Transition to IAS/IFRS

Effects on Finmeccanica consolidated financial results 2004

25 July 2005

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Group’s adoption strategy

The Finmeccanica Group has decided to adopt the new IAS/IFRS according to the following steps:

- application to the consolidated financial statements starting from the 2005 half-year report;
- application of IAS 32 and IAS 39 starting from 1 January 2005;
- application to the statutory financial statements of Finmeccanica S.p.A. as from 1 January 2006;
- application to the statutory financial statements of subsidiaries, including foreign subsidiaries, if applicable, as from 2006.

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Basis of preparation

The opening IAS/IFRS balance sheet and IAS/IFRS financial statements at 1 January 2004 and at 31 December 2004 have been prepared on the basis of the standards adopted by the EU as envisaged in Article 6 of Regulation no. 1606/2002.

Therefore, the standards described therein might differ from the provisions of IAS/IFRS in force at 31 December 2005 due to the future directives of the European Commission and the interpretations and implementation guidance of IASB or IFRIC.

The IAS/IFRS consolidated financial statements at 31 December 2004 do not include the effects of IAS32 and IAS39 principles (as permitted by IFRS1).

All amounts are in millions of euros, except otherwise specified

Audit activities

The consolidated results at 31 December 2004, together with the reconciliation prospectus which also includes the opening balance sheet, are currently being audited by PriceWaterhouseCooper.

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Effects on the consolidated profit and loss statements, the opening balance sheet and net financial debt of Finmeccanica

Main effects of the introduction of new international accounting principles

- Adjustment of net equity at 31/12/2003 (opening balance sheet impact of IAS/IFRS) determined retrospectively;
- Reclassification of profit & loss statement 2004 according to the new principles;
- Changes to the classification of the accounts required by the new directive;
- Adaptation of the Group’s reporting disclosure to the requirements foreseen by IAS/IFRS;
- Changes to the area of consolidation.

Changes to the area of consolidation

The application of the new principles has caused the following changes:

- proportional consolidation (50%) of the "Special Purpose Entities" (SPES) operating within the GIE ATR consortium, in partnership with EADS (IAS27);
- consolidation of the main companies currently in liquidation (IAS27);
- proportional consolidation (50%) of the ATIL JV in the Helicopter division, in partnership with Boeing (IAS31).

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Impact on Value of Production in 2004

Value of production decreased by Eur 229 m mainly due to the reclassification of AMS UK and BredaMenariniBus as discontinued operations.

(Eur mln)	2.004
Revenues from sales and services	7.529
Change in contract work in progress	1.446
Change in semifinished goods	335
Other revenues	77
Value of production according to Italian GAAP	9.387
IAS/IFRS adjustments:	
Inclusion of GIE ATR	197
Other changes to scope of consolidation	50
Reclassification other revenues	(77)
Reclassifications to discontinued operations (BMB, AMS UK)	(398)
Other minor reclassifications	(1)
	(229)
Value of production according to IFRS/IAS	**9.158**

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Impact on EBIT in 2004

EBIT decreased by Eur 52m due to the reclassification of extraordinary items.
Extraordinary costs may be classified separately only when relating to companies which meet the IFRS5 requirements for "discontinued operations".

(Eur mln)	2004
EBIT according to Italian GAAP	*518*
IFRS/IAS adjustments:	
Derecognition of 2004 goodwill amortisation	91
Changes to scope of consolidation	(40)
Severance pay and pension fund effects	29
Reclassification of extraordinary items, net of discontinued	(146)
Reclassification of financial charges and other minor adjustments	14
	(52)
EBIT according to IFRS/IAS	**466**

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Impact on Profit & Loss statements in 2004

Finmeccanica consolidated income statements are presented using a classification based on the nature of expenses.

(Eur mln)	ITA GAAP	IFRS
Revenues from sales and change in WIP	8.975	8.851
Other revenues	38	
Total revenues	***9.013***	***8.851***
Change in semi-finished goods	335	307
Capital of internal construction costs	39	
Value of production	***9.386***	***9.158***
Purchases and services	5.994	5.888
Personnel costs	2.516	2.389
Amortis,deprec. and writedowns	405	355
Other operating costs (income) - net	(47)	99
Capit. of internal construction costs		(39)
Ebit	***518***	***466***
Net financial income	414	569
Extraordinary items	(210)	
Taxes	(174)	(185)
Losses on assets held for sale		(265)
Net income	**548**	**585**

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Impact on 31 December 2003 and 31 December 2004 balance sheets

(Eur mln)	Net equity at 31/12/2003	2004 net income	Net equity at 31/12/2004
Amount according to Italian GAAP	***3.302***	***548***	***3.724***
IAS/IFRS adjustments			
Adjustments to book value of tangible assets, financial lease, derecognition of intangible assets	6	14	20
Adjustments to staff severance provision (IAS 19)	(2)	33	31
Recognition of defined benefit pension funds	(76)	(3)	(79)
Recognition of other employee benefits based on actuarial rules	(53)	(3)	(56)
Change in scope of consolidation	(32)	(10)	(42)
Derecognition of goodwill amortisation		70	70
Deferred tax assets	6	(11)	(5)
Value adjustments to STM		(49)	4
Forex differences and other minor adjustments	4	(4)	(17)
Total IAS/IFRS adjustments	(147)	37	(74)
Amounts according to IAS/IFRS principles	***3.155***	***585***	***3.650***

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Impact on Assets and Liabilities at 31 December 2004

The IAS/IFRS principles require that assets and liabilities are classified according to their maturity and to their degree of liquidity as “current” and “non current”.

(Eur mln)	ITA GAAP	IFRS
Non-current assets	**4.945**	**5.357**
Inventories	4.932	4.589
Work in progress	11.498	2.169
Receivables	3.192	3.353
Cash and equivalents	2.007	2.056
Other current assets	2.048	1.427
Total current assets	**23.677**	**13.594**
Non-current assets held for sale	**-**	**687**
Total Assets	**28.622**	**19.638**

(Eur mln)	ITA GAAP	IFRS
Shareholders' equity	**3.724**	**3.650**
Non-current liabilities	**2.379**	**3.565**
Trade payables	15.760	6.046
Other current liabilities	6.759	5.995
Total current liabilities	**22.519**	**12.041**
Liabilities due to assets held for sale	**-**	**382**
Total Liabilities	**28.622**	**19.638**

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Impact on net debt at 31 December 2004

Net debt at 31 December 2004 rose from €371m to €640m due to the introduction of IAS/IFRS principles. This does not include the effects deriving from the application of IAS32 and IAS39, which will take effect from 1 January 2005.

(Eur mln)	Importo
Net financial debt according to Italian GAAP	**(371)**
Application of IAS 17 for financial lease recognition	(36)
Changes in scope of consolidation	(184)
Reclassification of annual accretion fund on Finmeccanica SpA’s convertible bonds	(53)
Other minor adjustments	4
Total effect of IAS/IFRS adjustments	*(269)*
Net financial debt according to IAS/IFRS at 31 Dec 2004	**(640)**

Comments on main IAS/IFRS adjustments

Preliminary effects of the transition

Fixed assets: Tangibles

Application of the component approach for calculating depreciation

The new standards require that if an asset is made up of component parts, whose useful life is significantly different from that of the other components, each component part is depreciated separately.

This standard has been applied when calculating depreciation of land and buildings, which in certain cases were considered as a whole, without segregating the value of lands on which buildings stand.

Other adjustments to the book value of tangible assets

During the transition Finmeccanica applied the “deemed cost” criterion, and generally maintained the value of tangible assets according to the new standards. However, statutory revaluations which did not approximate the fair value at the date the asset book value was revalued, were not maintained during the IAS/IFRS transition.

Fixed assets: Finance leases

Assets held under finance leases are now recognised according to the finance lease method unlike in Italian financial statements.

Owing to this recognition method, the lessee recognises the asset in the balance sheet at its fair value or, if lower, at the current value of the minimum lease payments, and a financial debt of the same amount is recorded accordingly among liabilities.

In the subsequent years the asset is depreciated while lease payments are apportioned between a reduction in the lease liability and interest expense.

Fixed assets: Intangibles

IAS/IFRS principles are more restrictive regarding the capitalization of intangible assets if compared to previous GAAP. The application of IAS 38 has impacted the group as follows:

(Eur mln)	Shareholders' equity at 31 Dec. 2003
Share of research included among R&D costs	(11,0)
Patents and intellectual property rights	(2,0)
Other pluriennel expenses	(6,0)
	(19,0)

Research costs relate to expenses for studies capitalised before the year 2004. Finmeccanica modified its accounting policies already in 2003 to comply with IAS38 requirements.

Pluriennal expenses not compliant with IAS38 requirements mostly refer to leasehold improvements and costs incurred by the Parent Company as part of a project aimed to reduce costs of purchases to the benefit of the operating Group companies

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Fixed assets: Derecognition of goodwill amortisation

Goodwill is no longer amortised. It is tested for impairment at least annually.

Cash Generating Units to be taken into account when making impairment test are generally considered as the legal entities through which the Group operates in the various business segments.

Recoverable amount is the higher of fair value less costs to sell and value in use. The value in use was estimated based on the present value of expected future cash-flows.

Personnel costs: Staff severance provision

The staff severance provision ("TFR") has been considered as a defined benefit plan

Hence, under IAS 19 the liability is no longer recognised at nominal value but at current value, calculated on the basis of demographic, statistical and actuarial assumptions, as well as pay performance and staff turnover trends.

TFR costs, including interest and actuarial gains and losses, are entirely recognised among operating expenses (before EBIT).

The application of the new measurement of the staff severance provision reduced the balance sheet provision at end 2004 by € 31m while operating costs expensed to the P&L were lower by € 33 m.

Personnel costs: Pension plans

Under IFRS post-employment benefits (i.e. pension, life insurance and healthcare after employment, etc.) are classified as "defined contribution plans" and "defined benefit plans".

For defined contribution plans, the enterprise is only obliged to pay contributions to the separate legal entity responsible for the fund management. Therefore, IFRS measurement is the same as the measurement according to the previous Italian accounting standards.

For defined benefit plans, which are typical of the Anglo-Saxon context, the entity guarantees to employees a defined level of benefits, without regard for the performance of the plan's assets.

The entity recognises the defined benefit obligation, based on actuarial assumptions, net of the fair value of the plan's assets.

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Personnel cumulative costs: employee defined benefit plans

The cumulative actuarial losses accumulated at 1 January 2004 were fully recorded as opening balance-sheet adjustments. In subsequent years actuarial gains and losses will be reported using the "corridor approach", which will dilute the impact along the residual life of the plan's participants.

Costs for defined benefit plans, including interest expense and actuarial gains and losses, are entirely recognised as operating expenses (before EBIT).

The application of this method to AgustaWestland brought the following effects. Group operating costs for the period, considering a 50% consolidation during the first eleven months, increased by €4m.

	1.1.2004 (100%)			31.12.2004		
	ITA	IAS adj	IAS/IFRS	ITA	IAS adj	IAS/IFRS
Receivables	21	(21)	0	21	(21)	(0)
Deferred tax assets (liabilities)	(6)	65	59	(6)	(67)	(67)
IFRS translation reserve		(152)	(152)		(152)	(152)
Liabilities arising from defined benefit plans		**(196)**	**(196)**		**(202)**	**(202)**
Personnel costs				(21)	(8)	(30)
Deferred taxes				(0)	4	3

Due to the application of the "corridor approach" under IAS 19, AW unrecognised actuarial losses at 31 December 2004 amounted to €22m.

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Personnel costs: other employee benefits

The item includes adjustments to other long-term employee benefits (seniority premiums, healthcare, etc.), which are recognised based on actuarial assumptions.

As permitted by IFRS 1, all cumulative actuarial gains and losses arising from the new measurement were recognised at the date of the transition:, in subsequent years actuarial gains and losses will be entirely recognised immediately, as the “corridor approach” does not apply.

Costs for other long-term employee benefits, including interest expense and actuarial gains and losses, are entirely recognised among operating expenses (before EBIT).

Change in scope of consolidation

The new IAS/IFRS heavily restrict cases of exclusion from the scope of consolidation and require a substantial interpretation of relations with companies and SPEs, regardless of existing shareholdings.

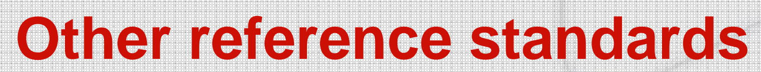
Therefore, at present the scope of consolidation includes all Group subsidiaries, shareholdings that, due to a substantial interpretation of shareholders' agreements, may be considered as joint ventures, and the SPEs acting on behalf of the Group.

As a result of the new scope of consolidation the group's net equity decreased by € 36m at 31 December 2003 while the group's net income at 31 December 2004 decreased by € 10m.

Adjustments to the book value of the investment in STM

The contribution of the equity investment in STMicroelectronics (STM) to the consolidated income statement was adjusted to reflect the following effects due to the adoption of IAS:

- the revaluation of the investment increased by € 7m (from € 100m to € 107m), as a consequence of the derecognition of goodwill amortisation previously recorded in STM;
- the capital gain from the sale of 93m shares on 23 December 2004 decreased from € 758m to € 754m as a result of the aforementioned increase in the book value;
- since Finmeccanica has applied the exemption granted by IFRS 1 for the calculation of cumulative translation differences (assumed to be equal to zero at the transition date to IAS/IFRS), the income statement for the period included the loss due to the re-calculation of the accumulated translation differences, which were transferred to the income statement at the sale date as required by IAS 21 (€mil 52 for the devaluation of the US dollar – functional currency of STM – from the transition to the sale date).



Other reference standards

Tangible assets

- Tangible assets have been stated, except for the effects we have already commented on of the adjustments due to the introduction of IFRS, consistently with the principles used for the 2004 financial statements prepared according to Italian accounting standards. We have therefore measured tangible assets at cost;
- Tangible assets decrease as a consequence of the reclassification, as permitted by IAS 20, of capital grants, which are now deducted from the related assets. Capital grants were previously recognised as deferred income;
- Due to the proportional consolidation of GIE ATR, tangible assets also include aircraft for which the risk of ownership has not been transferred to the user. These aircraft are depreciated over twenty years;
- The recoverability of the values recorded is assessed through impairment tests on the related Cash Generating Units;
- The Group does not capitalise any financial charges.

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Intangible assets

- Intangible assets are stated at purchase or production cost calculated on the basis of previously applied standards;

- Intangible assets with a definite useful life are systematically amortised over their estimated useful lives. Assets with an indefinite useful life, among which goodwill, are not amortised;

- The recoverability of the values recorded is assessed through impairment tests on the related Cash Generating Units: these tests are carried out at least annually on assets with an indefinite life and when key operating and financial indicators show any critical issue with respect to intangible assets with a definite useful life;

- The Group does not capitalise any financial charges.

R&D – “non-recurring expenses”

- Effective 1-1-2004 the Group capitalised only development costs fully compliant with IAS 38 requirements;

- Assets that could be defined as “non-recurring costs” were suspended among inventories at cost. Non-recurring costs relate to “*pre-definition, definition and designing (until the prototype) and plant organisation destined to a clear and measurable product under the company’s operating plans*”. This item used to include development costs, learning curve and tooling costs under previous GAAP.

IFRS treatment

- Recognition rules already adopted under Italian standards;
- Tooling costs reclassified as tangible assets; *but*
- Tooling costs still depreciated based on the sum of units method.

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Payables under Law 808/1985

Payables to the Ministry of Productive Activities under article 3a of Law 808/1985 are classified among current liabilities because they are destined to finance the operating cycle of activities of the Company (the related asset is recognised as an inventory within working capital).

Law 808 liability is recognised at its nominal value.

Impairment test

- Assets are tested for impairment at least annually and in all cases the Group reference indicators and the reference market situation show the risk of impairment;

- The impairment test is performed at the level of the Cash Generating Units ("CGU"), which are generally identified in each legal entity through which the Group operates.
  The test compares the book value of the CGU with the recoverable value calculated through the value in use (applying the "discounted cash flow" method) or the market value (identified through the methods of multiples or of comparable transactions);

- If the comparison shows an impairment, goodwill allocated to the CGU concerned is reduced; if, after goodwill is set to zero, a further impairment still exists, this is utilised to reduce the assets making up the CGU proportionally to the assets' book values.

Equity investments and securities

- Equity investments in associated companies are valued according to the equity method;
- Equity investments in other companies, which are in general companies in which the percentage held is lower than 20%, are recorded at cost;
- Equity investments in subsidiaries, excluded from the scope of consolidation in accordance with the principle of significance, are accounted for using the equity method.

Contracts

- Long-term contracts are measured based on the percentage of completion method;
- Contracts shorter than 12 months are measured under IAS/IFRS based on the percentage of completion (they were recognised at cost under previous GAAP);
- Work in progress is recognised net of advances and progress billings. This analysis is performed on a contract by contract basis: if progress billings exceed the value of work in progress, the amount is reported as a liability; if work in progress exceeds the value of progress billings, the net amount is reported among assets. Uncollected progress billings at the balance sheet date are included among trade receivables;
- The Group does not capitalise financial charges.

Safe Harbor Statement

NOTE: Some of the statements included in this document are not historical facts but rather statements of future expectations, also related to future economic and financial performance, to be considered forward-looking statements. These forward-looking statements are based on Company's views and assumptions as of the date of the statements and involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those expressed or implied in such statements. Given these uncertainties, you should not rely on forward-looking statements.

The following factors could affect our forward-looking statements: the ability to obtain or the timing of obtaining future government awards; the availability of government funding and customer requirements both domestically and internationally; changes in government or customer priorities due to program reviews or revisions to strategic objectives (including changes in priorities to respond to terrorist threats or to improve homeland security); difficulties in developing and producing operationally advanced technology systems; the competitive environment; economic business and political conditions domestically and internationally; program performance and the timing of contract payments; the timing and customer acceptance of product deliveries and launches; our ability to achieve or realize savings for our customers or ourselves through our global cost-cutting program and other financial management programs; and the outcome of contingencies (including completion of any acquisitions and divestitures, litigation and environmental remediation efforts).

These are only some of the numerous factors that may affect the forward-looking statements contained in this document.

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