QUARTERLY REPORT
AT 30 SEPTEMBER 2006
FINMECCANICA

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Finmeccanica Group

Report on company's activities at 30 September 2006

Results for the first nine months of the year

Highlights

€ millions	Sep-06	Sep-05	change	Dec-05
New orders	10,231	10,606	-4%	15,383
Order backlog	34,084	31,139		32,114
Value of Production	8,907	7,554	18%	11,469
EBIT	472	406	16%	735
Net result	612	180	n.a.	396
Net capital employed	7,087	6,873		5,670
Net debt	2,184	2,245		1,100
FOCF	-1,149	-650	77%	501
ROI	*13.1%*	*12.7%*	*0,4 p.p.*	*17.5%*
ROE	*17.2%*	*15.7%*	*1,5 p.p.*	*9.6%*
EVA®	-15	-7		217
R&D Costs	1,199	1,103	9%	1,742
Employees (no.)	57,705	55,195		56,603

Before the results at 30 September 2006 are discussed, it should be noted that 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 Space segment, in 2005, the agreement with Alcatel S.A. (Alcatel);
- in the Defence Systems segment, in 2006, the purchase of LFK GmbH from MBDA.

Different timing of transactions, especially for those taking place in 2005, 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.

Compared with 30 September 2005 value of production rose by 18% and operating profit grew by 16%; in terms of organic growth, these rose by 9% and 12% respectively. ROS stood at 5.3%, essentially in line with that for the year-earlier period (5.4%), and new orders are lower than those at 30 September 2005 by 4%. Regarding Group profitability indicators compared with the prior period (shown in brackets), ROI was 13.1% (12.7%), Group EVA®[1] was negative in the amount of €mil. 15 (a negative €mil. 7) and ROE stood at 17.2% (15.7%).

The first nine months of 2006 ended with consolidated net profit of €mil. 612 (€mil.180 in the first nine months of 2005). The net profit, including the gain from the public offering on 60.0% of Ansaldo STS S.p.A. - €mil. 405 less the effect of the consolidated taxation mechanism – reveals an increase of €mil. 27 in operating result (€mil. 207) compared with the same period of the prior year. This increase is mainly due to growth in EBIT (€mil. 66) which is partially taken over by greater net financial income and expense (€mil. 13) and greater taxes for the period (€mil. 25).

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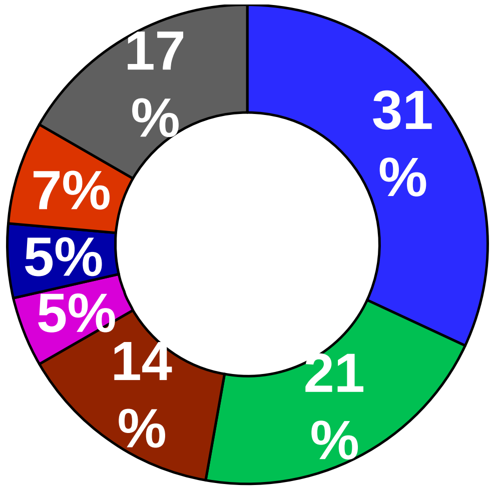
New orders at 30 September 2006 amounted to €mil. 10,231 as compared with €mil. 10,606 for the same period of the prior year. Some 53% of total new orders relates to the military market.

New Orders			
€ million	Sep-06	Sep-05	change
Helicopters	3,328	2,892	15%
Defence Electronics	2,195	3,367	-35%
Aeronautics	1,427	2,116	-33%
Space	515	330	56%
Defence Systems	496	403	23%
Energy	741	557	33%
Transport	1,738	1,394	25%
Eliminations and other activities	(209)	(453)	
	10,231	10,606	



The main new orders are:

- for the Helicopters segment, the acquisition of the first lot of the supply of 70 Future Lynx helicopters to the British Army for a value of some €mil. 550 (2nd quarter), the acquisition of the first lot, 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 (both in the 1st quarter). New orders for 42 helicopters with a total value of €mil. 280 (3rd quarter) including agreements with Aerolineas Ejecutivas (Mexico) and Synergy Aerospace (Brazil) which provide for an initial contract for 5 helicopters (and 37 options over the next 5 years) and an initial contract for 6 helicopters (and 56 options over the next few years) respectively.
- Defence Electronics: command and control and communications systems for the FREMM frigates of some €mil. 200 (1st, 2nd and 3rd quarter); avionics systems: the second lot of EFA IRST of some €mil. 114 (2nd quarter); FALCON, the main strategic communications programme of the British Ministry of Defence of some €mil. 87 (2nd quarter); air traffic control: the SMART contract in Turkey of €mil. 44 (3rd quarter); information technology and security: the Telecom order for the Italian secure postal network ‘Rete Sicura Poste Italiane’ of €mil 31 (2nd quarter) and the Russian order for ‘hybrid mail’ of €mil. 22 (3rd quarter). The first nine months of 2005 were positively and significantly affected (some €mil.

1,200) by the acquisition of an order for the production of the DASS (Defensive Aids Sub System) system for all the Eurofighter Typhoon aircraft for the second manufacturing lot;

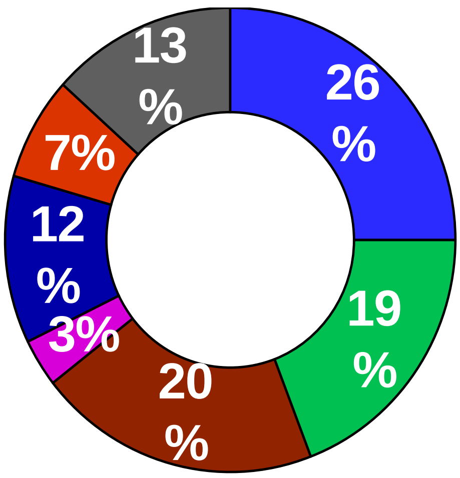
- Aeronautics: the consortium GIE-ATR received orders for 7 aircraft (3rd quarter), 29 aircraft (2nd quarter) and 18 aircraft (1st quarter) for a value of €mil. 350, and customer service of some €mil. 90, Alenia Aeronautica received an order for the supply of 10 ATR72 ASW aircraft to the Turkish Navy of some €mil. 180 and 5 C27Js to Bulgaria of some €mil. 90 (both in the 2nd quarter). In the third quarter of 2005 the civil segment received the first order from Boeing for a B787 (some €mil. 850); in 2006 new orders for B787s, for a smaller amount, are expected to arrive at year-end;
- Space: acquisition of orders for telecommunications satellites Turksat 3A and Ciel 2 (1st quarter), orders for the payloads of Arabsat 4AR and AMC1 commercial satellites, further acquisitions for the Galileo and Egnos navigation programmes (2nd quarter), orders for the BW Satcom programme and orders from Eutelsat for the W2A satellite (3rd quarter). The increase of €mil. 185 from the year-earlier period is essentially due to the acquisition of orders in the commercial satellite segment;
- Defence Systems: orders for the supply of the Trigat long-range anti-tank missile systems (Q2), Exocet SM39 anti-ship missile systems and Sea Wolf to Chile (1st quarter). Naval weapons: FREMMs for the Italian Navy (2nd quarter), whose initial lot includes the underwater segment (1st quarter);
- Energy: the combined-cycle power plant in Rizziconi, including scheduled maintenance, worth around €mil. 500 (1st quarter) and strong growth in Service orders, which increased from €mil. 193 in the first nine months of 2005 to €mil. 333 at 30 September 2006;
- Transport: in Signalling, the order for 'automated train control systems', both wayside and on-board, for Italy, worth around €mil. 70, and the order for the Ghaziabad-Kampur stretch in India, worth around €mil. 60 (1st quarter), the order for the high-speed train Perpignan-Figueras in France and Spain (2nd quarter) and the order from Trenitalia of the fifth implementing contract of on-board SCMT equipment worth around €mil. 100 (3rd quarter); in Systems, the

extension to 2010 of the operation and maintenance of Copenhagen's underground, worth €mil. 127 (1st quarter), and the driverless underground in Thessaloniki (worth around €mil. 280) and Milan Line 5 (worth around €mil. 153), which also affected the vehicles segment (2nd quarter) and the order for the Piscinola-Capodichino line of the Campania regional underground worth around €mil. 80 (3rd quarter); in vehicles, the order acquisition for Sirios trams in Turkey, worth around €mil. 50 (1st quarter), the implementation contract for Line 2 of the Milan underground, worth around €mil. 40 (2nd quarter) and the contract for the maintenance of vehicles of the Madrid underground worth around €mil. 240 (3rd quarter).

At 30 September 2006 the **order backlog** stood at €mil. 34,084 as compared with €mil. 32,114 at 31 December 2005. These cover three years of Group production. The increase of €mil. 1,970 is essentially due to ordinary purchase, order volumes, and customer invoicing activities.

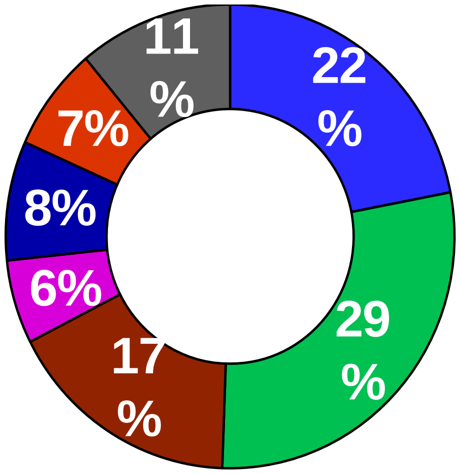
Order backlog

€ million	Sep-06	Dec-05	change
Helicopters	8,638	7,397	17%
Defence Electronics	6,745	6,946	-3%
Aeronautics	6,965	6,865	1%
Space	1,191	1,154	3%
Defence Systems	4,070	3,869	5%
Energy	2,455	2,329	5%
Transport	4,673	3,956	18%
Eliminations and other activities	(653)	(402)	
	34,084	32,114	



In line with the Group development objectives**, value of production** at 30 September 2006 was €mil. 8,907 compared with €mil. 7,554 at 30 September 2005, a net increase of €mil. 1,353 (+18%) of which €mil. 657 (8.7%) is due to internal growth and the remainder (€mil. 696) is due to the change in the scope of consolidation.

Value of production			
€ million	Sep-06	Sep-05	change
Helicopters	1,974	1,721	15%
Defence Electronics	2,565	1,922	33%
Aeronautics	1,535	1,415	8%
Space	518	547	-5%
Defence Systems	751	706	6%
Energy	633	519	22%
Transport	1,005	899	12%
Eliminations and other activities	(74)	(175)	
	8,907	7,554	

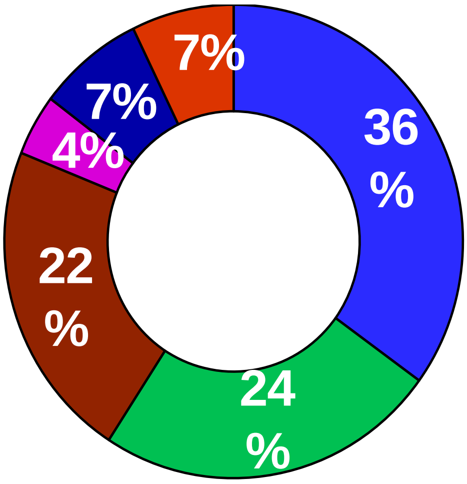


Organic growth in the **value of production** was registered in Helicopters (15%), thanks to the start of work on the VH 71 order for the President of the United States of America, the increased production rate for the AW139 line, and a greater volume of product support, mainly in the United Kingdom. Defence Electronics and Aeronautics also expanded, although the latter increased its civil activities with a slight decline in military activities following delays in order acquisitions. The slight decline posted in Space is due essentially to reduced activity in manufacturing. Defence Systems registered growth, principally in missiles and, to a lesser degree, in ground weapons systems. Growth in Energy (22%) is due to recent order acquisitions, mainly for power plants. Finally, growth in Transport is attributable almost entirely to signalling, thanks to increased activity.

EBIT in the first nine months of 2006 was €mil. 472 as compared with €mil. 406 at 30 September 2005, a net increase of €mil. 66 (+16%) of which €mil. 49 (12%) is for organic growth and the remainder (€mil. 17) is due to the change in the scope of consolidation.

EBIT

€ million	Sep-06	Sep-05	change
Helicopters	183	174	5%
Defence Electronics	125	114	10%
Aeronautics	115	99	16%
Space	22	24	-8%
Defence Systems	38	42	-10%
Energy	38	20	90%
Transport	39	5	
Other activities	(88)	(72)	
	472	406	



ROS totalled 5.3% and is mainly in line with that at 30 September 2005.

Organic change in EBIT included:

- a 5% increase in Helicopters due in part to increased production and the effect of efficiency drives implemented last year under the integration of Italian and UK activities;
- broad alignment in Defence Electronics due essentially to improved profitability in command and control systems and information technology offset by the protraction of delays caused by the postponement of the TETRA Interpolice order in communications;
- growth in Aeronautics is attributable to lower risks due to positive sales trends and the commercial prospects of the ATR programme, which permitted release of excess provision. This was partly offset by a deterioration at Alenia Aeronavali, due mainly to provisions for charges on orders and write-offs of development costs;
- the slight worsening in Space is due mainly to higher labour costs, net of productive synergies created by new joint ventures;
- the slight worsening in Defence Systems is mainly due to non-recurring income from sale of property in the same period of the prior year;
- the Energy growth is due mainly to increased volumes. Specifically growth relates to activities at the Rizziconi facilities, which were acquired in the first quarter of the year, and to activities on other orders for facilities;

- growth in Transport is also due to vehicles. Although the latter registered an operating loss which cannot be recovered in the next few months, this segment performed better than in the first nine months of 2005. Signalling also performed better due to substantial improvement in industrial profitability.

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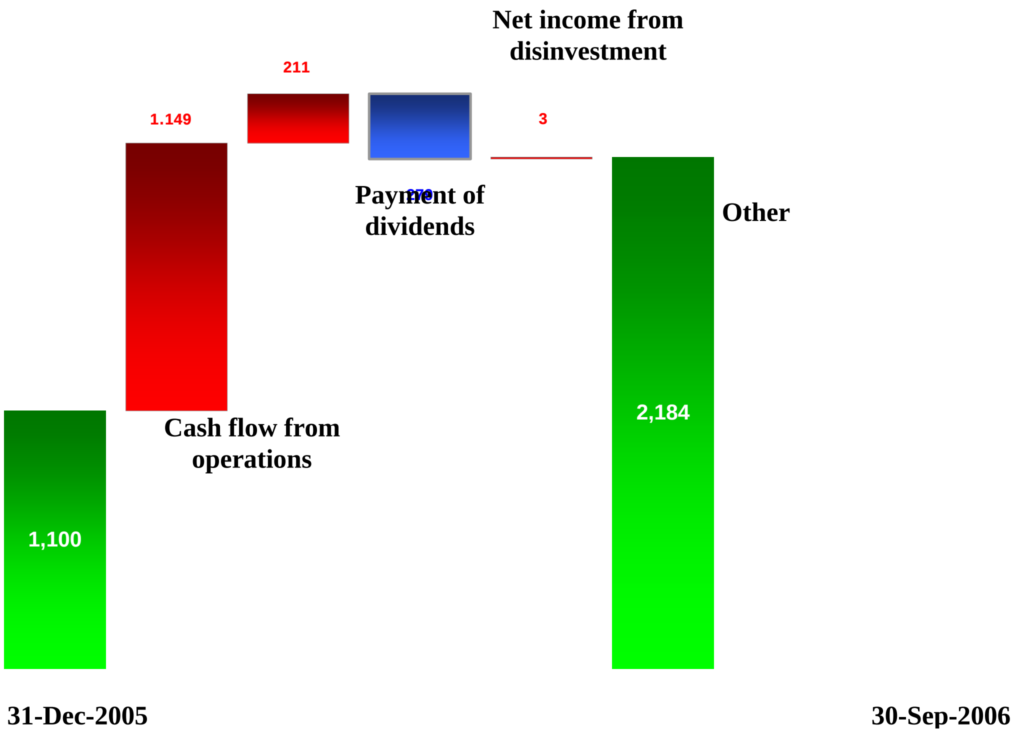
Group net debt (payables higher than financial receivables and cash and cash equivalents) at 30 September 2006 was €mil. 2,184 from €mil. 1,100 at 31 December 2005, a net increase of €mil. 1,084.
This debt level of 44% of consolidated shareholders’ equity is lower than the amount achievable on a careful and prudent financial management and falls within the maximum limits set by the main rating companies.

Free Operating Cash Flow **(FOCF)** at 30 September 2006, not including non-recurring events, was negative (cash) in the amount of €mil. 1,149 compared with negative €mil. 650 at 30 September 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. The decrease of €mil. 499 from the same period of the prior year are mainly the effects of: investments on major programmes for product development, at an advanced stage, that are greater by some €mil. 200 than those for the year-earlier period, and slowing down of payments mainly from public administration companies.

Non-recurring events for the period include the sale of 60.0% in Ansaldo STS S.p.A. through a public offering which generated a positive cash flow of €mil. 458, 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 90.005% in Datamat, including the shares acquired after the end of the PPO and Datamat’s treasury shares. In September 2006 €mil. 47 was paid to the French company Alcatel Partecipations SA as an adjustment payment as part of their alliance in the Space segment last year.

With regard to the gain from the flotation 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 (actually dividends were paid out in the amount of €mil. 80). Together with the ordinary dividend, total outlay was €mil. 211.

Net debt at 30 September 2006



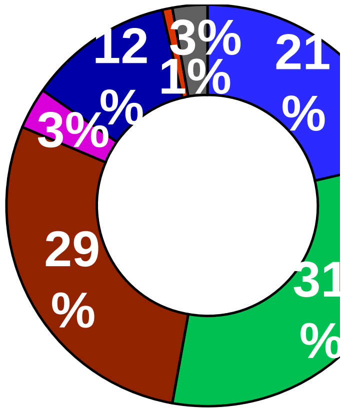
Consolidated **net capital employed** at 30 September 2006 was €mil. 7,087 compared with €mil. 5,670 at 31 December 2005, a net increase of €mil. 1,417. **Working capital** increased by €mil. 877 (€mil. 17 at 31 December 2005 compared with €mil. 894 at 30 September 2006). Current debt at 30 September 2006 included the €mil. 39 debt for the BAE put and call option for the right to exercise the purchase/sale option for the remaining 25% of Selex Sensors and Airborne Systems S.p.A..
Excluding the effect of the option, working capital increased by €mil 1,274, attributable in large part to the FOCF developments mentioned in the comments on net debt.

The increase in non-current assets of €mil. 540 mainly relates to goodwill from the acquisition of activities from BAE (€mil. 326), Datamat (€mil. 55), LFK GmbH (€mil. 63) and Alcatel Alenia Space (€mil. 41). The rest is due to routine investing activities in property, plant and equipment and intangible assets, less amortisation and depreciation, and to the decrease of €mil. 90 due to the fair value measurement of the investment in STMicroelectronics NV.

Research and Development costs, which were €mil. 1,199 from €mil. 1,103 in the first nine months of 2005, increased by around 9%. This represented around 13% of value of production.

R&D Costs

€ million	Sep-06	Sep-05	change
Helicopters	256	267	-4%
Defence Electronics	378	350	8%
Aeronautics	342	280	22%
Space	39	60	-35%
Defence Systems	141	109	29%
Energy	11	8	38%
Transport	32	29	10%
	1,199	1,103	



The main R&D activities regarded:

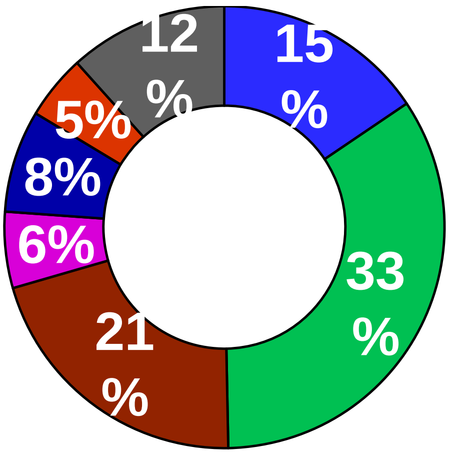
- Helicopters: research in the programmes funded under Law 808/85, such as the development of technology for a new helicopter category 6-7 tons dubbed A149, and the development of the BA 609 convertiplane;
- Defence Electronics: the continuation of the development in the EFA programme, the finetuning 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;
- Aeronautics: the development of civil programmes, including the B787 and the A380 programmes, and of military programmes with C27J, EFA and the M346 training aircraft;
- Space: the main satellite programmes and future experiments on board the International Space Station;

- Defence System: 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;
- Energy: the continuation of the technological autonomy plan in the steam and gas turbine field;
- Transport: in Signalling, work to meet new, emerging requirements in rail transport and mass transit, and the development of on-board equipment.

The number of **employees** at 30 September 2006 stood at 57,705 people, an increase of 1,102 from 56,603 at 31 December 2005. This rise is mainly due to the inclusion of LFK GmbH (246 employees) in the scope of consolidation (in the Defence System segment), while the remainder is due to positive turnover.

Employees

	Sep-06	Dec-05	change
Helicopters	8,806	8,531	3%
Defence Electronics	19,489	19,786	-2%
Aeronautics	11,826	11,198	6%
Space	3,199	3,194	0%
Defence Systems	4,289	4,104	5%
Energy	2,692	2,529	6%
Transport	6,619	6,321	5%
Other activities	785	940	
	57,705	56,603	



Results for the period

In the third quarter of 2006 the Finmeccanica Group registered production volumes totalling €mil. 2,942 (up 14% compared with €mil. 2,591 in the third quarter of 2005) and operating profit of €mil. 167 (up 7% from €mil. 156 in the same period of 2005).

This positive performance helped to achieve a significant ROS of 5.7% for the third quarter 2006 (ratio between operating profit and production value). This result is slightly lower than that for the third quarter of 2005 (5.9%), but is greater than that for the first six months 2006 (5.1%).

€mil.	1 Jul – 30 Sep 2006		1 Jul – 30 Sep 2005	
Segments	Value of production	EBIT	Value of production	EBIT
Helicopters	626	48	551	48
Defence Electronics	825	26	712	33
Aeronautics	569	54	469	51
Space	170	6	176	5
Defence Systems	239	16	236	22
Energy	206	20	181	7
Transport	316	12	313	18
Other Activities	55	(15)	40	(28)
Eliminations	(64)	-	(87)	-
	2,942	**167**	**2,591**	**156**

The third quarter of 2006 was marked by an increase of €mil. 36 in net financial expense (€mil. 61), of which €mil. 11 is due to greater liabilities undertaken to fund the requirements of Group companies for operations. The period was also affected by the progressive rise in interest rates, by exchange rate differences (€mil. 25) and by other net financial expense.

Income taxes for the period were €mil. 69, up €mil. 14 from those for the same period of 2005. This was partly due to the change in the scope of consolidation applied for the consolidated taxation mechanism.

Net profit for the period was €mil. 37, down €mil. 39 compared with that for the same period of 2005.

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 markets. 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 markets.

In the ***Defence Electronics*** segment, the first months of 2006 were 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 and naval mission systems, and integrated solutions in Defence, Space, Public Administration, Health, Banks, Finance and Telecommunications.
Last year Finmeccanica S.p.A. acquired 52.7% of the share capital of Datamat for an amount of around €mil. 151. Later on 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 required by the law to carry on the transaction. On 12 June 2006, Finmeccanica completed a number of purchases totalling 272,000 Datamat ordinary shares, equal to 0.959% of the share capital, exceeding the 90% required to commence the residual PPO.
As required by applicable laws, the duration and procedures of the PPO – to be launched at the set price on 25 October 2006 by Consob (the Italian Securities Regulator) at €9.911 per share – will be agreed with Consob and Borsa Italiana (the Italian Stock Exchange).

At the same time, an integration process started between Elsag and Datamat in order to ensure consistent coordination and management.

In the ***Aeronautics*** segment, on 19 January 2006, Aermacchi SpA (now Alenia Aermacchi S.p.A.) and Hellenic Aerospace Industry (HAI) signed a Memorandum of Understanding defining the terms of their industrial cooperation for the development programme for the M346 advanced, new-generation 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 Alenia Aermacchi HAI’s involvement 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.

On 27 April 2006 ***Alenia Aeronautica*** and L-3 Communications signed a Memorandum of Understanding with Boeing Integrated Defense Systems. Under the Memorandum, Boeing Integrated Defense Systems will participate in the Global Military Aircraft Systems (GMAS) joint venture for the C27J aircraft, set up in 2005 to take part in the Joint Cargo Aircraft (JCA) programme for the US Army and Air Force. Boeing will be fully involved in GMAS, including the development of a specific version of the aircraft requested by the US armed forces and, in the event of selection, in manufacturing the C27J in the United States. Boeing’s arrival boosts the C27J team, which, in addition to the companies already mentioned, includes leading components and system suppliers such as Dowty, Honeywell, Lockheed Martin and Rolls-Royce.

Furthermore, Boeing Integrated Defense Systems’s participation in GMAS could contribute to the development of special versions of the aircraft that satisfy any additional, future requirements of the US armed forces.

After the preliminary agreement signed in June 2006 negotiations are continuing between ***Finmeccanica and Sukhoi Aviation Holding*** and their subsidiaries Alenia Aeronautica and Sukhoi Civil Aircraft Company (SCAC), to start a strategic partnership for the Russian Regional Jet (RRJ) programme. The RRJ programme entails the design, development, manufacture, marketing and provision of technical support for a family of new-generation regional 75- and 100-seater jets. The negotiation under way relates to the acquisition by Alenia Aeronautica of a stake of 25% plus one share in SCAC (subject to approval by the Russian government) and a corresponding share of the development of the RRJ programme.

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 European Galileo 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 US GPS satellite system, also involves Telespazio S.p.A., a company owned by Finmeccanica and Alcatel, for the supply of all the services related with satellite launching and orbit placement and the management of the subsequent operations. 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.

Again in the Space segment, in September 2006, **Telespazio**, Telecom Italia, Hughes and Intelsat announced the creation of a new satellite platform called **'Marco Polo'** which will provide value-added broadband services to the business and institutional markets of Eastern Europe and North Africa. The platform, based on the capacities of the Intelsat IS-901 satellite, will be operated by Telespazio from the Fucino Space Centre. Thanks to this platform, Telecom will be able to complete its range of broadband land and satellite services to users such as institutions, companies, public and private entities.

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 transaction, 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 the **Ansaldo STS S.p.A**. flotation 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 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, at a price of €7.8 per share. 29 March 2006 was the first listing day. In later days, the banks guiding the placing consortium exercised the greenshoe option to purchase 7,826,000 shares (7.83% of the share capital) at a price of €7.8 per share, bringing total shares placed to 60%. 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 July 2006 **Ansaldo Energia**, a company of the Group operating in the supply of components and services for **Energy Generation**, acquired full control of Swiss company **Energy Service Group (ESG)**, which provides on-site plant maintenance and repair services. In September 2006 Ansaldo Energia also acquired from the US company Calpine European Finance 100% of shares in **Thomassen Turbine Systems**, a Dutch company specialising in the gas and turbines service sector. These two transactions, closely related with one another, are part of the process to strengthen Ansaldo Energia's competitiveness, both in achieving technological autonomy in gas turbines and in its service activities for power generation plants. Thomassen, which posted revenues of €mil. 45 million in 2005, specialises in heavy duty gas turbines service operations using General Electric (GE) technology. With this transaction Ansaldo Energia may expand its service operations from Siemens to GE technology, in place in most of the turbines installed worldwide. For Ansaldo Energia, these transactions open up new and important possibilities for commercial synergies both in Italy and abroad, and help boosting the company's value and visibility internationally.

On 6 August 2006 Finmeccanica signed agreements to resize its stake in **AvioGroup S.p.A** (formerly Aero Invest 1 S.p.A. which holds an interest in Avio S.p.A., a company operating in the development and production of large engines and important aeronautics and space components).
Under the agreements, based on an enterprise value of €bil. 2.57, Finmeccanica will sell, together with Carlyle, about 30% of AvioGroup to Cinven Investment Funds for a gross sum of around €mil. 430. Finmeccanica will buy back a 15% stake in AvioGroup for a sum currently estimated at around €mil. 150. This amount might be slightly different following the definition of the financial structure of the acquisition. The new shareholders' agreements between Finmeccanica and Cinven Investment Funds regarding the management of the Avio group provide for the same corporate governance rights and shareholder relations as before.

On 25 September 2006 Finmeccanica confirmed to Cinven Investment Funds that it is to sell 15% of AvioGroup. The transaction is expected to be completed in the next few weeks, as all the conditions precedent are met.

In October 2006 **Finmeccanica** signed a Memorandum of Understanding with **Russian railways** to co-operate in the production, sale and technical assistance of rolling stock and rail infrastructure. This agreement is part of the Group's co-operation with Russian companies, and lays the foundations for a series of industrial partnerships. Given growing demand of rolling stock and high-speed facilities in Russia and in other CIS markets, the companies of the Finmeccanica Group specifically operating in the railway sector will be able to enhance their industry and product expertise. This might potentially affect the priority development programmes of Italian railways.

Some of the Group companies changed their business name during the year. Specifically: Aermacchi S.p.A. changed its name to Alenia Aermacchi S.p.A, Officine Aeronavali Venezia S.p.A. to Alenia Aeronavali S.p.A., S.I.A.- Società Italiana Avionica S.p.A. to Alenia SIA S.p.A. and Selex Composite S.p.A. to Alenia Composite S.p.A..

Financial transactions

In the first nine months of 2006 Finmeccanica carried out no transaction on the capital markets. As a result, there was no substantial change in bond debt, which stood at around €mil. 1,755 (under IAS/IFRS). The average term of maturity is 9.2 years.

Below is a list of bonds at 30 September 2006 including the transactions placed on the market by the investee Finmeccanica Finance S.A.:

Issuer		Year of issue	Maturity	Amount (€mil)	Yearly coupon	Type of offer	IAS values €mil. (5)
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	428
Finmeccanica Finance S.A.	(3)	2003	12-Dec-18	500	5.75%	European institutional	519
Finmeccanica S.p.A.	(4)	2005	24-Mar-25	500	4.875%	European institutional	507

(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 listed on the Luxembourg Stock Exchange.

Rate transactions were made on these bonds and led to benefit throughout 2005 from low floating rates with an effective cost of some 3.25%. During 2006 the effective cost of the loan was 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 129 of Legislative Decree no. 385/93. Bonds listed on the Luxembourg Stock Exchange. Some rate transactions were made to optimise collection costs.

(5) The difference between the face value of bonds and book value is due to interest rates being classified as to increase debt and to discounts being recognised to decrease debt. As regards the issue of Exchangeable bonds in (2) above, IAS 39 provides for the separation of the financial debt component and the call option sold. 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 30 September 2006 this valuation method led to posting a debt €mil 73 less than the face value of the bond; this differential will gradually come down as the maturity date draws near.

All the bond issues of Finmeccanica Finance S.A. are irrevocably and unconditionally 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.
Based on negative pledge clauses, issuers Finmeccanica Finance S.A., Finmeccanica S.p.A. and their Material Subsidiaries (companies whose issuer or guarantor owns more than 50% of share capital or represent at least 10% of total revenues) are expressly and specifically prohibited from creating guarantees to secure financial transactions to the partial benefit of one or more creditors, without prejudice to the generalities of the foregoing. Exceptions to this prohibition are securitisation and, starting from July 2006, the creation of assets for the use indicated in Article 2447 bis and ff. of the Italian Civil Code.

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 (Fitch and Standard and Poor's), both with stable outlook. During the prior year Moody's credit rating improved from Baa2 to A3, in part due to a review of the Agency's methods.

As part of the centralisation of its financial operations, Finmeccanica S.p.A. has cash loans and endorsement loans facilities sufficient to meet the Group needs. Specifically, it holds a medium-term revolving credit line of €mil. 1,200 agreed in 2004 with a pool of national and foreign banks, whose interest rates and maturity (current maturity 2010 with an option for extension of two further years) improved during the prior year, thanks in part to the improved credit rating above. This transaction is also governed by negative pledge clauses, which have been illustrated above. At 30 September 2006 €mil. 150 was drawn down from such credit line. Finmeccanica also has additional short-term, credit lines, for cash loans, amounting to around €mil. 1,200 of which €mil. 900 is unconfirmed and around €mil. 300 is confirmed; at 30 September 2006 around €mil. 240

was drawn down from such credit lines. There are also unconfirmed endorsement loan lines of around €mil. 1,800.

On 21 July 2006, the EMTN bond-issue programme was extended for an additional 12 months, for a maximum of €bil. 2, under which the issues described in notes (1), (3) and (4) were carried out.

Group financial statements

I. ACCOUNTING STATEMENTS

Income Statement

	Nine months ended 30 September		Three months ended 30 September		1st quarter
	2006	***2005***	***2006***	***2005***	***2006***
(€mil.)					
Revenue	8,524	7,298	2,818	2,572	5,706
Changes in inventories of work in progress, semi-finished and finished goods	383	256	124	19	259
Other operating revenue	311	242	75	42	233
Costs for purchases	(3,264)	(2,572)	(1,096)	(906)	(2,168)
Costs for services	(2,526)	(2,195)	(854)	(705)	(1,673)
Personnel costs	(2,484)	(2,162)	(769)	(721)	(1,712)
Depreciation, amortisation and impairment	(288)	(257)	(100)	(90)	(187)
Other operating costs	(234)	(224)	(45)	(60)	(189)
(-) Capitalisation of internal construction costs	50	20	14	5	36
	472	406	167	156	305
Financial income	709	292	65	34	644
Financial expense	(385)	(357)	(127)	(58)	(259)
Effect of accounting for equity investments with equity method	(9)	(24)	1	(1)	(10)
Profit (loss) before taxes and the effect of discontinued operations	787	317	106	131	680
Income taxes	(174)	(137)	(69)	(55)	(105)
Loss associated with discontinued operations	(1)				-
Net profit	612	180	37	76	575
. Group	*594*	*172*	*30*	*73*	*564*
. Minority interests	*18*	*8*	*7*	*3*	*11*
Earnings per share					
Basic	*1.40*	*0.43*	*0.07*	*0.18*	*1.33*
Diluted	*1.40*	*0.49*	*0.07*	*0.17*	*1.32*
Earnings per share net of discontinued operations					
Basic	*1.40*	*0.43*	*0.07*	*0.18*	*1.33*
Diluted	*1.40*	*0.49*	*0.07*	*0.17*	*1.32*

Balance Sheet

€mil.	*30-Sep-06*	*31-Dec-05*	*30-Sep-05*	*30-Jun-06*
Non-current assets				
Intangible assets	4,185	3,596	3,765	4,102
Property, plant and equipment	2,623	2,506	2,415	2,564
Investment properties	3	2	2	3
Equity investments	173	138	137	164
Financial assets at fair value	816	906	856	751
Securities held to maturity	2	-	1	-
Receivables	107	122	117	107
Deferred tax assets	383	397	321	386
Other assets	4	4	10	5
	8,296	7,671	7,624	8,082
Current assets				
Inventories	6,127	5,511	5,281	5,910
Contract work in progress	2,893	2,538	2,909	2,756
Trade receivables	3,911	3,600	3,623	3,711
Financial assets at fair value	20	20	19	20
Securities held to maturity	-	-	-	-
Tax receivables	366	364	442	366
Financial receivables	338	460	375	414
Other assets	565	532	674	564
Cash and cash equivalents	422	1.061	438	680
	14,642	14,086	13,761	14,421
Non-current assets held for sale	126	120	10	135
Total assets	23,064	21,877	21,395	22,638
Shareholders' equity				
Share capital	1,845	1,858	1,856	1,845
Other reserves	3,029	2,586	2,339	2,903
Group shareholders' equity	4,874	4,444	4,195	4,748
Shareholders' equity of minority interests	75	154	443	67
Total shareholders' equity	4,949	4,598	4,638	4,815
Non-current liabilities				
Borrowings	1,985	1,975	2,050	1,957
Severance pay and other employee liabilities	1,151	1,114	1,116	1,139
Provisions for risks and charges	424	423	472	428
Deferred tax liabilities	182	101	96	184
Other liabilities	346	380	346	349
	4,088	3,993	4,080	4,057
Current liabilities				
Advances from customers	4,662	4,389	3,957	4,581
Trade payables	3,202	3,431	2,930	3,226
Borrowings	979	666	1,027	619
Tax payables	290	268	246	301
Provisions for risks and charges	476	523	588	496
Other liabilities	4,338	3,917	3,929	4,454
	13,947	13,194	12,677	13,677
Liabilities directly correlated with assets held for sale	80	92	-	89
Total liabilities	18,115	17,279	16,757	17,823
Total liabilities and shareholders' equity	23,064	21,877	21,395	22,638

Cash flow statement

€mil.	For the 9 months ended 30 September 2006	2005
Cash flow from operating activities:		
Gross cash flow from operating activities	811	710
Changes in working capital	(1,221)	(887)
Changes in other operating assets and liabilities, taxes and financial expense	(330)	682
Cash flow used for operating activities	**(740)**	**505**
Cash flow from investing activities:		
Investments in property, plant and equipment and intangible assets	(430)	(240)
Disposals of property, plant and equipment and intangible assets	60	32
Received from Ansaldo STS public offering	458	-
Acquisitions of companies, net of cash acquired	(206)	(642)
Other investing activities	112	68
Cash flow used for investing activities	**(6)**	**(782)**
Cash flow from financing activities:		
Share capital increases	20	4
Dividends paid to shareholders of the Group Parent	(211)	(110)
Dividends paid to minority shareholders	(3)	(1)
Net change in other financial payables	303	(231)
Cash flow used for financing activities	**109**	**(338)**
Net decrease in cash and cash equivalents	(637)	(615)
Translation differences	(2)	8
Cash and cash equivalents at 1 January	1,061	2,055
Cash and cash equivalents at 30 September	**422**	**438**

Statement of changes in shareholders' equity

€mil.	Share capital	Retained earnings and consolidation reserve	Other reserves	Total Group shareholders' equity	Shareholders' equity of minority interests	Total shareholders' equity
Shareholders' equity at 31 Dec 2004	1,856	1,798	(27)	3,627	22	3,649
Adoption of IAS 32: Treasury stock	(1)			(1)		(1)
Adoption of IAS 32 and IAS 39: other effects		109	418	527		527
Adoption of IFRS 2		(5)	5	0		0
	(1)	104	423	526	0	526
Change in fair value of available-for-sale assets			46	46		46
Change in fair value of cash-flow hedges and transfers to the income statement			(56)	(56)		(56)
Repurchase of treasury stock	(1)			(1)		(1)
Net change in reserve for stock-option plans			12	12		12
Translation differences			13	13	(1)	12
	(1)	0	15	14	(1)	13
Dividends		(110)		(110)	(1)	(111)
Share capital increases	4	9		13	1	14
Changes in scope of consolidation and other minor changes		(1)	2	1	110	111
Net profit (loss) at 31 Dec 2005		373		373	23	396
Shareholders' equity at 31 Dec 2005	**1,858**	**2,173**	**413**	**4,444**	**154**	**4,598**
Change in fair value of available-for-sale assets			(90)	(90)		(90)
Change in fair value of cash-flow hedges and transfers to the income statement			77	77		77
Repurchase of treasury stock	(19)			(19)		(19)
Net change in reserve for stock-option plans		2	8	10		10
Translation differences			22	22	(3)	19
	(19)	2	17	0	(3)	(3)
Dividends		(211)		(211)	(3)	(214)
Share capital increases	6	14		20	2	22
Changes in scope of consolidation and other minor changes		27		27	(93)	(66)
Net profit (loss) at 30 Sep 2006		594		594	18	612
Shareholders' equity at 30 Sep 2006	**1,845**	**2,599**	**430**	**4,874**	**75**	**4,949**

II. GENERAL INFORMATION

The Finmeccanica Group is a major Italian high technology organisation. Finmeccanica S.p.A., the holding company responsible for guiding and controlling industrial and strategic operations, coordinates its 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 transport 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).

III. FORM AND CONTENT

The consolidated quarterly report of the Finmeccanica Group at 31 September 2006 was 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), as endorsed at the reporting date.

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.

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 5.

The quarterly report at 30 September 2006, which was prepared in accordance with IFRSs, was not audited.

IV. ACCOUNTING STANDARDS ADOPTED

IV.1 Standards and scope of consolidation

This quarterly report at 30 September 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 30 September 2006 was prepared based on the ending balances at 30 September.

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 29 September 2006).

IV.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.

IV.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 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 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. If this is the case, exchange differences are recognised in the income statement.

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

The rules for translating financial statements expressed in a foreign currency into 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, charges 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.

IV.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 rate applied takes into account the period of actual use of the asset.

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 5.1).
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 unconsolidated associated companies or subsidiaries is included in the value of investments.

IV.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 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 useful life
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 5.1), 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.

IV.6 Investment properties

Those investments that can generate cash flows, regardless of the company business, are carried under 'Investment properties'; they are valued at purchase or construction cost plus any related charges, net accumulated depreciation and impairment, if any.

IV.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 write-downs should cease to obtain, the asset's book value is restored within the limits of its net book value; the write-back 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.

IV.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 write-back, 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.

IV.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 write-downs are eliminated in future periods if the reason for the write-down 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 5.1, include non-recurring costs.

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

IV.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 write-downs, 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 in question. 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 5.3 below are applied.

IV.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’s 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 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. If the reasons for the write-down 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. If the reasons for the write-down should cease to obtain in future periods, the value of the asset is restored up to the amortised cost value it would have if no impairment had been recognised.

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 write-down should cease to obtain, the value of the asset is restored.

IV.12 Derivatives

Derivatives are still regarded as assets held for trading and stated at fair value through profit and loss unless 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 5.3.

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 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.

IV.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.

IV.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.

Profits (losses) carried forward

These include net profits or losses for the period 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.

Other reserves

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.

IV.15 Payables and other liabilities

Payables and other liabilities are initially recognised at fair value net of transaction costs. They are subsequently valued at their amortised cost using the effective interest rate method (see Section 4.22).
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.

IV.16 Deferred taxes

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.

IV.17 Employee benefits

<u>Post-employment benefit plans</u>

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, 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.

<u>Other long-term benefits and post-employment benefit plans</u>

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.

IV.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.

IV.19 Leasing

<u>Group entities as lessees in a finance lease</u>

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.

<u>Group entities as lessors in a finance lease</u>

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.

<u>Operating leases</u>

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

IV.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 4.10 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.

IV.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, set-up 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.

IV.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.

IV.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.

IV.24 Costs

Costs are recorded in compliance with the inherence principle and the matching principle.

IV.25 Treatment of income taxes applied in the preparation of interim reports and the seasonality of operations

Treatment of income taxes

In the interim financial statements, 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.

IV.26 New IFRSs and IFRIC interpretations

Over the last few months, the IASB and the International Financial Reporting Interpretations Committee (IFRIC) published 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	N/A

	in a specific market - waste electrical and electronic equipment	
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies	Not significant
IFRIC 8	Scope of IFRS 2	Not significant
IFRIC 9	Reassessment of Embedded Derivatives	Not significant

V. SIGNIFICANT ISSUES

V.1 Non-recurring costs

The Group classifies costs incurred for design activities, prototype development and customisation to the technical and operating specifications of clearly identified customers are carried 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 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 (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 the present year which should affect the accounting treatment of non-recurring costs. Until then, non-recurring costs continue to be recognised as inventories in the quarterly financial statements at 30 September 2006 which have been prepared in accordance with IFRSs.

V.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 not 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.

V.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 8 '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.

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

The equity investment indirectly held in STM was designated as 'available for sale'. Accordingly, the carrying value is adjusted at each balance-sheet or interim 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 'Non-current assets' (Section 8).

V.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 and in the interim reports represent management’s best estimate at the reporting date using said procedures.

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 8 under ‘provisions for risks and charges’.

VI. SIGNIFICANT NON RECURRING EVENTS OR TRANSACTIONS

During the first nine months of 2006, 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 system and railway signalling in the Transport segment. On 24 March 2006 52.17% (52,174,000 shares) of the company’s share capital was placed to institutional and retail investors, at a price of €7,8 per share. 29 March 2006 was the first listing day. In later days, the banks guiding the placing consortium exercised the greenshoe option to purchase 7,826,000 shares (7.83% of the share capital) at a price of €7.8 per share, bringing total shares placed to 60%. The shares are listed in the STAR segment of the Automated Stock Market of the Italian Stock Exchange.

Placing 52.17% of the share capital of Ansaldo STS at a price of €7.80 each brought total revenue of €mil. 398 less commissions. The sale of an additional 7.83% of the share capital in April brought net revenue of €mil. 60. The overall gain was €mil. 405 excluding taxes. Below is a summary of the transaction:

	€mil.
Revenue from IPO	458

Gain	417
Tax expense	(12)

At present the company is consolidated on a line-by-line basis and 60% of net income and equity is attributable to minority interests.

VII. SEGMENT INFORMATION

Primary frame of reference

The Group operates in a variety of industry segments: helicopters, defence electronics, aeronautics, space, defence systems, energy, transport 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 30 September 2006, as compared with those of the same period of the previous year, are as follows:

30 September 2006	Helicopters	Defence Electronics	Aeronautics	Space	Defence Systems	Energy	Transport	Other activities	Eliminations	Total
Revenue from external customers	1,934	2,097	1,089	514	678	630	999	135		8,076
Revenue from other segments	15	347	240	5	50	1		23	(233)	448
Operating result	183	125	115	22	38	38	39	(88)		472
Financial income and expense - net										324
Share of result of associates	1	(1)	(2)		(1)			(6)		(9)
Tax expense										(174)
Profit (loss) from discontinued operations										(1)
Profit (loss) for the period										612
Group share of net result										594
Minority share										18
Investments	44	446	246	55	89	9	15	6		910

30 September 2005	Helicopters	Defence Electronics	Aeronautics	Space	Defence Systems	Energy	Transport	Other activities	Eliminations	Total
Revenue from external customers	1,696	1,511	817	539	634	516	893	141		6,747
Revenue from other segments	7	320	415	8	59	3		23	(284)	551
Operating result	174	114	99	24	42	20	5	(72)		406
Financial expense - net										(65)
Share of result of associates		1						(25)		(24)
Tax expense										(137)
Profit (loss) from discontinued operations										-
Profit (loss) for the period										180
Group share of net result										172
Minority share										8
Investments	35	983	91	125	28	8	18	4		1,292

The assets and liabilities attributable to the segments at 30 September 2006 and 31 December 2005 are as follows:

30 September 2006

	Helicopters	Defence Electron-ics	Aero-nautics	Space	Defence Systems	Energy	Transport	Other activities	Eliminations	Total
Assets	5,646	6,219	4,838	1,057	2,101	1,097	1,760	3,666	(3,446)	22,938
Liabilities	3,690	3,856	4,590	635	1,460	1,061	1,673	4,777	(3,707)	18,035

31 December 2005

	Helicopters	Defence Electron-ics	Aero-nautics	Space	Defence Systems	Energy	Transport	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):

	30-Sep-06	30-Sep-05
Europe	6,570	5,941
North America	924	558
Other	1,030	799
	8,524	7,298

Assets are geographically distributed as follows:

	30-Sep-06	31-Dec-05
Europe	22,496	21,167
North America	361	539
Other	81	51
	22,938	21,757

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

	30-Sep-06	30-Sep-05
Europe	895	1,280
North America	13	6
Other	2	6
	910	1,292

VIII. NOTES TO THE QUARTERLY FINANCIAL STATEMENTS AT 30 SEPTEMBER 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 Alenia Composite S.p.A. and Telespazio Argentina S.A. were consolidated on a line-by-line basis;
- 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;
- starting from 1 January 2006 European Company for Mobile Communication Operations BV and European Company for Mobile Communication Services BV were consolidated on the equity method;
- on 17 January 2006 Seicos S.p.A was incorporated. Starting from that date it was consolidated on the equity method;
- On 1 March 2006 joint venture MBDA took control of LFK GmbH. This company is consolidated on the proportional method (25%) from that date;
- starting 14 June 2006 Westland Technologies Canada Ltd was deconsolidated due to shutdown;

- starting 28 July 2006, following acquisition by third parties of the remaining 55% of the share capital, Energy Service Group Ltd was consolidated on the full consolidation method;
- starting 28 September 2006, following acquisition by third parties, the Thomassen group was consolidated on the equity method;
- during the first nine months of 2006 these mergers were made:
  - with date of efficacy 1 January 2006 Als S.p.A. and Iritech S.p.A. were merged into SO.GE.PA. S.p.A.;
  - with date of efficacy 1 January 2006 Sistemi Radiomobili S.p.A. was merged into Selex Communications S.p.A.;
  - with date of efficacy 1 January 2006 Elsag Security S.r.l. was merged into Elsag S.p.A.;
  - with date of efficacy 1 July 2006 Westland do Brasil - Commercio e Representacoes Ltda was merged into Sobrahel - Societade Brasileira Ltda, which changed its corporate name to AgustaWestland do Brasil Ltda;
- Elsag Security S.r.l., which was incorporated on 25 February 2005, was consolidated on a line-by-line basis for the year 2005, starting from the date of incorporation;
- 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 consolidated on a line-by-line basis.

  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 in the British company AMS Ltd. was sold to BAE Systems. The company was deconsolidated accordingly;

- on 1 July 2005 Finmeccanica and Alcatel Partecipations SA 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. Until 30 June 2005 the Italian companies which later formed the joint venture were fully consolidated on a line-by-line basis, 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 AG was deconsolidated from 4 August 2005 after the interest in the company was sold;
- Elsag Back-Office S.p.A. was deconsolidated from 29 August 2005 after 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%. Later on, Finmeccanica carried out a number of additional acquisitions, bringing its interest to more than 90%.

The ‘Income Statement’ includes figures for the periods 1 Jan – 30 Sep and 1 Jul – 30 Sep and for the comparative periods as well, but from the date of purchase and until the date of sale (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 nine 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 30 September 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 +6.82% and euro/pound sterling -1.12%); average exchange rates for the period (euro/US dollar –1.55% and euro/sterling pound – 0.07%).

Below are the exchange rates adopted for the currencies that are most significant for the Group:

	At 30 Sep 2006		At 31 Dec 2005	At 30 Sep 2005	
	average exchange rate for the period	closing exchange rate for the period	closing exchange rate for the year	average exchange rate for the period	closing exchange rate for the period
US Dollar	1.24416	1.266	1.1797	1.2635	1.2042
Pound Sterling	0.68472	0.6777	0.6853	0.6852	0.68195

The table below shows the consolidated results for the first nine months and for the third period of 2006.

€mil.	For the 9 months at 30 September		For the 3 months at 30 September		H1
	2006	2005	2006	2005	2006
Revenue	8,524	7,298	2,818	2,572	5,706
Change in work in progress, semi-finished and finished goods	383	256	124	19	259
	8,907	7,554	2,942	2,591	5,965
Purchase and personnel costs	(8,218)	(6,902)	(2,708)	(2,320)	(5,508)
Depreciation and amortisation	(279)	(246)	(97)	(90)	(182)
Write-downs	(9)	(11)	(3)	(1)	(5)
Restructuring costs	(15)	(17)	-	(7)	(15)
Other net operating income (costs)	86	28	33	(17)	50
EBIT	472	406	167	156	305
Net financial income (expense)	315	(89)	(61)	(25)	375
Income taxes	(174)	(137)	(69)	(55)	(105)
NET RESULT BEFORE DISCONTINUED OPERATIONS	613	180	37	76	575
Net result from discontinued operations	(1)	-	-	-	-
NET RESULT	612	180	37	76	575
of which:					
. Group	*594*	*172*	*30*	*73*	*564*
. minority interests	*18*	*8*	*7*	*3*	*11*

- ‘value of production’ of €mil. 8,907 rose by some 18% from the year-earlier period (€mil. 7,554). The increase is mainly due to: Helicopters, Defence Electronics, mostly due to the change in the scope of consolidation, Energy, due to the recent acquisitions of orders for plants, and Transport. This increase is offset by a slight decline in Space. The increase for the quarter was €mil. 2,942 (€mil. 2,591 in the same period of the prior year) and mainly relates to Aeronautics, Helicopters and Defence Electronics;

- ‘purchase and personnel costs’ rose from €mil. 6,902 of the same period in 2005 to €mil. 8,218 in 2006. In particular, these include:

	30-Sep-06	30-Sep-05
Purchase of materials	3,393	2,752
Change in inventories	(129)	(180)
Purchase of services	2,351	2,012
Costs of rents and operating leases	175	183
Total costs of purchases and services	5,790	4,767
Wages and salaries	1,809	1,604
Social security contributions	478	424
Costs for staff severance pay	65	65
Costs related to other defined-benefit plans	58	25
Costs related to defined-benefit plans	23	18
Employee disputes	9	3
Other costs	36	16
Total personnel costs	2,478	2,155
Capitalisation of internal construction costs	(50)	(20)
Total	8,218	6,902

The performance of costs of purchases (up 21%), like ‘value of production’, is due to the change in the scope of consolidation and to the performance of the segment activities. Figures for the quarter totalled €mil. 1,950 compared with €mil. 1,611 in 2005.

The increase in personnel costs from €mil. 2,155 in the first nine months of 2005 to €mil. 2,478 in the first nine months of 2006 is mainly due to the change in the scope of consolidation for both Italian and foreign companies; regarding the scope of consolidation of foreign companies, the increase is also due to social security liabilities payable by enterprises in connection with the pension benefits due legally and contractually to UK employees, which are far more than those for the year-earlier period. Personnel costs for the third period 2006 were €mil. 772 compared with €mil. 714 for the third period of 2005. Costs for personnel reorganisation/restructuring are reported as restructuring costs.

The average workforce was 56,398 from 52,066 in the year-earlier period, an increase due to the change in the scope of consolidation stemming in particular from the different incidence of companies in the Defence Electronics segment (Selex Sensors and Airborne Systems Ltd and Selex Sistemi Integrati S.p.A.), the acquisition of the Datamat group later in the prior year, and the acquisition in 2006 of the LFK Group by MBDA, in addition to positive turnover.

The workforce at 30 September 2006 was 57,705, up 1,102 from 56,603 at 31 December 2005. This rise is due to the acquisition of the LFK Group (246 people, 25% of total employees), in addition to positive turnover.

- depreciation and amortisation rose due to the change in the scope of consolidation. Depreciation and amortisation for the period of €mil. 279 (€mil. 246 in the same period of 2005) include €mil. 228 of depreciation for property, plant and equipment (€mil. 207 in the same period of 2005) and €mil. 51 of amortisation of intangible assets (€mil. 39 in the same period of 2005); Depreciation and amortisation for the third period 2006 were €mil. 97 compared with €mil. 90 for the third period of 2005;

- write-downs of receivables were €mil. 9 (€mil. 11 in the same period of the prior year). Write-downs for the quarter were €mil. 3 from €mil. 1 in the third quarter of 2005;

- restructuring costs were €mil. 15 (€mil. 17 in the same period of the prior year);

- other net operating income and costs include net income of €mil. 86 (€mil. 28 of net income in the same period of 2005) and break down as follows:

	30-Sep-06	**30-Sep-05**
Grants for training, research and development	25	16
Net exchange rate differences on operating items	8	(5)
Indirect taxes	(24)	(15)
Net adjustment of receivables and payables in foreign currency at the end-of-period exchange rate	3	10
Gains from the sale of non-current assets	24	9
Insurance reimbursements	10	13
Gains from realisation of operating receivables	13	-

Transfers (accruals) of provisions	44	34
Other operating income (costs)	(17)	(34)
Total	86	28

Specifically, the gain from the sale of assets mainly relates to the disposal of the production site of Chelmsford (UK) by Selex Communications Ltd, while gains from realisation of receivables are mainly due to the assignment of receivables from SACE relating to insolvent countries. Other net operating income and costs for the period include income of €mil. 33 compared with costs of €mil. 17 for the same period of 2005;

- ‘EBIT’ stood at €mil. 472, up €mil. 66 (around +16%) from the year-earlier period (€mil. 406). This rise is due to an increase in: Energy, mainly due to a rise in volumes; Defence Electronics, specifically because of change in the scope of consolidation; Helicopters and Aeronautics; these improvements are balanced by a slight deterioration in the Space segment. The operating result for the quarter was €mil. 167 compared with €mil. 156 for the same quarter in 2005;

- ‘net financial income and expense’ include €mil. 315 of net financial income, an increase of €mil. 404 from the year-earlier period (€mil. 89 of net financial expense) and an increase in net financial expense of €mil. 36 in the quarter, from €mil. 25 in 2005 to €mil. 61 in 2006. This item includes ‘net financial income and expense’ which break down in net financial income of €mil. 324 in the first nine months of 2006 as compared with net financial expense of €mil. 65 in the same period of 2005, and the net negative effect of the valuation of equity investments with the equity method of €mil. 9 in the third quarter of 2006 as compared with a net negative effect of €mil. 24 in the same period of 2005. Specifically:

	30-Sep-06	**30-Sep-05**
Dividends and income from equity investments and securities	426	7
Net discounting of receivables, payables and provisions	(2)	(2)
Net interest	(88)	(82)
Net results from financial instruments at fair value through profit or	27	15

loss		
Net exchange rate differences	(23)	(8)
Other net financial income and expense	(16)	5
Total	324	(65)

Income from equity investments relate to the net gain of €mil. 417 from the placement of the Ansaldo STS group.

Net income from measurement of fair value through profit or loss is as follows:

	Income	**Expense**	**Net**
Swaps and forex options	2	-	2
Interest rate swaps	15	(3)	12
Inefficient swap component on hedging exchange rates	13	(24)	(11)
Options on STM	24	-	24
Option embedded in the exchangeable bond	24	(24)	-
	78	(51)	27

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:

	30-Sep-06	**30-Sep-05**
Aero Invest 1 S.p.A. results	(7)	(28)
Net results of other holdings	(2)	4
	(9)	(24)

- ‘income tax expense’ was €mil. 174 from the same period of 2005 (€mil. 137). Income taxes for the quarter were €mil. 69 from €mil. 55 in the third quarter of 2005.

  In particular, this is the algebraic sum of:

	30-Sep-06	**30-Sep-05**
Corporate income tax (IRES)	123	69
Regional business tax (IRAP)	83	72
Benefit under consolidated tax mechanism	(77)	(68)
Other income taxes	46	33
Tax related to previous periods	(6)	(1)
Provisions for tax disputes	6	7
Deferred tax (assets) liabilities - net	(1)	25
	174	137

Income from adopting the consolidated taxation mechanism for IRES purposes (a tax introduced by Legislative Decree 344/2003) from 1 January 2004 was considered in the calculation of income taxes. According to this mechanism, there is only one taxable income for all the Group companies included in the scope of consolidation.

This option makes it possible to offset the tax results (taxable income and losses in the consolidation period) of the participating companies. As a result, the quarterly report includes the benefit resulting from the tax losses for the period up to the limit of the taxable income included in the consolidated tax base. This income was then allocated to all the consolidated companies reporting a fiscal loss.

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 nine months of 2005, the result on the UK operations in the radar-devices segment through the sale date (29 April 2005);
- for the first nine months of 2006, the results of the operations being sold as held by the Group in the bus manufacturing industry.

	30-Sep-06	**30-Sep-05**
Revenue	64	93
Costs	(65)	(94)
Net financial income	-	1
Tax expense	-	-
	(1)	-

The table below shows an analysis of consolidated balance sheet at 30 September 2006.

€mil.	30-Sep-2006	31-Dec-2005	30-Sep-2005	30-Jun-2006
Non-current assets	8,296	7,671	7,624	8,082
Non-current liabilities	(2,103)	(2,018)	(2,030)	(2,100)
	6,193	5,653	5,594	5,982
Inventories	6,127	5,511	5,281	5,910
Contract work in progress	2,893	2,538	2,909	2,756
Trade receivables	3,911	3,600	3,623	3,711
Trade payables	(3,202)	(3,431)	(2,930)	(3,226)
Advances from customers	(4,662)	(4,389)	(3,957)	(4,581)
Provisions for short-term risks and charges	(476)	(523)	(588)	(496)
Other net current assets (liabilities)	(3,697)	(3,289)	(3,059)	(3,825)
Net working capital	894	17	1,279	249
Net capital employed	7,087	5,670	6,873	6,231
Group shareholders' equity	4,874	4,444	4,195	4,748
Shareholders’ equity of minority interests	75	154	443	67
Shareholders' equity	4,949	4,598	4,638	4,815
Net debt (cash)	2,184	1,100	2,245	1,462
Net (assets) liabilities held for sale	(46)	(28)	(10)	(46)

‘Non-current assets’ (€mil. 8,296 at 30 September 2006 from €mil. 7,671 at 31 December 2005) show a net increase of €mil. 625:

	30-Sep-06	**31-Dec-05**
Intangible assets	4,185	3,596
Property, plant and equipment	2,623	2,506
Investment properties	3	2
Equity investments	173	138
Financial assets at fair value	816	906
Securities held to maturity	2	-
Receivables	107	122
Deferred taxes	383	397
Other assets	4	4
	8,296	7,671

This rise is specifically due to:

- the recognition of the relevant goodwill deriving from the possible exercise of the put and call options over 25% of the Selex Sensors and Airborne Systems Group, now held by BAE Systems Ltd (€mil. 326). Based on these agreements, the companies involved have been fully consolidated on a line-by-line basis and minority interests have not been calculated, provided that the legal portion held by the Finmeccanica Group amounted to 75%, and GBPmil. 269 (€mil. 397 at the exchange rate prevailing at 30 September 2006) has been recorded as a liability at 30 September 2006. The put option can be exercised by BAE Systems Plc during a fixed time period (from May 2007 through August 2007), and the call option can be currently exercised by Finmeccanica. The aforesaid amount is contractually subject to price adjustments upon the occurrence of certain events;

- the recognition of goodwill arising from the completion on 4 January 2006 of the mandatory PPO on the Datamat S.p.A. shares with subsequent adjustments (€mil. 55), and the acquisition by the joint venture MBDA of the residual 81.25% of the LFK Group (€mil. 63);

- the completion of the purchase price allocation process for the helicopter operations of the joint venture AgustaWestland, which were previously held at 50% by GKN Plc. This led to decrease in goodwill of €mil. 132 and recognition of other intangible assets (€mil. 211) and deferred tax liabilities (€mil. 79);

- the re-determination of the purchase price for Alcatel Alenia Space S.A.S., which brought increase in goodwill of €mil. 41;

- the valuation of the interest held indirectly in STMicroelectronics NV (STM) (6.6% at 30 September 2006) as ‘financial assets held at fair value’, which broke down as follows:

31 December 2005	906
Fair value adjustment at 30 September 2006	(90)
30 September 2006	816

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

- due to investing activities (specifically in aeronautics) and opening of receivables and repayments and depreciation and amortisation for the period;

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

'Non-current liabilities' (€mil. 2,103 at 30 September 2006 from €mil. 2,018 at 31 December 2005) show a net increase of €mil. 85.

	30-Sep-06	**31-Dec-05**
Severance pay and other employee liabilities	1,151	1,114
Provisions for risks and charges	424	423
Deferred taxes	182	101
Other liabilities	346	380
	2,103	2,018

This rise is specifically due to:

- the net increase of 'severance pay and other employee liabilities' (€mil. 37) resulting from 'defined benefit plans' having been reviewed by the British companies of AgustaWestland and by Selex Sensors and Airborne System Ltd and Alcatel Alenia Space SAS, and normal accruals and uses for the period;

- the net increase of €mil. 1 in 'provisions for risks and charges', in particular in provision for product guarantees (€mil. 15) net of transfers and uses from the provision for contractual risks and charges and the provision for penalties (€mil. 14);

- the increase in deferred tax liabilities of €mil. 81, mainly due to the completion of the purchase price allocation process for the helicopter operations of the joint venture AgustaWestland, which was previously held at 50% by GKN Plc. This also led to recognition of deferred taxes (€mil. 79);

- the net decrease of €mil. 34 of 'other liabilities', mainly due to deferred income;

'Net working capital' shows a net value of €mil. 894 as compared with €mil. 17 at 31 December 2005. More specifically:

- ‘inventories’ of €mil. 6,127 from €mil. 5,511 in the prior year:

	30-Sep-06	31-Dec-05
Raw materials, supplies and consumables	1,421	1,297
Work in progress and semi-finished goods	3,909	3,527
Finished goods and merchandise	185	168
Advances to suppliers	612	519
	6,127	5,511

Work in progress includes assets defined according to Group practice as non-recurring costs (€mil. 3,008 at 30 September 2006), which are largely related to programmes in the aeronautics (€mil. 1,658), helicopter (€mil. 798) and defence electronics (€mil. 507) segments. Inventories are shown net of impairment charges of €mil. 404 (€mil. 404 at 31 December 2005);

- ‘contract work in process’ amounted to €mil. 2,893 as compared with €mil. 2,538 at 31 December 2005); ‘advances from customers’ were €mil. 4,662 from €mil. 4,389 at 31 December 2005:

	30-Sep-06	31-Dec-05
Contract work in progress (gross)	6,689	5,728
Advances from customers	(3,796)	(3,190)
Contract work in progress (net)	2,893	2,538
Advances from customers (gross)	11,886	11,146
Contract work in progress	(7,224)	(6,757)
Advances from customers (net)	4,662	4,389

- ‘trade receivables and payables’ of €mil. 3,911 and €mil. 3,202 respectively as compared with €mil. 3,600 and €mil. 3,431 respectively at 31 December 2005 relate to:

	30-Sep-06		31-Dec-05	
	Receivables	Payables	Receivables	Payables

Associates and subsidiaries not consolidated on a line-by-line basis	169	18	206	27
Consortia	62	4	63	7
Other partners of joint ventures	68	20	63	27
Other third parties	3,612	3,160	3,268	3,370
	3,911	3,202	3,600	3,431

- ‘provisions for short-term risks and charges’ of €mil. 476 decreased by a net €mil. 47 as compared with €mil. 523 at 31 December 2005.The reduction relates to use of the conversion and restructuring provision for Space, Helicopters and Other Activities (€mil. 21), the provisions for penalties and product guarantees (€mil. 11), the reversal of the provision for contractual risks and charges (€mil. 17) and other provisions (€mil. 39), which rose due to 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.

  Interest due calculated using a different calculation method is around €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 S.p.A. (formerly ALS S.p.A., now SO.GE.PA 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 events dating back to 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 by the various degrees of jurisdiction. Regarding the dispute against Finmeccanica and ALS, on 8 June 2006 the plaintiff filed a Petition for Writ of Certiorari to the Federal Supreme Court of the United States to obtain a review of all the papers of the case. With ruling dated

2 October 2006, the Federal Court of the Unites States rejected this Petition. Accordingly, both cases commencing in Texas can be considered as closed.

- 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. The arbitration award will be filed by November 2006;

- on 1 October 2003, the European Commission notified the Ministry of Foreign Affairs of the formal proceedings initiated for an investigation against the Italian State, pursuant to Article 11 of the EU 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 considers these subsidies to be state aids. 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. At present, information is being exchanged between the Italian Government and the Commission before the latter issues its final decision.

- ‘other net current assets (liabilities)’ totalled €mil. 3,697 of net current liabilities, up €mil. 408 from the prior year (€mil. 3,289 of net current liabilities at 31 December 2005):

	30-Sep-06		31-Dec-05	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Employees	23	280	22	299
Prepaid expenses and deferred income	87	89	101	93
Direct taxes and others to the Tax Office	366	290	364	268
Social security	13	191	10	182
Min. of Prod. Act. Law 808/1985	-	2,858	-	2,767
Associates, consortia and subsidiaries not consolidated on a line-by-line basis	7	11	10	8
Derivatives	105	57	59	121
Other	330	852	330	447
	931	4,628	896	4,185

Other liabilities of €mil 852 also include €mil. 397 due to Bae Systems Plc in connection with the put and call option on the remaining 25% of Selex Sensors and Airborne Systems S.p.A..

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

	30-Sep-06		31-Dec-05	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Forward forex instruments	53	36	25	69
Forex options	1	-	-	1
Interest rate swaps	12	12	-	18
Options on STM	30	-	1	-
Exchangeable bond option	9	9	33	33
	105	57	59	121

Forward forex instruments

The notional value of the forward transactions totalled €mil. 2,937 of which €mil. 2,055 is related to contracts to sell and €mil. 882 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 recognized through profit or loss (no income or expense at 30 September 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. The positive change in the fair value of forward instruments is due to the considerable depreciation of the US dollar against the euro: the exchange rate rose from 1.1797 at 31 December 2005 to 1.266 at 30 September 2006.

Forex options

At 30 September 2006 forex options are held in the notional amount of €mil. 97, carried out by the Group Parent on behalf of its subsidiaries in prior years. The fair value of the instruments included in the portfolio is positive in the amount of €mil. 1 (at 31 December 2005 it was negative in the amount of €mil. 1). Given their nature and the particularly restrictive requirements of IAS 39, these instruments do not qualify for hedge accounting: fair value adjustment brought income of €mil. 2.

Interest rate swaps

At 30 September 2006, the Group held interest rate swaps totalling €mil. 830.A detail of the main instruments is as follows:

Description	**Notional**	**Underlying position**	
Fixed/floating /fixed swap	€mil. 500	Bonds - 2003	(a)
Fixed/floating swap	€mil. 200	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.
The transaction was measured at fair value through profit or loss, thereby generating a profit of €mil. 14.At 30 September 2006, the fair value of the instrument was a positive €mil. 3.

(b) The transaction was carried out during 2005 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.

The transaction was measured at fair value through profit or loss, thereby generating no net income or costs (income and expense were €mil. 1 and €mil. 1 respectively). The net fair value of instruments was positive in the amount of €mil. 7 at 30 September 2006.

(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 30 September 2006, the fair value of the instrument was nil.

This item also includes other minor transactions with a total negative fair value of €mil. 5 (negative fair value of €mil. 3 at 31 December 2005 with a subsequent expense of €mil. 2 for the nine-month period) 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. 5 at 30 September 2006 (negative fair value of €mil. 8 at 31 December 2005), and recognised as a cash-flow hedge.

The transactions recognised as cash-flow hedges have resulted in a negative reserve at 30 September 2006 in the amount of €mil. 5 (€mil. 11 at 31 December 2005), whereas those that have been recognised at fair value through profit or loss have produced financial income of €mil. 15 and expense of €mil. 3.

Options on STM

This item includes transactions to hedge a portion of the remaining portfolio of STM securities, which were valued at fair value through profit or loss. During the period, transactions were made on an additional 15,337,360 shares for premiums paid of €mil. 4.5 which extend the hedge to 45,337,360 STM shares at 30 September 2006. The fair value of the instruments is positive in the amount of €mil. 30 with income for the period of €mil. 24.

Exchangeable bond options

These include the liability related to the call option embedded in the exchangeable bonds. On 1 June 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.

‘Net capital employed’ and ‘net assets held for sale’ of €mil. 7,087 (€mil. 5,670 at 31 December 2005) and €mil. 46 (€mil. 28 at 31 December 2005) respectively are covered by shareholders’ equity (€mil. 4,949, €mil. 4,598 at 31 December 2005) and net debt (€mil. 2,184 as compared with €mil. 1,100 at 31 December 2005).

Below is consolidated net debt at 30 September 2006 as compared with that for 30 September 2005 and 31 December 2005.

	30-Sep-06	30-Jun-06	31-Dec-05	30-Sep-05
Short-term financial payables	536	145	190	504
Medium/long-term financial payables	1,880	1,851	1,879	1,954
Cash and cash equivalents	(422)	(680)	(1,061)	(438)
BANK DEBT AND BONDS	1,994	1,316	1,008	2,020
Securities	(20)	(20)	(20)	(20)
Financial receivables from Group companies	(35)	(21)	(17)	(38)
Other financial receivables	(303)	(393)	(443)	(337)
FINANCIAL RECEIVABLES AND SECURITIES	(358)	(434)	(480)	(395)
Financial payables to Group companies	334	394	379	304
Other short-term financial payables	109	80	97	221
Other medium/long-term financial payables	105	106	96	95
OTHER FINANCIAL PAYABLES	548	580	572	620
NET DEBT (CASH)	2,184	1,462	1,100	2,245
Net debt (cash and cash equivalents) of discontinued operations	9	10	5	-

Net Group debt at 30 September 2006 was €mil. 2,184 as compared with net Group debt at 31 December 2005 of €mil. 1,100, and net Group debt of €mil. 1,462 at June 2006.

With particular regard to the application of IAS 32 and 39, payables include the following effects:

- for the €mil. 501 Finmeccanica Finance S.A. bond issue, bearing a 0.375% 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 30 September 2006 this valuation method led to posting a debt €mil 73 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 at 30 September 2006 was €mil. 22 as compared with €mil. 39 at 31 December 2005 and with €mil. 167 at 30 September 2005.

Consistent with the approach adopted in the presentation of the accounts for 2005, at 30 September 2006 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 the fair value measurement of the derivatives on the date that the accounts were closed: at 30 September 2006 these contra-items showed a negative balance of €mil. 48.

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. 2,184 at 30 September 2006.

The figure at 30 September 2006, including non-recourse assignments, deteriorated by €mil. 1,084 compared with the figure at 31 December 2005 and confirms the performance of inflows and outflows with great sums in cash used during the period, whose recovery is increasingly concentrated in the last quarter. The figure at 30 September 2006 also includes some improvements in operating receipts recorded in the last days of December 2005. The FOCF revealed a net decrease of €mil. 1,149, due to routine investing activities and slowness in inflows, especially those from public administration companies, which are very important to the Finmeccanica Group.

The figure was also significantly impacted by the negative and positive effects of the following 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). Later on, after a public notice was issued, additional shares were purchased. Because of this acquisition Finmeccanica's ownership exceeded 90% of the share capital of Datamat. This led to Finmeccanica being required to launch a PPO on the surplus shares, which will be launched at the price set on 25 October 2006 by CONSOB of €9.911 per share;

- the payment by Finmeccanica of an ordinary dividend of €mil. 131 and an extraordinary dividend of €mil. 80 paid out to shareholders following the positive outcome of the Ansaldo STS flotation, which is illustrated below;

- the payment of €mil. 47 in September to the French company Alcatel Partecipations SA as an adjustment payment as part of the agreements signed during 2005 in the Space segment;

- the payment of €mil. 18 by Ansaldo Energia to buy Thomassen Turbine System B.V. from Calpine European Finance LLC; Ansaldo Energia also purchased 55% of Swiss company Energy Service Group (ESG) for an amount of €mil. 2, during 2005 Ansaldo Energia had purchased a 45% interest in that company;

- the payment of €mil. 260 for the purchase of LFK GmbH, which was partly offset (€mil. 237) by the acquisition of the cash on hand at the company. Due to this, and considering the proportionate consolidation method adopted for MBDA, the overall financial impact on the Group was not significant;

- 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 transport segment, which holds shares in companies operating in the railway segment (Ansaldo Trasporti – Sistemi ferroviari S.p.A.) and railway signalling (Ansaldo Signal N.V.) in March by selling 52,174,000 shares at a price of €7.80 each.

In April, the net amount of €mil. 60 was also received in relation with the exercise of the greenshoe option by the banks coordinating the public offering. A further 7,826,000 shares were sold equal to 7.83% of the share capital of the company. Upon completion of these two transactions, the share capital of Ansaldo STS is held by the market at 60% and by Finmeccanica S.p.A. at 40%. The company being listed did not cause it to be deconsolidated; net Group debt for September includes net debt for this company as well.

As in the previous year, Group net financial debt took advantage of the offsetting mechanism following the application of the national consolidated taxation mechanism, which resulted in lower expenditure of around €mil. 127 for the period at issue.

As regards the composition of debt, with reference to bank debt in particular, bank debt and bonds did not change substantially from €mil. 1,879 (at 31 December 2005) to €mil. 1,880 (at 30 September 2006), and short-term financial payables rose from €mil. 190 (at 31 December 2005) to €mil. 536 (at 30 September 2006).

Cash and cash equivalents fell from €mil. 1,061 at 31 December 2005 to €mil. 422 at 30 September 2006. The reduction in cash, together with the increase in short-term financial payables, as noted above helped cover the financial and operational requirements for the period, and also benefited from the receipt related to the flotation of Ansaldo STS discussed above. Liquid assets at the reporting date include: amounts available at investees of joint ventures (MBDA) or at companies which are no longer part of the cash pooling (Ansaldo STS); cash and cash equivalents in currencies other than the euro, generated at the end of the quarter, of subsidiaries that paid these amounts over to the cash pooling system in the first days after the end of the period; cash and cash equivalents held at foreign companies to hedge local operating requirements. During the first days of October 2006 the cash pooling procedure was started for the foreign companies of the AgustaWestland Group.

As regards the composition of the remaining debt items, the item ‘other financial receivables’ includes about €mil. 263 in respect of the unconsolidated portion of financial receivables that the joint venture MBDA holds vis-à-vis the other partners in pursuance of cash pooling agreements made 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 around €mil. 286 of Group companies toward the joint ventures, for the unconsolidated portion.

	For the 9 months ended 30 September			
	2006		**2005**	
Cash and cash equivalents at 1 January	1,061		2,055	
Gross cash flow from operating activities	811		710	
Changes in working capital	(1,221)		(887)	
Changes in other operating assets and liabilities	(330)		(328)	
Cash flow generated from (used in) operating activities	(740)		(505)	
Cash flow from ordinary investing activities	(409)		(145)	
Free operating cash-flow		**(1,149)**		**(650)**
Strategic investments	280		(637)	
Changes in other financial assets	123		-	
Cash flow generated from (used in) investing activities	(6)		(782)	
Dividends paid	(214)		(111)	
Cash flow from financing activities	323		(227)	
Cash flow generated from (used in) financing activities	109		(338)	
Translation differences	(2)		8	
Cash and cash equivalents at 30 September	422		438	

The first nine months of 2006 closed with a net decrease in cash and cash equivalents of €mil. 639. This can be attributed to the following factors:

- cash flow from operations was a negative €mil. 740, in line with the year-earlier period (which registered a negative cash flow of €mil. 505). 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 Helicopters and Energy segments.

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

	30 Sep 06	30 Sep 05
Net profit	612	180
Depreciation, amortisation and impairment	288	257
Tax expense	174	137
Accrued (transferred) to funds	(44)	(34)
Loss associated with discontinued activities	1	-
Cost of staff severance pay, defined-benefit plans and stock grants	132	90
Effects of the measurement of equity investments on the equity method	9	24
Gains from the sale of non-current assets	(24)	(9)
Gains from realisation of operating receivables	(13)	-
Gain on public offering of Ansaldo STS	(417)	-
Financial charges, net of the gain from public offering of Ansaldo STS	93	65
	811	710

- cash flow from investing activities was a negative €mil. 6 (it was negative in the amount of €mil. 782 at 30 September 2005), which includes the receipt of €mil. 458 from Ansaldo STS IPO and the expense of €mil. 89 necessary to complete the mandatory PPO on the Datamat shares. Strategic transactions at 30 September 2005 included the effects of the re-definition of Group activities amounting to €mil. 637, mainly in the Defence Electronics and Space segments;

- cash-flow from financing activities was a positive €mil. 109 (was a negative €mil. 338 at 30 September 2005), mainly due to net increase in financial payables which was partially offset by the dividend paid out to shareholders (of which €mil. 211 and €mil. 110 directly by the Group parent at 30 September 2006 and 30 September 2005). At 30 September 2005, the cash flow from financing activities was adversely affected by the repayment of the convertible bond matured in June (€mil. 953, including interest of the last coupon and additional interest recognised as the debt was discharged) which was partially offset by the placement in March 2005 of a new bond issue worth €mil. 500.

IX. 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.

The application of IFRSs by Finmeccanica involves the adoption of fair value to measure the total portfolio of derivatives.

Exchange rate risk management is governed by the directive issued by Finmeccanica in December 2002 and is currently being updated. 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 neutralizing 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; Selex Sensors Airborne Systems and its subsidiaries; Alcatel Alenia Space Italia; Ansaldobreda; AgustaWestland and its subsidiaries; Selex Communications and its subsidiaries; and Selex Sistemi Integrati. At 30 September 2006, Finmeccanica had outstanding foreign exchange transactions with highly rated financial counterparties in the interest of other Group companies totalling €mil. 3,034 (for a decrease of approximately 11% from 30

September 2005), of which €mil. 2,937 for swap and forward transactions and €mil. 97 for options.

The IFRS and related interpretations effectively make a distinction between derivatives considered to be for hedging purposes, for which it is possible to apply hedge accounting, and those for which hedge accounting is not possible and which must be recognized at fair value through profit or loss.

As a result, the Finmeccanica group recognizes the fair value of foreign exchange derivatives as follows:

- forward instruments, the fair value of which totalled a positive €mil. 17 as of 30 September 2006;
- options not eligible for hedge accounting, the fair value of which came to a positive €1 million.

The fair value of forward instruments of the Finmeccanica group was mainly affected by the great volatility of the euro/US dollar exchange rate, which was 1.1797 at 31 December 2005. At 30 September 2006 the ECB registered an exchange rate of 1.2660 with a significant depreciation of the dollar against the euro. This depreciation determined the recovery of the net fair value of instruments held from a negative €mil. 44 at 31 December 2005 up to the portfolio’s current positive value of €mil. 17.

The depreciation of the dollar in the first nine months of 2006 and the risks of further weakening led to an increase in the level of attention from Finmeccanica and the Group companies on the expectations for new orders and the participation in new tenders where the reporting currency is the dollar. Under IASs/IFRSs, any hedging transaction would be recognised using hedge accounting only in respect of orders that are very likely to be made, not in respect of all the potential orders. Specifically, according to Group policy only orders acquired can be hedged.

In essence, the Finmeccanica Group does not have any financial transactions of a speculative nature, in the sense that none of its transactions add risk to that which is already implicit to its business. On the contrary, in compliance with the Group directive, all existing financial transactions have the specific objective of eliminating or minimizing such risks.

The *management of interest rate risk* is consistent with the long-standing practice of reducing the impact of fluctuations in interest rates while seeking to minimise related financial expense. To that end, at 30 September 2006 Finmeccanica had outstanding interest rate swaps for medium and long-term financing with highly rated financial counterparties totalling €mil. 830. Thanks to these transactions, it was possible to earn benefits from low costs of floating rates, especially in 2004-2005, with the debt structure mainly including fixed rates starting from 2006. This policy shields the company from rises such as those that made short-term interest rates increase by more than 1% since December 2005. At 30 September 2006, the total fair value of the interest rate derivatives portfolio came to a net zero balance, as compared with the negative €mil. 18 of 31 December 2005. The transactions designated as a hedge had a positive change in fair value from 31 December 2005 of €mil. 6 (from a negative €mil. 11 to a negative €mil. 5). At the same date, transactions not eligible for hedge accounting had a positive change in fair value for the period of €mil. 12 (from a negative €mil. 7 at 31 December 2005 to a positive €mil. 5). The restrictive IFRS standards and related interpretations make it necessary to consider certain transactions as speculative even when they are essentially intended to contain finance costs mitigating the risk for the Group in the event of rising interest rates.

Since the end of 2005, the European Central Bank has adopted an anti-inflationary stance, raising official rates by a total of 1 percentage point. This fostered market expectations for additional increases, which have already been partially discounted in current rates (6-month Euribor at 3.27%, from 2.12% 12 months ago).

The *management of price risk on equity* concerns the management of the indirect investment held in STMicroelectronics NV (STM). At 30 September 2006 options were in place for an underlying position of 45.4 million of STM shares. These hedges are classified as trading operations. In the first nine months of 2006, with premiums paid of €mil. 4.5, the recognition of the fair value through profit or loss of these instruments led to a gain of €mil. 24.

In June 2005, a call option was purchased for STM stock for €mil. 17, which duplicates and neutralises the option sold with the convertible STM bond maturing in 2010. The purpose of the transaction was to sterilise the effects of the introduction, under IFRSs, of the separation of the debt and option components of the instrument. In 2005, this transaction resulted in revenues for Finmeccanica of about €mil. 21 as 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 securing the bond and replace them with the option purchased, thereby making these shares available to the Group.

X. 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. The following table summarises the situation:

(millions of euros) ***RECEIVABLES AT 30 SEPT 2006***	**Non-current receivables**	**Current financial receivables**	**Trade receivables**	**Other current receivables**	**Total**
Subsidiaries					
Finmeccanica Inc.		4			4
Ansaldo Invest Denmark A/S (in liq.)				3	3
Finmeccanica UK Ltd		3			3
Alifana Due S.c.r.l.			3		3
Gieinter A.G.		2			2
IGS SPA (in liq.)		2			2
Oto Melara North America Inc.		1		1	2
Ansaldo Argentina S.A.			1		1
Ansaldo Do Brasil Equip.Eletrom. Ltda				1	1
Ansaldo Electric Drives S.p.A.		1			1
Thomassen Turbine Systems B.V.		1			1
Seicos S.p.A.		1			1
Other companies with unit amount of less than €mil. 1			1		1
Associates					
Eurofighter Jagdflugzeug GmbH			61		61
Iveco Fiat/Oto Melara S.c.a.r.l.			30		30
Eurosysnav S.A.S.			16		16
Orizzonte - Sistemi Navali S.p.A.			12		12
Galileo Vacuum Systems S.p.A.		9	1		10
Macchi Hurel Dubois S.A.S.			9		9
Euromids S.A.S.			8		8
NH Industries S.a.r.l.			5		5
Nicco Communications S.A.S.			3		3
Sostar GmbH			3		3
Remington Elsag Law Enforc.Systems LLC			3		3
Ansaldo Trasmissione e Distribuzione S.p.A.	2		1		3
Elettronica S.p.A.			2		2
I.M. Intermetro S.p.A			2		2
Consorzio Start S.p.A.			1		1
Advanced Air Traffic Systems Sdn Bhd			1		1
Nahuelsat S.A.			1		1
Industrie Aeron. Rinaldo Piaggio S.p.A. (spec. mgt)			1		1
Eurofighter Simulation System GmbH			1		1
Comlenia Sendirian Berhad			1		1
Iniziative Industriali Milano S.r.l. (in liq.)				1	1
Other companies with unit amount of less than €mil. 1			2		2
Joint ventures/GIE (*)					
GIE ATR				39	39
MBDA S.A.S. (group)			45		45
Alcatel Alenia Space S.A.S.			21		21
Aviation Training Int. Ltd	11	1			12
Telespazio S.p.A.			2		2
Advanced Logistic Technology Eng. S.p.A.				1	1

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

(millions of euros) **PAYABLES AT 30 SEPT 2006**	**Non-current payables**	**Current borrowings**	**Trade payables**	**Other current payables**	**Total**
Subsidiaries					
Alifana Due S.c.r.l.			2		2
Selex Sensor Airborne Syst El. (Overseas) Ltd			1		1
Oto Melara North America Inc.			1		1
Finmeccanica UK Ltd			1		1
Associates					
Eurosysnav S.A.S.		20			20
Iveco Fiat/Oto Melara S.c.a.r.l.				10	10
Eurofighter Jagdflugzeug GmbH			6		6
Pegaso S.c.r.l.			4		4
Elettronica S.p.A.			1		1
Advanced Air Traffic Systems Sdn Bhd			1		1
Orizzonte - Sistemi Navali S.p.A.				1	1
Europea Microfusioni Aerospaziali S.p.A		1			1
Other companies with unit amount of less than €mil. 1			1		1
Joint ventures/GIE (*)					
MBDA S.A.S. (group)		287	12		299
Telespazio S.p.A.		20	1		21
GIE ATR			4		4
Alcatel Alenia Space S.A.S.			3		3

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

(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 of less 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 of less than €mil. 1			5		5
Joint ventures/GIE (*)					
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 in 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 Amercia Inc.			1		1
Finmeccanica Inc.			1		1
Other companies with unit amount of less 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 of less than €mil. 1		1	2		3
Joint ventures/GIE (*)					
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 in consolidation

(millions of euros) 30 SEPT 2006	**Revenues**	**Financial income**	**Purchases and costs**	**Financial expense**
Subsidiaries				
Finmeccanica UK Ltd			3	
IGS S.p.A (in liq.)			1	
Associates				
Eurofighter Jagdflugzeug GmbH	209			
Eurosysnav S.A.S.	45			
Iveco Fiat/Oto Melara S.c.a.r.l.	38		3	5
NH Industries S.a.r.l.	13			
Euromids S.A.S.	11			
Eurofighter Simulation Systems GmbH	10			
Orizzonte - Sistemi Navali S.p.A.	5		1	
Elettronica S.p.A.	2		1	
Nahuelsat S.A.	2			
Remington Elsag Law Enforc.Systems LLC	2			
Consorzio Start S.p.A.	1			
Nicco Communications S.A.S.	1			
Advanced Air Traffic Systems Sdn Bhd	1		1	
Sostar GmbH	1			
Eurofigh. Aircraft Management GmbH	1			
Comlenia Sendirian Berhard	1			
Ansaldo Trasmissione e Distribuzione S.p.A	1			
Joint ventures/GIE (*)				
MBDA S.A.S. (group)	49			6
GIE ATR	36			
Alcatel Alenia Space S.A.S.	13		5	
Telespazio S.p.A.	2		1	
Dataspazio S.p.A.			1	

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

(millions of euros) 30 SEPT 2005	**Revenues**	**Financial income**	**Purchases and costs**	**Financial expense**
Subsidiaries				
Finmeccanica Inc.			2	
Oto Melara North America Inc.			1	
Associates				
Eurofighter Jagdflugzeug GmbH	398			
Iveco Fiat/Oto Melara S.c.r.l.	40			2
Eurosysnav S.A.S.	24			
Eurofighter Simulation Systems GmbH	11			
Euromids S.A.S.	11			
Dataspazio S.p.A.			7	
NH Industries S.a.r.l.	5			
Nicco Communications S.A.S.	4			
Orizzonte Sistemi Navali S.p.A.	2		2	
Consorzio Start S.p.A.	1			
Elettronica S.p.A.	1		1	
Lockheed Martin Alenia Tactical Transport Systems LLC	1			
Sostar GmbH	3			
Joint ventures (*)				
MBDA S.A.S. (group)	37			5
GIE ATR	17			
Alenia Marconi Systems S.p.A. (++)	4			
AMS Ltd (++)				1
Telespazio S.p.A. (+)			1	
Alcatel Alenia Space S.A.S. (+)	4		3	

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

(+) Starting from 1 July 2005

(++) Until 29 April 2005

Performance by division

HELICOPTERS

€ millions	30.09.2006	30.09.2005	Q3 2006	Q3 2005	31.12.2005
New orders	3,328	2,892	507	472	3,712
Order backlog	8,638	7,039	n.a.	n.a.	7,397
Value of production	1,974	1,721	626	551	2,490
EBIT	183	174	48	48	272
R.O.S.	9.3%	10.1%	7.7%	8.7%	10.9%
Working capital	398	472	n.a.	n.a.	309
Net invested capital	2,108	2,085	n.a.	n.a.	2,023
R.O.I (*)	13.3%	11.1%	n.a.	n.a.	13.4%
Research and development	256	267	76	81	436
Employees (no.)	8,806	8,545	n,a	n.a.	8,531

(*) calculated on invested capital at period-end

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

Total volume of **new orders** for AgustaWestland, which reached €mil. 3,328 at 30 September 2006, is sharply higher (+15%) over the same period of the previous year (€mil. 2,892).

The first nine months of the year saw a number of particularly significant commercial developments in the military segment, including the following orders received from the UK Ministry of Defence:

- the €mil. 1,400 programme for the provision of 70 Future Lynx helicopters to the British Armed Forces (2nd quarter), the first group of which, for the development phase, has a value of about €mil. 550. This contract, which calls for the delivery of 30 helicopters to the Royal Navy and 40 to the Royal Army beginning in 2011, is part of the strategic partnering agreement between the UK Ministry of Defence and AgustaWestland, which calls for close collaboration in the helicopter programmes of the British armed forces as also defined by the British government's Defence Industrial Strategy. This agreement, together with the Future Lynx contract, will ensure that the high-profile engineering and systems skills required by the UK Ministry of Defence are maintained at the AgustaWestland facilities in Yeovil in order to provide the needed support;
- the contract for the Merlin Capability Sustainment Plus (MCSP) programme with a value of about €mil. 550, which includes upgrading 30 EH 101 Merlin Mk1 helicopters in service with the British Royal Navy, with an option for a further 8 helicopters (1st quarter);
- the Integrated Merlin Operational Support (IMOS) contract, in the amount of about €mil. 640 for the first five of a total of 25 years, for the transformation of the *modus operandi* for the provision of logistics support for the fleet of EH 101 in service with the Royal Air Force and Navy (1st quarter).

Given its unique and virtually complete range of modern and competitive products, AgustaWestland has also proven its ability to compete in increasingly broad segments of the civilian market. Of note in that regard are the following:

- orders for an additional 53 AW139 helicopters, including the provision of 12 helicopters to *Mitsui Bussan* (a Japanese civil aviation firm) and 8 to *Hawker Pacific* (an Australian government agency) in the first quarter. The portfolio of orders for the AW139 continues to grow, with some 137 helicopters currently on order;
- orders for an additional 80 A109 light twin-turbine helicopters, including the contract with the Japanese national police force (2nd quarter) for the provision

of an additional 4 helicopters. The company has scored a number of major successes for this type of craft, as demonstrated by the steady increase in the orders for this product, which now stands at 168 units;

- the order of 33 A119 helicopters, including 20 to Seacor for oil platform support and transport links;
- in the third quarter of 2006, an agreement was signed with Aerolineas Ejecutivas, Mexico City, which calls for an initial order for five A119 Koala, A109 Power, Grand, and AW139 helicopters, plus 37 options for the next five years, as well as the signing of a long-term agreement with the Brazilian company Synergy Aerospace (a division of the Synergy Group), which calls for the delivery in three years of A119 Koala, A109 Power, Grand, and AW139 helicopters for a total of six craft plus 56 options. The helicopters are to be used and leased by Ocean Air Taxi Aéreo, a subsidiary of Synergy Aerospace responsible primarily for offshore and VIP transport. In both agreements, the helicopters are to be produced in the AgustaWestland plants in Philadelphia (USA) and Vergiate (Italy).

Comparing the two periods, the three types of helicopters mentioned above posted orders for a total of 170 craft for the first nine months of 2006, as compared with the 104 units sold at 30 September 2005.

As a result of the high volume of new orders for the first half of the year, the value of the **order backlog** at 30 September 2006 came to €mil. 8,638 for an increase of approximately 17% over the same figure of 31 December 2005 (€mil. 7,397).
The orders at 30 September 2006 can be broken down into 68% for helicopters, 28% for support activities, and 4% for engineering and other activities.

The **value of production** at 30 September 2006 amounted to €mil. 1,974, for an increase of 15% over 30 September 2005 (€mil. 1,721). This improvement is primarily attributable to the start of production on the VH 71 contract for the President of the United States, as well as to the increase in the rate of production on the AW139 line and the greater volumes for the support activities generated primarily in the UK.

AgustaWestland output focused on the following main programmes:

- the EH101 for the Italian Navy, continuing activities for the second lot; seven further units delivered to the Danish government in the first nine months of the year; the Portuguese government, which received all of the units ordered; and continuing activities for the provision of the EH101 to the Japanese Navy with the delivery of the first helicopter;
- the Super Lynx 300 helicopter, with work continuing on contracts with the South African Navy, as well as the completion of the contract with the Air Forces of Oman;
- the A109 Power helicopter for the civil/government market, of which 20 units have been delivered;
- the A109 Grand helicopter, of which 13 units have been delivered;
- the A129 helicopter in the combat (CBT) configuration and the upgrade in this configuration of the A129 Mangusta, currently in service with the Italian Army;
- the AB412 helicopter for Italian and foreign government agencies, of which three units have been delivered;
- manufacturing of the A109E Power variant for contracts with the Swedish Armed Forces and the South African Air Force, with an additional 19 units delivered;
- activities concerning the production of the NH90 helicopter;
- logistics and support services for existing civil/governmental and military fleets.

EBIT at 30 September 2006, in the amount of €mil. 183, posted an increase of 5.2% over the same period of the previous year (€mil. 174). This improvement is due, in part, to the aforementioned growth in volumes, as well as to the effect of efficiency enhancement actions undertaken last year as part of the process of integrating British and Italian activities.

ROS came to at 9.3%, down from 30 September 2005 (10.1%) due to product support activities related to the new contracts acquired in the UK.

Working capital reached €mil. 398 at 30 September 2006 from the €mil. 309 of 31 December 2005, an increase of €mil. 89 due to the rise in current assets as a result of the expansion of production volumes noted earlier.

Net invested capital at 30 September 2006, in the amount of €mil. 2,108, posted an increase of €mil. 85 over 31 December 2005 (€mil. 2,023), which was essentially due to the increase in working capital.

Return on investment (**ROI**) reached 13.3% at 30 September 2006, increasing by about two percentage points over the figure at 30 September 2005 (11.1%) due primarily to the increase in EBIT, but was essentially in line with that of 31 December 2005 (13.4%).

Research and development expenditure at 30 September 2006, amounting to €mil. 256 (€mil. 267 at 30 September 2005), primarily concerned:

- research as part of programmes financed through Law 808/85, which include the development of technologies for a new helicopter of the 6/7-tonne class named the A149 and development of the BA 609 convertiplane, which has reached an important milestone with the scheduling of its first flight by the end of the year;
- research into upgrading products, where activities continued on the customisation of the AW139 and Agusta Grand helicopters.

The AgustaWestland had 8,806 employees at 30 September 2006, a 3% increase from 31 December 2005 (8,531 employees). This rise was necessary in order to meet the technical/production needs related to the increase in business volumes.

DEFENCE ELECTRONICS

€ millions	30.09.2006	30.09.2005	Q3 2006	Q3 2005	31.12.2005
New orders	2,195	3,367	541	517	4,627
Order backlog	6,745	7,114	n.a.	n.a.	6,946
Value of production	2,565	1,922	825	712	3,324
EBIT	125	114	26	33	269
R.O.S.	4.9%	5.9%	3.2%	4.6%	8.1%
Working capital	1,284	1,194	n.a.	n.a.	802
Net invested capital	2,991	2,712	n.a.	n.a.	2,154
R.O.I. (*)	5.6%	5.6%	n.a.	n.a.	12.5%
Research and development	378	350	97	165	501
Employees (no.)	19,489	18,593	n.a.	n.a.	19,786

(*) calculated on invested capital 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 Systems, which groups together the activities of Galileo Avionica S.p.A. and Selex Sensors and Airborne Systems Ltd.;
- the acquisition by BAE Systems of the military and secure communications business, which was 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.

Since the fourth quarter of 2005, the Defence Electronics division also includes Datamat, a group involved in the design and creation of information technology solutions, particularly in the defence, space and government markets. Finmeccanica S.p.A. currently holds a 90.005% stake in Datamat S.p.A., taking account of treasury shares.

Also last year, Finmeccanica, through its subsidiary Selex Service Management S.p.A. (SE.MA.), finalised participation in the consortium Innovazione e Progetti S.c.p.A., which is to develop the programme for the realisation and dissemination of the electronic ID card.

The different timing of the execution of these transactions, 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, and private mobile radio communications systems and IT and security activities.

This area also includes Finmeccanica’s International Naval Systems division, the assets of which were sold to the associated company Orizzonte – Sistemi Navali S.p.A., which also manages contracts that remain wholly controlled by Finmeccanica.

In addition to the production of electronic equipment and systems for defence and security, the division also continued its intensive efforts concerning the provision of large-scale integrated systems based on complex architectures and network-centric approaches.

The goal is to meet the increasingly pressing needs of customers to possess large-scale systems that integrate a variety of functions, platforms and sets of sensors in order to ensure effective performance in the surveillance, control, and protection of critical areas and infrastructures.

To that end, Selex Sistemi Integrati has begun numerous sales campaigns, particularly in export markets, in order to promote large-scale homeland protections systems, especially for applications related to border control and security management in conjunction with major events. This effort leverages all of the skills of the various group companies and takes advantage of the consolidated presence of a number of these companies in the various countries concerned.

At 30 September 2006, **new orders** totalled €mil. 2,195. The main new orders during the period include the following:

- Avionics: additional orders finalized in the third quarter for the EFA programme, which join those recorded during the first half of the year for the provision of some 200 Pirate infrared search and track (IRST) systems and replacement parts for the Defensive Aids Sub-System (DASS) of the second group of aircraft, as well as for the production of the DASS for the aircraft destined for Austria; in the first half of the year, there were also new orders for the development of the Helicopter Integrated Defensive Aids System (HIDAS) for AgustaWestland's future Lynx helicopters for the UK Ministry of Defence and for activities concerning the Capability Sustainment Plus programme for the Merlin EH101 helicopter;
- land and naval command and control systems: additional activities in the third quarter for the combat management system and the other command and control systems for the FREMM frigates by Orizzonte – Sistemi Navali S.p.A., which join the order received in the second quarter by Orizzonte – Sistemi Navali S.p.A. and that by MBDA in the first quarter for the Empar radar for the frigates' missile system; for air-traffic control in the third quarter, the contract was finalized for the Systematic Modernization of ATM Resources in Turkey

(SMART) programme related to the provision of systems with the most advanced software features and control towers, both in existing centres and in centres under construction, while in the first half of the year, the E-Net order was received by ENAV, as well as the order for the provision of primary and secondary radar systems and control centres for two locations from the Malaysian Ministry of Transportation;

- integrated communications systems and networks: significant orders in the UK for the main strategic communications programme (Falcon) of the Ministry of Defence and for the second batch of Type 45 vessels, as well as for communication systems of the FREMM frigates and the EFA and for the provision of a new Mobile Radio Relay Station (MRRS) as part of the Theatre Independent Tactical Army and Air Force Network (TITAAN) programme for the Dutch Armed Forces, all of which were acquired in the second quarter;
- information technology and security: an order for postal automation in Greece acquired in the first quarter; the Telecom Italia order for the Italian secure postal network (*Rete sicura Poste Italiane*) and a *Nuova Rete* (new network) order change by Poste Italiane acquired in the second quarter; the hybrid mail order for the Russian postal system acquired in the third quarter; and FREMM orders (Datamat, acquired in the second and third quarters).

The **order backlog** at 30 September 2006 came to €mil. 6,745, which is essentially in line with the figure posted at 31 December 2005.

Value of production came to €mil. 2,565 at 30 September 2006, an increase of 33% or €mil. 643 in absolute terms compared with the same period of the previous year. This increase is essentially due to the acquisition of the British avionics business and of Datamat. Revenues increased principally due to the following:

- avionics: the continuation of activities relating to DASS production and the production of avionics equipment and radar for the first and second tranches of the EFA programme, as well as systems for countermeasures, avionics for the helicopter programmes and AMX, Grifo combat radar and PAR systems, Mirach 100/5 targets, and logistics;

- radar and command and control systems: the continuation of activities relating to contracts with the Italian Navy, particularly for naval systems on the Nuova Unità Maggiore vessel and for the modernisation of the Maestrale Class and De La Penne frigates, FSAF and Orizzonte international cooperation contracts, FADR D-band land-based radar, as well as air traffic control programmes both in Italy and abroad;
- integrated communications systems and networks: activities relating to the development and manufacture of equipment for the NH90 and EFA aircraft (V/UHF, MIDS interface, interrogator, transponder), the provision of radio systems for NATO's AWACS aircraft, and the production of personal role radios;
- IT and security: activities relating to security, automation, IT, and defence systems and services.

EBIT at 30 September 2006 came to €mil. 125 for an increase of €mil. 11 over the same figure posted for September 2005. This growth is the result of the contribution of the UK avionics component and of Datamat, as well as, although to a lesser extent, of the improvement in command and control systems and the increase in margins for the IT segment, which primarily reflects the first benefits of the strategic repositioning of Elsag. This result also shows the effects of continuing delays in receiving the Interpolizie order in the communications area.

ROS at 30 September 2006 came to 4.9%, down from the 5.9% recorded for September 2005 due to difficulties in the communications segment and, above all, to the consolidation of the UK avionics business, the profitability of which was lower than the sector average. This overall cyclical effect will be recovered over the coming financial years by achieving important synergies from projects of integration and rationalisation.

Net invested capital at 30 September 2006 came to €mil. 2,991, up €mil. 837 compared with 31 December 2005 (€mil. 2,154) due both to an increase in **working capital** (up

€mil. 482 over the figure posted at the end of 2005), which reflects the delays in certain invoices and in receipts, particularly from public sector accounts, as well as to an increase in capital assets, which reflects the different classification of the put and call option of Finmeccanica and BAE Systems for the purchase/sale of the remaining 25% of avionics activities (€mil. 397) and the €mil. 55 increase in goodwill related to Datamat.

Research and development costs at 30 September 2006 came to €mil. 378, as compared with the €mil. 350 of the same period of the previous year, and include the continuation of development for the EFA programme, the fine-tuning of the Falco UAV system, the development of naval and land-based command and control systems, the completion of development of radar systems for air traffic control, and the completion of the TETRA network.

At 30 September 2006, there were 19,489 employees, a decrease of 297 employees from 31 December 2005, related essentially to the Information Technology & Security area due to the sale of Elsag STI S.p.A. and Elsag Business Process S.r.l. and of the ERP division of Datamat Soluzioni per le Imprese S.r.l., as well as the workforce reduction under way in the communications area.

AERONAUTICS

€ millions	30.09.2006	30.09.2005	Q3 2006	Q3 2005	31.12.2005
New orders	1,427	2,116	256	1050	3,230
Order backlog	6,965	6,302	n.a.	n.a.	6,865
Value of production	1,535	1,415	569	469	2,046
EBIT	115	99	54	51	166
R.O.S.	7.5%	7.0%	9.5%	10.7%	8.1%
Working capital	(159)	(398)	n.a.	n.a.	(764)
Net invested capital	483	43	n.a.	n.a.	(227)
R.O.I. (*)	n.s.	n.s.	n.a.	n.a.	n.s.
Research and development	342	280	117	89	405
Employees (no.)	11,826	10,974	n.a.	n.a.	11,198

(*) calculated on invested capital at period-end

Note that the figures for the GIE-ATR consortium are consolidated on a proportionate basis at 50%.

The Aeronautics division includes Alenia Aeronautica S.p.A. (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: Alenia Aermacchi S.p.A. (production of military training aircraft and engine nacelles for civil aeronautics), Alenia Aeronavali S.p.A. (aircraft conversions and maintenance), and the GIE-ATR consortium, in which a 50% equity stake is held (marketing and assembly of ATR aircraft).

During the first nine months of 2006, the principal activities in the military division were as follows:

- Alenia Aeronautica: EFA development, production and logistics; production of the C27J aircraft; the continuation of upgrades to the Tornado aircraft (retrofit pre-mid-life upgrade) and the modernisation of avionics (ACOL) of the AMX for the Italian Air Force; and design and planning activities for the JSF aircraft commissioned by Lockheed;
- Alenia Aermacchi: the production and logistical support for the MB339 and SF260 training aircraft, further development of the new M346 training aircraft, and feasibility studies for the M311 aircraft;
- Alenia Aeronavali: development and production for the B767 tanker programme; the overhaul and logistical support for the B707 Tanker, AWACS and Atlantic aircraft; and return to airworthiness of the 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. Development and sales activities continued for the new B787, the manufacturing of which is to be done in the new facilities at Grottaglie (central sections of the fuselage) and Foggia (horizontal tail wings) beginning by the end of 2006. At Global Aeronautica LLC (a joint venture with Vought Aircraft Industries) facilities in Charleston, South Carolina, the sections of the fuselage manufactured by the two partners will then be assembled.
- 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: the production of the ATR 42 and 72 turboprops;
- Dassault Aviation: the fuselage section of the Falcon 2000 Extended Range and the engine nacelles for the Falcon 900EX.

The activities of Alenia Aeronavali involved the transformation from passenger to cargo craft of the MD10, MD11, B767, and ATR, while those of Alenia Aermacchi concerned the production of engine nacelles.

It should also be noted that, following the agreement signed in June 2006, Finmeccanica and Sukhoi Aviation Holding and their subsidiaries Alenia Aeronautica and Sukhoi Civil Aircraft Company (SCAC), respectively, continued negotiations to establish a strategic partnership for the Russian Regional Jet (RRJ) programme. The RRJ programme calls for the design, development, manufacture, marketing and technical support for a family of next-generation regional jets with capacities of between 75 and 100 seats. The proposed agreement currently being discussed calls for Alenia Aeronautica to purchase a 25% plus one share stake in SCAC (subject to approval by the Russian government) and to participate, in corresponding measure, in the development of the RRJ programme.

New orders at 30 September 2006 came to €mil. 1,427, for a decline of €mil. 689 from the €mil. 2,116 of 30 September 2005 due to a lower level of orders received during the third quarter in the civil segment. More specifically, the change is related to the significant B787 order received in the third quarter of 2005 for some €mil. 850, whereas for 2006, the B787 orders are expected to arrive by year-end, but will be of a more limited amount.
The main orders received during the first nine months of 2006 include the following:

- the military segment: new orders related to five C27J aircraft plus an option for three more to Bulgaria; the provision of ten ATR72 anti-submarine warfare (ASW) aircraft for sea patrol and anti-submarine activities to the Turkish Navy; AMX logistics; orders related to the EFA, JSF, and Tornado programmes; and the maintenance and upgrading of the avionics of 12 MB339 aircraft already in use by Nigeria;
- the civil segment: new orders for the GIE-ATR consortium, which received orders for 54 aircraft (of which, in the third quarter, orders totalling about €mil. 90 related to seven aircraft and customer service activities), thereby consolidating the positive trend posted last year (new orders for 53 aircraft at 30 September 2005); the additional tranches for the A380, B777, B767, Falcon

programmes, engine nacelles, and the transformation of three B767-300 aircraft.

Continuing with sales activities, and the sale of the C27J to the United States in particular, in June 2006 the proposal was submitted in response to the RFP related to the joint programme of the US Army and Air Force known as the Joint Cargo Aircraft (JCA). In August 2006, following an initial selection process, EADS-CASA's Lockheed C130J and CN235 aircraft were excluded from the tender process. As such, EADS-CASA's C27J and C-295 are the only aircraft to remain in the running. The initial provision concerns a maximum of 75 aircraft, but this could increase to more than 200 if the US Air Force confirms the selection of the C27J for its own needs. Partnering with Alenia Aeronautica for the initiative are both L3 Communications and Boeing Integrated Defense Systems.

Also of note, again in June, is the signing of the order for the provision of three C27J aircraft to Lithuania. This order will be operational by the end of the year.

The **order backlog** at the end of September 2006 came to €mil. 6,965 made up principally of the following programmes: EFA (50%), B767 (17%), C27J (5%), and AMX (5%) programmes. The backlog grew by €mil. 100 from the €mil. 6,865 at the end of 2005, and is expected to continue expanding over the medium/long term.

Value of production at 30 September 2006 totalled €mil. 1,535, an increased of €mil. 120 (+8.5%) over the same period of the previous year (€mil. 1,415). As forecast, civil activities contributed to this growth with increases in ATR and A380 sales and manufacturing. Military production for Alenia Aermacchi and Alenia Aeronavali was slightly lower due, respectively, to the delay of a number of foreign orders and the reduced activities in aircraft for the Italian Air Force for the B707 tanker overhaul and Breguet Atlantic inspections.

EBIT at 30 September 2006 came to €mil. 115, an increase of €mil. 16 over the €mil. 99 posted for the first nine months of the previous year and ROS of 7.5%, as compared with the 7.0% of 30 September 2005. Alenia Aeronautica and the GIE/ATR consortium posted improved performance, and for the GIE/ATR consortium the reduction in risk due to the positive trends in sales and in the commercial outlook for the ATR programme has resulted in the release of an excess portion of the provision that had been accumulated. The use of this provision was partially offset by the worsening of Alenia Aeronavali related primarily to the allocation of charges on contracts, the expensing of development costs, and lower than expected productivity. Affected by the aforementioned decline in business in the military segment, Alenia Aermacchi also posted a decline.

Similarly to the previous year, results and profitability for the third quarter of 2006 benefited from the conclusion of negotiations, which resulted in the acquisition of the expected payments from Boeing for the close of production.

Working capital at 30 September 2006 came to a negative €mil. 159, up €mil. 605 compared with 31 December 2005 (a negative €mil. 764). This increase, which is expected to decline over the coming months, was primarily attributable to the increase in net inventories, which were affected by a number of delays in invoicing, as well as to increased trade receivables due to lower receipts from the public sector for certain military programmes. Non-recurring work in progress also increased over 31 December 2005 as a result of the development activities conducted during the period concerning programmes being developed, the status of which is in line with forecasts.

Net invested capital at 30 September 2006 came to €mil. 483, an increase of €mil. 710 over the negative €mil. 227 at 31 December 2005, due to developments in working capital, as noted above, and the increase in capital assets as a result of larger investments, particularly those regarding the new Grottaglie facilities and plant, machinery and equipment for B787 production.

Research and development costs for the first nine months of 2006 came to €mil. 342, an increase of €mil. 280 over the same period of 2005. This result reflects the greater commitment to activities of programmes such as B787, C27J, M346, second tranche EFA activities, Tornado, AMX, Unmanned Air Vehicles (UAVs), 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 30 September 2006 stood at 11,826, representing an increase of 628 over the 11,198 employees at 31 December 2005. This increase was due to new hires by Alenia Aeronautica in order to meet the needs of higher workloads, particularly for engineering and new programmes.

SPACE

€ millions	30.09.2006	30.09.2005	Q3 2006	Q3 2005	31.12.2005
New orders	515	330	184	63	599
Order backlog	1,191	1,042	n.a.	n.a.	1,154
Value of production	518	547	170	176	736
EBIT	22	24	6	5	26
R.O.S.	4.2%	4.4%	3.5%	2.8%	3.5%
Working capital	32	53	n.a.	n.a.	(18)
Net invested capital	389	357	n.a.	n.a.	309
R.O.I. (*)	7.5%	9.0%	n.a.	n.a.	8.4%
Research and development	39	60	9	6	79
Employees (no.)	3,199	3,125	n.a.	n.a.	3,194

(*) calculated on invested capital at period-end

Note that the figures at 30 September 2005 includes the first 6 months of activity of the companies Alenia Spazio e Telespazi, 100% consolidated, and the following 3 months of activities concerning the two new joint ventures (Alcatel Alenia Space S.A.S. and Telespazio Holding S.r.l.), consolidated on a proportionate basis at 33% and 67% respectively, while the figures for 30 September 2006 refer to the two new joint ventures, consolidated as specified. Therefore, the figures for the current financial period cannot be compared with those of the previous period.

Since 1 July 2005, Finmeccanica has operated in the space industry through Telespazio Holding S.r.l. (satellite services), which is based in Italy and has its main industrial facilities in Italy, France and Germany and in which Finmeccanica holds a 67% stake, as well as through Alcatel Alenia Space S.A.S. (manufacturing), which is based in France and has its main industrial facilities in France, Italy, Belgium and Spain and in which Finmeccanica holds a 33% stake.

More specifically, Telespazio Holding concentrates on satellite navigation and earth observation, the provision of telecommunications networks and services, the management and orbital control of satellites and of terrestrial centres, and multimedia and high value applications.
Alcatel Alenia Space S.A.S. focuses on the design, development and production of space systems, satellites, orbital infrastructures, space transport systems, equipment, instruments, and terrestrial systems for civil and military applications.

During the first nine months of 2006, **new orders** came to €mil. 515, up €mil. 185 from the same period of 2005 (€mil. 330), thanks, above all, to commercial satellites. The most significant new orders for the period were:

- in the first quarter, orders related to the Turksat 3A and Ciel 2 telecommunications satellites and to the Kompsat payload, the additional tranche related to the Herschel/Plank science programme, the renewal of long-term TV service contracts (particularly W3/Express for RAI), and the new orders for orbital satellite management (particularly Eutelsat AB1 and Satelcom Geo);
- in the second quarter, the orders related to the payload of the Arabsat 4AR and AMC21 commercial satellites, the additional new orders related to the Galileo and Egnos satellite navigation programmes, the new orders in the transport equipment and infrastructures sector, and new orders for the provision of telecommunications and earth observation satellite services (particularly the Agrisian contract);
- in the third quarter, orders related to the BW Satcom programme for the provision of two telecommunications satellites to the German Ministry of Defence, the Eutelsat order related to the W2A satellite, new orders related to the provision of two payloads for the Express AM33/44 programme, and two radar altimeters as part of the Siral 2 programme, as well as additional orders for the provision of satellite TV and telecommunication services.

The **order backlog** at 30 September 2006 came to €mil. 1,191, an increase of €mil. 37 over the same figure at 31 December 2005 (€mil. 1,154). The order backlog, based on the amount of work ready to begin, guarantees coverage of approximately 1.5 years of production. The backlog at 30 September 2006 is composed of manufacturing activities

(48% satellites, 15% infrastructure and equipment) for 63% and satellite services for the remaining 37%.

Value of production for the first nine months of 2006 came to €mil. 518, down €mil. 29 from the same period of the previous year (€mil. 547) due to lower production levels in the manufacturing segment. The principle sources of production revenues were:

- the start of project activities related to the Turksat 3A, Ciel 2, BW Satcom, and W2A telecommunications satellites;
- the continuation of activities relating to:
  - the Cosmo-SkyMed and Pleiades earth observation programmes;
  - the StarOne C1/C2, Alphabus, Thaicom 5, Chinasat 6B/9, Galaxy 17, Rascom and Koreasat 5 commercial satellites;
  - the Herschel/Plank, Alma and Goce science programmes and the Meteosat Second Generation programme;
  - the Syracuse and Sicral 1B military telecommunications satellites;
  - the Galileo and EGNOS navigation programmes;
- the continuation of the programmes connected with the International Space Station;
- the development of equipment and devices for EQS France/Italy and for the Koreasat 5 satellite, and the payloads for the Arabsat 4A/4B/4R, Express AM33/34, Kompsat, and AMC21 satellites;
- the provision of telecommunications satellite services, earth observation services, orbital satellite management, and, in the television sector, the resale of satellite capacity and provision of broadcasting services.

EBIT at 30 September 2006 came to €mil. 22 for a decrease of €mil. 2 from the figure for 30 September 2005 (€mil. 24) due essentially to a greater incidence of labour costs, net of production synergies resulting from the new joint ventures. As a result, **ROS** fell from the 4.4% of the first nine months of 2005 to 4.2% at 30 September 2006.

Net invested capital at 30 September 2006 came to €mil. 389, an increase over 31 December 2005 of €mil. 80, attributable primarily to **working capital** of €mil. 32, posting an increase for the first nine months of the year of €mil. 50 over 31 December

2005 (a negative €mil. 18) due primarily to growth in net inventories due to delays in invoicing for a number of important programmes, which also led to lower receipts of trade receivables.

Research and development costs for the first nine months of 2006 came to €mil. 39, down about €mil. 21 from the same period of 2005 (€mil. 60) as a result of the synergies achieved with the establishment of joint ventures. Key activities in this area included:

- research and development phases for programmes such as:
  - Cosmo, Syracuse and Sicral 1B, and Sentinel 1 (SAR radar, altimeter and radiometer);
  - science programmes (Alma, Spirale/Melissa, Bepi-Colombo, Goce, and Herschel/Plank);
  - Egnos and Galileo (phase GSTB V2);
- studies relating to:
  - future experiments on board the International Space Station;
  - capsules, orbital infrastructure and manned re-entry craft;
  - the development of production technology (equipment, flexible payloads, etc.) for mobile and/or broadband applications in particular;
  - the development of GIS platforms, algorithms and processors for SAR interferometry;
  - the definition of solutions for advanced telecommunication, satellite navigation, infomobility, and digital terrestrial TV.

The **number of employees** at 30 September 2006 came to 3,199, for an increase of 5 employees over the 3,194 of 31 December 2005 due to delays in the implementation of the approved Alcatel Alenia Space reorganisation in France, as well as to normal turnover.

DEFENCE SYSTEMS

€ millions	30.09.2006	30.09.2005	Q3 2006	Q3 2005	31.12.2005
New orders	496	403	158	71	763
Order backlog	4,070	4,098	n.a.	n.a.	3,869
Value of production	751	706	239	236	1,154
EBIT	38	42	16	22	112
R.O.S.	5.1%	5.9%	6.7%	9.3%	9.7%
Working capital	(245)	(193)	n.a.	n.a.	(321)
Net invested capital	244	242	n.a.	n.a.	111
R.O.I. (*)	20.8%	23.1%	n.a.	n.a.	n.s.
Research and development	141	109	15	36	268
Employees (no.)	4,289	4,130	n.a.	n.a.	4,104

(*) calculated on invested capital at period-end

Note that the figures relating to the MBDA joint venture are consolidated on a proportionate basis at 25%.

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 counter-measures) and sonar systems.

In February, as part of the integration of the European missiles industry, MBDA finalised the acquisition of the German firm LFK GmbH, which has been consolidated as of 1 March 2006.

New orders for the first nine months of the year came to €mil. 496, which is greater than that of the same period of 2005 when there was a significant level of new orders for torpedoes in Portugal and for submarine counter-measures in India by WASS. The increase in orders for 2006 is primarily attributable to the new orders received in the third quarter for the FREMM missile systems, the Mistral anti-aircraft defence missiles to France, and the Taurus long-range air-to-surface missiles in the area of missile systems. Other important new orders for the first nine months of 2006 include the order of the German company recently acquired by MBDA for the third-generation Trigat long-range anti-tank missile systems for German helicopters. Furthermore, related to Oto Melara and WASS, of note are the new orders as part of the FREMM programme for the Italian Navy, as well as the new orders received by Oto Melara for the Hitfist turrets in Ireland and for turret components in Poland within the land-based weapons segment.

The **order backlog** at 30 September 2006 came to €mil. 4,070, 69% of which related to missile systems, for an increase of approximately 5% over 31 December 2005.

Value of production at 30 September 2006 came to €mil. 751, for an increase of 6% over the first nine months of 2005 attributable to missile systems related to the consolidation of the German firm LFK and, to a lesser extent, to growth in the PZH 2000 programme in land-based weapons systems.
Revenues benefited from the following activities:

- activities relating to the following: the production of Storm Shadow air-to-surface missile systems for the British Ministry of Defence, SCALP EG for the French Ministry of Defence, and Black Shaheen for exporting; the production of FSAF systems; the production of MICA air-to-air missiles and Brimstone anti-tank missiles, as well as customer support activities;
- land, naval and aeronautical weapons systems: the provision of PZH 2000 howitzers to the Italian Army; 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 nine months of 2006 came to €mil. 38, a decrease of €mil. 4 from the same period of 2005 due primarily to a non-recurring gain recorded in 2005 for the disposal of an Oto Melara property. In the missile systems segment, the consolidation of the newly-acquired German firm offset the decline from September of the previous year.

ROS at 30 September 2006 was lower than that of 30 September 2005 due essentially to the reduction in EBIT.

Working capital came to a negative €mil. 245 at 30 September 2006 due principally to advances from MBDA customers, an increase of €mil. 76 over 31 December 2005 (a negative €mil. 321) due primarily to an increase in net inventories. **Net invested capital** at 30 September 2006 came to €mil. 244, an increase of €mil. 133 over 31 December 2005 due both to the growth in working capital and the recognition of goodwill related to the acquisition of LFK GmbH (€mil. 63) in the missile systems segment.

Research and development spending for the first nine months of 2006 came to €mil. 141 for an increase of 29% over the same period of 2005. Some of the key activities included the continuation of development of the Meteor air-to-air missile, guided munitions in the land and naval weapons segment, and the Black Shark heavy torpedo in the underwater systems segment.

The **number of employees** at 30 September 2006 numbered 4,289, an increase of 185 from 31 December 2005, due essentially to the acquisition of LFK GmbH.

ENERGY

€ millions	30.09.2006	30.09.2005	Q3 2006	Q3 2005	31.12.2005
New orders	741	557	65	121	1032
Order backlog	2,455	2,130	n.a.	n.a.	2,329
Value of production	633	519	206	181	772
EBIT	38	20	20	7	39
R.O.S.	6.0%	3.9%	9.7%	3.9%	5.1%
Working capital	(355)	(247)	n.a.	n.a.	(193)
Net invested capital	(320)	(240)	n.a.	n.a.	(184)
R.O.I. (*)	n.s.	n.s.	n.a.	n.a.	n.s.
Research and development	11	8	4	3	13
Employees (no.)	2,692	2,527	n.a.	n.a.	2,529

(*) Calculated on invested capital at period-end.

In the third quarter of 2006, Ansaldo Energia S.p.A., a leader in the provision of components and services for power generation plants, completed the acquisition from the US firm Calpine European Finance LLC of 100% of Thomasen Turbine Systems B.V. (TTS), a Dutch firm specialised in services for heavy-duty gas turbines based on General Electric technology, for which the company provides parts, repairs, maintenance, and upgrades.

The TTS acquisition joins the acquisition completed last July for the 100% stake in the Swiss firm Energy Service Group (ESG), which provides on-site maintenance and repair services.

These transactions are part of a process of strengthening being undertaken by Ansaldo Energia, which is centred around two main strategies: achieving full technological autonomy in the creation of power generation machines; and strengthening the company’s technological skills in the service segment.

These acquisitions also provide Ansaldo Energia with new, important opportunities for commercial synergies in Italy and abroad, thereby helping to boost the company’s strength and visibility internationally. In particular, TTS is operates worldwide through an important network of sales offices and has two workshops, one in Rheden (the Netherlands) and the other in Abu Dhabi in the Middle East. The breadth of TTS’s offering is also demonstrated by the significant number of long-term service agreements (LTSAs) signed in recent years, especially in Europe and the Middle East.

Finally, again in the third quarter, the acquisition of Ansaldo Ricerche S.p.A. from SO.GE.PA. S.p.A. (a wholly-owned subsidiary of Finmeccanica) was also completed. This acquisition is aimed at rationalising and optimising the area of energy research and development activities.

In light of the recent acquisitions, at 30 September 2006, the energy sector is comprised of Ansaldo Energia S.p.A. and its subsidiaries.

In the third quarter of 2006, **new orders** came to €mil. 741 (with 82% in Italy and 18% abroad), which is sharply higher than the same period of the previous year (€mil. 557), of which 50% related to plants and components, 45% to service activities, and 5% to nuclear work.

The main new orders for plant and components for the third quarter included the design, provision, assembly supervision, and upgrade of a gas turbine and related alternator for the Valathur plant in India for the Tamil Nadu Electricity Board (€mil. 14).

The service segment again saw rapid growth in new orders, going from €mil. 193 at 30 September 2005 to €mil. 333 at 30 September 2006, an increase of 72%. Specifically, LTSAs accounted for 72% of new orders, as compared with 28% for flow contracts (i.e. repairs, replacement parts, maintenance, and upgrades).

As a result of these new orders, the **order backlog** at 30 September 2006 increased to €mil. 2,455, as compared with the €mil. 2,329 of 31 December 2005, providing a production equivalent of about 2.5 years.

Value of production came to €mil. 633 at 30 September 2006, an improvement of 22% over the same period of the previous year (€mil. 519). This increase is due essentially to the Rizziconi order in the first quarter and activities related to other contracts of a prevalently systems nature for the plants at Sparanise, Rosignano, Vado Ligure, and Escatron, as well as to the continuation of work for Enipower for its various sites in Italy and for the Iranian customer Mapna.
The contribution of each area of business to value of production is as follows: Plant 77%; Services 17%; and Nuclear 6%.

EBIT at 30 September 2006 came to €mil. 38, an increase of 90% over the same period of the previous year (€mil. 20) attributable to the aforementioned increase in volumes, despite the increase in research and development spending for the period (€mil. 11 vs. the €mil. 8 of the first nine months of 2005). **ROS** came to 6%, an improvement of 2.1 percentage points over 30 September 2005.

Working capital continued to improve and came to a negative €mil. 355 at 30 September 2006, compared with the negative €mil. 193 at 31 December 2005. The main effects include the advances received on new orders (Rizziconi) and an efficient balance of cash inflows and outflows on existing contracts. As a result, **net invested capital** also improved to a negative balance at 30 September 2006 of €mil. 320, compared with the negative €mil. 184 at the end of 2005.

Research and development costs at 30 September 2006 came to €mil. 11, compared with €mil. 8 for the same period of the previous year, and were related primarily to the continuation of the activities called for by the plan for technological independence in the area of steam and gas turbines which began in previous periods.

The **number of employees** at 30 September 2006 numbered 2,692, as compared with the 2,529 at 31 December 2005, for an increase of 163 resulting from routine turnover.

TRANSPORTATION

€ millions	30.09.2006	30.09.2005	Q3 2006	Q3 2005	31.12.2005
New orders	1,738	1,394	595	558	1,615
Order backlog	4,673	4,182	n.a.	n.a.	3,956
Value of production	1,005	899	316	313	1,230
EBIT	39	5	12	18	(48)
R.O.S.	3.9%	0.6%	3.8%	5.8%	(3.9%)
Working capital	194	350	n.a.	n.a.	235
Net invested capital	428	498	n.a.	n.a.	441
R.O.I. (*)	12.1%	1.3%	n.a.	n.a.	n.s.
Research and development	32	29	9	12	40
Employees (no.)	6,619	6,260	n.a.	n.a.	6,321

(*) Calculated on invested capital at period-end.

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

On 24 February 2006, Ansaldo STS acquired stakes in Ansaldo Trasporti - Sistemi Ferroviari S.p.A. (Systems) and Ansaldo Signal N.V. (Signalling) from Finmeccanica S.p.A., while in April 2006 Finmeccanica S.p.A. completed a public tender for the sale of a 60% stake in Ansaldo STS. Since 29 March 2006, the company's shares have been traded on the STAR segment of the Italian electronic stock market.

At 30 September 2006, the three business divisions showed the following performance:

- Signalling: positive trends with improvements both in financial standing and performance (ROS at 10.3%), especially thanks to the Italian subsidiary Ansaldo Segnalamento Ferroviario;
- Systems: strong commercial performance both in Italy and abroad, particularly in the area of driverless metro systems, with EBIT essentially in line with that of the same period of 2005 (ROS at 8.7%);
- Vehicles: financial performance continues to be characterised by operating losses, which will not be recovered in the coming months and which is affected by the significant reductions in contract margins as a result of the revision of estimates following the emergence of significant production difficulties for a number of contracts. At present, it remains to be seen what the potential effects will be of any settlements with customers and/or any new developments in that regard.

New orders acquired in the first nine months of 2006 totalled €mil. 1,738, an increase of €mil. 344 over the same period of the previous year (€mil. 1,394), reflecting increased orders in Systems and Vehicles, while orders in the Signalling division declined. The key orders during the period included the following:

- 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) framework agreement, the order by Trenitalia concerning the fourth contract for supplying on-board SCMT devices for trains, the orders related to the Ghaziabad-Kanpur line in India and for the Chicago subway line, all acquired in the first quarter; the order related to the high-speed Perpignan-Figueras line in France and Spain acquired in the second quarter; the order placed by Trenitalia for the fifth contract for supplying on-board SCMT devices acquired in the third quarter; and contracts as part of the agreement signed with the Australian Rail Track Corporation (ARTC) in the first, second and third quarters;
- Systems: the extension of the operation and maintenance contract for the automated underground transit system in Copenhagen in the first quarter; the

orders related to the automated (driverless) metro systems in Thessaloniki and Milan (line no. 5) received in the second quarter; and order for the Piscinola-Capodichino regional metro line in Campania received in the third quarter;

- Vehicles: the Sirio trams for Kayseri in Turkey and the options for Line 1 of the Milan underground, both acquired in the first quarter; the contract for Line 2 of the Milan underground and the orders related to the automated metro systems in Thessaloniki and Milan (Line 5) acquired in the second quarter; and the vehicle maintenance contract for the Madrid metro acquired in the third quarter.

At 30 September 2006, the **order backlog** for the division totalled €mil. 4,673, an increase of €mil. 717 over the same figure at 31 December 2005 (€mil. 3,956).

Value of production for the first nine months of 2006 came to €mil. 1,005, an increase of €mil. 106 over the same period of 2005 (€mil. 899), which was attributable to the Signalling and Vehicles divisions. 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 wayside and on-board, for Italy; second phase of the Channel Tunnel Rail Link; the project for the realisation of the Optimizing Traffic Planner (OTP) system for Union Pacific Railroad; and the manufacture of components;
- Systems: the metro systems of Naples and Copenhagen; the Alifana regional line; and high-speed rail orders in Italy;
- Vehicles: trains for the Madrid metro; DMU trains for the Danish railways; high-volume passenger trains for Morocco; high-speed trains for the Dutch-Belgian railways; trains for regional service for Ferrovie Nord Milano; E402 locomotives and ETR500 Politensione trains for Trenitalia; trams for the city of Los Angeles; and service and revamping activities.

EBIT for the first nine months of 2006 came to €mil. 39, an increase of €mil. 34 over the same period of 2005 (€mil. 5), thanks to the improvement primarily in the Signalling division. **ROS** for the sector improved as a result, reaching 3.9% compared with the 0.6% recorded for the same period of the previous year.

Working capital at 30 September 2006 amounted to €mil. 194, a decline of €mil. 41 compared with the total at 31 December 2005 (€mil. 235), with improvements attributable to Systems and Signalling and a worsening in Vehicles.

Net invested capital at 30 September 2006 came to €mil. 428, down €mil. 13 from 31 December 2005 (€mil. 441), as the aforementioned reduction in working capital was attenuated primarily by an increase in equity investments in the Systems segment due to investments in the companies established for the contracts related to the new Rome (Line C) and Milan (Line 5) metro lines.

Research and development costs for the first nine months of 2006 came to €mil. 32, up €mil. 3 from the same period of 2005 (€mil. 29), which is essentially attributable to the Signalling segment. In particular, these activities concerned Signalling projects, aimed primarily at meeting the new requirements emerging both in the railway segment (level 2 of the European Rail Traffic Management System, or ERTMS rbc) and the mass transit segment (Communications Based Train Control, or CBTC), as well as the development of certain on-board equipment (the next-generation cab).

The **number of employees** at 30 September 2006 stood at 6,619, an increase of 298 compared with 31 December 2005 (6,321 workers), principally due to hiring in the Signalling division.

OTHER ACTIVITIES

€ millions	30.09.2006	30.09.2005	Q3 2006	Q3 2005	31.12.2005
New orders	42	96	3	12	465
Order backlog	353	164	n.a.	n.a.	487
Value of production	159	108	55	40	170
EBIT	(88)	(72)	(15)	(28)	(101)
R.O.S.	n.s.	n.s.	n.s.	n.s.	n.s.
Working capital	(255)	48	n.a.	n.a.	(33)
Net invested capital	718	1,834	n.a.	n.a.	975
R.O.I. (*)	n.s.	n.s.	n.a.	n.a.	n.s.
Research and development	-	-	-	-	-
Employees (no.)	785	1,041	n.a.	n.a.	940

(*) calculated on invested capital 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; Ansaldo Fuel Cells S.p.A. for the production of energy through fuel cells; Finmeccanica Finance SA, responsible for providing financial support to the Group; and SO.GE.PA - Società Generale di Partecipazioni S.p.A., responsible for centrally managing the pre-winding-up/winding-up and rationalisation processes of companies falling outside the business sectors through transfer/repositioning transactions. Effective 27 July 2006, the shareholdings ALS S.p.A. and Iritech S.p.A. were merged into SO.GE.PA. S.p.A. The division also includes Fata S.p.A., which operates 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 that regard, it should be noted that, during the previous 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.

As a result of the adoption of the IFRSs, the following equity investments in liquidation were included within the scope of consolidation as from 31 December 2004: Ansaldo Industria S.p.A., Fata Automation S.p.A., and Fata Group S.p.A.
Also as of 2004, Bredamenarinibus S.p.A., which manufactures urban and interurban buses, was deconsolidated from the division, with the recognition of the income and expense items under discontinued operations and of the assets and liabilities as held for sale. This company's operations are undergoing reorganisation in order to make the business more attractive to potential buyers.

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 during 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 ensure that the financial objectives set by the Group would be met, the corporate division has 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 done 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.

- the assignment of specific objectives to the companies: firstly, the constant growth of EBIT, thanks to increased volumes and continuous efficiency-enhancement efforts, 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, the reduction of industrial and structural costs;
- review of processes from a Group perspective, in particular those that could have an effect on the optimisation of areas with possible synergies, such as information technology and real estate management;
- the issuance of specific directives aimed at the progressive alignment of cash flows with income and expenses 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 dissemination 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 IAS/IFRS transition project, which has 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 implementation 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 over the medium term with a broad-based management-by-objectives (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.

Outlook

Performance in the first nine months of 2006 improved with respect to that in the same period of the previous year, in line with the forecasts made at that time. In the light of developments to date, there would appear to be no circumstances that would alter the forecasts made during the preparation of the 2005 annual report, which are summarized below.

During 2006 we expect overall growth in Group revenues of between 10.5% and 13.5% with an increase in EBIT of between 14.0% and 17.0%, over 2005.

The forecasts for 2006 reflect the consolidation for the full year of the acquisitions made in 2005, particularly the Defence Electronics activities purchased from BAE Systems and consolidated as of 1 May 2005, and Datamat, fully consolidated as of 5 October 2005, the date on which we acquired 52.7% of the company.

The integration of recently acquired businesses, especially BAE Systems in the avionics sector and those in the Space division arising from the joint venture with Alcatel, will give rise to integration-related costs that must be incurred to permit us to exploit the considerable synergies expected.

for the Board of Directors

Pier Francesco Guarguaglini
Chairman and Managing Director