

UNIVERSITA' DEGLI STUDI DI NAPOLI «FEDERICO II»
LABORATORIO OPERAZIONI STRAORDINARIE – CORSO DI PERFEZIONAMENTO

RELATORE: VITTORIO GRIMALDI

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RACE DE-MERGER

A VALUE CREATION MOVE



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- **KEY – POINTS: STRATEGIC / FINANCIAL**
- **VALUE CREATION: FIAT INDUSTRIAL / RACE**
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KEY - POINTS: STRATEGIC / FINANCIAL



- On 3 March 2015, in the frame of the Geneva Motor Show, Sergio Marchionne reiterated that the car industry needed more consolidation. FCA is ready to take part in this process either as an active or passive player.
- The car industry consolidation is made necessary by the higher and higher R&D costs imposed by increasingly strict emission regulations. The smaller players (i.e. those who are ranking behind Toyota, VW and GM) reportedly need to consolidate.
- FCA is ready to join forces with someone else in this process; VW is not reportedly the “ideal” partner for FCA, while the fit with Mercedes would be perfect under certain standpoints, but problematic under other aspects.
- We argue that the spin-off of Ferrari is the premise to merge FCA-ex-Ferrari with someone else.

KEY - POINTS: STRATEGIC / FINANCIAL



- FCA announced a plan to reinforce its capital at the end of October 2014. The company issued mandatory convertible notes worth USD 2.875bn (~EUR 2.3bn) and the selling of 100m new shares with proceeds for USD 1,100m (~EUR 885m). These actions were carried out in December 2014.
- The capital plan also foresees the selling of a 10% Ferrari stake in October 2015 and the distribution of another 80% to the FCA shareholders in January 2016. Exor, FCA's reference shareholder (it holds ~30% of the company) will keep its FCA stake unchanged and will become Ferrari's reference shareholder with an ~24.3% stake (Piero Ferrari holds another 10% stake).
- Before being IPOed, Ferrari will pay to its shareholders a EUR 2.5bn extra-dividend with an estimated positive impact of FCA's net debt of ~EUR 0.7bn.

KEY - POINTS: STRATEGIC / FINANCIAL



- The capital plan announced in October is going to have a positive impact on FCA's net debt exposure: we estimate that net industrial debt could be ~EUR 6.0/6.5bn by the end of 2015, when it was previously expected to be at ~ EUR 10.5/11.0bn.
- The IPO of a 10% Ferrari stake is likely to generate a scarcity effect on the stock price with possible (positive) repercussions on FCA's and Exor stock price this summer.
- Part of FCA mandatory convertible securities will be paid through Ferrari shares. The mandatory convertible security holders are expected to be granted ~14% of Ferrari.
- FCA capital strengthening is expected to make the marginal funding cheaper; FCA is in the process of paying back in advance two Chrysler bonds carrying a 8.00% and 8.25% coupon maturing in 2019 and 2021 respectively

KEY - POINTS: STRATEGIC / FINANCIAL



- The current Chrysler Group bonds have covenant restrictions on cash (USD 3.0Bn 8.0% notes due 2019 – callable as of June 15, 2015 at 104, USD 3.2Bn 8¼% notes due 2021 – callable as of June 15, 2016 at 104⅞).
- FCA's stronger equity position will make it possible to (possibly) pay in advance the two Chrysler bonds and remove the ring-fence between Fiat's and Chrysler's treasuries, thus making it possible to carry out the "cash pool".
- The cash pool will reduce liquidity requirements and the connected cost of carry. FCA had ~EUR 23bn in gross cash as at the end of 2014; that level of cash is expected to come down to ~EUR 15bn (EUR 5bn being the minimum level of liquidity to sustain operations).
- FCA claims it can reduce its financial charges by ~EUR 1bn by 2017 by reducing the cost of carry. In 2014, FCA's financial charges reached ~EUR 2.0bn.

KEY - POINTS: STRATEGIC / FINANCIAL



- FCA management made reference to the industry's need for consolidation several times since October. Exor would accept to get diluted.
- Consolidation carries executional risks BUT benefits are too large to ignore: -> Up to EUR 4.5bn per annum, ~70% of which is a reduction in investments and R&D -> Optimized industrial allocations, with no impact on number employed -> Distribution (dealer networks not merged) and brands untouched by consolidation -> An exceptional value creation opportunity for shareholders -> It is ultimately a matter of leadership style and capability...
- Marchionne says he has done the math and discovered there's far too much upside in a merger of FCA and GM to let a deal go undone, or at least unexplored.
- ...the numbers come out so good that FCA BoD has no choice but to put pressure on GM to begin discussions now.

KEY - POINTS: STRATEGIC / FINANCIAL



- **“Not hostile,” said the FCA chief. “There are varying degrees of hugs (...). Everything starts with physical contact. Then it can degrade, but it starts with physical contact.”**
- **“We're not talking about marginal improvement in margins,” he said, “we're talking about cataclysmic changes in performance, just huge.**
- **... the only deal that offers them the same benefits as we potentially get ... is us.”**
- **Marchionne says GM isn't taking his phone calls. (...). “They won't listen. And that kind of abject refusal to engage ... the capital markets won't understand why you are rejecting the discussion.**

KEY - POINTS: STRATEGIC / FINANCIAL



- Marchionne says he doesn't lack for potential partners and he could sell or merge FCA (...). "There have been responses of people who have shown interest in discussing," he said. "Are they the people I wanted to get the response from? The answer is probably not (...). Because there's a better deal.
- Marchionne cites a staggering combined EBITDA figure that he says would result from the merger of FCA and GM. "...the combined entity can make USD 30bn/year in cash (...) "In steady-state environments, it'll make me USD 28 to 30bn," at a SAAR of 17m.
- On October 29, 2014, in connection with (...) the new 5-year business plan, the BoD of FCA approved an equity incentive plan ("EIP") and a new long term incentive program, covering a 5 year performance period, 2014-2018, consistent with the Company's strategic horizon and under which equity awards can be granted to eligible individuals.
- The award vesting under the program is conditional on meeting two independent metrics: 1) Net Income and 2) Relative Total Shareholder Return weighted 50/50 at target. The awards have 3 vesting opportunities, 1/3 after 3 years' cumulative results, 1/3 after 4 years' cumulative results and 1/3 after the full 5 years' results.

KEY - POINTS: STRATEGIC / FINANCIAL



- **Half of the target award that is subject to the Net Income metric's performance begins a pay-out at 80% of the target achieved and the maximum pay-out is at 100% of target.**
- **The other half of the award, the Relative Shareholder Return metric has a partial vesting if ranked 7th or better among an industry specific peer group of 11 and a maximum pay-out of 150% if ranked 1st among the 11 peers. The peer group includes FCA, VW, Toyota, Daimler, GM, Ford, Honda, BMW, Hyundai, PSA, and Renault.**
- **On October 29, 2014, the BoD of FCA authorized the issuance of up to a maximum of 90m common shares under the framework equity incentive plan which had been adopted before the closing of the Merger**

KEY - POINTS: STRATEGIC / FINANCIAL



- On 23 July 2015, FCA announced that its subsidiary, Ferrari N.V. had filed a SEC registration statement (...) for a proposed IPO of common shares currently held by FCA. (...) The proposed offering is not expected to exceed 10% of the outstanding common shares. In connection with the IPO, Ferrari intends (...) to list its common shares on the NYSE.
- UBS Investment Bank, BofA Merrill Lynch and Banco Santander are acting as Joint Book runners for the offering and UBS Investment Bank is acting as Global Coordinator. The IPO was expected to take place after 12 October (it took place on 21 October).
- FCA is due to distribute the remaining 80% of Ferrari shares to FCA shareholders for free by January 2016. Exor (it holds ~29% of FCA) will thus become the reference shareholder of the Maranello-based company with a ~23.4% direct stake.
- The Ferrari shares are due to be listed on another European stock market at the time of the spin-off (i.e. in January 2016); Milan's MTA is one of the possible options.

KEY - POINTS: STRATEGIC / FINANCIAL



- The Ferrari management team has been strengthened in recent months; the company has appointed a new CFO (Alessandro Gili from FCA) in April; Sergio Marchionne may substitute Amedeo Felisa as CEO if the former leaves as some rumours suggest.
- Ferrari exposure to China domestic market is limited indeed (~10% of the total). We currently value Ferrari on the basis of a 12.5x EV/EBITDA 2015 multiple, which gives us a ~EUR 9.4bn enterprise value and a EUR 8.5bn equity value. Our valuation is consistent with the current luxury good multiples (median of 12.4x).
- Ferrari builds the most prestigious/pricy sports cars in the world. Scuderia Ferrari is the most successful team in the history of the F1. Ferrari benefits from a strong visibility and resilience, coupled with limited exposure to the Chinese market (~10% of revenues vs ~25% of the luxury good industry).

KEY - POINTS: STRATEGIC / FINANCIAL



- Cash generation is expected to improve after some years of overinvestments and strong R&D: we expect the Adj. FOCF to be ~EUR 340m on average in the 2015-19 timeframe with 2016 being the weakest year due to the cyclical nature of investments and a one-off fiscal cash out of ~EUR 100m.
- Ferrari is in the process of refreshing almost 100% of its road cars with the introduction of the California T (2014), the 488 GTB and spider (late 2015), the GTC4Lusso (March 2016) and the heir to the F12 Berlinetta sometime in 2016/early 2017.
- Ferrari will continue launching limited edition supercars periodically: once the "LaFerrari" and the "F12tdf" deliveries are over, we believe Ferrari will introduce another supercar in 2017 to celebrate the 70th anniversary of the brand.

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- We expect Scuderia Ferrari to reap the fruits of the heavy investments made in the last two years: the 2016 F1 car is expected to be very competitive.
- Ferrari offers an Adj. FCF yield of ~3.7% at current prices: an ESN research on RACE will follow.

Fiat Industrial de-merger

Announcement date: 21/04/2010
 Execution date: 01/01/2011

Fiat share price performance between announcement and execution

	Date	EUR	Market Cap
Fiat	20/04/2010	10.42	12,599
Fiat price	05/01/2011	7.48	9,228
Fiat Industrial	05/01/2011	8.80	10,717
Fiat + Fiat Industrial	05/01/2011	16.28	19,945

Fiat relative performance vs Euro Stoxx between announcement and execution

	Date	Performance
+ Fiat	20/04/2010 - 05/01/2011	58.3%
- Euro Stoxx & Parts	20/04/2010 - 05/01/2011	36.7%
= Δ performance	20/04/2010 - 05/01/2011	21.6%

Fiat value creation in connection with the spin-off of Fiat Industrial

	Date	Market Cap
+ (Fiat + Fiat Industrial)	05/01/2011	19,945
- Fiat market cap	20/04/2010	12,599
= Value creation in the period		7,346
- Industry performance	20/04/2010 - 05/01/2011	(4,618)
= Value creation from spin-off		2,728



VALUE CREATION METRIC [FIAT IND. de-merger]



RACE de-merger

Announcement date: 28/10/2014
 Execution date: 01/01/2015

FCA share price performance between announcement and execution

	Date	EUR	Market Cap
FCA	27/10/2014	7.63	9,534
FCA	04/01/2016	8.56	10,696
Ferrari (80%)	04/01/2016	43.67	6,603
Fiat + Ferrari	04/01/2016	13.84	17,299

Fiat relative performance vs Euro Stoxx between announcement and execution

	Date	Performance
+ FCA	27/10/2014 - 04/01/2016	81.4%
- Euro Stoxx & Parts	27/10/2014 - 04/01/2016	24.1%
= Δ performance	27/10/2014 - 04/01/2016	57.4%

Fiat value creation in connection with the spin-off of Ferrari

	Date	Market Cap
+ (FCA + Ferrari)	04/01/2016	17,299
- FCA market cap	27/10/2014	(9,534)
= Value creation in the period		7,765
- Industry performance	27/10/2014 - 04/01/2016	(2,295)
= Value creation from separation		5,470



VALUE CREATION METRIC [RACE de-merger]



ESN FERRARI STUDY (click to open)



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<http://www.sec.gov/Archives/edgar/data/1648416/000119312515346154/d61094df1a.htm>