

Fiat at crossroads as demerger vote nears

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Sergio Marchionne's transformation of Fiat will take an irrevocable turn this week when he asks shareholders to approve the demerger of the 111-year-old Italian sports-cars-to-tractors conglomerate.

At an extraordinary meeting on Thursday, Fiat will put to the vote Mr Marchionne's proposal to divide Fiat's cars and engines business – which also includes the Ferrari, Maserati, Lancia and Alfa Romeo brands – from its Iveco trucks unit and CNH, which makes farm and construction equipment.

If they agree to the demerger, shareholders will get one share in each of the two new companies when they list in Milan on January 1 next year. Debt will be split equally between the cars division – which will continue as Fiat Spa – and its capital-goods businesses, which will trade as Fiat Industrial.

If the split is approved, Mr Marchionne, who joined Fiat's board in 2003 not long after the death of its patriarch Gianni Agnelli, and became chief executive in 2004, will divide permanently a group built originally around engines and everything they power, and which has become Italy's largest private sector employer and a symbol of Italian industrial might.

At its height the empire built by Mr Agnelli, whose family still own a 30 per cent stake in the group and whose grandson John Elkann is Fiat chairman, extended from cars to publishing, football, paper manufacturing, telecoms, banking, art and Château Margaux wines.

Markets are welcoming Mr Marchionne's move, albeit cautiously. Fiat's five-year credit default swap spreads have narrowed over the past five days as the cost of insuring its debt against default fell. On Friday its shares closed at their highest level in a month.

Mr Marchionne, in the six years he has run the group, has spoken often of bifurcating it when the time was right in order to free businesses with vastly different capital requirements, customers and valuations.

When announcing the split in April, he described its conglomerate status as "a thorn in Fiat's side". The two companies, he said, would now be free to pursue their own strategic choices, including alliances.

The demerger will take Mr Marchionne a step closer to what is widely considered to be his goal of merging Fiat's motor business with Chrysler, the US carmaker in which the Italian group acquired a 20 per cent stake last year and with which it is now jointly developing cars.

But analysts who follow Fiat are divided on the merits of the split, which will lay bare the sobering fundamentals faced by its cars division, which was helped in bad years by steadier earnings at Fiat's industrial businesses.

In the short term, the demerger plan will be of greater financial benefit to Fiat Industrial, especially CNH and Iveco, which have been overshadowed by the cars businesses.

Laura Pennino, an analyst at Banca Leonardo in Milan, has a target price of €15.60 \$19.8 on the combined group, an increase of almost 20 per cent on its share price on Friday.

She estimates an enterprise value of €13.8bn for Fiat's motors business after the demerger and €10.6bn for Fiat Industrial if the stock's conglomerate discount is removed.

Yet some analysts say that in the longer term, Fiat Industrial would lack scale compared with rivals, and could thus be vulnerable to a break-up.

Fiat's core volume-cars business will face even more serious scale issues as a standalone company. The division loses money in Europe, but is profitable overall only because of its big business in Brazil, where it is the country's largest carmaker.

With a portfolio skewed towards small cars such as the Panda and the 500, Fiat profited more than its peers from last year's scrappage subsidies in Italy, Germany, and elsewhere, but has been hit harder this year after they were wound down. Its first-half sales in Europe were 10 per cent lower than a year ago on an overall flat market.

Mr Marchionne has not yet turned round the underperforming Alfa Romeo brand, which in spite of well-reviewed new models such as the Mito and the Giulietta, which is being marketed by actress Uma Thurman in a high-profile campaign, still loses money.

Chrysler made a loss after tax in the first half of this year, although Mr Marchionne said he might upgrade earnings guidance for Fiat's US partner in the third quarter.

"Investors should not be blinded by the technical effects of the demerger, because fundamentally nothing changes," says Arndt Ellinghorst, head of European auto research with Credit Suisse. "It will be difficult for Chrysler and Fiat to generate cash over the next few years."

While analysts are generally supportive of Mr Marchionne's demerger plan, they also say it still faces some threats in Italy.

Fiat's CEO has held out the prospect of doubling car output and investing €20bn in Italy by 2014 if workers accept more flexible, US-style working agreements.

Although he has gained the support of the Confindustria employers' association, he still faces some union opposition from Fiom, the militant metalworkers' union.

Fonte: Financial Times, London, Sept. 13th 2010, Companies, online.