QUARTERLY REPORT
FIRST QUARTER 2006
FINMECCANICA

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Finmeccanica Group

Report on company's activities at 31 March 2006

Results for the first three months of the year

Highlights

€ millions	Mar-06	Mar-05	change	Dec-05
New orders	4,199	3,031	39%	15,383
Order backlog	34,194	26,039		32,114
Value of Production	2,748	2,157	27%	11,469
EBIT	100	76	32%	735
Net result	383	7	n.a.	396
Net capital employed	6,444	5,594		5,670
Net debt	1,481	1,611		1,100
FOCF	(676)	(658)	3%	501
ROI	*14.4%*	*13.6%*	*0,8 p.p.*	*17.5%*
ROE	*17.2%*	*17.1%*	*0,1 p.p.*	*9.6%*
EVA®	(52)	(29)	79%	217
R&D Costs	379	282	34%	1,742
Employees (no.)	56,970	49,187		56,603

Before the results for the first three months of 2006 are discussed, it should be noted that in 2005 the scope of consolidation of the Finmeccanica Group changed significantly mainly due to integration – strengthening transactions in the Aerospace and Defence segment, including:

- in the Defence Electronics segment, in 2005 the agreement with Bae Systems Plc (BAE) and the purchase of Datamat S.p.A.;
- in the Defence Systems segment, in 2006, the purchase of LFK GmbH from MBDA;
- in the Space segment, in 2005, the agreement with Alcatel S.A. (Alcatel).

Different timing of transactions, different incidence of newly-included companies on the scope of consolidation and, in certain cases, the unavailability of data for prior periods regarding these companies do not make it always possible to make a consistent comparison between figures, especially for costs and revenues.

In order to give a fair view of the Group internal growth, figures are approximated as less as possible, and the effects of changes in the scope of consolidation are implicitly considered.

Consolidated results for the first quarter of 2006 of the Finmeccanica Group are not very indicative of the performance for the entire year, because more than half of the Company's operations are concentrated in the second half of the year. Compared with 31 March 2005 value of production rose by 27% and operating profit grew by 32%; in terms of organic growth, these rose by 18% and 20% respectively. ROS stood at 3.6%, a slight increase from the prior period, and new orders for the period rose by 39%. Regarding Group profitability indicators compared with the prior period, ROI was 14.4% (13.6%), Group EVA®[1] was negative in the amount of €mil. 52 (a negative €mil. 29) and ROE stood at 17.2% (17.1%).

The first quarter of 2006 ended with consolidated net profit of €mil. 383 (€mil. 7 in the first quarter of 2005). The net profit, including the gain from the PPO on 52.17% of Ansaldo STS S.p.A. - €mil. 355 less the effect of the consolidated taxation mechanism – reveals a significant increase in operating result (€mil. 21). This increase is mainly due to growth in EBIT, since the improvement in financial products (€mil. 19) is essentially taken over by greater taxes for the period.

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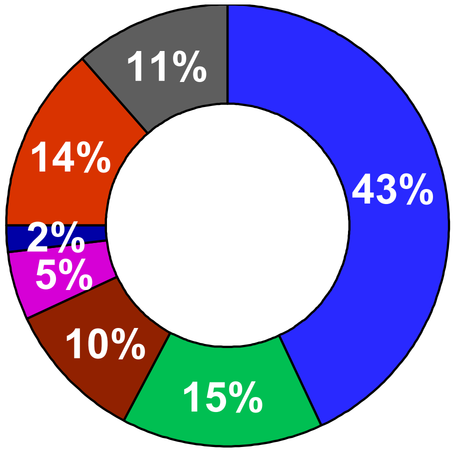
New orders for the first quarter 2006 amounted to €mil. 4,199 as compared with €mil. 3,031 for the same period of the prior year; they rose by €mil. 1,168 (39%).

New orders

€ millions	Mar-06	Mar-05	change
Helicopters	1,836	1,274	44%
Defence Electronics	629	627	0%
Aeronautics	431	333	29%
Space	218	110	98%
Defence Systems	89	138	-36%
Energy	576	228	153%
Transportation	484	293	65%
Other	(64)	28	
	4,199	3,031	

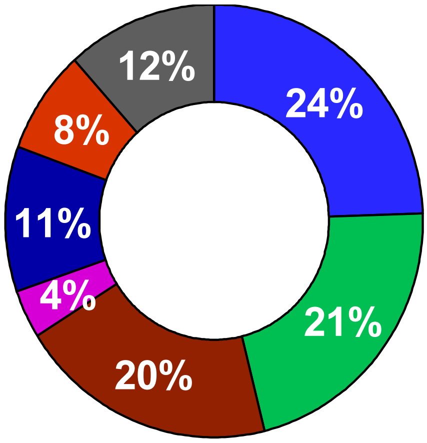


The main new orders are: for the Helicopters segment, the acquisition of the first tranche, for the first 5 years out of 25, of the contract named IMOS for the logistical support of the entire EH 101 fleet in place at the RAF and the British Royal Navy for a value of €mil. 640 and the acquisition of the contract named MCSP for the update of 30 EH 101 Merlin Mk1 helicopters in place at the Royal Navy of the value of €mil. 550; for the Aeronautics sector, the order of the consortium GIE-ATR for 18 aircraft (of which 15 from the Indian Kingfisher) for some €mil. 200; for the Energy segment, the Rizziconi Combined Cycle Gas Turbine plant, inclusive of planned maintenance, for some €mil. 500.

In other segments: for the Defence Electronics segment, the contract for the supply of air traffic radars and control centres acquired by the Malaysian Ministry of Transportation; for the Defence System segment, orders for the supply of the Exocet and Sea Wolf missile systems to Chile; for the Transportation segment, the extension to 2010 of the Copenhagen automated underground operation and maintenance and, for the Space segment, the acquisition of orders for the Turksat 3A and Ciel 2 satellites.

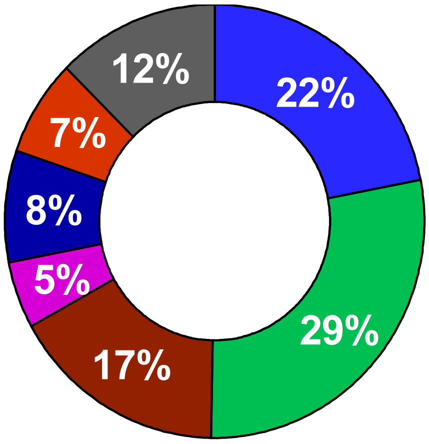
At 31 March 2006 the order backlog stood at €mil. 34,194 as compared with €mil. 32,114 at 31 December 2005. These cover three years of Group production. The increase of €mil. 2,080 is essentially due to ordinary purchase, order and customer invoicing activities.

Order backlog			
€ million	Mar-06	Dec-05	change
Helicopters	8,536	7,397	15%
Defence Electronics	7,530	6,946	8%
Aeronautics	6,935	6,865	1%
Space	1,237	1,154	7%
Defence Systems	3,731	3,869	-4%
Energy	2,709	2,329	16%
Transportation	4,090	3,956	3%
Other	(574)	(402)	
	34,194	32,114	



In line with the Group development objectives, value of production at 31 March 2006 was €mil. 2,748 compared with €mil. 2,157 at 31 March 2005, a net increase of €mil. 591 (20%) of which €mil. 400 (18.0%) is due to internal growth and the remainder (€mil. 191) is due to the change in the scope of consolidation.

Value of production			
€ millions	Mar-06	Mar-05	change
Helicopters	603	548	10%
Defence Electronics	778	445	75%
Aeronautics	463	402	15%
Space	140	170	-18%
Defence Systems	225	196	15%
Energy	202	132	53%
Transportation	343	298	15%
Other	(6)	(34)	
	2,748	2,157	

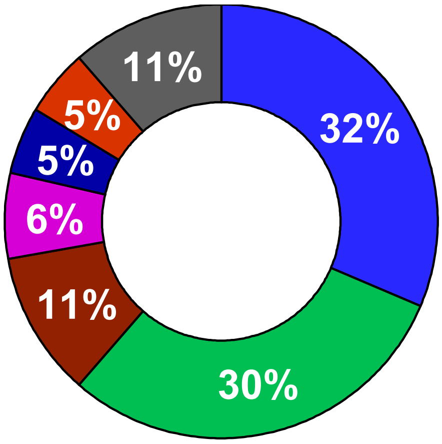


In terms of organic change in the value of production, the increase in the Defence Electronics segment (about 13%) is mainly due to an increase in activities of control systems and Space (6%). The strong growth in the Energy segment (53%) is due to the recent acquisitions of orders for plants such as those for the Sparanise, Rosignano, Vado Ligure, Escatron and Rizziconi plants.

EBIT in the first quarter of 2006 was €mil. 100 as compared with €mil. 76 at 31 March 2005, a net increase of €mil. 24 (32%) of which €mil. 15 (22%) is for organic growth and the remainder (€mil. 9) is due to the change in the scope of consolidation.

EBIT

€ million	Mar-06	Mar-05	change
Helicopters	44	41	7%
Defence Electronics	42	21	100%
Aeronautics	15	10	50%
Space	9	12	-25%
Defence Systems	7	2	250%
Energy	7	6	17%
Transportation	16	10	60%
Other	(40)	(26)	
	100	76	



Percentage profitability is slightly higher and came to 3.6% at 31 March 2006 from 3.5% at 31 March 2005. In terms of organic change in EBIT, the Space segment became in line with the other segments and the growth in the Defence Electronics segment (some 47%) was essentially due to an improvement in profitability from command and control systems activities. In March 2005 this was penalised by additional costs for orders of land-based radars and by a gain from the sale of a property of Selex Communications Ltd. Growth in all the other segments is a confirmation of the Group improvement expected for 31 December 2006.

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Group net debt (payables higher than financial receivables and cash and cash equivalents) at 31 March 2006 was €mil. 1,481 from €mil. 1,100 at 31 December 2005, a net increase of €mil. 381.

This debt level of 29% of consolidated shareholders' equity is lower than the amount achievable on a careful and prudent financial management and falls within the maximum limits set by the main rating companies.

Free Operating Cash Flow (FOCF) at 31 March 2006 was negative (cash) in the amount of €mil. 676 compared with negative €mil. 658 at 31 March 2005. In analysing this FOCF, seasonal factors have to be taken into account. The balance between trade collections and payments reveals that payments are particularly higher than collections.

Non-recurring events for the period include the sale of 52.17% in Ansaldo STS S.p.A. through a PSO which generated a positive cash flow of €mil. 398, and the outlay of €mil. 89 for purchasing additional shares of 33% in Datamat through a PPO launched in 2005 and ended in January 2006. Finmeccanica now holds 89.48% in Datamat, including Datamat's treasury shares.

With regard to the gain from the listing of Ansaldo STS, on 28 March 2006 the Board of Directors of Finmeccanica proposed to the Shareholders, in the meeting for the approval of the Company Financial Statements 2005, to distribute an extraordinary dividend of €0.19 for each share, with a total maximum countervalue of €mil. 81.

At 31 March 2006 net consolidated capital employed was €mil. 6,444 compared with €mil. 5,670 at 31 December 2005. The net increase of €mil. 774 is due to the change for the period in working capital (€mil. 703 at 31 March 2006 from €mil. 17 at 31 December 2005) of €mil. 686, which essentially relates to the FOCF performance as noted above.

The increase in non-current assets of €mil. 88 mainly relates to goodwill (€mil. 115) from the purchase of Datamat (€mil. 52) and LFK GmbH (€mil. 63) and to ordinary investing activities in property, plant and equipment and intangible assets, less amortisation and depreciation.

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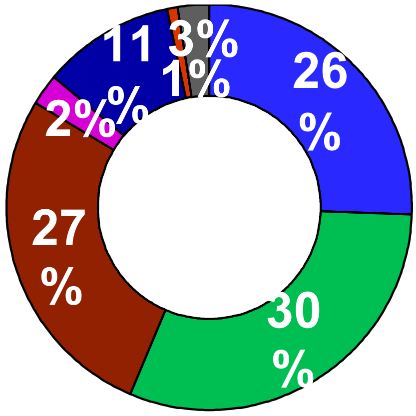
In the first quarter 2006 Research and Development costs were €mil. 379 from €mil. 282 in the first quarter of 2005, an increase of more than 34%, accounting for around 14% of value of production.

Research and Development Costs

€ million		Mar-06	Mar-05	change
■	Helicopters	97	51	90%
■	Defence Electronics	117	76	54%
■	Aeronautics	103	88	17%
■	Space	9	20	-55%
■	Defence Systems	40	37	8%
■	Energy	3	2	50%
■	Transportation	10	8	25%
		379	282	



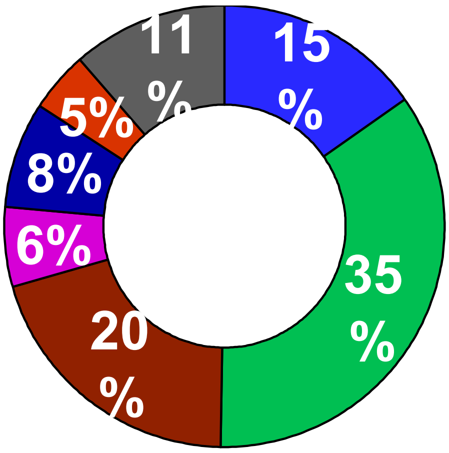
The main R&D activities regarded:

- in the Helicopters segment, research in the programmes funded under Law 808/85, such as the development of military technology for a new helicopter category 6-7 tons dubbed A149, and the development of multi-role versions of the BA 609 convertiplane for national security matters.
- in the Defence Electronics segment, the continuation of the development in the EFA programme, the finetuning of the UAV FALCO system, developments in naval and land command and control systems, the completion of the development of radar systems for air traffic control and the completion of the TETRA technological network;
- in the Aeronautics segment, the development of civil programmes, including the B787 and the A380 programmes, and of military programmes with C27J, EFA and the M346 trainer ;
- in the Space segment, in the main satellite programmes and future experiments on board the International Space Station;
- in the Defence System sector, the continuation of developments for the Meteor air-to-air missile in the missile segment, the Guided Multiple Launch Rocket System as part of land and naval weapons, and the Black Shark heavy torpedo in the underwater system segment.
- in the Energy sector, the continuation of the technological autonomy plan in the steam and gas turbine field;

- in the Transportation segment, for the completion and development of products and, more specifically, for ensuring the update to the new requirements in both the railway segment and the mass transit segment.

The number of employees at 31 March 2006 stood at 56,970 people, an increase of 367 from 56,603 at 31 December 2005. This rise is mainly due to the inclusion in the scope of consolidation (in the Defence System segment) of LFK GmbH (246 employees), while the remainder is due to positive turnover.

Employees	Mar-06	Dec-05	change
Helicopters	8,599	8,531	1%
Defence Electronics	19,660	19,786	-1%
Aeronautics	11,364	11,198	1%
Space	3,214	3,194	1%
Defence Systems	4,334	4,104	6%
Energy	2,525	2,529	0%
Transportation	6,409	6,321	1%
Other	865	940	
	56,970	56,603	



Significant events for the period and after the end of the quarter

Industrial transactions

In the ***Helicopters*** segment, on 28 February 2006 AgustaWestland signed an agreement with the British company Sloane Helicopters Ltd for the distribution of civil helicopters in the UK and Irish market. The agreement with Sloane Helicopters will further strengthen AgustaWestland position in the British market for light twin-engine helicopters for VIP and Corporate uses and will bring further growth in the medical rescue and police force market.

In the ***Defence Electronics*** segment, the first quarter of 2006 was marked by the finalisation of the activities for the purchase of the interest in the share capital of Datamat S.p.A., an Italian company which develops and builds avionics mission systems, maritime Combat Management systems and integrated solutions in the Defence, Space, Public Administration, Health, Banks, Finance and Telecommunications.

In the prior year Finmeccanica S.p.A. originally acquired a 52.7% stake in the share capital of Datamat S.p.A. for an amount of €mil. 151. After that, in November 2005 a PPO was launched on 100% of the Datamat stock still outstanding at a price of €9.65 per share. The transaction was completed in the first days of 2006 for an amount of some €mil. 89. At the end of the PPO, Finmeccanica owned 89% of the share capital, including Datamat’s treasury shares. On 1 March 2006 the Board of Directors of Finmeccanica resolved the implementation of the delisting procedure for the Datamat shares by launching a PPO on the remaining shares pursuant to Article 108 of Legislative Decree 58/1998, after it had reached the ownership percentage necessary for the transaction. At the same time a process was started to assess the opportunities deriving from a gradual integration of Datamat with Elsag; such integration will be implemented after Datamat is delisted.

With regard to this, on 26 January 2006 the Board of Directors of Finmeccanica resolved to start a process aimed at ensuring that Datamat and Elsag are coordinated and manages consistently. Elsag is a Group company already operating in the sector of IT services for defence and safety.

In the ***Aeronautics*** segment, on 19 January 2006 Aermacchi SpA and Hellenic Industry (HAI) signed a Memorandum of Understanding setting forth the terms for the industrial cooperation between these two companies in the programme for the development of the M346 new-generation advanced jet trainer. Under the Memorandum, HAI will be the Greek prime contractor for the programme and will be responsible for a number of activities, such as the designing, production and assembling of some important parts of the aircraft, including the rear fuselage. HAI will also have the duty of managing the contribution from other Greek companies as sub-contractors.

The industrial part assigned to the Greek industry will be 10% of the activities in the international programme for the industrialisation and production of an aircraft and its sub-systems.

For Aermacchi the interest in HAI is important and reflects the company strategy of extending the M346 project to an international level by setting up very qualified partnerships in order to develop the most advanced programme for a high-performance training aircraft.

In the ***Space*** segment, on 19 January 2006 in Berlin a contract was signed worth €bil. 1 for the development and construction of the first four satellites for the Galileo European satellite navigation system and the related land infrastructure. The contract was signed by Galileo Industries (a consortium where Finmeccanica has an interest through Alcatel Alenia Space, together with EADS Astrium, Thales SA and Galileo Sistemas y Servicios) and the European Space Agency (ESA). The Galileo project, which is the European Union's and ESA's response to the GPS US satellite system, also involves Telespazio S.p.A., a company owned by Finmeccanica and Alcatel, for the supply of all the services related with launching and putting into orbit satellites and the management of the subsequent operating stage. Finmeccanica is a member of this consortium, which is the result of the merger of two consortiums, Eurely (Finmeccanica S.p.A., Alcatel S.A., AENA and Hispasat) and iNavSat (EADS, Thales and Inmarsat), to negotiate the licence contract for the management of system operations. As Finmeccanica is a

consortium-holder, this is a fundamental opportunity for the operations in satellite services, in that it allows the Group to be a leader in a world-scale project which is strategic for new added-value applications (PRS - Public Regulated Services, infomobility, Security, etc.).
Italy was awarded one of the two Constellation Mission Control System and Performance Assessment Centres for the new satellite navigation system.

In the ***Defence System*** segment, the procedure for the purchase by MBDA of LFK GmbH, the major German producer of missile systems, was completed in January 2006. This was announced last year and was formalised after approval from the European Commission and the German government. Thanks to this MBDA, which is 25%-owned by Finmeccanica (other shareholders: BAE Systems and EADS), further strengthens its world leadership in the guided missile segment and further goes ahead in the rationalisation process for the European offer in the segment. The integration of the two companies will also lead to broadening MBDA’s international relationships in Europe and in trans-atlantic programmes, and to strengthening overall system and product abilities.

As part of the valorisation of civil activities, a project was finalised for admitting ***Ansaldo STS S.p.A***. to listing at the Italian Stock Exchange. ***Ansaldo STS S.p.A***. is the head of a group which includes Ansaldo Trasporti - Sistemi Ferroviari S.p.A. (ATSF) and Ansaldo Signal N.V.. On 8 March 2006 CONSOB (the Italian Securities Regulator) issued an approval and the Italian Stock Exchange had earlier resolved upon admitting the company to listing. On 24 March 2006 52.17% (52,174,000 shares) of the company’s share capital was placed to institutional and retail investors, and the price was set at €7.8 per share; in April the banks guiding the placing consortium exercised the greenshoe option to purchase 7,826,000 shares (7.83% share capital) at a price of €7.8 per share. The shares are listed in the STAR segment of the Automated Stock Market of the Italian Stock Exchange. The new industrial company will fully benefit from the highly complementing skills of the two companies: ATSF will benefit from greater opportunities to penetrate foreign markets thanks to the commercial network and the international scale of Ansaldo Signal, one of the world leading companies in the railway signalling segment, and its capability to compete in the integrated system market thanks to the ATSF designing and system capabilities.

In the side business of national and international promotion of professional and cultural training, Finmeccanica signed a master agreement with Scuola Superiore Sant'Anna and the Italian Ministry of Education, University and Research for the training of 20 engineers from the UAE in order to strengthen the knowledge of industrial technology and to develop technology transfer skills.

Financial transactions

In the first quarter of 2006 Finmeccanica did not start any new transaction in the financial market; so the medium/long-term debt structure has not changed significantly.

Below is a list of bonds at 31 March 2006 including the transactions placed on the market by the investee Finmeccanica Finance S.A. and secured by the Group Parent:

Issuer		Year of issue	Maturity	Amount (€mil)	Yearly coupon	Type of offer	IAS values €mil.
Finmeccanica Finance S.A.		1997	16-Jan-07	6	3.30%	Japanese institutional	6
Finmeccanica Finance S.A.	(1)	2002	30-Dec-08	297	Variable	Italian retail	295
Finmeccanica Finance S.A.	(2)	2003	8-Aug-10	501	0.375%	European institutional	420
Finmeccanica Finance S.A.	(3)	2003	12-Dec-18	500	5.75%	European institutional	504
Finmeccanica S.p.A.	(4)	2005	24-Mar-25	500	4.875%	European institutional	495

(1) Bonds exclusively offered to the public in Italy and listed on the TLX market, which is managed by Trading Lab Banca S.p.A. – Unicredito Italiano Group. Issued as part of the Euro Medium Term Notes ('EMTN') programmes for a maximum €bil. 2, the bonds are governed by a specific Italian

regulation. Transaction authorised pursuant to Article 129 of Legislative Decree no. 385/93. Prospectus filed with CONSOB on 4 December 2002 (authorisation notified with note no. 2079342/3.12.02)

(2) Exchangeable bonds with a maximum number of 20,000,000 shares in STMicroelectronics N.V. (STM) at a conversion price of €25.07 per share. Starting from the third anniversary of the issue, Finmeccanica Finance can ask for the loan to be converted if the average price recorded during the 30 working days prior to the date of notice to bond-holders exceeds 125% of the conversion price. At the maturity date Finmeccanica Finance can repay in cash or, upon prior notice to be given with at least 15 working days, through a combination of STM shares valued at the average prices recorded in the prior 5 working days. Transaction authorised pursuant to Article 129 of Legislative Decree no. 385/93. Bonds are listed on the Luxembourg Stock Exchange.

(3) Bonds issued as part of the EMTN programmes for a maximum of €bil. 2. The entire issue was converted from a fixed-rate issue to a floating-rate one for the first two years of the loan. The transaction was authorised pursuant to Article 129 of Legislative Decree no. 385/93. Bonds are listed on the Luxembourg Stock Exchange.

Rate transactions were made on these bonds and these led to benefit throughout 2005 from low floating rates with an effective cost of some 3.25%. From 2006 the effective cost of the loan will be again at a rate equal to the average value of some 5.80%.

(4) Bonds issued as part of the EMTN programmes for a maximum of €bil. 2. The transaction was authorised pursuant to Article Art.129 of Legislative Decree no. 385/93. Bonds are listed on the Luxembourg Stock Exchange. Some rate transactions were made to optimise collection costs.

All the bond issues of Finmeccanica Finance S.A. are irrevocably secured by Finmeccanica S.p.A.

All the bonds above are governed by regulations with standard legal clauses for this type of company transactions. In the case of the Finmeccanica issues, these clauses do not require any commitment for specific financial parameters (financial covenants) but require negative pledge and cross default clauses.

All Finmeccanica S.p.A. and Finmeccanica Finance S.A. bonds were given a medium-term financial credit rating by the three international rating agencies: Moody's Investors Service, Fitch and Standard and Poor's. More specifically, at the reporting date these credit ratings were A3 (Moody's) and BBB (Fitche and Standard and Poor's), both with stable outlook. In June 2005 Moody's credit rating was two levels ahead from Baa2 to A3, also following a methodological review of Moody's level of correlation in the relationships between enterprises and Government where the Government holds shares in such enterprises.

Earlier in January 2006 the PPO that was launched in 2005 for the purchase of the remaining shares of Datamat was completed, an expenditure of €mil. 89 adding to the €mil. 151 paid in 2005 for the purchase of 52.7% of the company share capital. Overall expenditure was €mil. 240 and the ownership percentage amounted to some 89% including the shares directly held by the company. Later, as noted in the previous section, procedures started for the purchase of the remaining equity investments for delisting purposes.

In March 52.17% of the share capital of Ansaldo STS S.p.A. was listed on the stock exchange. This company holds equity investments in ATSF and Ansaldo Signal NV through the sale of 52,174,000 shares at a price of €7.80 each and overall income was some €mil. 398 less commissions. In April net income of €mil 60 was generated from the exercise of the greenshoe option by the banks coordinating the PSO. This led to the sale of additional 7,826,000 shares, again at a price of €7.80 (7.83% of the share capital), an overall sale of 60% of the company share capital.

Group income statement

Income Statement

€mil.	*Notes*	*Quarter ended 31 March* **2006**	**2005**	*Twelve months ended 31 December* **2005**
Revenue		2,583	2,086	10,952
Changes in inventories of work in progress, semi-finished and finished goods		165	71	517
Other operating income		83	80	493
Costs for purchases		(942)	(680)	(4,127)
Costs for services		(790)	(681)	(3,234)
Personnel costs		(848)	(669)	(3,042)
Depreciation and impairment		(88)	(83)	(365)
Other operating costs		(74)	(54)	(514)
(-) Capitalisation of internal construction costs		11	6	55
		100	76	735
Financial income		470	100	435
Financial expense		(128)	(137)	(559)
Effect of accounting for equity investments with equity method		(4)	(9)	(25)
Profit (loss) before taxes and the effect of discontinued operations		438	30	586
Income tax expense		(55)	(23)	(200)
Profit (loss) associated with discontinued operations		-	-	10
Net profit (loss)		383	7	396
. Group		*379*	*6*	*373*
. Minority interests		*4*	*1*	*23*
Earnings per Share (*)				
Basic		*0.896*	*0.015*	*0.883*
Diluted		*0.891*	*0.015*	*0.877*
Earnings per share net of discontinued operations (*)				
Basic		*0.896*	*0.015*	*0.861*
Diluted		*0.891*	*0.015*	*0.854*

(*) For ease of comparison, earnings per share were determined based on the calculation of comparative figures for the effects from the reverse split of ordinary shares made by the Parent Company on 18 July 2005.

Balance Sheet

€mil.	Notes	31-Mar-06	31-Dec-05	31-Mar-05
Non-current assets				
Intangible assets		3,689	3,596	2,242
Property, plant and equipment		2,512	2,506	2,310
Investment property		3	2	2
Equity investments		132	138	124
Financial assets valued at fair value		914	906	771
Securities held-to-maturity		3	-	-
Receivables		133	122	116
Deferred tax assets		395	397	259
Other assets		4	4	18
		7,785	7,671	5,842
Current assets				
Inventories		5,765	5,511	4,809
Work in progress		2,732	2,538	2,477
Trade receivables		3,528	3,600	3,483
Financial assets valued at fair value		20	20	64
Securities held to maturity		1	-	2
Tax assets		358	364	376
Financial receivables		316	460	493
Other assets		522	532	568
Cash and cash equivalents		686	1,061	1,944
		13,928	14,086	14,216
Non-current assets held for sale		136	120	398
Total assets		21,849	21,877	20,456
Shareholders' equity				
Share capital		1,863	1,858	1,855
Other reserves		3,005	2,586	2,234
Group shareholders' equity		4,868	4,444	4,089
Minority interests		137	154	23
Total shareholders' equity		5,005	4,598	4,112
Non-current liabilities				
Borrowings		1,983	1,975	2,053
Severance pay and other employee liabilities		1,134	1,114	977
Provisions for risks and charges		434	423	467
Deferred tax liabilities		111	101	92
Other liabilities		365	380	389
		4,027	3,993	3,978
Current liabilities				
Advances from customers		4,425	4,389	2,935
Trade payables		3,073	3,431	2,784
Borrowings		521	666	2,061
Tax liabilities		258	268	136
Provisions for risks and charges		541	523	536
Other liabilities		3,905	3,917	3,645
		12,723	13,194	12,097
Liabilities directly correlated with assets held for sale		94	92	269
Total liabilities		16,844	17,279	16,344
Total liabilities and shareholders' equity		21,849	21,877	20,456

Cash flow statement

€mil.	For the 3 months ended 31 March 2006	2005
Cash flow from operating activities:		
Gross cash flow from operating activities	225	164
Changes in working capital	(706)	(602)
Changes in other operating assets and liabilities, taxes and financial expense	(114)	(160)
Cash flow used for operating activities	**(595)**	**(598)**
Cash flow from investing activities:		
Investments in property, plant and equipment and intangible assets	(120)	(60)
Disposals of property, plant and equipment and intangible assets	39	-
Received from Ansaldo STS PSO	398	-
Acquisitions of companies, net of cash acquired	(96)	-
Other investing activities	124	75
Cash flow used for investing activities	**345**	**15**
Cash flow from financing activities:		
Share capital increases	15	-
Issues of debenture loans	-	494
Net change in other financial payables	(138)	(26)
Cash flow used for financing activities	**(123)**	**468**
Net decrease in cash and cash equivalents	(373)	(115)
Translation differences	(2)	4
Cash and cash equivalents at 1 January	1,061	2,055
Cash and cash equivalents at 31 March	**686**	**1,944**

Statement of changes in shareholders' equity

€mil.	Share capital	Retained earnings and consolidation reserve	Other reserves	Group shareholders' equity	Minority interests	Total shareholders' equity
Shareholders' equity at 31 December 2004	1,856	1,798	(27)	3,627	22	3,649
Adoption of IAS32: treasury shares	(1)			(1)		(1)
Adoption of IAS32 and IAS39: other effects		109	418	527		527
Adoption of IFRS2		(5)	5	0		0
	(1)	104	423	526	0	526
Change in the fair value of assets available for sale			(79)	(79)		(79)
Change in the fair value of cash-flow hedge instruments and transfers to the income statement			(9)	(9)		(9)
Repurchase of treasury shares				0		0
Net change in reserve for stock option plans				0		0
Translation differences			23	23		23
	0	0	(65)	(65)	0	(65)
Dividends				0		0
Share capital increases				0		0
Change in scope of consolidation and other minor changes			(5)	(5)		(5)
Net profit (loss) at 31 March 2005		6		6	1	7
Shareholders' equity at 31 March 2005	1,855	1,908	326	4,089	23	4,112
Shareholders' equity at 31 December 2005	1,858	2,173	413	4,444	154	4,598
Change in the fair value of assets available for sale			8	8		8
Change in the fair value of cash-flow hedge instruments and transfers to the income statement			26	26		26
Repurchase of treasury shares				0		0
Net change in reserve for stock option plans			4	4		4
Translation differences			(22)	(22)	(3)	(25)
	0	0	16	16	(3)	13
Dividends				0	(8)	(8)
Share capital increases	5	10		15	1	16
Change in scope of consolidation and other minor changes			14	14	(11)	3
Net profit (loss) at 31 March 2006		379		379	4	383
Shareholders' equity at 31 March 2006	1,863	2,562	443	4,868 0	137	5,005

I GENERAL INFORMATION

The Finmeccanica Group is a major Italian high technology organisation. Finmeccanica S.p.A., the holding company responsible for guiding and controlling operations and strategy, coordinates its operating subsidiaries (the Finmeccanica Group or, simply, the Group), which are especially concentrated in the fields of aeronautics and helicopters, space and defence. The Group also has important businesses in the energy and transportation industries.

Finmeccanica is a company limited by shares based in Rome (Italy), at Piazza Monte Grappa 4, and is listed on the Milan stock market (S&P/MIB).

II BASIS OF PREPARATION AND ACCOUNTING STANDARDS USED

In application of Regulation (EC) no. 1606/2002 of 19 July 2002, the consolidated accounts of the Finmeccanica Group for the financial year ending 31 December 2005 are the first financial statements to be prepared in accordance with the international accounting standards (IFRSs) endorsed by the European Commission, supplemented by the relevant interpretations (Standing Interpretations Committee - SIC and International Financial Reporting Interpretations Committee - IFRIC) issued by the International Accounting Standard Board (IASB). The quarterly report at 31 March 2006 has been prepared in accordance with the IASs/IFRSs issued by the International Accounting Standard Board (IASB) and with IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’, as is approved at the closing date of these consolidated financial statements. Specifically, the standards used are those that have been endorsed by the European Union and which are contained in the following EU regulations: nos. 1725/2003, 707/2004, 2236/2004, 2237/2004, 2238/2004, 2086/2004, 211/2005, 1751/2005, 1864/2005, 1910/2005, 2106/2005 and 108/2006.

The entire legislation was acknowledged by CONSOB which, by resolution no. 14990 of 14 April 2005, required that companies whose shares are admitted to trading in a EU-regulated market prepare their consolidated financial statements in accordance with IFRSs (instead of the individual local GAAPs) from the financial year beginning 1 January 2005.

The IFRS used in preparing the quarterly report are supplemented by the IFRIC interpretations applicable at the reporting date. At the date of preparation of this report, certain aspects of adaptation and interpretation by the relevant official bodies, as well as the process of endorsement by the European Commission, have yet to be completed. As a result, there may be further changes or supplements to such standards and interpretations which could result in the Finmeccanica Group being required or opting to alter the accounting policies adopted in preparing these quarterly report.

The general principle used in preparing the financial statements at 31 March is the cost method, except for the recognition of derivative instruments and some financial assets, which must or - to the extent of financial assets – can be recognised at fair value under IAS 39.

The accounting standards specified below have been applied consistently for the comparative periods presented.

All figures are shown in millions of euros unless otherwise indicated.

Preparation of the quarterly report required management to make certain estimates. The main areas affected by estimates or assumptions of particular importance or that have significant effects on the balances shown are described in Section 4.

The quarterly report at 31 March 2006 prepared in accordance with IFRS was not audited.

III ACCOUNTING STANDARDS ADOPTED

III.1. Standards and scope of consolidation

The Group quarterly report at 31 March 2006 includes the statements of the companies/entities included in the scope of consolidation (‘consolidated entities’), which have been prepared in accordance with the IFRSs adopted by Finmeccanica Group.

Subsidiaries and entities controlled jointly

In particular, the entities over which Finmeccanica exercises a controlling power, either by directly or indirectly holding a majority of shares with voting rights or by exercising a dominant influence through the power to govern the financial and operating policies of an entity and obtain the related benefits regardless of the nature of the shareholding, have been consolidated on a line-by-line basis.

Not consolidated on a line-by-line basis are those entities which, because of the dynamics of their operations (e.g. consortia without shares and controlling interests in equity consortia which, by charging costs to their members, do not have their own financial results and the financial statements of which do not, net of intercompany assets and liabilities, have material balances) or their current status (e.g. companies that are no longer operational, have no assets or personnel, or for which the liquidation process appears to be essentially concluded), would be immaterial to the Group's situation in both quantitative and qualitative terms. These holdings have been consolidated using the equity method.

Participating interests in entities (including special-purpose entities) over which control is exercised jointly with other parties are consolidated proportionally (so as to incorporate only the value of the assets, liabilities, costs and income proportional to the percentage held without, therefore, including the holdings of the other parties).

All controlled entities are consolidated at the date on which control was acquired by the Group. The entities are removed from the consolidated financial statements at the date on which the Group relinquishes control.

Business combinations are recognised using the purchase method, whereby the acquirer purchases the equity and recognises all assets and liabilities, even if merely potential, of the acquired company. The cost of the transaction includes the fair value at the date of purchase of the assets sold, the liabilities assumed, the capital instruments issued, and all other incidental charges. Any difference between the cost of the transaction and the fair value at the date of purchase of the assets and liabilities is allocated to goodwill. In the event the process of allocating the purchase price should result in a negative difference, this difference is recorded as an expense immediately at the purchase date.
In the case of purchase of controlling stakes other than 100% stakes, goodwill is recognised only to the extent of the portion attributable to the Group Parent.

Amounts resulting from transactions with consolidated entities have been eliminated, particularly where related to receivables and payables outstanding at the end of the period, as well as interest and other income and expenses recorded on the income statements of these enterprises. Also eliminated are the net profits or losses posted between the consolidated entities along with their related tax adjustments.

The consolidated entities all close their financial years on 31 December. The quarterly report at 31 March 2006 has been prepared based on the ending balances at 31 March.

Other equity investments

Investments in entities over which significant influence is exercised, which generally corresponds to a holding of between 20% and 50%, are accounted for either using the equity method or at fair value. In the case of the equity method, the value of the investment is in line with shareholders' equity adjusted, when necessary, to reflect the application of IFRSs, and includes the recognition of goodwill (net of impairments) calculated at the time of purchase, and to account for the adjustments required by the standards governing the preparation of consolidated financial statements. Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Any value losses in excess of book value are recorded in the provision for risks on equity investments if there is an obligation to cover these losses.

The fair value of equity investments, in the event this method applies, is calculated based on the bid price of the last trading day of the month for which the IFRS report was prepared (in this case 31 March 2006).

III.2. Segment information

The Group considers the organisation by industry to be ‘primary’, as company risks and benefits are influenced significantly by differences in the products and services provided, with the organisation by geographic area being ‘secondary’, as company risks and benefits are also significantly influenced by operating in different countries or different geographic areas.

III.3. Currency translation

Identification of the functional currency

The balances of the financial statements of each Group entity are presented in the currency of the primary economy in which each enterprise operates (the functional currency). The consolidated quarterly financial statements for the Finmeccanica Group have been prepared in euros, which is the functional currency of the Group Parent.

Translation of transactions denominated in a foreign currency

Items expressed in a currency other than the functional currency, whether monetary (cash and cash equivalents, receivables or payables due in pre-set or measurable amounts, etc.) or non-monetary (advances to suppliers of goods and/or services, goodwill, intangible assets, etc.), are initially recognised at the exchange rate prevailing at the date on which the transaction takes place. Subsequently, the monetary items are translated into the functional currency based on the exchange rate at the reporting date, and any differences resulting from this conversion are recognised in the income statement. Non-monetary items continue to be carried at the exchange rate on the date of the transaction, except in situations where there is a persistent unfavourable trend in the exchange rate concerned. The differences receive the accounting treatment (income statement or translation reserve) required of adjustments of these items.

Translation of financial statements expressed in a currency other than the functional currency

The rules for translating quarterly financial statements expressed in a foreign currency other than the functional currency (except where the currency is that of a hyper-inflationary economy) are as follows:

- the assets and liabilities presented, even if solely for comparative purposes, are translated at the end-of-period exchange rate;
- costs and revenues, expense and income presented, even if solely for comparative purposes, are translated at the average exchange rate for the period in question, or at the exchange rate on the date of the transaction in the event this is significantly different from the average rate;
- the 'translation reserve' includes both the exchange rate differences generated by the translation of balances at a rate different from that at the close of the period and those that are generated by the translation of opening balances of shareholders' equity at a rate different from that at the close of the period.

Goodwill and adjustments to fair value related to the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the end-of-period exchange rate.

III.4. Intangible assets

Intangible assets are non-monetary items without physical form, but which can be clearly identified and generate future economic benefits for the company. They are carried at purchase and/or production cost, including directly related expenses allocated to them when preparing the asset for operations and net of accumulated amortisation (with the exception of intangibles with an indefinite useful life) and any impairments of value. Amortisation begins when the asset is available for use and is recognised systematically over its remaining useful life. In the period in which the intangible asset is recognised for the first time, the amortisation is on a pro-rata basis.

Development costs

This account includes costs related to the application of the results of research or other knowledge in a plan or a project for the production of materials, devices, processes, systems or services that are new or significantly advanced, prior to the start of commercial production or use, for which the generation of future economic benefits can be demonstrated. These costs are amortised over the entire period in which the future earnings are expected to be realised for the project itself. If such costs are reimbursed in whole or in part by the customer or fall within the scope of costs defined by Group standards as 'non-recurring costs', they are recognised under inventories (Section 4.1).
Research costs, on the other hand, are expensed in the period in which they are incurred.

Industrial patent and intellectual property rights

Patents and intellectual property rights are carried at acquisition cost net of amortisation and accumulated impairment losses. Amortisation begins in the period in which the rights acquired are available for use and is calculated based on the shorter of the period of expected use and that of ownership of the rights.

Concessions, licences and trademarks

This category includes: concessions, i.e. government measures that grant private parties the right to exclusive use of public assets or to manage public services under regulated conditions; licences that grant the right to use patents or other intangible assets for a determinate or determinable period of time; trademarks that establish the origin of the products of a given company; and licences for the know-how or software owned by others. The costs, including the direct and indirect costs incurred to obtain such rights, can be capitalised after receiving title to the rights themselves and are amortised systematically over the shorter of the period of expected use and that of ownership of the rights.

Goodwill

Goodwill recognised as an intangible asset is associated with business combinations and represents the difference between the cost incurred to acquire a company or division and the Group's share of the sum of the values assigned, based on current values at the time of the acquisition, to the individual assets and liabilities of the given company or division. As it does not have a definite useful life, goodwill is not amortised but is subject to impairment tests conducted at least once a year, unless market and operational factors identified by the Group indicate that an impairment test is also necessary in the preparation of interim financial statements. In conducting an impairment test, goodwill is allocated to the individual cash-generating units (CGUs), i.e. the smallest financially independent business units through which the Group operates in its various market segments.

Goodwill related to the acquisition of consolidated companies is recognised under intangible assets. Goodwill related to associated companies or subsidiaries not consolidated on a line-by-line basis is included in the value of the investments.

III.5. Property, plant and equipment

Property, plant and equipment is measured at purchase or production cost net of accumulated depreciation and any impairment losses. The cost includes all direct costs incurred to prepare the assets for use, as well as any charges for dismantlement and disposal that will be incurred to return the site to its original condition.

Charges incurred for routine and/or cyclical maintenance and repairs are expensed in full in the period in which they are incurred. Costs related to the expansion, modernisation or improvement of owned or leased structural assets are only capitalised to the extent that such costs meet the requirements for being classified separately as an asset or part of an asset. Any public capital grants related to property, plant and equipment are recognised as a direct deduction from the value of the asset to which they refer.

The value of an asset is adjusted by systematic depreciation calculated based on the residual useful life of the asset itself. In the period in which the asset is recognised for the first time, the depreciation rate applied takes into account the period of actual use of the asset. The estimated useful lives adopted by the Group for the various asset classes are as follows:

	Years
Land	indefinite
Buildings	20-33

Plant and machinery	5-10
Equipment	3-5
Other assets	5-8

In the event the asset to be depreciated is composed of distinct elements with useful lives that are significantly different from those of the other constituent parts, each individual part that makes up the asset is depreciated separately, in application of the component approach to depreciation.

This item also includes equipment intended for specific programmes (tooling), although it is depreciated, as with other non-recurring costs (see Section 4.1), on the basis of units manufactured in relation to those expected to be produced.

The gains and losses from the sale of assets or groups of assets are calculated by comparing the sales price with the related net book value.

III.6. Investment properties

Investments that generate income independent from company operations are classified as 'investment properties'. These investments are measured at purchase or production cost, increased by any related incidental expenses and reduced by accumulated depreciation and any impairment losses.

III.7. Impairment of intangible assets and property, plant and equipment

Assets with indefinite lives are not depreciated or amortised, but are rather subject to impairment tests at least once a year to ascertain the recoverability of their book value.
For assets that are depreciated or amortised, an assessment is made to determine whether there is any indication of a loss in value. If so, the recoverable value of the asset is estimated, with any excess being recognised in the income statement.
If the reasons for such writedowns should cease to obtain, the asset's book value is restored within the limits of its net book value; the writeback is also taken to the income

statement. Under no circumstances, however, is the value of goodwill that has been written down restored to its previous level.

III.8. Equity investments

The Group classifies its equity investments as follows:

- 'subsidiaries' in which the owner of the interest has the power to determine the financial and operating decisions and to receive the related benefits;
- 'associated companies' in which the owner of the interest exercises significant influence (which is assumed to exist when owner can exercise at least 20% of the votes in the ordinary shareholders' meeting). This also includes companies subject to joint control (joint ventures);
- 'parent companies', when the company held holds shares in its own parent;
- 'other companies' that do not fall under any of the categories above.

Equity investments due to be sold and those purchased for the sole purpose of being sold within twelve months are classified separately under 'assets held for sale'.

Subsidiaries (including those subject to joint control), associates and other companies, with the exception of those that are held for sale, are recognised at the cost of purchase or start-up posted in the separate accounts of the companies of the Group that have been prepared for consolidation purposes. The cost value is maintained in subsequent financial statements except in the event of a loss of value, or any writeback, following a change in its economic use or capital transactions. Equity investments held for sale are carried at the lower of cost and fair value net of sales costs.

III.9. Inventories

Inventories are recorded at the lower of cost and net realisable value. The Group used the weighted average cost method. The net realisable value is the sales price in the course of normal operations net of estimated costs to finish the goods and those needed to make the sale. Any writedowns are eliminated in future periods if the reason for the writedown should cease to obtain.

The Group classifies inventories as follows:

- raw materials, supplies and consumables
- work in progress and semi-finished goods
- finished products
- goods

In particular, work in progress and semi-finished goods, as specified in Section 4.1, include non-recurring costs.

Work in progress is recognised at production cost using the weighted average cost, excluding financial charges and general overheads.

III.10. Contract work in progress

Work in progress is recognised on the basis of progress (or percentage of completion), whereby costs, revenues and margins are recognised based on the progress of production. The state of completion is determined on the basis of the ratio between costs incurred at the measurement date and the total expected costs for the programme.

The valuation reflects the best estimate of the schedules prepared at the reporting date. The assumptions upon which the valuations are made are periodically updated. Any impact on profit or loss are recognised in the period in which the updates are made.

In the event the completion of a contract is expected to result in a loss at the gross margin level, the loss is recognised in its entirety in the period in which it becomes reasonably foreseeable.

Contract work in progress is recorded net of any writedowns, as well as pre-payments and advances related to the contract being performed.

This analysis is carried out contract by contract: in the event of positive differences (where the value of work in progress is greater than total pre-payments), the difference is recorded as an asset; negative differences, on the other hand, are recorded as a liability under ‘due to customers for contract work’. If it has not been collected at the date of preparation of the annual or interim accounts, the amount recorded among advance payments will have a directly contra-item in trade receivables.

Contracts with payments in a currency other than the functional currency (the euro for the Group) are measured by converting the portion of payments due, calculated using the percentage-of-completion method, at the exchange rate prevailing at the close of the period. However, the Group's policy for exchange-rate risk calls for all contracts in which cash inflows and outflows are significantly exposed to exchange rate fluctuations to be hedged specifically. In such cases, the recognition methods described in Section 4.3 below are applied.

III.11. Receivables and financial assets

The Group classifies its financial assets into the following categories:

- financial assets at fair value through profit or loss;
- loans and receivables;
- held-to-maturity financial assets;
- available-for-sale financial assets.

Management classifies assets at the time they are first recognised.

Financial assets at fair value through profit or loss

This category includes financial assets acquired for the purpose of short-term trading transactions, or designated for this use by management, as well as derivatives, which are discussed in the next section. The fair value of these instruments is determined with reference to their end-of-period bid price. For unlisted instruments, the fair value is calculated using commonly adopted valuation techniques. Changes in the fair value of instruments in this category are recognised immediately in the income statement.

The classification of assets as current or non-current reflects management expectations regarding their trading. Current assets include those that are planned to be sold within 12 months or those designated as held for trading purposes.

Loans and receivables

This category includes non-derivative financial assets with fixed or determinable payments that are not quoted on an active market. They are measured at their amortised cost using the effective interest method. Should objective evidence of impairment emerge, the value of the asset is reduced to the value obtained by discounting the expected cash flows from the asset; the loss ascertained in the impairment test is recognised in profit or loss. If the reasons for the writedown should cease to obtain, the value of the asset is restored up to the amortised cost value it would have if no impairment had been recognised. Loans and receivables are posted under current assets except for the portion falling due beyond 12 months, which is carried under non-current assets.

Financial assets held to maturity

These are non-derivative assets with fixed maturities that the Group has the intention and ability to hold to maturity. Those maturing within 12 months are carried as current assets. Should objective evidence of impairment emerge, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

Financial assets available for sale

This category encompasses non-derivative financial assets specifically designated as available for sale or are not classified in any of the previous items. They are recognised at fair value, which is calculated with reference to their market price at the reporting date or using financial valuation techniques and models. Changes in value are recognised in a specific equity item ('Reserve for assets available for sale'). The reserve is taken to the income statement only when the financial asset is effectively sold or, in cases of a loss of value, when it become evident that the impairment in value already recognised in equity is unrecoverable. Classification as current or non-current depends on the intentions of management and the effective marketability of the security itself. Assets that are expected to be sold within 12 months are carried under current assets.

Should objective evidence of impairment emerge, the value of the asset is reduced to the value obtained by discounting the expected cash flows from the asset; reductions in value previously recognised in equity are reversed to profit or loss. If the reasons for the writedown should cease to obtain, the value of the asset is restored.

III.12. Derivatives

Derivatives are still regarded as assets held for trading and stated at fair value through profit and loss unless, in the light of the new standards and current interpretation, they are deemed eligible for hedge accounting and effective in offsetting the risk in respect of underlying assets, liabilities or commitments undertaken by the Group.

In particular, the Group uses derivatives as part of its hedging strategies to offset the risk of changes in the fair value of assets or liabilities on its balance sheet or the risk associated with contractual commitments (fair value hedges) and the risk of changes in expected cash flows in contractually defined or highly probable operations (cash flow hedges). For details regarding the methodology for recognising hedges of the exchange rate risk on long-term contracts, see Section 4.3.

The effectiveness of hedges is documented both at the start of the operation and periodically thereafter (at least every time an annual or interim report is published) and measured by comparing changes in the fair value of the hedging instrument against changes in the hedged item ('dollar offset ratio'). For more complex instruments, the measurement involves statistical analysis based on the variation of the risk.

Fair value hedges

Changes in the value of derivatives that have been designated and qualify as fair value hedges are recognised in profit or loss, similarly to the treatment of changes in the fair value of the hedged assets or liabilities that are attributable to the risk that has been offset with the hedge.

Cash flow hedges

Changes in the fair value of derivatives that have been designated and qualify as cash flow hedges are recognised - with reference to the 'effective' component of the hedge only - in a specific equity reserve ('cash flow hedge reserve'), which is subsequently recognised in profit or loss when the underlying transaction affects profit or loss. Changes in fair value attributable to the non-effective component are immediately recognised in profit or loss for the period. If the derivative is sold, or ceases to function as an effective hedge against the risk for which it was originated, or the occurrence of the underlying operation ceases to be highly probable, the relevant portion of the cash flow hedge reserve is immediately recognised in the income statement.

Determining fair value

The fair value of instruments quoted on public markets is determined with reference to the bid price for the instrument in question at the reference date. The fair value of unquoted instruments is determined with financial valuation techniques. Specifically, the fair value of interest rate swaps is measured by discounting the expected cash flows, while the fair value of foreign exchange forwards is determined on the basis of the market exchange rate at the reference date and the rate differentials among the currencies involved.

III.13. Cash and cash equivalents

The item includes cash, deposits with banks or other institutions providing current account services, post office accounts and other cash equivalents, as well as investments maturing in less than three months from the date of acquisition. Cash and cash equivalents are recognised at their fair value.

III.14. Shareholders' equity

Share capital

Share capital consists of the capital subscribed and paid up by the Group Parent. Costs directly associated with the issue of shares are recognised as a decrease in share capital when they are directly attributable to capital operations.

Treasury shares

Treasury stock is recognised as a decrease in Group shareholders' equity. The costs incurred in the issue of new shares by the Group Parent are recognised as decreases in shareholders’ equity, net of any deferred tax effect. Gains or losses realised in the acquisition, sale, issue or cancellation of treasury stock are recognised directly in shareholders’ equity.

<u>Profits (losses) carried forward</u>

These include net profits or losses for the year and for previous years that are not distributed or allocated to reserves (for profits) or covered (for losses). The item also includes transfers from other equity reserves when the restrictions on their release cease to apply, as well as the effects of changes in accounting policies and significant errors.

<u>Other reserves</u>

Other reserves consist of specific-purpose equity reserves of the Group Parent. They include the fair value reserve relating to items accounted for using the fair value method recognised in equity and the cash flow hedge reserve in respect of the effective portion of such hedges.

III.15. Payables and other liabilities

Payables and other liabilities are initially recognised at fair value net of transaction costs. Then they are valued at amortised cost, using the effective interest rate method (Section 3.22).

Payables and other liabilities are defined as current liabilities unless the Group has the contractual right to settle its debts at least 12 months after the reporting date.

III.16. Deferred tax assets

Deferred tax assets and liabilities are calculated based on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax assets and liabilities are calculated by applying the tax rate in force at the time the temporary differences will be reversed. Deferred tax assets are recognised to the extent that it is probable the company will post taxable income at least equal to the temporary differences in the financial periods in which such assets will be reversed.

III.17. Employee benefits

Post-employment benefit plans

Group companies use several types of pension and supplementary benefit plans, which can be classified as follows:

- *Defined contribution plans* in which the company pays fixed amounts to a distinct entity (e.g. a fund) but has no legal or constructive obligation to make further payments if the fund does not have sufficient assets to pay the benefits accrued by employees during their period of employment with the company. The company recognises the contributions to the plan only when employees rendered their services to the company specifically in exchange for these contributions;
- *Defined benefit plans* in which the company undertakes to provide agreed benefits for current and former employees and incur the actuarial and investment risks associated with the plan. The cost of the plan is therefore not determined by the amount of the contributions payable in the financial period but, rather, is redetermined with reference to demographic and statistical assumptions and wage trends. The methodology used is the projected unit credit method. The 'trattamento di fine rapporto', a staff severance pay mechanism peculiar to Italy, belongs to this category.

In compliance with IAS 19, the Finmeccanica Group uses the so-called 'corridor' approach in recognising actuarial losses and gains relating to defined benefit plans. This method makes it possible to dilute the effects of changes in the valuation parameters over a number of financial years. Consequently, for each plan net actuarial losses and gains at the end of the prior period that exceed the greater of 10% of the present value of the obligation and 10% of the fair value of the benefit plan assets divided by the remaining working life of employees are recognised in each period.

Other long-term benefits and post-employment benefit plans

Group companies grant employees with other benefits (such as seniority bonuses after a given period of service with the company) that, in some cases, continue to be provided after retirement (for example, medical care). These receive the same accounting treatment as defined benefit plans, using the projected unit credit method. However, the corridor approach cannot be used for ‘other long-term benefits’. Consequently, net actuarial gains and losses are recognised both immediately and in full as they occur.

Benefits payable for the termination of employment and incentive plans

Termination benefits are recognised as liabilities and expenses when the enterprise is demonstrably committed to terminating the employment of an employee or group of employees before the normal retirement date or to providing termination benefits as a result of an offer made in order to encourage voluntary redundancy. The benefits payable to employees for the termination of employment do not bring any future economic benefit to the enterprise and are therefore recognised immediately as expenses.

Equity compensation benefits

The Group uses stock option plans or stock grant to compensate top management. In these cases, the theoretical benefit attributable to the recipients is charged to the income statement in the financial periods for which the plan is operative with a contra-item in an equity reserve. The benefit is quantified by measuring the fair value of the assigned instrument using financial valuation techniques that take account of market conditions and, at the date of each annual or interim report, an updated estimate of the number of instruments expected to be distributed.

III.18. Provisions for risks and charges

Provisions for risks and charges cover certain or probable losses and charges whose timing or amount was uncertain at the reporting date.

The provision is recognised only when a current obligation (legal or constructive) exists as a result of past events and it is probable that an outflow of economic resources will be required to settle the obligation. The amount reflects the best current estimate of the cost of fulfilling the obligation. The interest rate used to determine the present value of the liability reflects current market rates and includes the additional effects relating to the specific risk associated with each liability.

Risks for which the emergence of a liability is merely a possibility are reported in the section in the notes on commitments and risks and no provision is recognised.

III.19. Leasing

Group entities as lessees in a finance lease

At the date on which a lease is first recognised, the lessee records a non-current asset and a financial liability at the lower of the fair value of the asset and the present value of the minimum lease payments at the date of the inception of the lease, using the implicit interest rate in the lease or the incremental borrowing rate. Subsequently, an amount equal to the depreciation expense and the finance charge separated from the principal component of the lease payment made in the period is recognised in the income statement.

Group entities as lessors in a finance lease

At the date on which a lease is first recognised, the value of the leased asset is eliminated from the balance sheet and a receivable equal to the net investment in the lease is recognised. The net investment is the sum of the minimum payments plus the residual unguaranteed value discounted at the interest rate implicit in the lease contract. Subsequently, financial income is recognised in the income statement for the duration of the contract in an amount providing a constant periodic rate of return on the lessor's net investment.

The unsecured residual value is reviewed periodically for possible impairment.

Operating leases

Receipts and payments in respect of contracts qualifying as operating leases are recognised in the income statement over the duration of the contract.

III.20. Revenue

Revenues generated by an operation are recognised at the fair value of the amount received and receivable, inclusive of volume discounts and reductions.

Revenues also include changes in work in process, the accounting policies for which were described in Section 3.10 above.

Revenues generated from the sale of goods are recognised when the enterprise has transferred to the buyer substantially all of the significant risks and rewards of ownership of the goods, which, in many cases, will coincide with the transfer of title or possession to the buyer; and when the value of the revenues can be reliably determined.
Revenues from services are recognised on a percentage-of-completion method when they can be reliably estimated.

III.21. Government grants

Once formal authorisation for their assignment has been issued, grants are recognised on an accruals basis in direct correlation with the costs incurred. Specifically, capital grants are taken to the income statement in direct relation to the depreciation of the relevant goods or projects, and are recognised as a direct reduction in the value of the depreciation expense.

III.22. Financial income and expense

Interest is recognised on an accruals basis using the effective interest rate method, i.e. the interest rate that results in the financial equivalence of all inflows and outflows (including any premiums, discounts, commissions etc) that make up a given operation.
Financial expense is never capitalised.

III.23. Dividends

Dividends are recognised as soon as shareholders obtain the right to receive payment, which is normally when the shareholders' meeting approves the distribution of dividends.
Dividends distributed to Finmeccanica shareholders are recognised as liabilities for the period in which their distribution is approved by the shareholders’ meeting.

III.24. Costs

Costs are recognised on an accruals basis in the expectation that the Group companies will continue operations.

III.25. Accounting policies applied in the preparation of interim reports and the seasonality of operations

Current taxes

In the interim financial statements of Group companies, income taxes are estimated by applying the expected effective annual tax rate to the interim pre-tax result.

Cash flows relating to operations

The businesses in which the Group is primarily active are characterized by a high concentration of cash flows from customers in the closing months of the year. This pattern affects both the interim cash flow statements and the volatility of the debt situation of the Group over each interim period, which shows a marked improvement in the final months of the calendar year.

III.26. New IFRSs and IFRIC interpretations

Over the last few months, the IASB and the International Financial Reporting Interpretations Committee (IFRIC) published the new standards and interpretations. Although at the date of preparation of this report the standards and interpretations are not compulsory or have not been endorsed by the European Commission, the Group has considered their effects and reported their potential impact on its balance sheet and income statement, as follows:

IFRS - IFRIC interpretation		Effects for the Group
IFRS 6 Amendment	Exploration for and Evaluation of Mineral Assets	N/A
IAS 19 Amendment	Employee benefits	The Group expects to apply these changes from 1 January 2007
IAS 39 Amendments	Financial instruments	Not significant

IFRS 4 Amendment	Insurance contracts	N/A
IFRS 7	Disclosures and changes to IAS 1 – Presentation of financial statements	The application of this standard implies more disclosures on financial instruments and capital
IFRIC 4	Determining a lease contract	Not significant
IFRIC 5	Rights from interests and Environmental Rehabilitation Funds	N/A
SIC 12 Amendment	Special purpose entities	Not significant
IFRIC 6	Liabilities arising from participating in a specific market - waste electrical and electronic equipment	N/A

IV SIGNIFICANT ISSUES

IV.1. Non-recurring costs

The Group classifies costs incurred for design activities, prototype development and customization to the technical and operating specifications of clearly identified customers under inventories at the item work in progress and semi-finished goods even if there is no contractual relationship if it feels that the contract is highly likely to be awarded on the basis of actions by potential customers to conclude a contract or the correspondence of the Group's projects with the business and financial plans of potential customers. The item also includes the difference between the increased labour costs in the initial manufacturing stage and those considered standard on the basis of the expected learning curve. Such costs are suspended until the contract is formally awarded without recognition of any margin; subsequently, they are allocated to the relevant contract (under the item contract work in progress) and amortised against the margin on the contract on the basis of units manufactured in relation to those expected to be produced.

If the prospects for being awarded a contract should change as a result of changes in the conditions noted above or are delayed to the extent that the time horizon for the award is less clearly specified, the suspended costs are immediately recognised in the income statement. This classification also takes into account that said expenses generally benefit from the provisions of Law 808/85 (regarding the implementation of interventions for the development and competitiveness growth of the companies in the aeronautics industry), which is expected to undergo changes in 2006 which should affect the accounting treatment of non-recurring costs. In this context, now that these changes have not been made yet, non-recurring costs continue to be recognised as inventories in the quarterly financial statements at 31 March 2006 which have been prepared in accordance with IFRSs.

IV.2. Financing for GIE ATR aircraft

In order to enhance its competitive position, in certain cases GIE ATR facilitates access to financing by its customers by providing specific guarantees to third parties (an approach taken by its direct competitors), an activity that in the past it also conducted through special purpose entities.

Where, due to the effect of the guarantees provided or the content of other contractual provisions, it is felt that substantially all risks and benefits attaching to aircraft sale contracts have been transferred to customers, the sale is not recognised as such in the accounts. Rather, the entire operation is recognised as a lease, postponing the recognition of profits until such time as the risks no longer obtain by way of recognition under deferred income and carrying the aircraft among the Group’s assets, undergoing normal depreciation. If, however, the operation is structured in a manner in which substantially all risks and benefits are transferred to the customer, it is booked as a loan or a finance lease, with the sale being recognised upon delivery and the financial component being recognised under financial income on an accruals basis. If contracts envisage a buy-back clause or a residual value guarantee, the operation is recognised as a sale only if the present value of the guarantees can be considered immaterial with respect to the overall value of the transaction; otherwise, the aircraft is carried under the Group's assets and depreciated. All likely risks associated with operations carried out by GIE ATR are measured on the basis of a prudent valuation conducted by management and are either deducted directly from the carrying value of the asset or are recognised under provisions for risks and charges.

IV.3. Hedging long-term contracts against foreign exchange risk

In order to hedge exposure to changes in flows of receipts and payments associated with long-term construction contracts denominated in currencies other than the functional currency, the Group enters into specific hedges for the expected individual cash flows in respect of the contracts. The hedges are entered into at the moment the commercial contracts are finalised, except where the award of the contracts is felt to be highly likely as a result of existing framework contracts. Exchange-rate risk is normally hedged with plain vanilla instruments (forward contracts); in some cases, however, in order to protect the Group against the persistent adverse trend in the US dollar, we have entered into more highly structured operations that, while substantively hedging the positions, do not qualify for hedge accounting under IAS 39. In these cases, as in all cases where hedges prove to be ineffective, changes in the fair value of such instruments are taken immediately to the income statement as financial items, while the underlying is valued as if it were exposed to exchange rate variations. The effects of this recognition policy are reported in Section 39. Hedges in the former case are carried as cash flow hedges, considering as ineffective the part relating to the premium or discount in the case of forwards or the time value in the case of options, which is recognised under financial items. The effects of this recognition policy are reported in Section 6 'Net financial income and expense'. Hedges in the former case are carried as cash flow hedges, considering as ineffective the part relating to the premium or discount in the case of forwards or the time value in the case of options, which is recognised under financial items.

IV.4. Recognition of the equity investment in STMicroelectronics (STM)

The indirect investment in STM was designated at the adoption date for IAS 32 and IAS 39 (1 January 2005) as available for sale. Accordingly, the carrying value is adjusted at each balance-sheet date to market value (bid price), recognising the differential with respect to the carrying value determined in accordance with previous GAAP, as well as subsequent changes in fair value, in a specific equity reserve (reserve for assets available for sale), which will be reversed to profit or loss only if and when the equity investment is sold.

The effects of this recognition policy are reported in the comments on the quarterly report (Section 6).

IV.5. Provisions for risks and estimates of final costs of long-term contracts

The Group operates in sectors and with contractual arrangements that are especially complex. They are recognised on a percentage-of-completion basis. Margins recognised in the income statement are a function of both the state of progress on contracts and the margins that are expected to be recognised for the completed contract. Accordingly, correct recognition of work in progress and margins on contracts that have not yet been completed requires management to make a careful estimate of the final costs and expected increases as well as delays, extra costs and penalties that could reduce the expected margin. In order to enhance support for this activity, the Group has adopted contract management and risk analysis tools designed to identify, monitor and quantify the risks associated with such contracts. The amounts posted in the financial statements represent management's best estimate at the reporting date using the procedures above.

In addition, the Group's operations regard sectors and markets where many disputes are settled only after a considerable period of time, especially in cases where the customer is a government entity, making it necessary for management to estimate the outcome of such disputes. The main potential loss situations classified as 'probable' or 'possible' (no provision is recognised for the latter) are reported in Section 6 under 'provisions for risks and charges'.

V Segment information

Primary frame of reference

The Group operates in a variety of industry segments: helicopters, defence electronics, aeronautics, space, defence systems, energy, transportation and other activities.

For a more detailed analysis of the main programmes, outlooks and operating indicators for each segment, see the Report on Operations in the business segment section. The results for each segment at 31 March 2006, as compared with those of the same period of the previous year, are as follows:

31 March 2006

	Helicopters	Defence Electronics	Aeronautics	Space	Defence Systems	Energy	Transportation	Other activities	Eliminations	Total
Revenue from external customers	575	595	333	140	208	201	340	56		2,448
Revenue from other segments	3	113	75	-	6	-	-	5	(67)	135
Operating result	44	42	15	9	7	7	16	(40)		100
Financial income and expense - net										342
Share of result of associates	-	(1)	(1)	-	-	-	-	(2)		(4)
Tax expense										(55)
Profit (loss) from discontinued operations										-
Profit (loss) for the period										383
Group share of net result										379
Minority share										4
Investments	15	72	66	4	70	3	5	2		237

31 March 2005

	Helicopters	Defence Electronics	Aeronautics	Space	Defence Systems	Energy	Transportation	Other activities	Eliminations	Total
Revenue from external customers	554	344	256	167	178	147	296	26		1,968
Revenue from other segments	1	79	84	2	12	1	-	5	(66)	118
Operating result	41	21	10	12	2	6	10	(26)		76
Financial income and expense - net										(37)
Share of result of associates	-	-	-	-	-	-	-	(9)		(9)
Tax expense										(23)
Profit (loss) from discontinued operations										-
Profit (loss) for the period										7
Group share of net result										6
Minority share										1
Investments	9	10	24	3	7	1	5	1		60

The assets and liabilities attributable to the segments at 31 March 2006 and 31 December 2005 are as follows:

31 March 2006

	Helicopters	Defence Electronics	Aeronautics	Space	Defence Systems	Energy	Transportation	Other activities	Eliminations	Total
Assets	5,318	5,418	4,476	935	2,126	1,048	1,816	3,714	(3,138)	21,713
Liabilities	3,396	3,415	4,216	560	1,474	1,028	1,734	4,205	(3,278)	16,750

31 December 2005

	Helicopters	Defence Electronics	Aeronautics	Space	Defence Systems	Energy	Transportation	Other activities	Eliminations	Total
Assets	5,283	5,394	4,510	967	2,093	941	1,920	3,798	(3,149)	21,757
Liabilities	3,383	3,392	4,281	594	1,430	909	1,845	4,667	(3,314)	17,187

Secondary frame of reference

Group revenue can also be broken down geographically as follows (based on the customer's home country):

	31 Mar 2006	31 Mar 2005
Europe	1,925	1,662
North America	264	157
Other	394	267
	2,583	2,086

Assets are geographically distributed as follows:

	31 Mar 2006	31 Dec 2005
Europe	21,113	21,167
North America	533	539
Other	67	51
	21,713	21,757

Capital expenditure is distributed as follows (based on the location in which it is made):

	31 Mar 2006	**31 Mar 2005**
Europe	232	57
North America	2	1
Other	3	2
	237	60

VI Notes to the quarterly financial statements at 31 March 2006

To give additional information on the Group state of affairs, statements of reclassification for the ‘Income Statement’, the ‘Balance Sheet’, the ‘Net debt’ and ‘Cash flow statement’ have been prepared.

For ease of understanding and comparability, below are the main changes in the scope of consolidation:

- starting 1 January 2006 Elsag Business Process S.r.l, Elsag STI S.p.A and CTM S.c.p.a. were deconsolidated; these companies were sold;
- on 17 January 2006 Seicos S.p.A was incorporated. Starting from that date it was consolidated on the equity method;
- Elsag Security S.r.l., which was incorporated on 25 February 2005, was consolidated on a line-by-line basis starting from the date of incorporation;
- On 1 March 2006 joint venture MBDA took control of LFK GmbH. This company is consolidated on the proportional method (25%) from that date;
- on 29 April 2005, under the agreements with BAE Systems (Eurosystems transaction), the share capital of Selex Sensors and Airborne Systems S.p.A., which was incorporated in March 2005, was increased through the transfer of Galileo Avionica S.p.A. and its investees from Finmeccanica S.p.A. and of Selex Sensors and Airborne Systems Ltd (formerly BAE Systems Avionics Ltd) and its investees from BAE Systems Electronics Ltd. From that date Selex Sensors and

Airborne Systems Ltd and Selex Sensors and Airborne Systems S.p.A were fully consolidated.

At the same date, always under the agreements with BAE Systems, Finmeccanica purchased the control of the remaining 50% of Alenia Marconi Systems S.p.A. (currently Selex Sistemi Integrati S.p.A.), which was formerly consolidated using the proportional consolidation method. Under the agreement some companies were purchased, specifically Selex Sistemi Integrati GmbH, Selex Sistemi Integrati Ltd and Selex Sistemi Integrati Inc.. Starting from that date these companies were consolidated on a line-by-line basis. At the same time, under the agreements above, the indirect interest of the British company AMS Ltd. was sold to BAE Systems. The company was deconsolidated accordingly;

- on 1 July 2005 Finmeccanica and Alcatel Partecipations SAS formed two joint ventures operating in the Space segment: Alcatel Alenia Space SAS (Finmeccanica 33%), to which Alcatel Alenia Space Italia S.p.A. (formerly Alenia Spazio) was transferred, and Telespazio Holding S.r.l. (Finmeccanica 67%), to which the companies of the Telespazio S.p.A. Group were transferred. From the date above the two companies and their own subsidiaries are consolidated using the proportional consolidation method. In the first quarter of 2005 the Italian companies which later formed the joint ventures were fully consolidated (100%), but the companies of the Alcatel Group were not consolidated;
- Consult Data S.r.l. was deconsolidated from 29 July 2005; the interest in the company was sold;
- Elsag Solution was deconsolidated from 4 August 2005; the interest in the company was sold;
- Elsag Back-Office S.p.A. was deconsolidated from 29 August 2005; the interest in the company was sold;
- on 4 October 2005 52.7% of the share capital of Datamat S.p.A was purchased. After the PPO launched at the end of 2005 and ended in January 2006, the percentage owned rose up to 89%.

The ‘Income Statement’ includes figures for the first quarter in the comparative period as well, but from the date of purchase (or date of efficacy of the deed).

The ‘Balance Sheet’ at 31 December 2005 does not include figures for the Groups and companies which were consolidated starting from 2006.

Always with reference to data comparability, the first three months of 2006 have been marked by changes in the euro against the main currencies of interest for the Group. Specifically, the currency exchange rates at 31 March 2006 and the average exchange rates for the period showed, for the main currencies, these changes from 2005: final exchange rates for the period (euro/US dollar +2.54% and euro/sterling pound +1.59%); average exchange rates for the period (euro/US dollar –9.08% and euro/sterling pound –1.09%).

The table below shows the consolidated results for the first three months of 2006.

€mil.	For the 3 months at 31 March		Financial statements
	2006	**2005**	**2005**
Revenue	2,583	2,086	10,952
Change in work in progress, semi-finished and finished goods	165	71	517
	2,748	2,157	11,469
Purchase and personnel costs	(2,569)	(2,021)	(10,330)
Depreciation and amortisation	(85)	(80)	(347)
Write-downs	(3)	(3)	(18)
Restructuring costs	(6)	(6)	(32)
Other net operating income (costs)	15	29	(7)
EBIT	100	76	735
Net financial income (expense)	338	(46)	(149)
Income tax expense	(55)	(23)	(200)
NET RESULT BEFORE DISCONTINUED OPERATIONS	383	7	386
Net result from discontinued operations	-	-	10
NET RESULT	383	7	396
Of which:			
. Group	*379*	*6*	*373*
. minority interests	*4*	*1*	*23*

- ‘value of production’ of €mil. 2,748 rose by some 27.4% from the year-earlier period (€mil. 2,157). The increase is mainly due to: Defence Electronics, and the change in the scope of consolidation with a view to growth in command and control system activities and Energy for the recent acquisitions of the job orders above. Such increase is offset by a decrease in the Space segment, which is due to a change in the scope of consolidation;

- ‘purchase and personnel costs’ rose from €mil. 2,021 of the same period in 2005 to €mil. 2,569 in 2006. In particular, these include:

	31 Mar 2006	31 Mar 2005
Purchase of materials	971	729
Change in inventories	(29)	(49)
Purchase of services	736	624
Costs of rents and operating leases	54	57
Total costs of purchases and services	1,732	1,361
Wages and salaries	613	494
Social security contributions	170	139
Costs for staff severance pay	21	20
Costs related to other defined-benefit plans	21	8
Employee disputes	2	1
Other costs	21	4
Total personnel costs	848	666
Capitalisation of internal construction costs	(11)	(6)
Total	2,569	2,021

The performance of costs of purchases (some +27.3%), like ‘value of production’, is due to the change in the scope of consolidation and to the performance of the segment activities.

‘Personnel costs’ of €mil. 848 as compared with €mil. 666 for the period 2005, rose due to the increase in the number of paid employees and the average unit cost.

The average workforce was 55,959 from 48,304 in the year-earlier period, an increase due to the change in the scope of consolidation as compared with the year-earlier period (inclusion of Selex Sensors and Airborne System Ltd, the Datamat Group and LFK GmbH in the joint venture MBDA), to the net effect of the deconsolidation of the joint venture AMS Ltd and the different incidence of Selex Sistemi Integrati S.p.A and Alcatel Alenia Space S.A.S. and Telespazio Holding S.r.l. (joint ventures incorporated in July 2005 – 33% and 67% respectively – as compared with the first quarter of 2005, when Alenia Spazio S.p.A and the Telespazio Group were fully consolidated).

The workforce at 31 March 2006 was 56,970, up 367 from 56,603 at 31 December 2005 mainly due to the purchase of LFK GmbH (246 people, 25% of total employees) and the positive turnover.

In Italy the average unit personnel cost rose due to the change in the scope of consolidation, the renewal of the collective bargaining agreement and the change in employee categories; abroad, this grew due to the change in the scope of consolidation, the different breakdown of professional titles and the increase of the value of the sterling pound and the US dollar against the euro, as illustrated above;

- ‘depreciation and amortisation’ rose due to the change in the scope of consolidation. Depreciation and amortisation for the period of €mil. 85 (€mil. 80 in the same period of 2005) include €mil. 71 of depreciation for property, plant and equipment (€mil. 68 in the same period of 2005) and €mil. 14 of amortisation of intangible assets (€mil. 12 in the same period of 2005);

- ‘write-downs’ of receivables were €mil. 3 and relate to the write-down of receivables in the year-earlier period;

- ‘restructuring costs’ of €mil. 6 are the same as in the year-earlier period;

- ‘other net operating income and expense’ include net income of €mil. 15 (€mil. 29 of net income in the same period of 2005) and break down as follows:

	31 Mar 2006	**31 Mar 2005**
Grants for training, research and development	6	7
Net exchange rate differences on operating items	-	-
Indirect taxes	(5)	(4)
Net adjustment of receivables and payables in foreign currency at the end-of-period exchange rate	2	7
Gains from the sale of non-current assets	18	-
Insurance reimbursements	6	7
Transfers (accruals) of provisions	(8)	22

Other operating income (costs)	(4)	(10)
Total	15	29

Specifically the gain from the sale of non-current assets relates to the sale of the production site of Chelmsford (UK) by Selex Communications Ltd;

- ‘EBIT’ stood at €mil. 100, up €mil. 24 (around +31.6%) from the year-earlier period (€mil. 76). The increase is due to growth in the Defence Electronics segment due to the change in the scope of consolidation, the command and control system activities, and in the Defence System, Aeronautics and Energy segments. The Helicopters segment remain substantially unchanged;

- ‘net financial income and expense’ include €mil. 338 of net financial income and rose by €mil. 384 from the year-earlier period (€mil. 46 of net financial expense). This item includes ‘net financial income and expense’ which break down in net financial income of €mil. 342 in the first three months of 2006 as compared with net financial expense of €mil. 37 in the same period of 2005, and the net negative effect of the valuation of equity investments with the equity method of €mil. 4 in the first quarter of 2006 as compared with a net negative effect of €mil. 9 in the same period of 2005. In particular:

	31 Mar 2006	**31 Mar 2005**
Dividends and income from equity investments and securities	366	1
Net discounting of receivables, payables and provisions	(1)	(1)
Net interest	(23)	(17)
Net results from financial instruments at fair value through profit or loss	2	(12)
Net exchange rate differences	(1)	(2)
Other net financial income and expense	(1)	(6)
Total	342	(37)

Income from equity investments relates to the net gain from the sale through PSO of 52.174% of Ansaldo STS S.p.A. (€mil. 364).

Net gains resulting from the recognition at fair value through profit or loss include the effects of derivative instruments which, although they meet the objective of limiting the fluctuations of the underlying position within a specific range, do not meet the particularly restrictive conditions of IAS 39, either because of the nature of the instruments themselves or the inability to mathematically demonstrate their effectiveness. In detail, these gains are as follows:

	Income	Charges	Net
Derivates on exchange rates	4	-	4
Interest rate swaps	2	(11)	(9)
Inefficient swap component on hedging exchange rates	12	(6)	6
Options on STM	1	-	1
Option embedded in the exchangeable bond	10	(10)	-
	29	(27)	2

Income and expense on the option embedded in the exchangeable bond relate to the fluctuations of (i) the fair value of the option embedded in the exchangeable bond with STM shares as underlying and (ii) the fair value of the option purchased in 2005 with the same underlying position and same key parameters as that embedded in issued bonds: following this transaction, the Group is substantially neutral as regards changes in the fair value of the call option sold.

The ‘effects of the valuation using the equity method’ mainly relate to:

	31 Mar 2006	31 Mar 2005
Aero Invest 1 S.A. results	(2)	(11)
Net results of other holdings	(2)	2
	(4)	(9)

- ‘income tax expense’ was €mil. 55 from the same period of 2005 (€mil. 23).
  In particular, this is the algebraic sum of:

	31 Mar 2006	31 Mar 2005
Corporate income tax (IRES)	27	18
Regional business tax (IRAP)	26	22
Benefit under consolidated tax mechanism	(20)	(15)
Other income taxes	14	5
Tax related to previous periods	-	-
Provisions for tax disputes	1	3
Deferred tax (assets) liabilities - net	7	(10)
	55	23

With regard to the Group Parent, the consolidated income statement includes neither current taxes (as there was no taxable income during the period at issue) nor net deferred tax assets, as there is a lack of reasonable certainty as to the future realisation of taxable income that would allow them to be recognised and a lack, with specific regard to past tax losses, of the prerequisites established by the applicable accounting standard.

- ‘net result from discontinued operations’ was separately indicated in the income statements. Accordingly, the item includes the result for the period of the operations sold or being sold:
  - for the first three months of 2005, the result on the UK operations in the radar-devices segment through the sale date (29 April 2005);
  - for the first three months of 2006, the results of the operations being sold as held by the Group in the bus manufacturing industry.

	31 Mar 2006	31 Mar 2005
Revenue	28	72
Costs	28	73
Financial gains - net	-	1
Tax expense	-	
	-	-

The table below shows an analysis of consolidated balance sheet at 31 March 2006.

€mil.	31 Mar 2006	31 Dec 2005	31 Mar 2005
Non-current assets	7,785	7,671	5,842
Non-current liabilities	(2,044)	(2,018)	(1,925)
	5,741	5,653	3,917
Inventories	5,765	5,511	4,809
Contract work in progress	2,732	2,538	2,477
Trade receivables	3,528	3,600	3,483
Trade payables	(3,073)	(3,431)	(2,784)
Advances from customers	(4,425)	(4,389)	(2,935)
Provisions for short-term risks and charges	(541)	(523)	(536)
Other net current assets (liabilities)	(3,283)	(3,289)	(2,837)
Net working capital	703	17	1,677
Net capital employed	6,444	5,670	5,594
Group shareholders' equity	4,868	4,444	4,089
Shareholders' equity of minority interests	137	154	23
Shareholders' equity	5,005	4,598	4,112
Net debt (cash)	1,481	1,100	1,611
Net (assets) liabilities held for sale	(42)	(28)	(129)

'Non-current assets' (€mil. 7,785 at 31 March 2006 from €mil. 7,671 at 31 December 2005) show a net increase of €mil. 114:

	31 Mar 2006	**31 Dec 2005**
Intangible assets	3,689	3,596
Property, plant and equipment	2,512	2,506
Investment properties	3	2
Equity investments	132	138
Financial assets at fair value	914	906
Securities held to maturity	3	-
Receivables	133	122
Deferred tax assets	395	397
Other assets	4	4
	7,785	7,671

In particular:

- due to the increase in intangible assets and specifically in goodwill for the purchase of the additional share in Datamat S.p.A. (€mil. 52) following the PPO launched at the end of 2005 and ended in January 2006, and LFK GmbH (€mil. 63) for the joint venture MBDA;

- due to the valuation of the interest held indirectly in STM (6.6% at 31 March 2006) as 'financial assets held at fair value', which broke down as follows:

31 December 2005	906
Fair value adjustment at 31 March 2006	8
31 March 2006	914

  The increase due to fair value adjustment had a specific shareholders' equity reserve as a contra-item;

- due to investing activities, opening of loans and repayments, and depreciation and amortisation for the period;

- due to a net decrease stemming from the exchange rate differences due to the translation of financial statements in foreign currency (mainly US dollar and sterling pound).

'Non-current liabilities' (€mil. 2,044 at 31 March 2006 from €mil. 2,018 at 31 December 2005) show a net increase of €mil. 26.

	31 Mar 2006	**31 Dec 2005**
Severance pay and other employee liabilities	1,134	1,114
Provisions for risks and charges	434	423
Deferred tax assets	111	101
Other liabilities	365	380
	2,044	2,018

In particular:

- due to the net increase of ‘severance pay and other employee liabilities’ (€mil. 20) resulting from ‘defined benefit plans’ having been reviewed by the British companies AgustaWestland, Selex Sensors and Airborne System Ltd and Alcatel Alenia Space SAS;

- due to the net increase of €mil. 11 in ‘provisions for risks and charges’, in particular in provision for contractual risks and charges (€mil. 17) net of transfers from criminal provisions and product guarantees of €mil. 6;

- due to the net decrease of €mil. 15 of ‘other liabilities’, mainly due to deferred income and other sundry payables;

‘Net working capital’ shows a net value of €mil. 703 as compared with €mil. 17 at 31 December 2005. More specifically:

- ‘inventories’ of €mil. 5,765 from €mil. 5,511 in the prior year:

	31 Mar 2006	**31 Dec 2005**
Raw materials, supplies and consumables	1,327	1,297
Work in progress and semi-finished goods	3,669	3,527
Finished goods and merchandise	191	168
Advances to suppliers	578	519
	5,765	5,511

Work in progress includes assets defined according to Group practice as non-recurring costs (€mil. 2,805 at 31 March 2006), which are largely related to programmes in the aeronautics (€mil. 1,511) and helicopter (€mil. 799) segments. Inventories are shown net of impairment charges of €mil. 394 (€mil. 404 at 31 December 2005);

‘contract work in process’ amounted to €mil. 2,732 as compared with €mil. 2,538 at 31 December 2005); ‘advances from customers’ were €mil. 4,425 from €mil. 4,389 at 31 December 2005:

	31 Mar 2006	**31 Dec 2005**
Contract work in progress (gross)	5,921	5,728
Advances from customers	(3,189)	(3,190)
Contract work in progress (net)	2,732	2,538
Advances from customers (gross)	11,297	11,146
Contract work in progress	(6,872)	(6,757)
Advances from customers (net)	4,425	4,389

‘trade receivables and payables’ of €mil. 3,528 and €mil. 3,073 respectively as compared with €mil. 3,600 and €mil. 3,431 at 31 December 2005 relate to:

	31 Mar 06		**31 Dec 05**	
	Receivables	Payables	Receivables	Payables
Associates and subsidiaries not fully consolidated	207	27	206	27
Consortia	62	19	63	7
Other partners of joint ventures	62	25	63	27
Other third parties	3,197	3,002	3,268	3,370
	3,528	3,073	3,600	3,431

- ‘provisions for short-term risks and charges’ of €mil. 541 rose by €mil. 18 as compared with €mil. 523 at 31 December 2005. The greatest provisions were those for product guarantees and other provisions. Uses and releases were mostly done in connection with contractual risks and costs incurred for reorganisations commenced in previous years. This item rose due to the change in the scope of consolidation.

  With regard to the risk provisions, the Group’s operations regard industries and markets where many disputes are settled only after a considerable period of time, especially in cases where the customer is a government entity.

Based on the information currently available, it is believed that the various issues that could result in an outflow of resources, and which are not covered by a specific provision, can be resolved in a satisfactory manner without a significant impact on earnings.

Of course, in application of related accounting standards, provisions have been made for any obligations related to probable and quantifiable risks. The situations below do not fall under this category, but are mentioned here solely for the purposes of full disclosure.

Of particular note:

- the dispute in which Finmeccanica has been asked to cover the contractual commitments assumed upon the sale of the former subsidiary Finmilano S.p.A. to Banca di Roma (now Capitalia) originated from the assessment ordered by the Rome Office of Direct Taxes of Finmilano S.p.A. regarding the disallowance of the tax deductibility of the capital loss originating in 1987 on the sale of a non-recourse 'deferred' receivable at a price below the nominal value. In essence, the Italian tax authorities felt that this sale was actually a financing transaction and that the loss, in the same manner as a finance cost, should not have been deducted in its entirety in 1987, but should have been recognised over subsequent years as implicit interest in the transaction.

  After the Court of Cassation (the supreme court of appeal) - in allowing the appeal filed by the tax authorities - had returned the parties to the court of first instance, the latter once again upheld the company's complaint. This ruling was once again appealed to the Court of Cassation. It should be noted that substantial charges to be paid by Finmeccanica are not currently foreseeable. In agreement with the bank, it has been deemed that there is insufficient justification to accept the settlement of pending disputes pursuant to Article 16 of Law 289/2002, partly in light of the fact that the significant financial outlay that this would have required does not make sense from a cost-benefit point of view;

- the dispute resulting from the notice to settle the registry fee of about €mil. 10, which was received by Finmeccanica in July 2001 and due on the capital increase approved in 1998. Although the tax liability had already been recognized in the related financial year, the company felt it was unnecessary to meet the tax demand because it was unjustified both in law and in fact. In fact, in addition to being received after statutory deadline, the notice contained a request for a tax related to a tax base that was partially inconsistent with applicable laws. The Tax Commission for the Province of Rome upheld the company's dispute in its ruling filed in December 2002. The ruling was appealed by the company in relation to the failure to order the tax authorities to reimburse costs. In the first half of 2004, the tax authorities in turn filed a cross-appeal of the same ruling, but only with regard to the decision that confirmed the termination of the office's assessment power in the matter. No objection was raised, however, with regard to the substance of the original ruling establishing the partial lack of justification of the amount requested by the revenue office. In a ruling filed in October 2004, the appeal court rejected the company's primary appeal regarding the lack of reimbursement of costs, but at the same time declared that the cross appeal filed by the tax authorities was inadmissible in that it was filed after the ordinary statutory deadlines. In particular, the Regional Tax Commission in Rome upheld the complaint filed by the company regarding the fact that the tax authorities had erroneously deemed the suspension of the procedural deadlines defined by Article 16 of Law 289/02 (facilitated settlement of pending disputes) to be applicable, given that the case did not fall within the scope of this law. The sentence of the court of second instance has been appealed to the Court of Cassation by the tax authorities.

- The appeal, together with ENEL and other parties, filed with the Regional Administrative Court of Lombardy of the resolution of the Italian Electricity and Gas Authority regarding the method of calculating interest due on amounts to be paid, as compensation, in relation to the termination of the Italian national nuclear energy programme.

  The amount of interest that would result from a different calculation method amounts to roughly €mil. 13. Previous rulings by the Lombardy Regional

Administrative Court do not support the resolutions of the Authority. Accordingly, it is reasonable to expect a favourable outcome for Finmeccanica;

- on 6 July 2001, Finmeccanica and its subsidiary Alenia Spazio (now ALS S.p.A.) received notice of a summons to appear before the Texas Federal Court to respond to a request for damages resulting from the alleged violation of agreements as part of the Gorizont programme, which is related to the events of 1998-1999 when Alenia Spazio operated as a division of Finmeccanica (on 9 July 2001, Alenia Spazio alone received a second summons to appear before the court for the same issue).
  Based on an examination of the case files by U.S. lawyers, the company feels there are valid reasons to contest the substance of the demands of the plaintiffs; The pre-trial issue of the lack of jurisdiction of the Texan Court raised by Finmeccanica and ALS in both suits was given a favourable outcome after more than four years since its inception. The lack of jurisdiction of the Texan Court was finally found;

- arbitration is under way to settle a dispute between Consorzio Trevi - of which the subsidiary AnsaldoBreda S.p.A. is a member with a 40% stake - and Trenitalia S.p.A. in relation to the application of penalties for the late delivery of ETR 500 trains. Consorzio Trevi has contested the penalties and has requested reimbursement of the significant additional costs incurred. The arbitration board arranged for the issues involved in the arbitration to be examined by an independent expert. The expert’s report was filed on 10 January 2005 and is in favour of Consorzio Trevi. However, on 19 October 2005 the arbitration board arranged, upon request of Trenitalia, for a supplementation of the expert’s report; this was filed on 31 January 2006. The findings of this supplementation of report do not provide clear indications on the amount of Trenitalia’s delays; these indications had been clearly reported in the former report. For this reason, Consorzio Trevi has confirmed its own reservations concerning the lawfulness of the supplementation of report and demanded to file its own considerations on this matter. On 13 March 2006 the parties filed their final pleadings;

- on 1 October 2003, the European Commission notified the Ministry of Foreign Affairs of the formal proceedings initiated for an investigation of the Italian State, pursuant to Article 11 of the EC Treaty, in relation to subsidies granted by the Italian Government to the companies Alenia Aeronautica S.p.A., Aermacchi S.p.A., and Agusta S.p.A., based on Law 808/85, for six research and development projects. The Commission views the subsidies as State aid. The preliminary assessment of the Commission was that these subsidies were not notified to the Commission at the time, even though they were each in excess of the ECU 20 million threshold (1 ECU being equal to 1 euro). On 22 January 2004, the decision to open proceedings was published in the EU Official Journal.

  The Italian authorities submitted their own observations to the Commission on 30 January 2004.

  In response to requests of third parties, the Commission requested further information from the Italian Government, which was provided in the latter part of May 2004. Further exchanges of requests and information between the Commission and the Italian Government continued in the second half of the year. With its letter of 22 June 2005 C(2005)1813, received by the Permanent Representation of Italy in the EU on 24 June, the European Commission informed the Italian Government of its decision to extend the scope of the current proceedings to an additional six projects of the aforementioned companies that had initially been excluded by the Commission itself. The Italian Authorities submitted their reply to the Commission on 29 November 2005. On 19 December 2005 the Commission served on the Italian Government further considerations filed by a third anonymous party, and the Government replied accordingly on 24 February 2006. At the moment, this procedure deeply affects the application principles of Law no. 808/85; Finmeccanica will follow the issue with special attention with the assistance of local counsel. The Commission’s decision is expected.

‘other net current assets (liabilities)’ totalled €mil. 3,283 of net current liabilities, which are substantially unchanged from the prior year (€mil. 3,289 of net current liabilities at 31 December 2005):

	31 Mar 2006		31 Dec 2005	
	Assets	**Liabilities**	**Assets**	**Liabilities**

Employees	22	325	22	299
Prepaid expenses and deferred income	95	94	101	93
Direct taxes and others to the Tax Office	358	258	364	268
Social security	12	161	10	182
Min. of Prod. Act. Law 808/1985	-	2,780	-	2,767
Associates, consortia and subsidiaries not fully consolidated	10	10	10	8
Derivatives	60	80	59	121
Other	323	455	330	447
	880	4,163	896	4,185

The table below provides a detail of the asset and liability positions related to derivative instruments.

	31 Mar 06		**31 Dec 05**	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Forward forex instruments	35	32	25	69
Forex options	-	-	-	1
Interest rate swaps	-	24	-	18
Options on STM	1	-	1	-
Exchangeable bond option	24	24	33	33
	60	80	59	121

Forward forex instruments

The notional value of the forward transactions totalled €mil. 2,849 of which €mil. 1,974 is related to contracts to sell and €mil. 875 to contracts to buy, primarily US dollars.

The Group hedges its own contracts for purchases or sales denominated in a currency different from the functional currency using forward contracts of amounts, maturities, and key parameters that are similar to the underlying position. Under Group procedures, derivative instruments are purchased with the intent to hedge certain or highly probably commitments and, as such, are designated as hedging instruments at the time of purchase. The effectiveness of the hedge is tested at least at each interim or year-end reporting date using mathematical and statistical methods. In the event that, due to its nature or following such tests, a derivative instrument held should be found to no longer be an effective hedge, the fair value of the instrument is immediately recognised through profit or loss (income of €mil. 4 and expense amounting to nil at 31 March 2006). In the event the designation of the instrument as a hedge should continue to be supported by the tests of actual and future effectiveness, the cash-flow hedge accounting method of recognition is adopted.

Forex options

At 31 March 2006 forex options are held in the notional amount of €mil. 42, carried out by the Group Parent on behalf of its subsidiaries. The fair value of the instruments included in the portfolio is nil.

Interest rate swaps

At 31 March 2006, the Group held interest rate swaps totalling €mil. 730.A detail of the main instruments is as follows:

Description	Notional	Underlying position	
Fixed/floating /fixed swap	€mil. 500	Bonds - 2003	(a)
Fixed/floating /fixed swap	€mil. 100	Bonds - 2005	(b)
Floating/fixed swap	€mil. 130	Bonds - 2002	(c)
Interest rate options	€mil. 200	Bonds - 2005	(b)

(a) The transaction was carried out to benefit from low short-term interest rates without, however, exposing the Group to the risk of any subsequent increases. As such, the exposure was converted to a floating rate through 19 December 2005 and back to fixed (5.80% average) after that date.
In application of IAS 39, the transaction was measured at fair value through profit or loss, thereby generating a profit of €mil. 2. At 31 March 2006, the fair value of the instrument was a negative €mil 9.

(b) The transaction was carried out during the period in order to earn short-term benefits from low interest rates. The instruments purchased also include a number of interest rate options that enable the company to protect portion of the debt portfolio exposed to floating rates and to switch to floating for additional portions of the debt.

In application of IAS 39, the transaction was measured at fair value through profit or loss, thereby generating a loss of €mil. 9.The fair value of these instruments was negative at 31 March 2006 in the amount of €mil. 2.

(c) The transaction makes it possible to limit exposure to future changes in the reference interest rate (6-month Euribor) and has been recognised as a cash-flow hedge. At 31 March 2006, the fair value of the instrument was a negative €mil 9.1.

This item also includes other minor transactions with a total negative fair value of €mil. 5 and a floating/fixed interest rate swap carried out by the helicopter-related joint venture ATIL, the fair value of which was a negative €mil. 7 at 31 March 2006, and recognised as a cash-flow hedge.

The transactions recognised as cash-flow hedges have resulted in a negative reserve at 31 March 2006 in the amount of €mil. 8 (€mil. 11 at 31 December 2005), whereas those that have been recognised at fair value through profit or loss as a result of the particularly restrictive conditions defined by IAS 39 have produced financial charges totalling €mil. 2.

Options on STM

This item includes transactions to hedge a portion of the remaining portfolio of STM securities, which numbered 35,000,000 at 31 March 2006. These instruments have been measured at fair value through profit or loss with a positive €mil. 1.

Exchangeable bond options

These include the liability related to the call option embedded in the exchangeable bonds. In 2005, the Group purchased a call option with the same key parameters in order to hedge future changes in the value of the option sold. Positive changes on the option embedded in the bond are offset by the negative change of the call option purchased.

'Net capital employed' and 'net assets held for sale' of €mil. 6,444 (€mil. 5,670 at 31 December 2005) and €mil. 42 (€mil. 28 at 31 December 2005) respectively are covered by shareholders' equity (€mil. 5,005, €mil. 4,598 at 31 December 2005) and net debt (€mil. 1,481 as compared with €mil. 1,100 at 31 December 2005).

Below is consolidated net debt at 31 March 2006 as compared with that for 31 March 2005 and 31 December 2005.

	31 Mar 2006	31 Dec 2005	31 Mar 2005
Short-term financial payables	129	190	1,159
Medium/long-term financial payables	1,875	1,879	1,952
Cash and cash equivalents	(686)	(1,061)	(1,944)
BANK DEBT AND BONDS	1,318	1,008	1,167
Securities	(21)	(20)	(66)
Financial receivables from Group companies	(21)	(17)	(150)
Other financial receivables	(294)	(443)	(343)
FINANCIAL RECEIVABLES AND SECURITIES	(336)	(480)	(559)
Financial payables to Group companies	291	379	335
Other short-term financial payables	101	97	566
Other medium/long-term financial payables	107	96	102
OTHER FINANCIAL PAYABLES	499	572	1.003
NET DEBT (CASH)	1,481	1,100	1,611
Net debt (cash and cash equivalents) of discontinued operations	12	5	(60)

Net Group debt at 31 March 2006 was €mil. 1,481 as compared with net Group debt at 31 December 2005 of €mil. 1,100, and net Group debt of €mil. 1,611 in March 2005.
In particular, adjustments from the adoption of IAS 32 and 39 include the following effects:

- for the €mil. 500 Finmeccanica Finance S.A. bond issue, bearing a 0.37% coupon, due August 2010, exchangeable for STM shares, IAS 39 requires splitting the liabilities between the financial debt component and the assigned call option component. The debt component is measured by applying the market interest rate at the issue date in place of the nominal interest rate, while the option component, excluded from the financial position, is subject to periodic measurement at fair value. At 31 March 2006 this valuation method led to posting a debt €mil. 81 less than the face value of the bond; this differential will gradually come down as the maturity date draws near;

- inclusion in the financial position of liabilities in respect of the unpaid portion of part of trade receivables assigned without recourse to factoring companies in such a way as to make it prudent to recognise them as financial debt under IAS/IFRS. The residual amount was €mil. 28 as compared with €mil. 39 at 31 December 2005.

Consistent with the approach adopted in the presentation of the accounts for 2005, it was decided – in view of the fact that a significant part of these transactions are designed to hedge ‘underlying’ commercial positions – not to recognise as debt the balance entries resulting from fair value measurement of the derivatives on the date that the accounts were closed: at 31 March 2006 these contra-items showed a negative balance of €mil. 20.

Taking account of these adjustments, as well as the operational events described below, the Group’s net financial debt went from €mil. 1,100 at 31 December 2005 to €mil. 1,481 at 31 March 2006.

The figure for March worsened by €mil. 381 as compared with the figure for March and confirmed the traditional performance of cash inflows and outflows with high outflows in the first part of every year and, as illustrated in the Report on Operations 2005, includes advances of amounts collected by Group companies in the last days of December 2005 in connection with some contracts. This positively impacted the figure for the prior year. The figure for March was significantly impacted by the positive and negative effects of the following non-recurring operations:

- the payment in January for the PPO which was launched in 2005 to purchase the remaining share capital in Datamat and ended in the first days of January 2006 with an expenditure of €mil. 89. Adding this to the money paid in 2005 (€mil. 151) to purchase 52.7% of the share capital of the company, total expenditure came to €mil. 240 and total ownership percentage was 89% (including treasury shares directly owned by the company). On 1 March 2006 the Board of Directors of Finmeccanica resolved upon the implementation of the delisting procedure for the Datamat shares by launching a PPO on the remaining shares after the ownership percentage necessary for the transaction had been reached;

- the receipt, net of commissions, of €mil. 398 related to the sale on the market of 52.17% of the share capital of Ansaldo STS, Group parent for the transportation segment, in March by selling 52,174,000 shares at a price of €7.80 each. The company being listed did not cause it to be deconsolidated; net Group debt for March includes net debt for this company as well.

  In April some €mil 60 related to the year was received from the banks coordinating the PSO and the greenshoe option. This led to the sale of additional 7,826,000 shares amounting to 7.83% of the share capital. The total share capital sold was 60%.

As regards the composition of debt, with reference to bank debt in particular, bank debt and bonds declined from €mil. 2,069 (at 31 December 2005) to €mil. 2,004 (at 31 March 2006).

Cash and cash equivalents fell from €mil. 1,061 at 31 December 2005 to €mil. 686 at 31 March 2006. The reduction in cash is attributable to the coverage of the financial, strategic, operational, and refinancing requirements for the period, and also benefited from the receipt related to the listing of Ansaldo STS discussed above. Liquidity is partially held by the Parent Company and partially by the subsidiaries. Activities are under way to centralise the liquidity of the recently acquired foreign companies as part of the transfer of the Group's financial management operations to Finmeccanica.

As regards the composition of the remaining debt items, note that the item 'other financial receivables' includes about €mil. 261 in respect of the unconsolidated portion of financial receivables that the joint ventures MBDA and Alcatel Alenia Space hold vis-à-vis the other partners in the implementation of the treasury agreements entered into previously. In accordance with the consolidation method used, these receivables, like all the other items, are included in the Group's scope of consolidation on a proportional basis. The item 'financial payables to Group companies' includes the debt of approx €mil. 263 of Group companies toward the joint ventures, for the unconsolidated portion.

	For the 3 months ended 31 March			
	2006		2005	
Cash and cash equivalents at 1 January	1,061		2,055	
Gross cash flow from operating activities	225		164	
Changes in working capital	(706)		(602)	
Changes in other operating assets and liabilities	(114)		(160)	
Cash flow generated from (used in) operating activities	(595)		(598)	
Cash flow from ordinary investing activities	(81)		(60)	
Free operating cash-flow		**(676)**		**(658)**
Strategic investments	302		-	
Changes in other financial assets	124		75	
Cash flow generated from (used in) investing activities	345		15	
Share capital increases	15		-	
Cash flow from financing activities	(138)		468	
Cash flow generated from (used in) financing activities	(123)		468	
Translation differences	(2)		4	
Cash and cash equivalents at 31 March	686		1,944	

The first three months of 2006 closed with a net decrease in cash flow generation of €mil. 375. This can be attributed to the following factors:

- cash flow from operations was a negative €mil. 595, in line with the year-earlier period (which registered a negative cash flow of €mil. 598). This was the result of seasonal factors in receipts for the business segments, which are usually concentrated in the last months of the year. This negative cash-flow was attributable to the Aeronautics, Defence Electronics and Defence Systems, and was only partially offset by the significant cash-flow generation attributable to the operations of the Ansaldo STS Group and the Energy segment.

A breakdown of gross cash flow from operations is provided below:

	31 Mar 2006	31 Mar 2005
Net profit	383	7
Depreciation, amortisation and impairment	88	83
Tax expense	55	23
Accrued (transferred) to funds	8	(22)
Cost of staff severance pay, defined-benefit plans and stock grants	47	27
Effects of the measurement of equity investments on the equity method	4	9
Gains from the sale of non-current assets	(18)	-
Gain on PSO of Ansaldo STS	(364)	-
Financial charges, net of the gain from Ansaldo STS PSO	22	37
	225	164

- cash-flow from investing activities was a positive €mil. 345 (€mil. 15 at 31 March 2005) and include €mil. 398 of receipt for the Ansaldo STS interest sold through a PSO in March and the effects of the acquisition through a PPO (€mil. 89) of an additional interest in Datamat S.p.A. of some 33%, and further acquisitions of €mil. 7;

- cash-flow from financing activities was a negative €mil. 123 (was a positive €mil. 468 at 31 March 2005), mainly due to change in financial payables (€mil. 138) which was partially offset by share capital and reserve increases resulting from the exercise of part of the stock option rights assigned as part of the 2002 - 2004 plan (€mil. 15). Cash-flow from financing activities in the year-earlier period included €mil. 494 of net receipts from the placement of the bond issued by Finmeccanica S.p.A. in March 2005 and amounting to a nominal €mil. 500.

VII Financial risk management

Within the scope of the policies of the Group Parent aimed at centralising the financial management of the Group, this section describes the operating criteria adopted to manage foreign exchange risk, interest rate risk and equity risk.

Finmeccanica's adoption of the International Financial Reporting Standards (IFRS) has led to substantial differences in the management of and exposure to derivatives.
Some of the main changes from the previous Italian accounting standards include the adoption of the fair value method of measuring the total portfolio of derivative instruments. Whereas in the past derivative transactions intended to hedge specific underlying positions were not valued at market prices, but merely reported in memorandum accounts, the new standards call for their measurement at fair value with entries on the balance sheet or income statement depending on whether a given derivative is classified as being for hedging or trading purposes.

Exchange rate risk management is governed by the directive issued by Finmeccanica in December 2002. The goal of the directive remains that of creating uniformity in management criteria based on industrial - not speculative - strategies so as to contain risks within specific limits by carefully and constantly assessing all foreign currency positions. The methodology adopted calls for the systematic hedging of commercial cash flows resulting from the assumption of contractual commitments of a specific nature as either buyer or seller, thereby ensuring current exchange rates at the date of acquisition of multi-year contracts and neutralising the effects of exchange rate fluctuations. Therefore, at the moment of receiving payment from a customer (or making payment to a vendor), which takes place at the current exchange rate on that day, the related hedging transactions are extinguished in order to offset the effects of the difference between the current exchange rate and the rate of the hedging instrument. These transactions are carried out almost exclusively with banks by Finmeccanica's Group Finance Department and then matched with the companies of the Group. The companies that have the greatest need for such hedging transactions are: Alenia

Aeronautica and its subsidiaries, Ansaldo Energia, Oto Melara, Alcatel Alenia Space Italia, Galileo Avionica, Ansaldobreda, AgustaWestland and its subsidiaries, and Selex Communications and its subsidiaries. At 31 March 2006, Finmeccanica had outstanding foreign exchange transactions with highly rated financial counterparties in the interest of other Group companies totalling €mil. 2,891 (a slight decrease of about 7% over 31 December 2005), €mil. 2,849 of which for swaps and forwards and €mil. 42 for foreign exchange options.

The IFRSs and the related interpretations effectively make a distinction between derivatives considered to be held for hedging purposes, and for which it is possible to apply hedge accounting, and those that are not eligible for hedge accounting and which must be recognised at fair value through profit or loss.

As a result, the Finmeccanica Group recognises the fair value of foreign exchange derivatives as follows:

- forward instruments, the net fair value of which totalled a positive €mil. 1 at 31 March 2006;
- options not eligible for hedge accounting, the fair value of which amounted to nil.

The change in the fair value of forward instruments is due to the change in the exchange rate with the US dollar, which came to 1.2104 at 31 March 2006 from 1.1797 at 31 December 2005.

With regard to commercial contracts that under previous GAAP were considered to be hedged by options, the fair value is calculated for the portion of commercial activities already invoiced and for work in progress. The portion of the commercial portfolio subject to fair value measurement will always be nominally less than that of the derivatives, which are used to hedge risk throughout the entire life of the contracts. The same concept also applies to the portion of the commercial portfolio hedged with foreign exchange transactions that qualify for hedge accounting, with the difference being that the volatility experienced will be reflected in equity.

In any event, the Finmeccanica Group does not have financial transactions of a speculative nature, in the sense that none of its transactions add risk to that which is already implicit in its operations. On the contrary, in compliance with the Group directive, all existing financial transactions have the specific objective of eliminating or minimising such risks. In order to put hedging transactions in line with the IAS/IFRS requirements, Group Companies closed any transactions that were considered as non-IAS-compliant and replaced them with more ‘conventional’ forward instruments.

The management of interest rate risk is consistent with the long-standing practice of reducing the risk of fluctuations in interest rates while seeking to minimise related financial charges. To that end, at 31 March 2006 Finmeccanica had interest rate swaps for medium and long-term financing with highly rated financial counterparties totalling €mil. 730. These transactions are focused on benefiting from the low level of short-term floating interest rates while protecting the company against any increases that have been taking place since the end of 2005 and made the debt structure return to fixed rates. At 31 March 2006, the total fair value of the interest rate derivatives portfolio was a negative €mil. 24, as compared with the negative €mil. 18 at 31 December 2005:

- at 31 March 2006, transactions eligible for hedge accounting had a negative fair value of €mil. 7, compared with the negative €mil. 11 at 31 December 2005, an improvement of €mil. 4 during the period;
- at the same date, transactions not eligible for hedge accounting had a negative fair value of €mil. 17, compared with the negative €mil. 8 at 31 December 2005, a deterioration of €mil. 9 during the period.

The restrictive IFRSs and the related interpretations make it necessary to consider certain transactions as speculative even when they are essentially intended to contain finance costs without exposing the Group to excessive risk in the event of rising interest rates.

The management of price risk on equity concerns the management of the indirect investment held in STMicroelectronics NV (STM). At the date of the adoption of IAS 32 and 39 (1 January 2005), the Group had outstanding hedges for a total of 35 million STM shares in order to protect a portion of the remaining portfolio of STM stock immediately available to Finmeccanica (totalling 39.7 million shares, in addition to the further 20 million shares backing the bond that can be converted into STM shares in the amount of €mil. 501 with a maturity of 2010: these additional shares are therefore unavailable to the Group). At 31 March 2006 the outstanding options on 35 million

STM shares have been classified as trading securities, and the recognition of the changes in fair value through profit or loss of these instruments led to a gain for the period of €mil. 1.

In June 2005, a call option was purchased for STM stock for €mil. 17, which duplicates and neutralizes the option sold with the convertible STM bond with maturity date 2010. The purpose of the transaction was to sterilize the effects of the separation, under IFRS, of the debt component from the option, thereby allowing Finmeccanica to recognise consolidated revenue of roughly €mil. 21 for the year 2005, which is the difference between the value of the option sold in the exchangeable bond at 1 January 2005 and the purchase price of the new option. Finmeccanica also finalised negotiations that make it possible to free up the 20 million STM shares used to guarantee the bond and replace them with the option purchased, thereby making these shares available to the Group.

VIII Transactions with related parties

In general, commercial relations with related parties are carried out at arm's length, as is settlement of the interest-bearing receivables and payables when not governed by specific contractual conditions. Below are the amounts:

(millions of euros) ***RECEIVABLES AT 31 MAR 2006***	**Non-current receivables**	**Current financial receivables**	**Trade receivables**	**Other current receivables**	**Total**
Subsidiaries					
Alifana Due S.c.r.l.			10		10
CLC S.r.l. (in liq.)				3	3
Ansaldo Invest Denmark A/S (in liq.)				3	3
Finmeccanica UK Ltd		3			3
Gieinter A.G.		2			2
IGS S.p.A. (in liq.)		2			2
Ansaldo Argentina S.A.			1		1
Finmeccanica Inc.		1			1
Ansaldo do Brasil Equip. Electrom. Ltda				1	1
Lumiq S.p.A.		1			1
Oto Melara North America Inc.		1			1
Associates					
Eurofighter Jagdflugzeug GmbH			83		83
Iveco Fiat/Oto Melara S.c.r.l.			31		31
Eurosysnav S.A.S.			29		29
Bell/Agusta Aer. Co. LLC			15		15
Macchi Hurel Dubois S.A.S.			10		10
Eurofighter Simulation Systems GmbH			6		6
Euromids S.A.S.			4		4
NH Industries S.a.r.l.			3		3
Sostar GMBH			3		3
Nicco Communications S.A.S.			2		2
Comlenia SDN BHD			2		2
Iniziative Industriali Milano S.r.l. (in liq.)				2	2
I.M. Intermetro S.p.A.			2		2
Ansaldo Trasmissione & Distribuzione S.p.A.			1		1
Remington Elsag Law Enforcement Sys. LLC			1		1
Advanced Air Traffic Systems SDN BHD			1		1
Ind. Aer. Meccaniche Piaggio S.p.A. (Am. Str.)			1		1
Orizzonte - Sistemi Navali S.p.A.				1	1
Consorzio Start S.p.A.			1		1
Elettronica S.p.A.			1		1
J.V. (*)					
GIE ATR				48	48
MBDA S.A.S.		1	41		42
Alcatel Alenia Space S.A.S.			18		18
Aviation Training Int. Ltd	12	1			13
Telespazio S.p.A.			2	1	3

(*) Amounts refer to the portion not eliminated for consolidation

(millions of euros) ***PAYABLES AT 31 MAR 2006***	**Non-current payables**	**Current borrowings**	**Trade payables**	**Other current payables**	**Total**
Subsidiaries					
Alifana Due S.c.r.l.			5		5
CLC S.r.l. (in liq.)		2			2
Selex composite S.p.A.				2	2
Oto Melara North America Inc.			1		1
Selex Sensor Airborne Syst. El (Overseas) Ltd			1		1
Finmeccanica UK Ltd			1		1
Quadrics Ltd			1		1
Associates					
Eurofighter Jagdflugzeug GmbH			11		11
Iveco Fiat/Oto Melara S.c.r.l.				7	7
Pegaso S.c.r.l.			3		3
Macchi Hurel Dubois S.A.S.			2		2
Orizzonte Sistemi Navali S.p.A.				1	1
Other companies with unit amount lower than €Mil. 1			2		2
J.V. (*)					
MBDA S.A.S.		263	13		276
Telespazio S.p.A.		20	1	1	22
Alcatel Alenia Space S.A.S.			7		7
GIE ATR			5		5

(millions of euros) ***RECEIVABLES AT 31 DEC 2005***	**Non-current receivables**	**Current financial receivables**	**Trade receivables**	**Other current receivables**	**Total**
Subsidiaries					
Alifana Due S.c.r.l.			6		6
CLC S.r.l (in liq.)				3	3
Finmeccanica UK Ltd		3			3
Ansaldo Invest Denmark A/S				3	3
Ansaldo Argentina S.A.			1	1	2
IGS S.p.A. (in liq.)		2			2
GIEINTER A.G.		1			1
Finmeccanica Inc.		1			1
Ansaldo Do Brasil				1	1
Other companies with unit amount lower than €Mil. 1		2	2		4
Associates					
Eurofighter Jagdflugzeug GmbH			89		89
Bell Agusta Aer. Co			32		32
Iveco Fiat/Oto Melara S.c.r.l.			32		32
Macchi Hurel Dubois S.A.S.			17		17
Eurofighter Simulation System GmbH			4		4
Euromids S.A.S.			3		3
Eurosysnav S.A.S.			3		3
Sostar GMBH			3		3
Iniziative Industriali Milano S.r.l. (in liq.)				2	2
Nicco Communications S.A.S.			2		2
Comlenia Sendirian Berhad			2		2
Intermetro S.p.A.			2		2
Remington Elsag Law Enforcement Systems Llc			1		1
Advanced Air Traffic Systems SDN BHD			1		1
Other companies with unit amount lower than €Mil. 1			5		5
J.V. / G.I.E (*).					
MBDA S.A.S. (Group)		1	41		42
GIE ATR				34	34
Alcatel Alenia Space S.A.S.			19		19
Aviation Training Int. Ltd	12	1			13
Telespazio S.p.A.			3		3

(*) Amounts refer to the portion not eliminated for consolidation

(millions of euros) ***PAYABLES AT 31 DEC 2005***	**Non-current payables**	**Current borrowings**	**Trade payables**	**Other current payables**	**Total**
Subsidiaries					
Alifana Due S.c.r.l.			3		3
CLC S.r.l (in liq.)		2			2
Selex Sensors and Airborne Systems Infrared Ltd			1		1
Finmeccanica UK Ltd			1		1
Selex Sensors and Airborne Systems Electro Optics (overseas) Ltd			1		1
Oto Melara North America Inc			1		1
Finmeccanica Inc.			1		1
Other companies with unit amount lower than €Mil. 1			2		2
Associates					
Eurofighter Jagdflugzeug GmbH			11		11
Iveco Fiat/Oto Melara S.c.r.l.				7	7
Pegaso S.c.r.l.			4		4
Other companies with unit amount lower than €Mil. 1		1	2		3
J.V. / G.I.E.(*)					
MBDA S.A.S. (Group)		349	16		365
Telespazio S.p.A.		19		1	20
Alcatel Alenia Space S.A.S.			6		6
GIE ATR			5		5

(*) Amounts refer to the portion not eliminated for consolidation

(millions of euros) 31 Mar 2006	**Revenue**	**Financial income**	**Purchases and costs**	**Financial expense**
Subsidiaries				
Finmeccanica UK Ltd			1	
Associates				
Eurofighter Jagdflugzeug GmbH	66			
Eurosysnav S.A.S.	19			
Eurofighter Simulation Systems GmbH	9			
Iveco Fiat/Oto Melara S.c.r.l.	6			1
Euromids S.A.S.	4			
NH Industries S.A.R.L.	3			
Nicco Communications S.A.S.	1			
J. V. (*)				
MBDA S.A.S.	13			2
GIE ATR	11			
Telespazio S.p.A. (+)			1	
Alcatel Alenia Space S.A.S. (+)	3			

(*) Amounts refer to the portion not eliminated for consolidation

(+) Starting from 1 July 2005

(millions of euros) 31 Mar 2005	**Revenue**	**Financial income**	**Purchases and costs**	**Financial expense**
Subsidiaries				
Associates				
Eurofighter Jagdflugzeug GmbH	81			
Iveco Fiat/Oto Melara S.c.r.l.	10			1
Eurofighter Simulation System GmbH	7			
Euromids S.A.S.	5			
Eurosysnav S.A.S.	2			
Nicco Communications S.A.S.	2			
Orizzonte Sistemi Navali S.p.A.	1			
Lockheed Martin Alenia Tactical Transport Systems LLC	1			
J. V. (*)				
GIE ATR	5			
MBDA S.A.S.	3			2
Alenia Marconi Systems S.p.A.	3			
AMS LTD				1

(*) Amounts refer to the portion not eliminated for consolidation

Company's performance in business sectors

HELICOPTERS

€millions	31 Mar 2006 100%	31 Mar 2005 100%	31 Dec 2005 100%
New orders	1,836	1,274	3,712
Order backlog	8,536	6,449	7,397
Value of production	603	548	2,490
Operating profit (loss) (EBIT)	44	41	272
R.O.S.	7.3%	7.5%	10.9%
Working Capital	426	314	309
Net capital employed	2,131	2,003	2,023
R.O.I. (*)	8.3%	8.2%	13.4%
Research and Development	97	51	436
Employees (no.)	8,599	8,951	8,531

(*) Calculated on net capital employed at period-end

Finmeccanica is, together with AgustaWestland NV and its subsidiaries, the leader in the extremely restricted circle of systems designers in the world helicopter industry with EADS (Eurocopter) and United Technologies (Sikorsky).

Total **new orders** acquired by AgustaWestland, which in the first quarter of 2006 stands at €mil. 1,836, strongly grew (+44%) as compared with the same period of the previous year (€mil. 1,274). Among the commercial events that marked the period are, in the military sector, these orders acquired with the UK Ministry of Defence:

- the MCSP (merlin capability sustainment plus) contract, which is worth some €mil. 550 and relates to the upgrade of 30 helicopters and an option for 8 additional EH 101 Merlin Mk1s in service with the Royal Navy;

- the IMOS (integrated merlin operational support) contract, which is worth €mil. 640 for the first 5 years out of 25, and which relates to the conversion of the modus operandi for the supply of logistic support to the EH 101 fleet in service with the Royal Air Force and the Royal Navy.

Thanks to a complete range of modern and competitive products, AgustaWestland proved it is capable of addressing increasingly broad market segments. To that regard, these are worth noting:

- the order of a further 33 AW139 helicopters, including the supply of 12 helicopters to Mitsui (Japanese civil operator) and 8 units to Hawker Pacific (UAE government agency). The order backlog for the AW139 continues to grow, with over 130 machines ordered to date;

- the order of a further 14 A 109 'Grand' helicopters, the new light twin-engine helicopter; the company has scored some major successes for this helicopter, as demonstrated by the steady increase in the order backlog for this product, which now stands at 53 machines.

Due to the high volume of new orders acquired during the first quarter of 2006, the **order backlog** at 31 March 2006, equal to €mil. 8,536, jumped by about 15% compared with 31 December 2005 (€mil. 7,397). The order backlog at 31 March 2006 breaks down into 65% for helicopters, 30% for support activities and 5% for engineering activities and other.

The **value of production** at 31 March 2006 stood at €mil. 603, up 10% compared with 31 March 2005 (€mil. 548). This increase is mainly due to the production activities commenced on the US 101, dubbed VH 71, for the US President and to the growth in the production rate on the AW139.
AgustaWestland output also focused on the following main programmes:

- the EH101 for the Italian Navy, continuing activities for the second lot; two further units were delivered to the Danish government in the first three months of the year; the supply to the Portuguese government is expected to be completed by the end of the year and activities continued for the supply of EH101s to the Japanese Navy;

- the Super Lynx 300 helicopter, with work on contracts with the Air Forces of Oman, South Africa and the Thai navy;

- the A109 Power helicopter for the civil/government market, of which 4 units have been delivered;

- A109 “GRAND” helicopter, with a second delivery being made after the first one, which was made during the Le Bourget air show;

- A129 helicopter in the CBT (Combat) configuration and the upgrade in this configuration of the A129 Mangusta, currently in service with the Italian Army;

- AB412 helicopter for Italian and foreign government agencies, of which one unit was delivered in the period;

- manufacturing of the A109E Power variant for contracts with the Swedish Armed Forces and the South African Air Force. Seven additional units have been delivered;

- NH90 helicopter manufacturing activities;

- logistics and support service activities for existing civil/government and military fleets.

EBIT at 31 March 2006 amounted to €mil. 44, an increase of 7% compared with the same period of the previous year (€mil. 41). This improvement can be attributed in part to the higher volumes above, and in part to the effect of efficiency drives implemented during the previous year as part of the integration process of Italian and British activities. The **ROS** reached 7.3% in line with that for 31 March 2005 (7.5%).

Capital employed at 31 March 2006 came to €mil. 2,131, up €mil. 108 compared with 31 December 2005 (€mil. 2,023). This can be ascribed to an increase in non-current assets due to growth in production volumes as noted above; the increase is also reflected in **working capital**, which came to €mil. 426 at 31 March 2006 compared with €mil. 309 at 31 December 2005.

Research and development costs at 31 March 2006, amounting to €mil. 97 (€mil. 51 at 31 March 2005), concentrated on: research as part of programmes financed through Law 808/85, which include the development of technologies, mainly for military purposes, for a new helicopter of the 6/7-ton class named the A149 and development of multi-role versions of the BA 609 convertiplane for national security purposes.

AgustaWestland had 8,599 **employees** at 31 March 2006, up 68 compared with 31 December 2005 (8,531). The increase was necessary to address technical/production requirements associated with an increase in the business volume.

DEFENCE ELECTRONICS

€millions	31 Mar 2006	31 Mar 2005	31 Dec 2005
New orders	629	627	4,627
Order backlog	7,530	3,303	6,946
Value of production	778	445	3,324
EBIT	42	21	269
R.O.S.	5.4%	4.7%	8.1%
Working Capital	998	1.144	802
Net capital employed	2,378	1,283	2,154
R.O.I. (*)	7.1%	6.5%	12.5%
Research and Development	117	76	501
Employees (no.)	19,660	12,369	19,786

(*) Calculated on net capital employed at period-end

As already detailed above, the agreement signed with BAE Systems Plc (BAE) at the end of April 2005 deeply changed the structure of Finmeccanica's Defence Electronics division. This agreement entailed:

- the formation of a new company, Selex Sensors and Airborne Systems S.p.A., 75% owned by Finmeccanica and 25% owned by BAE, grouping together the activities of Galileo Avionica S.p.A. and Selex Sensors and Airborne Systems Ltd;
- the transfer by BAE Systems to Finmeccanica S.p.A. of its military and secure communications business, which were absorbed by Selex Communications S.p.A.;
- the termination of the AMS joint venture and the return of the Italian business, now Selex Sistemi Integrati S.p.A., under full control of Finmeccanica.

From the fourth quarter of 2005, the Defence Electronics division also includes Datamat, a group involved in the design and creation of information and communication technology solutions, particularly in the defence, space and government markets. In January 2006 Finmeccanica S.p.A. acquired a further 26.3% in the share capital of Datamat S.p.A., of which to date it holds 89.48%.

The different times when these transactions took place, the varying contributions to consolidated results of these new enterprises and a lack of data regarding the prior period performance of the incoming entities means that it has not always been possible to provide a like-for-like comparison of the figures, particularly earnings figures.

The division includes activities concerning the manufacture of avionics equipment and systems, unmanned aircraft, radar systems, land and naval command and control systems, air traffic control systems, integrated communications systems and networks for land, naval, satellite and avionic applications; private mobile radio communications systems and IT and security activities. This division also included the International Naval Systems division of Finmeccanica.

New orders at 31 March 2006 amounted to €mil. 629. The main acquisitions included:

- avionics: further orders relating to the EFA programme, in particular the production of the DASS (Defensive Aids Sub System) system for the aircraft intended for Austria, avionic systems for the F18 and activities related to the Capability Sustainment Plus programme for the Merlin helicopter;
- land and naval command and control systems: acquisition of a further order for activities on the new Italian and French (FREMM) multi-role frigates and of an order for activities related to the air traffic control system sector in Malaysia;
- integrated communications systems and networks: orders for the supply of identification systems (NGIFF) for the domestic market and of MIDS (Multifunction Information Distribution System) terminals as part of the activities of the consortium whose members are Italy and Germany, United Kingdom and Spain, in addition to orders related to the Personal Role Radio abroad;

- information technology/security activities: acquisition of one order for postal automation in Greece.

The **order backlog**, less work in progress, at 31 March 2006 reached €mil. 7,530, up €mil. 584 compared with 31 December 2005.

Value of production at 31 March 2006, equal to €mil. 778, rose by 75% compared with the same period of the previous year (€mil. 333). The increase is mainly due to the acquisition of British avionics activities and the acquisition of Datamat, as well as growth in command and control system activities. Specifically, revenues included:

- avionics: the continuation of activities relating to the production of the DASS system and avionics equipment and radars for the first and second tranche of the EFA programmes, Grifo combat radars and PAR systems, and logistics;
- radar and command and control systems: the continuation of activities relating to contracts with the Italian Navy for naval systems, especially on the Nuova Unità Maggiore vessel, FSAF and Orizzonte international cooperation contracts, Austria and Nato FADR D-band land-based radars, and air traffic control programmes in Italy, in addition to the 'India' programme;
- integrated communications systems and networks: activities relating to the development and manufacture of equipment for the NH90 and EFA (V/UHF, MIDS interface, Interrogator, Transponder) and the development of the Tetra network;
- IT: activities relating to Security, Automation, Information Technology and Defence Systems and Services.

EBIT reached €mil. 42 at 31 March 2006, up €mil. 21 compared with the first quarter of 2005. This growth results from the change in the scope of consolidation and the improvement of earnings on activities for command and control systems, which in March 2005 were penalised by additional costs for orders for the supply of land-based radars and for activities in the information technology/security activities; the increase is also due to the gain from the sale of a property owned by Selex Communications.

The **ROS** showed the effects of initiatives aimed at increasing efficiency and containing costs, and rose up to 5.4% at 31 March 2006 from 4.7% in March 2005, in spite of the consolidation of the British avionics activities, which showed lower profitability than the division average. This overall cyclical effect will be recovered over the coming financial years by achieving important synergies from projects for the integration and rationalisation of the avionics area.

Net capital employed amounted to €mil. 2,378 at 31 March 2006, up €mil. 224 from 31 December 2005 (€mil. 2,154). This is mainly due to the **working capital**, as in the first part of the year payments to suppliers are greater than commercial receipts (up €mil. 196 from the end of 2005). The increase in fixed assets includes €mil. 52 of goodwill arising from the purchase of an additional interest in Datamat.

Research and development costs at 31 March 2006 amounted to €mil. 117 from €mil. 76 at 31 March 2005. They mainly relate to the continuation of the development in the EFA programme, the finetuning of the UAV FALCO system, developments in naval and land command and control systems, the completion of the development of radar systems for air traffic control and the completion of the TETRA technological network.

Employees at 31 March 2006 were 19,660, down 126 from 31 December 2005, essentially due to the information technology/security segment, as Elsag STI S.p.A. and Elsag Business Process S.r.l. were sold and could no longer be included in the scope of consolidation.

AERONAUTICS

€millions	31 Mar 2006	31 Mar 2005	31 Dec 2005
New orders	431	333	3,230
Order backlog	6,935	5,374	6,865
Value of production	463	402	2,046
EBIT	15	10	166
R.O.S.	3.2%	2.5%	8.1%
Working Capital	(417)	(177)	(764)
Net capital employed	154	278	(227)
R.O.I. (*)	39.0%	14.4%	n.s.
Research and Development	103	88	405
Employees (no.)	11,364	10,805	11,198

(*) Calculated on net capital employed at period-end

The Aeronautics division includes Alenia Aeronautica (production of military aircraft for combat, transport and special missions, as well as civil applications such as aerostructures and regional turboprop aircraft) and its subsidiaries, including Aermacchi (production of military training aircraft and engine nacelles for civil aeronautics), Officine Aeronavali Venezia (aircraft conversions and maintenance) and the GIE-ATR consortium, in which a 50% equity stake is held (marketing and assembly of ATR aircraft).

In the first quarter of 2006 principal activities in the military division were as follows:

- Alenia Aeronautica: EFA development, production and logistics; production of the C27J aircraft, upgrades to Tornado aircraft (retrofit Pre-Mid Life Upgrade) and the modernisation of avionics (ACOL) of the AMX for the Italian Air Force;
- Aermacchi: the production and logistical support for the MB339 and SF260 training aircraft and further development of the new M346 training aircraft;

- Officine Aeronavali Venezia: development and production for the B767 Tanker programme in addition to overhaul and logistical support for the Atlantic, B707 and G222 aircraft.

The civil activities of Alenia Aeronautica mainly involved the following:

- Boeing: production of components for fuselages and control surfaces for the B767 and B777 aircraft;
- Airbus: the design of components for the central section of the fuselage of the A380, of the tail cone for the A300, of mechanical wing components for the A340 and of a fuselage section for the A321;
- GIE ATR; in partnership with EADS-ATR, for the production of the ATR 42 and 72 turboprops;
- Dassault Aviation: for the fuselage section of the Falcon 2000 Extended Range and the engine nacelles for the Falcon 900EX.

Key activities for Officine Aeronavali Venezia included the transformation of passenger aircraft for cargo transport and the production of engine nacelles for Aermacchi.

During the period, negotiations with the Russian Sukhoi continued for the involvement of Alenia Aeronautica in the development and sale of a new family of jet-powered civil aircraft for regional transport. Some joint activities for technical collaboration in the programme have started.

New orders at 31 March 2006 amounted to €mil. 431, up €mil 98 from €mil. 333 in the first quarter of 2005 due to greater orders acquired by Alenia Aeronautica. The main orders acquired in the military segment during the first quarter of 2006 include: orders relating to AMX logistics, JSF, EFA and Tornado programmes. The orders acquired in the civil segment include: orders for GIE-ATR, which posted sales of 18 aircraft, of which 15 from the Indian Kingfisher, B777, A380, Falcon and engine nacelles.

The **order backlog** at the end of March 2006 amounted to €mil. 6,935 as follows: EFA programmes (53%), B787 (17%), C27J (5%) AMX (5%). The order backlog rose by €mil. 70 compared with the end of 2005 (€mil. 6,865), and is expected to continue expanding over the medium/long term.

The **value of production** for the first quarter of 2006, totalling €mil. 463, rose by €mil. 61 (+15%) compared with the first quarter of 2005 (€mil. 402). The rise is due to civil activities, with increased sales and activities for the ATR programmes, and military activities related to the C27J programmes for aircraft ordered by the Italian Air Force and Greece, as well as to the expanded contribution of the EFA and the AMX.

EBIT at 31 March 2006 amounted to €mil. 15, up €mil. 5 compared with €mil. 10 for the first quarter of the prior year. The improvement both in absolute terms and in average profitability (ROS of 3.2% compared with 2.5% at 31 March 2005) is essentially due to the above-said increase in business volumes.

Working capital at 31 March 2006 was a negative €mil. 417, worsening by €mil. 347 compared with 31 December 2005 (negative €mil. 764). The increase, quite natural in the first part of the year, is mainly due to an increase in net inventories resulting from invoicing postponements, greater advances to suppliers and a slow-down in receipts from advances. Non-recurring work in progress for development activities made during the period relating to programmes under development rose compared with 31 December 2005.

Net capital employed at 31 March 2006 amounted to €mil. 154, an increase of €mil. 381 compared with a negative €mil. 227 at 31 December 2005. This rise was due to the performance of working capital, as noted above, and the increase in fixed assets for larger investments.

Research and development costs at the end of the first quarter of 2006 came to €mil. 103, up from €mil. 88 of the same period of 2005. This result reflects greater commitment to activities of ongoing development programmes, such as B787, C27J, M346, the second tranche of the EFA activities, Tornado, AMX, UAV (Unmanned Air Vehicles), A380, engine nacelles and B767 Tankers. Technical research and development also continued along two main strands, namely aerostructures and systems integration.

The number of **employees** at 31 March 2006 was 11,364, an increase of 166 compared with the 11,198 people employed at 31 December 2005. This increase was caused essentially by recruitment made by Alenia Aeronautica associated with higher workloads, particularly for engineering and new programmes.

SPACE

€millions	31 Mar 2006	31 Mar 2005	31 Dec 2005
New orders	218	110	599
Order backlog	1,237	1,385	1,154
Value of production	140	170	736
EBIT	9	12	26
R.O.S.	6.4%	7.1%	3.5%
Working Capital	20	165	(18)
Net capital employed	342	254	309
R.O.I. (*)	10.5%	18.9%	8.4%
Research and Development	9	20	79
Employees (no.)	3,214	3,223	3,194

(*) Calculated on net capital employed at period-end

Note that the information at 31 March 2005 includes information of Alenia Spazio and Telespazio, 100% consolidated, and information at 31 March 2006 relates to the new joint ventures (Alcatel Alenia Space S.A.S. and Telespazio Holding S.r.l), consolidated using the proportional method at 33% and 67% respectively. Therefore, the information for the current financial period cannot be compared with that of the previous period.

From a commercial perspective, in the first quarter of 2006 the group acquired **new orders** of €mil. 218, an increase of €mil. 108 from the year-earlier period (€mil. 110), mostly due to greater orders relating to commercial satellites. The most important orders during the period were: orders relating to the Turksat 3A and Ciel 2 telecommunications satellites; the further tranches of satellites for the scientific programme Herschel/Plank and the satellite navigation programmes Galileo and Egnos; new acquisitions in the transport equipment and infrastructures segment (Delta 2). Also significant was the renewal of the contracts for television broadcasting services (specifically W3/Express from RAI) and the collection of new orders for the supply of telecommunications satellite services and Earth observation (Agrisian) and management of orbiting satellites (specifically Eutelsat AB1 and Satelcom).

The **order backlog** at 31 March 2006 totalled €mil. 1,237, marking an increase of around 7% compared with 31 December 2005 (€mil. 1,154). The backlog at 31 March 2006 is composed of manufacturing activities (45% satellites, 15% infrastructure and equipment) for 60% and satellite services for 40%.

The **value of production** for the first quarter of 2006 amounted to €mil. 140, a decline of around 18% compared with the first quarter of 2005 (€mil. 170). The principle sources of production revenues were:

- Activities relating to:
  - the Cosmo-SkyMed and Pleiades Earth observation programmes;
  - the StarOne C1/C2, Alphabus, Thaicom 5 (launch is expected for 26 May), Chinasat 6B/9, Galaxy 17, Rascom and Koreasat 5 commercial satellites;
  - the Herschel/Plank, Alma and Goce scientific programmes and the Meteosat Second Generation programme;
  - the Syracuse 3/3C and Sicral 1B military telecommunications satellites;
  - the Galileo and EGNOS navigation programmes;
- the continuation of the programmes associated with the International Space Station (Node 3, the ATV vehicle);
- the development of equipment for EQS France and for the Koreasat 5 satellite, and the payloads for Arabsat 4A/4B and Express AM 33/34;
- the provision of telecommunications satellite services, Earth observation services and, in the television sector, the resale of satellite capacity and provision of broadcasting services.

EBIT at 31 March 2006 was €mil. 9, a decrease of €mil. 3 compared with 31 March 2005 (€mil. 12) due to greater structural costs and research and development costs, net of the improvement of industrial earnings. **ROS** worsened, passing from 7.1% in the first quarter of 2005 to 6.4% at 31 March 2006.

Capital employed at 31 March 2006 was €mil. 342, an increase of €mil. 33 compared with 31 December 2005. The rise is mainly due to **working capital** of €mil. 20 at 31

March 2006, a decline from the value at 31 December 2005 (a negative €mil. 18), resulting from a reduction in trade payables, excluding greater commercial receipts.

Research and development costs at the end of the first quarter of 2006 came to €mil. 9, down 55% from the same period of 2005 (€mil. 20). R&D activities mainly regarded:

- research and development phases for programmes such as:
    - Cosmo (SAR radar), Syracuse and Sicral 1B, Sentinel 1 (SAR radar, altimeter and radiometer);
    - scientific programmes (Alma, Spirale/Melissa, Bepi-Colombo, Gaia, Exomars, Goce and Herschel-Plank experiments);
    - EGNOS and Galileo (phases GSTB V1 and V2);
- studies relating to:
    - future experimentation on board the International Space Station;
    - capsules, orbital infrastructure and manned re-entry craft;
    - the development of production technology (equipment, flexible payloads, spacebus) for mobile and/or broadband applications in particular;
    - the development of GIS platforms, algorithms and processors for SAR interferometry, systems and networks for value added telecommunications services, satellite navigation systems.

At 31 March 2006, there were 3,214 **employees**, 20 more than the 3,194 workers registered at 31 December 2005.

DEFENCE SYSTEMS

€millions	31 Mar 2006	31 Mar 2005	31 Dec 2005
New orders	89	138	763
Order backlog	3,731	4,121	3,869
Value of production	225	196	1,154
EBIT	7	2	112
R.O.S.	3.1%	1.0%	9.7%
Working Capital	(245)	(41)	(321)
Net capital employed	237	284	111
R.O.I. (*)	11.8%	2.8%	n.s.
Research and Development	40	37	268
Employees (no.)	4,334	4,138	4,104

(*) Calculated on net capital employed at period-end

Note that the data relating to the MBDA joint venture are consolidated at 25% using the proportional method.

Defence Systems include MBDA for missile systems, the joint venture with BAE Systems and EADS in which Finmeccanica holds a 25% stake, Oto Melara SpA for land, naval and air weapons systems and WASS SpA in underwater weapons (torpedoes and countermeasures) and sonar systems.

As part of the integration process for the European missile industry, in February MBDA completed the acquisition of the German company LFK GmbH. Figures for this company were consolidated using the proportional method starting from 1 March 2006.

New orders acquired in the first quarter of 2006 amounted to €mil 89, less than in the year-earlier period, when there were significant orders for torpedoes from Portugal and countermeasures from India. The main orders acquired in the first quarter of 2006 include the supply of the Exocet SM39 anti-ship missile systems and of the Sea Wolf air defence and anti-missile systems (for Chilean submarines and frigates respectively), customer support activities in the missile system segment, the first tranche of activities for the FREMM in the underwater system segment and, for land-based and naval weapons, orders for HITFIST turrets from Ireland and turret components from Poland.

The **order backlog** at 31 March 2006 amounted to €mil 3,731, of which 66% relates to missile systems. Compared with 31 December 2005, the backlog decreased by some 3.5%.

The **value of production** at 31 March 2006 was €mil 225, an increase from the first quarter of 2005 mainly due to greater activities in missile systems and the growth in the PZH 2000 programme in the land-based and naval weapon systems.

Revenues benefited from the following activities:

- activities relating to the production of Storm Shadow air-to-surface missile systems for the British Ministry of Defence, SCALP EG for the French Ministry of Defence, of Black Shaheen for export programmes of MICA air-to-air missiles, as well as customer support activities;
- land, naval and aeronautical weapons systems: programmes for the supply of PZH 2000 howitzers for the Italian Armed Forces and the production of turrets for the Centauro armoured car for the Spanish Army;
- underwater systems: activities relating to the new Black Shark heavy torpedo and the production of MU90 light torpedoes.

EBIT for the first quarter of 2006 was €mil. 7, greater than in the first quarter of 2005 due to greater revenues and increased profitability.

Accordingly, **ROS** at 31 March 2006 improved by some two percentage points compared with the same period of 2005.

Working capital at 31 March 2006 was a negative €mil. 245 mainly due to advances from MBDA customers, down €mil 76 from the negative €mil. 321 at 31 December 2005, as a result of the performance of the first months of the year, when payments to suppliers are greater than commercial receipts. Net capital employed at 31 March 2006 was €mil 237, up €mil. 126 from 31 December 2005. The increase is due to a rise in working capital and to goodwill arising from the acquisition of LFK GmbH (€mil. 62) in the missile system segment.

Research and development costs at 31 March 2006 were €mil. 40, essentially in line with the first quarter of 2005. Main activities include: the continuation of developments for the Meteor air-to-air missile in the missile segment, the Guided Multiple Launch Rocket System as part of land and naval weapons, and the Black Shark heavy torpedo in the underwater system segment.

Employees at 31 March 2006 were 4,334, up 230 people from 31 December 2005, mainly due to the acquisition of LFK GmbH.

ENERGY

€millions	31 Mar 2006	31 Mar 2005	31 Dec 2005
New orders	576	228	1,032
Order backlog	2,709	2,172	2,329
Value of production	202	132	772
EBIT	7	6	39
R.O.S.	3.5%	4.5%	5.1%
Working Capital	(275)	(111)	(193)
Net capital employed	(274)	(97)	(184)
R.O.I. (*)	n.s.	n.s.	n.s.
Research and Development	3	2	13
Employees (no.)	2,525	2,537	2,529

(*) Calculated on net capital employed at period-end

The Energy division is made up of Ansaldo Energia S.p.A., a wholly owned subsidiary, and its direct subsidiaries, such as Ansaldo Nucleare S.p.A., and other smaller firms.

New orders were acquired in the first quarter of 2006 for €mil. 576, a sharp increase from the same period of 2005 (€mil. 228). The main orders acquired include: the turn-key agreement for the Rizziconi Combined Cycle Gas Turbine 800 MW plant (Reggio Calabria) and related planned maintenance from the EGL Group and other service agreements for the planned maintenance of the Ferrara and Teverola stations. This bears witness to the loyalty and trust of one of the main customers, and the steady growth in the service segment, which helps the success of Ansaldo Energia as one of the major service providers on the market.

Due to these new orders, the **order backlog** at 31 March 2006 came to €mil. 2,709 from €mil. 2,329 at 31 December 2005.

The **value of production** at 31 March 2006 stood at €mil. 202, up 53% compared with 31 March 2005 (€mil. 132). This growth is due to the recent acquisitions of orders for plants such as those for the Sparanise, Rosignano, Vado Ligure, Escatron and Rizziconi plants. Works for Enipower continued in connection with several plants located in Italy, as well as works for the Iranian customer (Mapna).

EBIT for the first quarter of 2006 was €mil. 7, greater than in the first quarter of 2005 (€mil. 6) due to greater revenues, as noted above. **ROS** declined by one percentage point (3.5% from 4.5%), since in the first quarter of 2005 the Group posted the repayment of a stamp tax paid in previous years and due to lower research and development costs.

In the first quarter of 2006, **working capital** was a negative €mil. 275, a further improvement from 31 December 2005 (a negative €mil. 193) mainly due to advances received on new acquisitions and to a confirmation of the positive performance of receipts. Accordingly, **net capital employed** improved with a negative €mil. 274 from a negative €mil. 184 at 31 December 2005.

Research and development costs (fully expensed to the income statement) amounted to €mil. 3 from €mil 2 in the first quarter of 2005 and relate to the continuation of the activities envisaged in the technological autonomy plan.

Employees at 31 March 2006 were 2,525, mainly in line with the 2,529 people at 31 December 2005.

TRANSPORTATION

€millions	31 Mar 2006	31 Mar 2005	31 Dec 2005
New orders	484	293	1,615
Order backlog	4,090	3,662	3,956
Value of production	343	298	1,230
EBIT	16	10	(48)
R.O.S.	4.7%	3.4%	(3.9%)
Working Capital	165	372	235
Net capital employed	379	510	441
R.O.I. (*)	16.9%	7.8%	n.s.
Research and Development	10	8	40
Employees (no.)	6,409	6,076	6,321

(*) Calculated on net capital employed at period-end

The Transportation division includes Ansaldo STS S.p.A. and its subsidiaries and associates (Systems and Signalling) and Ansaldobreda S.p.A. and its subsidiaries and associates (Vehicles).

On 24 February 2006 Finmeccanica S.p.A. sold to Ansaldo STS S.p.A its equity investments in Ansaldo Trasporti Sistemi Ferroviari S.p.A. (Systems) and Ansaldo Signal N.V. (Signalling); in April 2006 it completed a Public Sale Offer for 60% of the share capital of Ansaldo STS. From 29 March 2006 the company's shares are traded in the STAR segment of the Automated Stock Exchange of the Italian Stock Exchange. In the first quarter of 2006 the three business divisions showed the following performance:

- Signalling: good performance in the balance sheet and the income statement and positive commercial performance, especially thanks to the Italian subsidiary Ansaldo Segnalamento Ferroviario;
- Systems: positive performance, with profitability in line with that for the first quarter of 2005;

- Vehicles: operational profitability is affected by strong reductions in margins on orders following the revision of estimates in 2005; negative development of working capital.

New orders taken in the first quarter 2006 amounted to €mil. 484, an increase of €mil. 191 compared with the same period of the prior year (€mil. 293) due to greater orders for Vehicles and Systems. The main acquisitions for the period included:

- Signalling: orders placed by Rete Ferroviaria Italiana for the provision of ground systems relating to the 2c phase of the 'automated train control systems' (SCMT) master agreement; the order by Trenitalia concerning the fourth contract for supplying SCMT devices for use on board trains; the order regarding the Ghaziabad-Kampur route in India;
- Systems: the extension of the operation & maintenance contract for the automated underground of Copenhagen;
- Vehicles: the Sirio tramway for Kayseri in Turkey and option for line 1 of the Milan underground.

At 31 March 2006 the **order backlog** amounted to €mil. 4,090, up €mil. 134 from the value registered at 31 December 2005 (€mil. 3,956).

The **value of production** for the first quarter of 2006 came to €mil. 343, an increase of €mil. 45 compared with the first quarter of 2005 (€mil. 298), mainly due to greater Signalling activities. Among the noteworthy orders in the Transportation division were the following:

- Signalling: high-speed train orders in Italy and France; automated train control systems (SCMT), both ground and on-board, for Italy; second phase of the Channel Tunnel Rail Link; and the manufacturing of components;
- Systems: activities related to the subways in Naples and Copenhagen and for the Alifana regional line; high-speed railway orders in Italy;
- Vehicles: DMU trains for the Danish railways; trains for the Madrid subway; new ETR500 Politensione trains and E402 locomotives for Trenitalia, high-volume passenger trains for Morocco, orders for Sirio trams for various municipalities, and Service and Revamping activities.

EBIT for the first quarter of 2006 was €mil. 16, an increase of €mil. 6 from the first quarter of 2005 (€mil. 10), as the improvement in the Signalling business is partly mitigated by the costs for the Ansaldo STS listing process. **ROS** for the division was 4.7%, an increase from the value registered in the first quarter of 2005 (3.4%).

Working capital at 31 March 2006 was €mil. 165, down €mil. 70 compared with 31 December 2005 (€mil. 235), an improvement mainly due to the Signalling business.

Net capital employed at 31 March 2006 of €mil. 379 decreased by €mil. 62 from that at 31 December 2005 (€mil. 441).

Research and development costs for the first three months of 2006 were €mil. 10, up €mil. 2 compared with the same period of 2005 (€mil. 8), due to greater activities in the Signalling business.

Employees at 31 March 2006 were 6,409, up 88 people compared with 31 December 2005 (6,321 people), mainly due to a rise in employees in the Signalling business.

OTHER ACTIVITIES

€millions	31 Mar 2006	31 Mar 2005	31 Dec 2005
New orders	19	77	465
Order backlog	419	68	487
Value of production	61	33	170
EBIT	(40)	(26)	(101)
R.O.S.	n.s.	n.s.	n.s.
Working Capital	31	11	(33)
Net capital employed	1,054	1,127	975
R.O.I. (*)	n.s.	n.s.	n.s.
Research and Development	-	-	-
Employees (no.)	865	1,088	940

(*) Calculated on net capital employed at period-end

The division includes: the Elsacom NV group, which manages satellite telephony services; Mecfin – Meccanica Finanziaria S.p.A., a real estate and service management company; Iritech S.p.A., which holds a stake in Ansaldo Ricerche to carry out spin-offs of branches of business to be managed with other synergic partners, such as, for example, the production of energy through fuel cells with the Ansaldo Fuel Cells S.p.A. subsidiary; Finmeccanica Finance SA, responsible for providing financial support to the Group; SO.GE.PA - Società Generale di Partecipazioni S.p.A., responsible for directly managing the pre-winding up/winding up and rationalisation processes of companies falling outside the business sectors through transfer/repositioning transactions. Among the other smaller companies is ALS S.p.A., a company which in 2004 transferred its line of business to the Space sector. This company had a number of doubtful assets that were deemed no longer of use in the development of the space sector.

Following the adoption of IFRS, the equity investments in liquidation in Ansaldo Industria S.p.A., Fata Automation S.p.A. and Fata Group S.p.A. were included in the scope of consolidation as from 31 December 2004.

As part of the liquidation of Fata Group S.p.A., a company called Fata S.p.A. was formed, commencing operations on 1 April 2005, to conduct the following activities: in the area of plants for the processing aluminium and steel flat rolled products and engineering design in the electricity generation area for Engineering Procurement and Construction (EPC) activities. In the prior year the Hormozal contract for the provision of a second refining line at the Bandar Abbas smelter, with a production capacity of 147,000 tonnes of aluminium per year, came into effect. This contract is worth €mil. 315.

Bredamenarinibus S.p.A., a company manufacturing urban and intercity buses, was deconsolidated from the division from 2004, with the recognition of the economic effects under 'discontinued operations' and of the financial effects under assets/liabilities held for sale. The process for reorganising the industrial activities of this company is aimed at their valorisation with a view to the sale of the business.

This division's figures also include those of the Corporate division of Finmeccanica S.p.A., which for some years has been undergoing an extensive transformation process, altering its focus from a financial company to that of an industrial company. This process, which is not yet complete, received a boost in the previous year with a commitment from management to press on with a series of actions concerning industrial, technological and commercial integration. The Group will then be able to benefit from an additional impetus in improving its own productivity through processes to increase efficiency and rationalisation.

In order to guarantee that the economic and financial objectives set by the Corporate division would be met, the Group conducted various initiatives, including the following:

- further strengthening of the mechanisms for the coordination of companies, including through development of specific Central Management structures, so that the individual parts could operate through a single policy, not just in financial terms, but particularly in industrial terms, involving the key processes of product engineering, technology and commercial strategy. This was within the framework of optimising the allocation of resources within the Group in order to maximise returns and avoiding overlapping, which restricts effectiveness and efficiency;

- allocation of objectives to the companies: firstly, the constant growth of EBIT, thanks to increased volume and continuous efficiency drives, such as the optimisation of procurement, the rationalisation of production sites as well as company restructuring leading to the containment of working capital, and secondly, but of no less importance, was the reduction of industrial and structural costs;

- review of processes from a Group perspective, in particular those that could have a bearing on the optimisation of areas with possible synergies, such as IT and real estate management;

- issue of specific directives aimed at the progressive alignment of financial and economic flows and an ordered and the dynamic growth of investments. This will guarantee a more efficient correlation between the absorption of resources aimed at sustaining important future programmes and the associated returns.

- continued development of a process for the spread of a Group methodology for controlling and managing programmes, based on the integration of the international standards of Life Cycle Management, Phase Review, Project Control and Risk Management. The unification and implementation of control processes, scheduled to occur by the end of 2007, will reduce the level of risk, improve the quality of profitability and manage more efficiently reduction in inventories and increases in production efficiency;

- fulfilment of the principal aspects of the transition project to IAS/IFRS, which led to the preparation of the “Finmeccanica Group IAS/IFRS Accounting Standards Handbook”, which will also be used by the companies in drawing up their statutory individual financial statements for 2006. The new phase of planning activities will focus on the implementation of managerial and administrative processes and the information systems necessary for the definitive assimilation of new accounting standards within the company, as well as the review of administrative flows, including from the perspective of simplification/integration with other company functions, and for providing greater support for industrial processes.

The efficiency of policy and coordination activities in the Corporate Affairs department was further strengthened in its goal of reaching these objectives in the medium term with a broad-based management-by-objective (MBO) policy, which involved top management and key resources from all companies within the Group. The correct application and monitoring of the promotion of these objectives will represent one of the principal aims in achieving the goals.

Business outlook

The performance for the first three months of 2006 showed better economic results than those for the same period of the previous year and is in line with estimates. In light of this performance, to date there are no events that may change the estimates prepared when the financial statements 2005 were prepared. These are those estimates:

In 2006 Group revenues are expected to grow between 10.5% and 13.5%, with an increase in EBIT between 14.0% and 17.0% compared with 2005.

Estimates for 2006 include the consolidation for the entire year of the acquisitions made in 2005, specifically the operations in the defence electronics segment which were acquired by BAE Systems and are consolidated from 1 May 2005, and Datamat, which is fully consolidated from 5 October 2005, date of acquisition of 52.7% of the company.

The integration of newly-acquired operations, with particular regard to the avionics operations of BAE Systems and to the operations in the Space segment, which together with Alcatel’s space operations have been lately transferred into joint ventures, will involve integration costs in order to achieve the significant synergies expected.

For the Board of Directors
the Chairman and Managing Director
(Pier Francesco Guarguaglini)