10 and Keller in 5-6) and a more complete product portfolio (eg, Bauer does not do tunnels) than competitors.

Infrastructure outlook favours Trevi's footprint

We think that demand in Trevi's reference markets will continue in coming years, yet with different trends.

Emerging markets: 64% of Trevi Foundation Services' H108 backlog

In our note entitled *Infrastructure Powered* (15 October 2008), our emerging market economists reiterated their three-year Emerging Market infrastructure spend forecast of US$2.25tn (it was raised by 80% in the previous note *Rising EM Infrastructure Spend*, 16 June 2008). The drivers remain. In other words, infrastructure investment as an effective way to fight inflation by removing bottlenecks in the economy, but it becomes more selective.

- 75-80% of this spend forecast is backed by government expenditure, which while not immune, is at least less likely to be impacted by the credit crunch and ongoing distress in financial markets.
- Key for Trevi is the Gulf region (23% of backlog), where we estimate that US$400bn will be spent in the next three years (US$480bn according to the IMF, of which >75% outside the hydrocarbon sector), helped by recent current account surpluses.
- China is another key region showing ongoing commitment to infrastructure, and where Trevi sells machinery but at the moment no services.
- It may be that some countries cannot afford to continue spending if they are bailing out the banking system or stock markets (eg, Russia and possibly India – Trevi Foundation Services operates in neither of these).

Europe: 21% of Trevi Foundation Services' H108 backlog, all in Italy

Euroconstruct's[1] outlook for civil engineering in Europe in 2008-10 is optimistic compared to the negative outlook for the building sector, with annual growth rates of 3-4% (with Eastern well above Western Europe). Our sector analysts expect downgrades in the new market study due in mid-December, yet we continue to see demand – especially in maintenance and repair – for specialists like Trevi. For Italy, the current forecast points to a growth rate of 1.3% in 2008, 1.2% in 2009, 1.9% in 2010, after negative 2005-06, and a flattish 2007.

North America: 15% of Trevi Foundation Services' H108 backlog

The latest PCA[2] study's outlook for US public construction is not very positive. Demand growth is expected to drop to mid-single digits in 2009, after a flattish 2008, given the state/local authorities' difficulties to fund the much-needed infrastructure spend. Yet we think that while some sub-sectors might suffer cuts, some key maintenance/repair projects, especially if managed at the Federal level (eg, the renovation programme of 1,000 dams, see page 19), could top the priority list, especially if we consider the damage caused by recent hurricanes.

Oil/gas drilling industry: David and Goliath

The industry is very concentrated in the US, but there are important players in Europe as well. In terms of market penetration and financial muscle, there is little Trevi can do to compete with large players. However, there are also a number of mid-size players operating and the market is truly global. Using its expertise in underground engineering and its innovation capabilities, Trevi has been able to overcome typical industry entry barriers and open up space in the market.

In 2008, Trevi expects to sell c.50 drilling rigs, of which c.40 are for oil/gas. Still a relatively small number in contrast to the market leader US National Oilwell Varco' s c.6,000 rigs sold per year – all mechanical, both onshore and offshore, implying a market share of >65%. Nevertheless, Drillmec has a strategically important foothold in the industry, a relationship and track record with relevant clients in the oil industry that is gaining momentum and above all, an innovative, differentiated product (HH rig series) that adds value for the client.

Oil price may drop ST but capex should go on

Oil prices are the main driver behind oil companies' investments in exploration, drilling and production (E&P). Whether the level at which oil companies reduce or stop E&P capex is at <US$40, <US$60 or <US$80/bbl is arguable.

Our latest *Global Energy Weekly* notes (1 and 17 October 2008) forecast lowering oil demand and prices next year, but claim the super-cycle is not over. They forecast oil at US$90/bbl in 2009 on the back of slowing global demand and increasing productive capacity, and point at US$50/bbl in the worst case scenario of a synchronous global recession. With regards to an eventual production cut to be discussed next week by the OPEC, our analysts do not expect cuts other than those already built into the cartel's own 2009 forecasts. Moreover, they do not expect aggressive cuts until oil prices hit $50bbl, as OPEC members need prices in the range of $25 to $75/bbl for their government balances to break even. Thus, we could argue that US$50/bbl represents a valid short-term floor.

Long-term global energy demand will continue to be strong, in our view. Whenever the economic activity starts to recover, energy demand will again put upward pressure on prices. As a result, we think that although E&P investments by oil companies might slow mid term, these are not likely to freeze altogether.

[1] *European construction market trends to 2010*, 65th Euroconstruct conference 2008, 13 June 2008

[2] *US Cement and Construction Forecast*, Portland Cement Association, Summer 2008

Key features of the business model

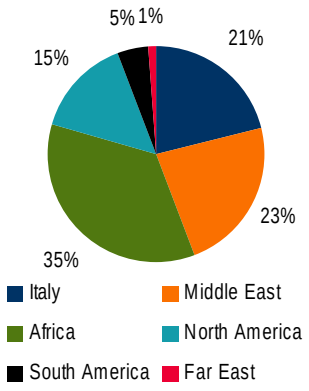
A) Strong order backlog: 1.2 yrs of visibility

The firm order backlog as of H108 increased by 42% YoY to €973mn:

- **Foundation works (Trevi) in the backlog rose strongest by 94% YoY,** allowing for sales visibility of one year. Management is confident about the further development of infrastructure commissions in its key markets, based on the bid processes in which it is currently participating. The geo mix of works is split in chart 10. The most relevant countries are Dubai, Qatar, Abu Dhabi, Oman, Algeria, Angola, Nigeria, Lybia, Venezuela and Argentina.
- **Foundation equipment (Soilmec) also registered an increase in orders of 42% YoY.** We do not expect orders to perform so strongly over the next months, but rather expect a flattish volume trend with an increase in value of units (more sales of larger vs smaller machines), thus enhancing margin prospects. Sales visibility in this division is currently 5-6 months.
- **Drilling rig (Drillmec) orders increased by 42% YoY,** allowing for a sales visibility of c.1.5 years (delivery times). We think this division will continue to deliver positive surprises in coming months, supported by an oil price that even if below peak levels, is still relatively high, and a global energy demand that despite short-term downward pressure due to a potential economic recession, should continue rising in the longer term.
- **Petreven's order portfolio was 5% down on H107**, although management is confident that this trend will reverse in coming months and so are we, given visibility of around three years.

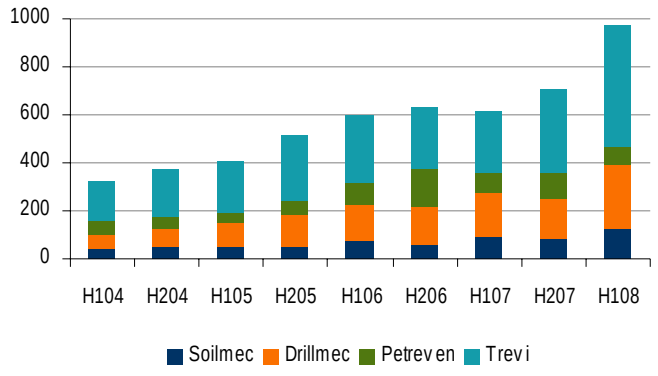
We believe that with the contracts awarded in recent weeks (eg, the Herbert Hooker dyke and Wolf Creek dam in USA and the Barwa Financial District in Qatar) the **order backlog,** which includes **only firm contracts with financing in place,** may have **risen to c.€1.2bn,** implying **c.1.2 years of sales visibility** - one-third repair, two-thirds new infrastructure (high emerging market exposure).

Chart 10: Trevi Foundation Services H108 order backlog



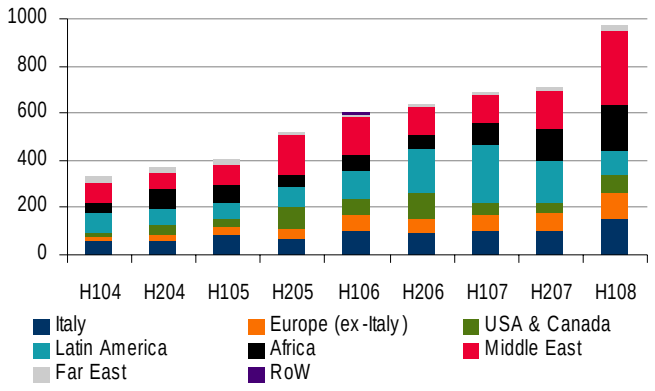
Source: Company data

Chart 11: Order backlog – divisional breakdown (€mn)



Source: Company data

Chart 12: Order backlog – regional breakdown (€mn)



Source: Company data

Geo-diversification helps offset weaker markets with booming ones

In geographical terms, we can see that the Middle East (+163%), Africa (+158%) and the Far East (+116%) generated considerably more orders in H108 than in H107. We think the underlying drivers for infrastructure and drilling demand in these countries will remain robust in coming years, and expect orders to continue to be strong. Also, we think that Latin America, where orders decreased by 58% in H108, will have a more positive H2 and H109, especially in oil-related activities.

B) The magic formula: 1 + 1 + 1 + 1 > 4 {foundations+drilling} + {services+equipment}

The vertical and horizontal integration of both Services and Equipment for its two interrelated business fields, Foundations and Drilling, is a very powerful formula that offers the following advantages vs pure players.

- Commercial synergies as many Equipment customers are or can become Services customers or even partners, as JVs to exploit large foundation works are frequent; eg the 50% JV with Soletanche-Bachy to carry on the Wolf Creek dam works worth US$341mn in the US – the order to proceed was released by the US Army Corps of Engineers two weeks ago.
- Inter-disciplinary know-how synergies between Foundations and Drilling, as both share a common fundamental discipline, ie, underground engineering in challenging geophysical and environmental conditions.
- Inter-divisional know-how synergies as the experience gained in Services is key to adding real value by 1) developing innovative Equipment solutions based on projects accomplished in house; 2) or by offering qualified technical advice in how and with which equipment to best tackle a specific project, as customers often come to Trevi with a project in hand.
- Maximum growth and protection, as the business mix 1) maximises benefits during positive cycles, eg, by selling Services as well as Equipment to other service providers; 2) minimises the potential negative impact during a downturn, thanks to the oil/gas drilling operations and their geo-mix, as well as that of their civil infrastructure business.
- Best resource allocation as Drillmec and Soilmec are both built around an analogue lean model that shares production resources, so that these can easily be re-allocated from one to the other, thus protecting margins.

C) There is 'life' beyond the order backlog

We think that having experienced record levels of sales, profitability and orders in these past 18 months, investors will be thinking about what could happen next. We have decided not to construct complex algorithms beyond 2010 based on a wide number of assumptions, in order to build our positive outlook for Trevi. Instead, we will list the reasons that we are convinced by Trevi's long-term prospects.

- **Long-term prospect for infrastructure is positive**. The need for more, ever-more sophisticated, civil infrastructure is unlikely to decrease. On the contrary, it should further increase in emerging countries. In developed countries, infrastructure spend is often used during downturns to maintain economic activity and improve competitiveness. Thus, it is not as cyclical an industry as construction.
- **Geo-diversification**. With >50% of sales generated in emerging economies, and across a large number of regions/countries, Trevi's geographical exposure will continue to be a strength, in our view.
- **Strong long-term oil demand will keep petro-dollars flowing.** This has a double beneficial effect for Trevi. On the one hand, demand for drilling equipment and services will continue to be strong – we should not forget that Trevi is starting from a relatively low base, and therefore can still benefit from increased market penetration of its products. On the other hand, oil-rich countries will continue to spend on infrastructure.

- **Cheaper oil does not mean the end of the game.** It is a fact that oil companies invest more when oil prices are higher (see page 13). Yet the company claims that its clients have based their longer-term investments on long-term oil prices of US$40-60/bbl, a level that seems to fit our bearish scenario of a synchronous global recession, ie, even in such an event, prices would remain within the US$40-60 range and oil companies could continue investing.
- **Falling oil prices increase appeal of HH drilling technology.** Since HH drilling technology is more cost-effective than conventional mechanical technology, as oil prices drop HH drilling turns more attractive, which would benefit Drillmec and Petreven.
- **A fifth leg already on the ground: Trevi energy.** Established in September 2007, this business unit aims at engineering and developing renewable energy projects, mainly (offshore) wind and geothermal energy. Even if it still in an early development phase, it could become an attractive growth area from 2011. The first 600MW of offshore wind farm projects in Southern Italy are currently undergoing the administrative authorisation process and could get the green light in 2010.
- **Track record of dynamic expansion.** Looking at how the company has managed to expand in different geographical markets, and even into other business activities (drilling equipment and services), we believe Trevi is capable of adapting to ever-changing market conditions and will seek growth opportunities outside its areas of comfort, leveraging its core capabilities (eg, offshore HH applications, which could be a reality in 2010).

D) Oil drilling: growing market with opportunities (automated HH series)

Mechanical rigs still dominate the industry because of 1) their long history of use both onshore and offshore; 2) reliability in all environmental conditions and in depths of up to 10,000m; 3) all operators know how to operate them; 4) a network for spare parts and service is widely available. In fact, only 81 out of a total of 3,200 rigs operational globally were hydraulic in October 2007.

Potential for automated, hydraulic rigs (HH series) is high. Trevi manufactures both mechanical and hydraulic (HH) drilling rigs. Current demand trends supported by high oil prices due to capacity constraints (demand has been growing faster than supply) offer further growth opportunities for Trevi, and all other players. However, we believe that there is great potential for higher penetration of hydraulic rigs. We think both Drillmec and Petreven will benefit from this because of the following:

- **Track record.** Although other peers are developing similar automated hydraulic rigs, few can yet be found on offer, as most competitors offer predominantly mechanical rigs – some European rig manufacturers have now started to offer hydraulic rigs. Drillmec has already sold 70 of its HH series so far. The range of geological/environmental conditions under which HH rigs are in operation is widening also, which further increases the market potential. As an example, there are now HH rigs in operation in countries and environmental conditions as diverse as the US, South America (from the tropical regions down to Patagonia), North Africa, Sub-Saharan Africa, the UK, Germany, Italy, Russia, Iceland, China, Australia and the Middle East.
- **Efficiency.** The group's HH rigs are more efficient and only 0-5% more expensive than conventional ones thanks to an increased level of process automation (including the automatic interchange of drill shafts), reduced

footprint (up to 75%), faster movement and rig-up, and lower waste production, leading to 1) 30% lower drilling costs; 2) a 30% improvement in drilling performance (drilling time); and 3) 40% lower transportation costs.

- **Safety.** They are also safer, as accidents are a major concern for oil companies, especially in South America, where trade unions play an important role. Petrobras concluded in a recent study on the five years of operation of a HH rig supplied by Drillmec (operated by Petreven) that no personal accidents were registered in the period. Better safety features make HH rigs more attractive in natural reserves (eg, Alaska) or close to urban areas (eg, the reactivation of old wells at lower capex in Texas).
- **Ease of use.** They require less skilled labour, and operators are easier to train (less than a year vs 3-5 years for conventional rigs). Note that finding skilled staff is a major industry constraint.
- **Externalisation**. In many countries with national oil companies (eg, Russia, Venezuela, Gulf area), the level of outsourcing of drilling to third-party oil services providers is still way lower than that of integrated oil companies in Europe and the US, which took place in the 1990s. We believe this gap will narrow in the coming years, offering attractive opportunities to innovative service providers such as Petreven.
- **Stronger incentive.** Since operators are paid by the day, incumbents (usually larger peers operating almost exclusively mechanical rigs) have little incentive to offer faster HH drilling services to oil companies, to avoid loss of revenues – Petreven, on the contrary, only operates state of the art HH rigs.
- **Widening applications: deeper, tougher conditions, offshore.** Although Drillmec's HH rigs are not yet applicable for depths over 4,000-4,500m, the fundamental technology can be applied for deeper drilling. In fact, Drillmec is currently developing five rigs for depth up to 6,000m (to be ready in 2009-10) in a JV with the Shoula Group (controlled by the Saudi Royal Family) in order to supply Aramco with HH drilling services. Also, we understand that Trevi is developing its first offshore HH applications.
- **Network effect.** As the installed base of rigs grows, revenues generated by maintenance will also increase, resulting in a positive effect on margins.

E) Flexible and efficient to grow faster

- **Services divisions are internal know-how driven.** The most important assets are knowledge, experienced staff, record and reputation. Trevi, therefore, operates a highly internalised business model. By focusing on its core niche and employing the best project and R&D specialists, it makes sure the know-how is retained within the group and offered to the its clients.
- **Equipment divisions have gradually outsourced most of the low value-added** parts of the supply chain, including most of the production. We estimate c.800 people could be working in the group's outsourced activities – half for Soilmec and the rest for Drillmec versus none in 2003.
- **Focus on final assembly and high value-added processes**: marketing and distribution, services and R&D. The group operates a close to JIT supply chain model, with optimised inventory management. Nevertheless, management recognises the potential to work even closer with suppliers to reduce inventories further.
- **No stock of raw materials.** It mainly sources sub-assemblies and components, while raw material costs account for c.1% in foundation equipment; 20-30% in drilling rigs, in which case suppliers are bound to

supply contract included in the tender offer. In 70% of foundation projects, raw materials (cement, iron, etc) are purchased by the final clients, whereas in the remainder they are bought on signature of binding contracts that include raw material supply contracts (sometimes also advanced payments). Thus, raw material price increases have no material impact on margins.

- **Drilling Services shows margin improvement potential.** Foundation Services tend to enjoy relatively stable profits – although in market upturns they tend to increase above the historical average (12-14% EBITDA margins). The coming of age of Petreven's Drilling Services should provide upside to the group's average margin, as the business thrives.
- **Expansion of production abroad to support growth.** A new plant in Dubai should start operating in H209. This should complement the group's production and logistics, leading to efficiency gains, as well as commercial advantages for being closer to some key markets. The capex planned for the plant is c.€4mn, to be incurred in 2009.
- **Margins appear sustainable and have the potential to increase.** Given the flexible approach to equipment manufacturing, we believe margins are sustainable. Moreover, the increasing positive momentum in drilling equipment and the launch of the Dubai production facility should enhance margins further. Continuous innovation to offer best solutions to sophisticated customers also adds to our list of margin drivers.
- **Employs c.200 R&D specialists** (of which half are at Soilmec) out of the total 5,300 staff and spends c.€15-20mn on R&D every year, underlining its emphasis on innovation.
- **Offers service and spare parts within 24-48 hours worldwide**, as part of its emphasis on after-sales care and offers training (see below).

F) Emphasis on training to overcome key sector bottleneck: skilled labour

Trevi's training policy aims at guaranteeing the supply of skilled labour through:

- **Optimisation of 'staffing' in new project/product developments:** Again, the group's experience in foundation/drilling works on the ground is a crucial asset to optimise the layouts and user-friendliness of the equipment manufactured by Soilmec and Drillmec, in order to help clients optimise the use of staff and combat the 'lack of crews'.
- **Mobility of staff:** Trevi's four decades of project experience across all continents has helped to maintain a deeply rooted entrepreneurial corporate culture. Its 'crews' have and can be re-deployed where needed.
- **Incentivisation:** management claims to pay wages that are at the top of the industry range in all countries where it operates, thus assuring a high level of employee retention. Labour cost inflation is not alleged to be a problem, but the bureaucracy involved in processing the visa applications for their migrant employees is. Labour costs for Soilmec/Drillmec are stable at c.10-12% of the total, and 30-40% for Trevi/Petreven, depending on the country, yet paid for by final clients. The group has an ad-hoc approach to pay rises.
- **Training programmes** and workshops (even on-site) for both internal and client staff on innovative works carried out by its Trevi arm not only retain know-how in-house but also help promote the group's franchise. They allow clients to tackle ever more complex works (jointly with Trevi or on their own using Soilmec's equipment) and increase customer loyalty. In 2008 the Trevi Academy was founded, aimed at emphasising these initiatives.

Drivers and opportunities

- **Services and Equipment: commercial and know-how synergies.** Commercial because many Equipment customers are, or can become, Services customers or even partners, eg the 50% JV with Soletanche-Bachy. Technological (know-how) because the experience gained in Services is key to 1) developing innovative Equipment; 2) offering qualified technical advice to clients on how and with which equipment to best tackle their projects.
- **Foundation and Drilling: synergies and diversification.** Both share a common fundamental discipline, ie, underground engineering in challenging geophysical and environmental conditions. The mix also maximises growth and protection: 1) it maximises benefits during positive cycles, and 2) it minimises potential negative impacts during downturns.
- **Best production resource allocation between Drillmec and Soilmec**, as both are built around an analogue lean model, so that resources can easily be re-allocated from one to the other, thus protecting margins.
- **Special foundation specialist (#4 in services, #2 in equipment, globally) with no residential/ commercial exposure.** Its 'niche' player status means Trevi operates in sophisticated foundation works (eg, bridges, railways, underground lines, dams, industrial systems and tunnels), both in new and repair works – an area with attractive margins and strong growth prospects.
- **Strong position in emerging markets, especially the Middle East:** the Group has a strong reputation and presence in the Gulf region. Its subsidiary Swissboring is market leader in the Emirates, Qatar and Oman. Its presence is also increasing in Saudi Arabia, Kuwait, Bahrain, Iran, Iraq and Egypt, helped by its drilling business (see pages 6, 7 and 10 for examples of recent project awards). Hence Trevi plans a new plant in Dubai operating in H209.
- **Good prospects for the US national programme of reconstruction of 1,000 dams**, which according to data of the US Dept. of Agriculture, will reach their 50-year life of operation within the next 10 years. The prospects for Trevi are high (eg recent awards on pages 6, 7 and 8), after having been awarded 'Best contractor' by the US Army Corp of Engineers in 2003 (dams in the US are owned by both the government and the military). The damages caused by recent hurricanes also offer opportunities. The Group holds an all-time record backlog of US$300mn in the US (non-residential).
- **Strong order backlog with average 1.2 years of sales visibility.** The order backlog as of H108 increased by 42% YoY to €973mn – we believe that orders are worth c.€1.2bn today, due to the recently awarded contracts. As outlined in page 12, the positive momentum of infrastructure investment in emerging economies is as strong as ever, with a mix of trends that favours Trevi's footprint (the Middle East, repair works in the US/Europe).
- **'Life' beyond the order backlog appears promising**, thanks to the long-term prospect for infrastructure (especially in emerging markets); Trevi's 'niche' player status and track record in innovation and sensible diversification; strong long-term oil demand; HH rigs' appeal even if oil prices drop; and the development of a fifth leg, Trevi energy, aimed at engineering in renewable energy projects (eg, offshore wind, geothermal).
- **Appealing drilling equipment portfolio: innovative HH series.** More so if oil prices drop. Wee find the Group's HH series rigs very appealing. They offer 1) 30% lower drilling costs; 2) a 30% improvement in drilling performance (drilling time); and 3) 40% lower transportation costs. They are also safer and require less trained staff to operate than conventional

mechanical rigs. While many operators have no incentives to switch to HH (drillers are paid by day of operating), Petreven operates exclusively with HH.

- **Flexible business model,** with only value-added processes in-house (assemble, engineer, R&D) and 80% of production in outsource.
- **M&A programme to acquire market share in attractive markets through small players:** The Group has indicated its interest to acquire small players that could grant it access to new markets. Both Services and Equipment suppliers would be under consideration, for which management could aim at paying around 3.5x EV/EBITDA.
- **Partnerships in specific growth areas** are also on the Group's list of priorities, in order to increase presence in areas with good growth prospects. Examples include Russia, where partnering with locals is key to gaining access to large drilling contracts, and China, where the increasing demand and sophistication of infrastructure works will demand external specialists such as Trevi.
- **The strengthening of the dollar can make Trevi even more competitive,** especially in the drilling equipment business.

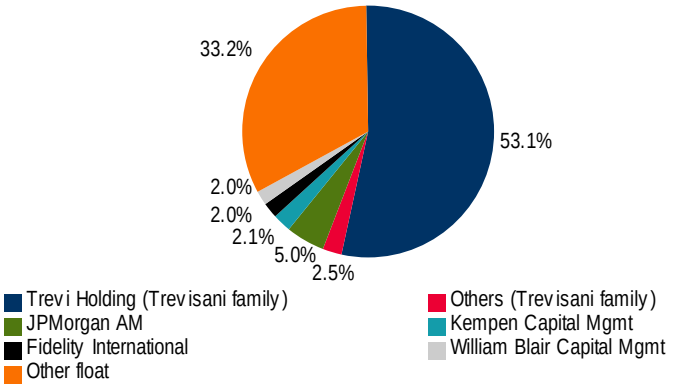
Risks and concerns

- A long-lasting, global recession could have a negative impact on governments' income revenues and budgets, and compromise the pipeline of new or even some maintenance infrastructure projects, especially in those nations most affected by the credit crunch. This could distort the natural industry cycle and introduced more competitiveness, affecting Trevi's growth and profitability.
- Growth is somewhat dependent on government policy and initiatives, which is a risk particularly in emerging countries, where political stability is under constant threat.
- Execution risk in sizeable project commissions.
- Project delay and cash flow risks are part of today's reality, considering the credit crunch and its economical/financial consequences.
- Clients facing liquidity or funding difficulties pose a risk to Trevi's business, even in those projects that are ultimately commissioned and funded by public entities. In those backed solely by private entities or PPP schemes, the risk is greater, in our view.
- Increased competition and NWC deterioration could also be the consequences of a slowing economy, in case clients and suppliers face operating and financing difficulties, and start passing them up and down the supply chain.
- Should demand remain strong, the scarcity of skilled labour could lead to wage inflation and project delivery delays in some regions.
- Downward oil prices or price prospects could also lead to oil companies slashing capex, which could increase competitive pressure for Trevi's drilling businesses. It could also negatively affect the prospects of, and the appetite for stocks related to oil drilling or infrastructure in oil-rich regions.
- Given Trevi's global exposure, currency fluctuations might affect both its top and bottom lines, as well as its risk profile.

Corporate governance

Trevi-Finanziaria Industriale, the quoted entity, holds the group's subsidiaries. It is 53.1%-owned by Trevi Holding, the investment vehicle controlled by the Trevisani family: 51% by Davide Trevisani, the group's founder with the rest in the hands of his brothers Gianluigi (31%) and Cesare (18%). Another 2.5% of the group is held by the founder and his brothers, outside the holding vehicle. This leaves a free float of 44.3% (excluding the convertible loan).

Chart 13: Shareholding structure (as of 20 October 2008)



Source: Reuters, accessed 20 October 2008

The BoD comprises nine members – all Italian. Founder, Davide Trevisani, who chairs the Board, no longer holds any operating responsibilities. His brothers Gianluigi and Cesare are also Board members. The former is Chairman of Trevi, while the latter is CEO of Trevi's Italian operations and Petreven. The founder's son Stefano is the fourth family member on the Board and is CEO of Trevi's international operations. The founder's other son Simone is CEO of the mechanical divisions (Soilmec and Drillmec) but is not a Board member.

Each division also has a General Manager that is unrelated to the family.

The other **five independent non-executive members** of the Board come from the financial, legal, academic and other relevant industrial sectors, and include a former Chairman of Italian oil/energy group ENI.

We believe the mix of operating and independent Board members, as well as their experience to be relevant to the group's business activities. However, we would prefer more international experience, maybe even in the form of non-Italian members, given the international exposure of the business.

The Board will be re-elected upon approval of the 2009 financial results. The external auditor is Reconta Ernst & Young under a mandate expiring in 2016.

The group has **no stock option or stock grant programme** in place. A variable remuneration scheme affects less than 20 top managers, under which part of their remuneration is subject to achieving specific operating margin, net income and cash generation targets.

On 29 April 2008, the BoD authorised a **share buyback programme** valid until 30 April 2009 for the purchase or sale of a maximum of 2m shares (equivalent to 3.125% of the total share capital) at a maximum price of €20 and a minimum of €3 per share. Currently, the company holds 720K of its own shares (average price paid of €11.75, totalling to c.€8.5mn).

Financials

The company gives **no official guidance** on future performance, apart from the order backlog. However, it has indicated that current consensus estimates for 2008 and 2009 fit well within management's expectations. Our numbers are 0-4% below consensus, reflecting a slightly more cautious, yet positive stand.

Trevi's order backlog gives a **visibility of sales of approximately 1.2 years** (see page 14), under which we forecast 23% growth in sales in 2008 – with Drillmec and Petreven growing well above the total and Trevi and Soilmec below.

We expect 2009 to be another positive year and forecast **sales growth** of 16.6%. Again, we forecast that sales at Petreven and Drillmec will grow above the group's total, whereas Trevi will grow pretty much in line. We estimate sales growth of foundation equipment (Soilmec) to be up in the mid-single digits next year, driven mainly by the typology of machines in demand (larger) rather than volume (flat, in our view).

Table 7: Trevi – net sales

(€mn, IFRS)							% MIX						% YoY chg				
By division	2005	2006	2007	2008E	2009E	2010E	2005	2006	2007	2008E	2009E	2010E	2006	2007	2008E	2009E	2010E
Soilmec	127.6	173.1	259.7	305.2	322.0	338.1	25.6	26.9	31.0	29.6	26.8	26.6	35.7	50.0	17.5	5.5	5.0
Drillmec	78.7	119.5	178.6	244.7	318.1	334.0	15.8	18.6	21.3	23.8	26.5	26.3	51.8	49.5	37.0	30.0	5.0
Petreven	18.3	27.4	42.1	53.9	75.5	86.8	3.7	4.3	5.0	5.2	6.3	6.8	49.5	54.0	28.0	40.0	15.0
Trevi	273.1	322.4	356.6	426.2	485.8	510.1	54.9	50.1	42.6	41.4	40.4	40.2	18.1	10.6	19.5	14.0	5.0
By geography																	
Italy	100.8	109.5	141.4	133.9	140.6	147.6	20.2	17.0	16.9	13.0	11.7	11.6	8.6	29.2	-5.3	5.0	5.0
Europe (ex-Italy)	53.8	84.9	139.1	133.9	140.6	147.6	10.8	13.2	16.6	13.0	11.7	11.6	57.7	63.9	-3.8	5.0	5.0
USA & Canada	55.9	89.0	91.0	160.7	192.8	202.4	11.2	13.8	10.9	15.6	16.0	16.0	59.1	2.3	76.5	20.0	5.0
Latin America	48.6	61.9	97.8	113.4	147.4	162.2	9.8	9.6	11.7	11.0	12.3	12.8	27.4	58.0	16.0	30.0	10.0
Africa	89.1	99.2	126.3	122.5	147.0	154.4	17.9	15.4	15.1	11.9	12.2	12.2	11.3	27.3	-3.0	20.0	5.0
Middle East	114.6	165.3	188.9	302.3	367.3	385.6	23.0	25.7	22.6	29.3	30.6	30.4	44.2	14.3	60.0	21.5	5.0
Far East	31.7	29.2	47.7	56.8	59.6	62.6	6.4	4.5	5.7	5.5	5.0	4.9	-8.0	63.6	19.0	5.0	5.0
RoW	3.2	3.5	4.8	6.0	6.3	6.7	0.6	0.5	0.6	0.6	0.5	0.5	9.3	39.3	25.0	5.0	5.0
Total net sales	497.8	643.3	837.5	1,029.9	1,201.3	1,269.0	100.0	100.0	100.0	100.0	100.0	100.0	29.2	30.2	23.0	16.6	5.6

Source: Company data, Merrill Lynch estimates

We think current **margin levels** are sustainable and could even increase. Foundation services are experiencing very positive times, with levels of profitability that could be above historical levels. Should margins in the foundations business come under pressure in 2-3 years, a number of positive factors should help Trevi to offset this impact: 1) flexible approach to manufacturing (high level of outsourcing); 2) increasing production and sourcing in lower-cost countries (new plant in Dubai); 3) increasing margin contribution of drilling business units, especially due to Petreven's coming of age.

All in all, we forecast what we consider to be an achievable 70bp EBITDA margin improvement in 2008 and a further 30bp improvement in 2009. Longer term, we take a cautious stand and forecast a 16.2% EBITDA margin.

Capex plans amount to €90mn for 2008 and to c.€60mn for 2009. Maintenance absorbs c.€35mn per year. The remainder is dedicated to support the group's growth, primarily that of Trevi (foundation services), which means in most capex will be used for acquiring Soilmec's equipment to be employed in commissioned works. For example, in 2008, of the €90mn, the equipment divisions will account for c.€9mn, Petreven €15mn and Trevi the rest. In 2009, the new plant in Dubai should cost c.€4mn. With its cash generation and NFP, the company seems able to finance these investments.

Debt structure: The total outstanding debt at the end of H1 2008 was €266mn (net debt €183mn).

- **Long-term gross debt** amounts to €176mn (66%) and includes a convertible bond of €70mn nominal (convertible to 6.19mn shares, strike at €11.3) issued in November 2006, with a residual value of €64mn. It expires in November 2011 and is fixed at a very favourable interest rate. Most of the remaining €112mn is amortised (interest + capital) – repayments due by year-end 2009 amount to c.€25mn in 35-40 different operations.
- **The short-term debt** amounts to €90mn (up from €60mn in 2007) and is mostly due to the growth at Drillmec and Soilmec – sufficient unused credit facilities are available to support further growth. Such facilities are generally drawn as advances from invoices or facilities backed with letters of credit, especially in the case of Drillmec (higher ASP per machine).
- **Risk:** Debt facilities are split over 60 operations with c.25 different banks and financial entities, thus diversifying risk.
- **Currencies:** Most of the debt is based in Italy and denominated in €. Around 20% is in US$ and mostly short term.
- **Leverage:** With a net debt/EBITDA of 1.2x and interest cover of 7.9x as at end-2008, and solid cash generation, the company shows a relatively solid balance sheet, able to fund the growth expected.
- **Sensitivity:** An analysis carried out by the group in June 2008 resulted in €0.4mn of additional interest expenses for each extra +50bp of the Euribor.

The **NWC** characteristics in equipment manufacturing are very favourable owing to the high level of outsourcing, whereas in the services divisions, the NWC follows the top-line growth. Trevi and Drillmec have the largest work commissions, and therefore demand more advanced payments. As Drillmec's volume has grown, advanced payments have also increased and, consequently, receivables as a % of sales have dropped (from 40% in 2004 to 22.4% in 2007).

On the other hand, the strong growth in recent years has increased inventory levels. As a result, we think NWC will rise to almost 19% in 2008 (vs 15.3% in 2007), in line with H108, but we do expect a gradual improvement to 18% in 2009 and to 16.5% longer term, as inventory management is further optimised. Our NWC scenario implies a cash outflow during 2008-2010 worth c.15% of Trevi's current market valuation, of which two thirds is due to the delta vs the 2007 NWC level.

Payout: it is company policy to distribute c.15% of net income in dividends.

Forex exposure: Our avg. $/€ used in our model is 1.50 for 2008 and 1.39 for 2009, in line with our foreign currency analysts' estimates and those of Trevi itself. Approx. 40% of 2008 sales and 35% of costs are denominated in €, which reflects a pretty good natural hedge against the strength of the Euro.

Foundation Services are generally invoiced in the local currency (c.50% in US$) but so are most costs incurred also. Foundation equipment sales are mainly denominated in €. Petreven operates mainly in US$, both on the revenue and cost side. Although drilling equipment tends, to a great extent, to be sold in US$, Drillmec was short of US$ in 2007, ie, it sold 70-80% in € while 45-50% of the cost side was denominated in US$, thanks to an ever increasing volume of purchases in that currency. A strengthening of the US$ is good news for Trevi, now that the US$ share in Drillmec's sales is increasing – the contract awarded in Iraq worth US$200mn was budgeted at 1.55, for instance.

Table 8: Trevi - company profile

Address (HQ and IR office)	IR Manager		Stefano Campana			
via Larga 201	Contact email		scampana@trevifin.com			
47023 Cesena (FC)	Website		www.trevifin.com			
Italy	Telephone		+39 0547 319111			
SHARE PROFILE (€)	2005	2006	2007	2008E	2009E	2010E
Share price, high	5.23	9.69	14.61	17.23		
Share price, low	1.11	4.31	9.11	8.85		
Share price, avg./current	2.57	6.55	12.09	10.00	10.00	10.00
% change in average	151.9	154.9	84.5	-17.3	0.0	0.0
Share number (avg., last)	63.3	64.0	63.7	70.2	63.4	63.4
Major Shareholders (%)				(†)		
Trevi Holding (Trevisani family)				53.1		
Others (Trevisani family)				2.5		
JPMorgan AM				5.0		
Kempen Capital Mgmt				2.1		
Fidelity International				2.0		
William Blair Capital Mgmt				2.0		
Other float				33.2		
VALUATION PROFILE (€)	2005	2006	2007	2008E	2009E	2010E
EPS	0.20	0.38	0.82	1.05	1.27	1.43
EPS adjusted	0.20	0.38	0.82	1.05	1.27	1.43
P/E, high	25.8	25.6	17.9	16.4	0.0	0.0
P/E, low	5.5	11.4	11.1	8.4	0.0	0.0
P/E (average) (x)	12.7	17.3	14.8	9.5	7.9	7.0
P/PBT (average) (x)	6.4	10.8	9.8	6.2	5.1	4.4
DPS total	0.03	0.05	0.10	0.15	0.19	0.21
DPS ordinary	0.03	0.05	0.10	0.15	0.19	0.21
Dividend yield (average) (%) (ordinary)	1.0	0.8	0.8	1.5	1.9	2.1
Dividend yield (average) (%) (total)	1.0	0.8	0.8	1.5	1.9	2.1
Payout ratio (%) (ordinary)	12.9	14.3	12.2	14.7	14.7	14.8
Book value per share	1.5	1.7	2.2	3.2	4.3	5.5
P/BV (average) (x)			5.4	3.2	2.4	1.8
CEPS	0.6	0.8	1.2	1.6	1.9	2.0
P/CE (average) (x)			9.9	6.4	5.3	5.0
FCFPS	0.23	-0.67	0.78	-0.62	0.69	1.13
P/FCF (average) (x)	11.2	-9.8	15.5	-16.0	14.4	8.9
Net debt/share	2.0	2.5	2.0	2.9	2.3	1.4
Net debt/share avg.	2.0	2.5	2.0	2.9	2.3	1.4
Enterprise value/share	4.6	9.1	14.1	12.9	12.3	11.4
Enterprise value/share (*)	5.1	8.6	13.7	12.7	12.2	11.3
EBIT/share	0.5	0.8	1.4	1.8	2.2	2.3
EV/EBIT (average)	10.1	10.9	10.0	7.0	5.6	4.9
EV/EBIT (average) (*)	11.3	10.4	9.7	6.9	5.6	4.8
EBITDA/share	0.9	1.2	1.8	2.4	2.8	2.9
EV/EBITDA (average)	5.2	7.4	7.7	5.4	4.4	3.9
EV/EBITDA (average) (*)	5.9	7.0	7.4	5.3	4.3	3.9
EV/Sales (average)	58.0	98.8	118.4	87.7	72.0	63.0
EV/Sales (average) (*)	65.3	93.7	114.9	86.3	71.4	62.5
MOMENTUM PROFILE (% change)	2005	2006	2007	2008E	2009E	2010E
Revenues from goods and services	35.9	29.2	30.2	23.0	16.6	5.6
EBITDA	32.8	54.9	51.2	28.8	18.8	3.9
EBIT	55.8	102.4	71.2	29.6	19.5	6.7
PBT	163.2	68.6	101.6	31.3	23.0	14.1
Net Income	401.9	108.7	108.5	29.0	21.5	12.9
EPS adjusted	396.4	87.0	115.9	28.2	21.0	12.6
CEPS	51.8	24.3	58.0	28.0	19.7	6.5
FCFPS		-391.8	-216.8	-179.9	-211.4	62.0
DPS ordinary	71.0	106.5	84.7	53.8	21.5	12.9

Source: Company data, Merrill Lynch estimates, Reuters; (†) Reuters accessed October 20, 2008; (*) Adjusted for convertible bond and advanced payments

Table 9: Trevi - financial summary

Income statement (year to December, €mn, IFRS)	2005	2006	2007	2008E	2009E	2010E
Revenues from goods and services	497.8	643.3	837.5	1029.9	1201.3	1269.0
Other revenues	9.0	32.1	36.9	20.0	20.0	20.0
Value of production	506.8	675.3	874.4	1049.9	1221.3	1289.0
Raw materials, consumables and goods (net of inventory variations)	-220.1	-314.6	-423.8	-500.1	-579.1	-610.9
Cost of services	-110.6	-143.7	-165.6	-198.7	-230.3	-247.6
Costs for use of third-party assets and other operating costs	-26.8	-26.8	-34.0	-41.0	-47.6	-50.0
Value added	149.3	190.3	251.1	310.2	364.4	380.4
Labour	-94.0	-104.7	-121.6	-143.5	-166.3	-174.6
EBITDA	55.3	85.6	129.5	166.8	198.1	205.9
Depreciation, amortisation and provisions	-26.6	-27.6	-30.1	-37.9	-44.1	-41.4
EBIT	28.7	58.1	99.4	128.8	154.0	164.4
Net financial items	-3.4	-15.5	-13.5	-16.1	-15.4	-6.3
Extraordinary items	0.0	0.0	0.0	0.0	0.0	0.0
Reported pre-tax profit	25.3	42.6	85.9	112.7	138.7	158.1
Minorities	-0.9	-1.2	-2.0	-3.0	-2.7	-4.1
Tax	-11.6	-14.7	-28.1	-37.8	-48.5	-55.3
Net profit	12.8	26.8	55.8	72.0	87.4	98.7
EBITDA margin (%)	*11.1*	*13.3*	*15.5*	*16.2*	*16.5*	*16.2*
EBIT margin (%)	*5.8*	*9.0*	*11.9*	*12.5*	*12.8*	*13.0*
Tax rate (%)	*45.8*	*34.4*	*32.7*	*33.5*	*35.0*	*35.0*
Return on equity (%)	*14.7*	*24.4*	*40.1*	*38.0*	*33.6*	*28.9*
Cash flow (€mn)	**2005**	**2006**	**2007**	**2008E**	**2009E**	**2010E**
Net Income (pre-minorities)	13.7	27.9	57.8	75.0	90.1	102.8
Non-cash items	35.9	30.2	43.8	37.9	44.1	41.4
Net change in commercial working capital	4.1	-14.4	-1.5	-65.5	-23.8	-4.6
Total net change in working capital	0.3	-55.8	-3.4	-65.5	-23.8	-4.6
Operating cash flow	50.0	2.3	98.2	47.4	110.4	139.6
Capital expenditures	-10.8	-49.2	-38.7	-88.1	-58.1	-56.8
Other investment	-24.7	-0.1	-4.7	-3.1	-3.6	-3.8
Free cash flow	14.5	-46.9	54.8	-43.8	48.8	79.0
Other	7.8	-0.9	-18.1	-8.0	0.0	0.0
Dividend paid	-1.0	-1.7	-3.5	-6.4	-10.8	-13.1
Share issue	0.7	0.0	-0.2	-0.1	0.0	0.0
Change in net debt	-22.0	49.5	-33.1	58.3	-38.0	-65.9
Operating cash flow/capex (%)	4.6	0.0	2.5	0.5	1.9	2.5
Capex/depreciation (%)	0.6	2.2	1.6	2.8	1.6	1.7
Balance sheet (€mn)	**2005**	**2006**	**2007**	**2008E**	**2009E**	**2010E**
Cash and liquid assets	51.4	89.9	90.8	70.3	112.6	287.1
Trade receivables	185.1	187.0	187.8	254.4	288.3	298.2
Other	46.3	57.1	76.6	97.1	97.1	97.1
Inventory	81.8	118.3	170.8	227.6	259.5	272.8
Current assets	364.6	452.4	525.9	649.4	757.5	955.2
Intangibles	3.5	4.9	5.4	5.8	7.1	8.8
Other fixed assets	183.0	213.2	230.2	290.8	311.8	334.3
Fixed assets	186.5	218.2	235.6	296.6	318.9	343.1
Total assets	551.1	670.5	761.6	945.9	1076.4	1298.3
Interest bearing	177.4	265.7	233.5	271.4	275.7	384.2
Trade payables	154.6	178.7	230.4	288.4	330.4	349.0
Other	117.0	98.6	134.2	155.1	162.6	171.8
Total liabilities	449.1	543.1	598.1	714.9	768.7	905.0
Minority	4.8	5.4	7.0	9.0	9.0	9.0
Shareholders' equity	97.2	122.0	156.5	222.0	298.7	384.2
Balance sheet total	551.1	670.5	761.6	945.9	1076.4	1298.3
Net debt	126.0	175.8	142.8	201.1	163.1	97.1
Net gearing (%) (net debt/equity)	123.5	138.0	87.3	87.0	53.0	24.7
Gross gearing (%) (debt/capital)	182.5	217.9	149.2	122.2	92.3	100.0
Interest cover (x)	2.7	4.6	5.9	7.9	10.0	17.0

Source: Company data, Merrill Lynch estimates

Price objective basis & risk

Trevi-Finanziaria Industriale SPA (TVFZF)

Our 12M price objective of EUR13.0 is based on a weighted, three-stage DCF model for 2008E and 2009E, which assumes: 1) two years with a +20% sales CAGR, 2) four years of +3% CAGR of sales, gradually converging to the final stage, 3) stable 1.5% EBIT growth. We use a WACC of 10%, which reflects an 8.5% equity and country risk premium and a tax rate of 35%. We have also subtracted the estimated advanced cash payments for WIP (c.EUR50mn in 2008) and the debt portion of the convertible, EUR64mn, from the net debt, while taking full account of the dilution (an additional 6.2m shares). Our PO implies a 2009E PE of 10x and EV/EBITDA of 5x. Based on a sum-of-the-parts comps analysis vs our broad coverage univers, our PO would imply a 15-20% premium vs EMEA Construction & Engineering peers, and would be in line with the EMEA Oil & Gas Equipment & Services peers.

The risks to our price objective would be: 1) risks related to the political stability and funding/budgeting in the countries of operation, 2) currency fluctuations, 3) a long-lasting, global recession, and other potential problems due to the credit crunch, such as project delays, cash flow and NWC risks, or higher competition due to decreasing demand, 4) execution risk in sizeable project commissions and potential liquidity or funding difficulties faced by clients, 5) the scarcity of skilled labour, should demand remain strong, and 6) the slashing of capex by oil companies due to downward oil price prospects.

Analyst Certification

I, Unai Franco, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

EMEA - Small Caps Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
BUY				
	Bechtle AG	XBACF	BC8 GR	Jan Ramsperger
	Biesse SPA	BIEEF	BSS IM	Unai Franco
	Brembo SPA	BRMXF	BRE IM	Unai Franco
	Fielmann	FLMNF	FIE GR	Flavio Cereda
	Galenica	GNHAF	GALN SW	Aymeric Poulain
	GFK	GFKAF	GFK GR	Claus Roller
	Grenke Leasing	ZGKRF	GLJ GR	Jan Ramsperger
	Il Sole 24 Ore	XIILF	S24 IM	Flavio Cereda
	Komax	KMAAF	KOMN SW	Aymeric Poulain
	KUONI	KUIRF	KUNN SW	Aymeric Poulain
	Landi Renzo SPA	XANLF	LR IM	Unai Franco
	MARR Spa	MRRFF	MARR IM	Flavio Cereda
	Mayr-Melnhof	MNHFF	MMK AV	Jan Ramsperger
	Neopost SA	NPACF	NEO FP	Caroline Cohen
	Nexans	NXPRF	NEX FP	Caroline Cohen
	Orpea	ORPEF	ORP FP	Caroline Cohen
	Prysmian	PRYMF	PRY IM	Caroline Cohen
	Schulthess	XSCHF	SGRN SW	Aymeric Poulain
	Sika	SKFOF	SIK SW	Aymeric Poulain
	Sperian	BDZAF	SPR FP	Caroline Cohen
	Takkt	TAKKF	TTK GR	Jan Ramsperger
	Trevi-Finanziaria Industriale SPA	TVFZF	TFI IM	Unai Franco

EMEA - Small Caps Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
	Velcan Energy	XVVEF	MLVEL FP	Caroline Cohen
	Vetropack	VTRKF	VET SW	Aymeric Poulain
	Wincor	WNXDF	WIN GR	Jan Ramsperger
	Zignago Vetro SPA	XZNGF	ZV IM	Flavio Cereda
NEUTRAL				
	Antichi Pelletti	ANPEF	AP IM	Flavio Cereda
	Bucher	BCHHF	BUCN SW	Aymeric Poulain
	Carbone Lorraine	CBLNF	CRL FP	Caroline Cohen
	Chantiers Beneteau	BTEAF	BEN FP	Caroline Cohen
	Georg Fischer	XGFDF	FI/N SW	Aymeric Poulain
	Gurit	ZGURF	GUR SW	Aymeric Poulain
	Ingenico	INGIF	ING FP	Caroline Cohen
	Luxottica Group	LUX	LUX US	Flavio Cereda
	Luxottica Group	LUXGF	LUX IM	Flavio Cereda
	Nice SPA	NIESF	NICE IM	Flavio Cereda
	Palfinger	PLFRF	PAL AV	Jan Ramsperger
	SEB	SEBYF	SK FP	Caroline Cohen
	SeLoger	SELOF	SLG FP	Caroline Cohen
UNDERPERFORM				
	Aeffe	XEAFF	AEF IM	Unai Franco
	Belimo	BLHWF	BEAN SW	Aymeric Poulain
	Charles Voegele	CHVOF	VCH SW	Aymeric Poulain
	Korian	XKOKF	KORI FP	Caroline Cohen
	Krones	KRNNF	KRN GR	Jan Ramsperger
	Mariella Burani	MRBFF	MBFG IM	Flavio Cereda
	Meyer Burger	MYBUF	MBTN SW	Aymeric Poulain
	Poltrona Frau	PFAUF	PFG IM	Flavio Cereda
	Rational AG	RTLLF	RAA GR	Jan Ramsperger
	Rieter	RTRZF	RIEN SW	Aymeric Poulain
	Safilo	SAFLF	SFL IM	Flavio Cereda
	Trigano SA	TGNOF	TRI FP	Caroline Cohen
RESTRICTED				
	Gemalto	GTOFF	GTO FP	Caroline Cohen
REVIEW				
	L'Espresso	GPEDF	ES IM	Flavio Cereda

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Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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Investment Rating Distribution: Engineering & Construction Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	21	67.74%	Buy	4	23.53%
Neutral	7	22.58%	Neutral	1	16.67%
Sell	3	9.68%	Sell	2	66.67%

Investment Rating Distribution: Global Group (as of 01 Oct 2008)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1647	45.31%	Buy	429	28.83%
Neutral	858	23.60%	Neutral	240	31.41%
Sell	1130	31.09%	Sell	227	22.02%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months. For purposes of this distribution, a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster*
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

* Ratings dispersions may vary from time to time where Merrill Lynch Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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