

Indra

Accumulate

4th January 2006

Spain

A Safe Flight

(Price Target increased to € 18.50; Recommendation upgraded to Accumulate)

- ▶ **Indra is the leading Spanish IT player**, offering services and solutions to a wide range of markets from transport and traffic, to public health and administration. The company also manages a foothold in defence electronics equipment (DEE) and simulation (SIM/ATS): this represents 25% of its revenue stream and is mainly related to the Tiger helicopter, Eurofighter and US Navy projects. All in all, Indra can be seen as a high margin player, working with a superior earnings visibility that is constantly surpassing its bold growth targets.
- ▶ **We recently visited Indra to follow its progress.** We have confirmed that the company is very well positioned to continue growing at a fast pace, in which further internationalisation should play an important role. Its IT arm should continue to be fuelled by (1) Transport & Traffic projects, (2) the acceleration of Public Administration and Health and (3) the commercial markets. Conversely, the SIM/ATS and DEE arms should grow at a slower pace. **All in all, we estimate EBITDA and net profit to post a 34 and 31% growth between 2005-08^F.**
- ▶ **We see Indra as an appealing story.** The company combines an excellent management team with (1) high growth potential, (2) an increasing backlog, (3) a lower risk profile due to the high diversification of its business mix and (4) a sound B/S. Indra is currently trading at a lower than average premium to its peers and at a significant discount over its historical multiples. **Overall, we have increased our YE06 price target from € 15.00 to € 18.50.** Moreover, we identify several triggers that could propel a superior price performance: (1) the announcement of important contracts, (2) potential acquisitions, (3) further enhancement of its dividend policy and (4) a potential take-over offer. We therefore **upgrade Indra to Accumulate.**

Stock data

Risk Rating:	High	Sector	IT and Defence
Price:	16.36	Price Target:	18.50
N° of shares (mn):	146.2	Market Cap:	2 416
Reuters/Bloomberg:	IDR.MC / IDR SM	Free-float:	87%
EPS Growth (3 years)	15%	Avg.Daily Vol. [€ '000]:	13 526
Major shareholders:	Caja Madrid (13.3%)		

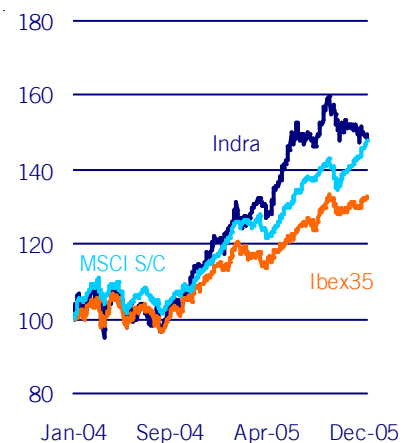
Estimates (€)

	2003	2004	2005 ^F	2006 ^F	2007 ^F	2008 ^F
P/E	35.2	29.6	23.0	21.8	19.6	17.6
EPS (€)	0.46	0.55	0.71	0.75	0.84	0.93
EV/EBITDA	22.0	18.0	14.8	13.4	12.1	11.1
Dividend Yield	1.0%	3.2%	1.7%	2.1%	2.6%	3.1%

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Indra vs. IBEX35 vs. MSCI SCaps



Source: Datastream.

Historical Recommendation

Date	Recommendation
07-Jul-03	Hold
27-Feb-04	Under Revision
03-Mar-04	Hold
12-Aug-04	Accumulate
11-Nov-04	Reduce

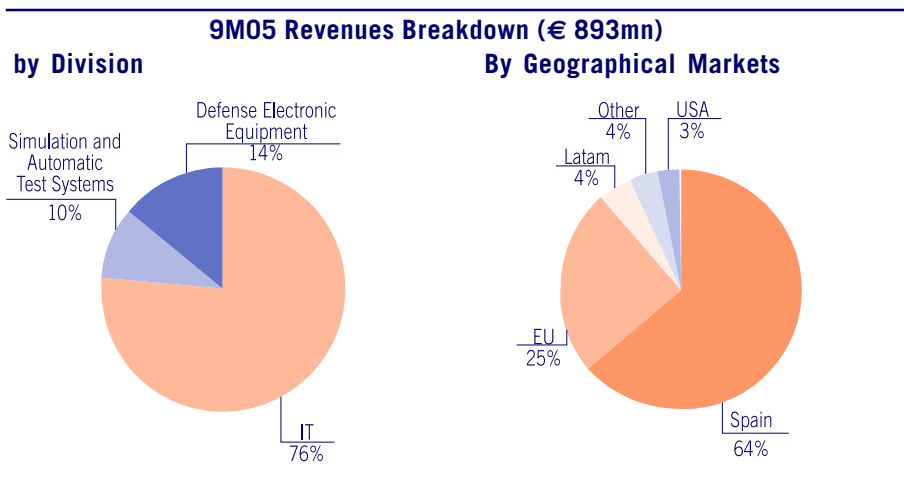
(1) Initiating Coverage.

Source: BPI Equity Research.

Available on our website:
www.bpi.pt/equity, **BPI Online**,
 and Bloomberg at **BPIR**.

EARNINGS OUTLOOK

We have recently visited Indra's headquarters in Madrid. We have confirmed that the company continues to hold an outstanding backlog, while facing some potential growth opportunities across the board. The company has recently stated that it should achieve a 9-10% revenue growth and an EBIT margin of 12% in 2006. We believe that Indra will continue to deliver a strong set of earnings, showing double-digit growth, helped by an increased internationalisation activity. Moreover, Indra is seriously committed to taking advantage of its sound B/S to undertake some selective acquisitions in order to complement its client portfolio and business mix. **Overall, we present the company's outlook per division.**



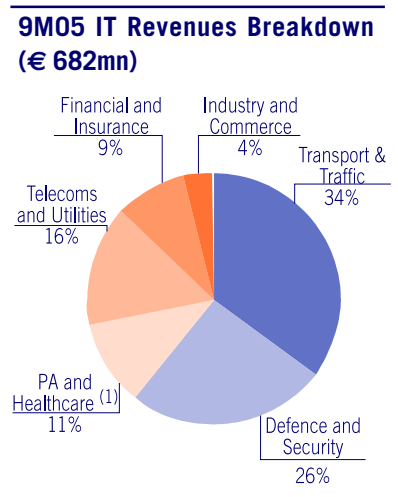
Source: Indra.

1 - IT

Indra's IT arm has been growing steadily at double digit rates: revenues recorded an 11% CAGR00-04. Looking forward, Indra continues to own a strong backlog (1.2x annual revenues) and the capability to attract contracts, which make us confident that the company will manage to maintain this pace, at least for the next three years. **Overall, this growth should be mainly fuelled by three major vectors:**

Firstly, Transport and Traffic. The recognition of Indra's success is shown in the growing number of orders and increasing backlog. We believe this business line has important drivers that should extend its success, namely (1) the numerous opportunities in air traffic management (ATM) under the Single European Sky project, (2) the expansion of the motorway networks in Eastern Europe and (3) the improvement in railway systems, including the expansion of high speed trains. Also, Indra has recently acquired Raytheon's 49% stake in its subsidiary Indra ATM (9% of Indra's transport and traffic revenues), absorbing the full cash-flow generation.

Secondly, Public Administration and Health sector. The increasing demand for e-government projects and digitalisation of government databases, as



(1) Includes Electoral Projects.

Source: Indra.

well as new technologies in national identity cards and passports should provide good business opportunities. Additionally, the Electoral Projects business should also benefit from the wave of elections expected in the next few years (Spain will hold regional elections this year and many LatAm countries will have general elections between 2006-08), and the health segment should continue to bear high demand for improving IT systems. Once more, international markets (11% of its revenues) are an important growth factor for this business area, and Indra has recently been able to attract several contracts in LatAm, namely identity cards and electoral projects.

Thirdly, Commercial markets. We believe that Indra should see the growth rate here picking up. After the acquisition of 50% of BMB, a company specialised in outsourcing business processes, the Financial and Insurance arm should grow more than 32% yoy, and over 10% on a like-for-like basis in FY05. Indra is showing good muscle in this area and has been attracting contracts with major Spanish financial institutions. In Industry and Commerce, demand is also picking up, with Indra focusing on the retail segment, which has a significant importance in Spain. Moreover, the internationalisation of this business should also be a key for success, as Spanish SME have been showing limited IT investment. Last but not least, the Telecommunications and Utilities division, which has lost some ground in the last two years, should accelerate its pace fuelled by Telefónica's investments abroad, both in its subsidiaries in LatAm or the recently acquired Cesky Telecom.

Overall, we have increased our CAGR05-08^f for IT by 1p.p. Consequently, we expect the revenues of this division to record a 10.4% CAGR05-08^f.

2 - SIMULATION AND DEFENCE ELECTRONICS (SIM/ATS & DEE)

Indra's Defence Electronics Equipment division has a powerful backlog and maintains a healthy level of orders intake. We believe this division will continue its good performance in the upcoming years, which should be driven by large programmes such as the Eurofighter, Tiger helicopter or A-400M (military transport aircraft), and to a large extent, by Indra's relationship with the Spanish Government. We believe that Defence should continue to be "en vogue" as countries invest in systems to guard against the current threat of terrorism, and could provide the market with new projects and extra demand for developments in technology and systems. However, internationalisation is key for regaining double-digit growth and decreasing its dependency on Spanish participation in European defence projects.

Simulators and Automatic test Systems have been losing ground, with order intakes declining 6% yoy in 2005 after several years of strong growth (since 2000). This division continues to be mainly fuelled by the domestic market, but also has important contracts with the US Navy and the Eurofighter project. Once more, further internationalisation should be the trigger for higher growth, but Indra has been experiencing some delays in the Training Systems Contract II (TSC II) with the US Navy.

We expect the division's growth to be around 5% yoy in FY05 before

accelerating slightly and regaining the double-digit growth levels by 2008. **Overall, we have fine-tuned our revenue estimate for SIM/ATS and DEE (average cut of 0.5% between 2005 and 2008) and we now expect revenues to post a 9.1% CAGR05-08^F.**

3. CHANGES IN ESTIMATES

We have fine-tuned our revenues estimates, to incorporate the better outlook for the IT division that is only partially offset by the SIM/ATS division, in which we now expect a slower growth until 2008. Furthermore, we increased our estimates for the EBIT margin after the company revealed that its guidance of 12% for 2006 should be maintained into the future. This led our expected net profit to increase by an average of 3% between 2005 and 2008.

Changes in Estimates

(€ mn)	2005 ^F		2006 ^F		2007 ^F		2008 ^F	
	New	Chg	New	Chg	New	Chg	New	Chg
Revenues	1 205	1%	1 319	1%	1 457	1%	1 606	2%
EBIT	142	3%	158	2%	175	2%	192	1%
Net Profit	106	5%	112	2%	125	2%	139	3%

Source: BPI Equity Research.

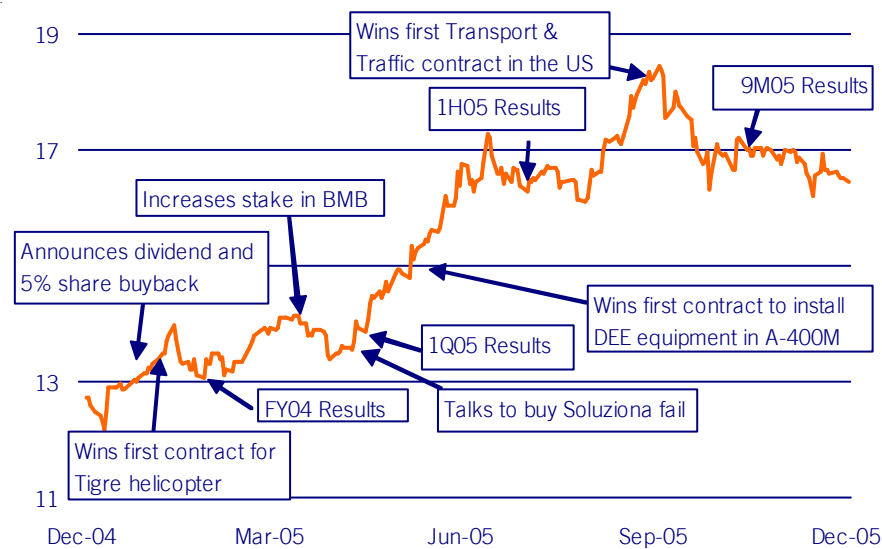
Furthermore, we recall that Indra seems to be well positioned to grab further contracts in the Single European Sky project, the US Navy and new Eurofighter trenches. We are not including these possibilities in our estimates.

Meanwhile, the company continues to hold a sound B/S, with a considerable net cash position. Indra continues to be interested in acquisitions, namely IT players (1) based in the Spanish market, although international players shouldn't be ruled out, (2) that require no major restructuring efforts and (3) owning interesting client portfolios, which would allow Indra to consolidate its market position and increase its ability to attract contracts. **We believe that we should have news from this front sooner rather than later.**

VALUATION AND RECOMMENDATION

Indra has posted a respectable market performance, with a 30% gain in the last 12 months. The newsflow on important contracts such as the Tiger and A-400M, together with the solid earnings results have fuelled the stock's performance throughout the year. This was also helped by the speculative environment about Indra being a target for a private equity, mostly due to (1) its stable revenue stream with high growth potential, (2) its high re-leveraging potential and (3) high free-float (85%) without voting rights limits or golden shares. Although it should not be ruled out, we believe that such an occurrence is unlikely: Indra operates in sectors with strong exposure to Governmental institutions, namely in Spain. This should make it difficult for any acquirer to maintain the company's current client portfolio.

Price Performance



Source: Bloomberg.

Hence, Indra is currently trading at a P/E06 and EV/EBIT06 of 21.8x and 14.7x respectively, which represents a mere 3% average premium to its peers. We recall that Indra has always traded at a significant premium to its peers on the back of its superior business mix, with exposure to numerous IT market segments, combined with Defence and Simulators. In fact, considering its historical multiples, Indra is currently trading at a significant discount. In that sense, we believe that it is fair to combine both market and historical multiples in our valuation. **Applying the average multiples of its peers, we would reach a YE06 fair price of € 15.30 per share. Furthermore, historical multiples point to a YE06 fair of € 23.50 per share.**

Historical multiples

	P/E	EV/EBIT
1999	46.5	35.3
2000	37.9	31.1
2001	29.4	20.5
2002	17.7	13.0
2003	21.9	17.4
2004	22.7	16.4
Average 99-04	29.3	22.3
2005^f	23.3	15.5
2006^f	21.8	14.7
2007^f	19.6	12.6
Discount	27%	36%

Source: BPI Equity Research.

Market Multiples

	P/E		EV/EBIT	
	06 ^F	07 ^F	06 ^F	07 ^F
Indra	21.8	19.6	14.7	12.7
Novabase	21.2	17.8	13.1	11.4
Atos Origin	15.9	13.8	10.4	9.3
Cap Gemini	38.4	21.4	20.0	12.0
LogicACMG	21.2	17.5	19.8	12.3
Tietoenator	20.4	17.1	15.1	13.2
Xansa	18.4	14.7	16.0	13.0
Getronics	20.4	15.3	17.0	11.5
Altran Technologies	26.8	17.5	18.6	13.6
Unilog	21.0	19.1	12.2	10.8
Sopra Group	21.1	17.4	14.0	12.1
GFI Informatique	17.7	13.7	11.3	9.0
Alten	20.9	18.2	12.6	11.1
Thales	18.4	16.1	11.6	9.6
BAE Systems	18.3	15.2	13.2	11.0
Smiths Group	16.4	14.7	13.5	12.2
EADS	19.1	16.2	9.1	7.7
Average	21.0	16.6	14.2	11.2
Premium	4%	18%	3%	13%

Source: BPI Equity Research (Indra, Novabase), IBES Consensus.

DCF Assumptions

Re	10.6%
Rf	4.0%
Beta Equity	1.10
Market Premium	6.0%
Rd	4.3%
Tax rate	27%
D/EV	0%
Wacc	10.6%
g	4.0%

Source: BPI Equity Research.

Last but not least, we have updated our DCF model valuation, which points to a fair value of € 17.60 per share.

In our valuation model, we have combined the three methods, giving a 50% weight to our DCF model. In that sense, we have reached a YE06 Price Target of € 18.50 per share, which clearly shows an appealing upside potential. Last but not least, we identify Indra's major triggers as: (1) the announcement of important contracts, such as the UK's air traffic management system, (2) potential acquisitions which could enlarge its portfolio of clients and re-leverage its B/S, (3) further enhancement of its dividend policy and (4) a potential take-over offer. We therefore upgrade our recommendation on the stock from Reduce to Accumulate.

**Valuation Summary
(€ per share)**

	Weight	Fair value
Market multiples	25%	15.30
DCF	50%	17.60
Historical Multiples	25%	23.50
YE06 Price Target		18.50

Source: BPI Equity Research.

Income Statement

(€ mn)	2003	2004	2005 ^F	2006 ^F	2007 ^F	2008 ^F	CAGR 04-08 ^F
Turnover	981	1 079	1 205	1 319	1 458	1 606	10%
EBITDA	112	136	165	183	202	221	13%
EBITDA Margin	11.4%	12.6%	13.7%	13.9%	13.8%	13.7%	
D&A	24	24	23	25	27	29	4%
EBIT	87	112	142	158	175	192	15%
EBIT Margin	8.9%	10.3%	11.8%	12.0%	12.0%	12.0%	4%
Net Financials	5	3	6	1	3	5	
Extraordinaries	0	0	0	0	0	0	
Taxes	-19	-25	-39	-43	-48	-53	21%
Minority Interest	-2	-5	-4	-4	-5	-6	
Net Profit	72	85	106	112	125	139	13%

Balance Sheet

(€ mn)	2003	2004	2005 ^F	2006 ^F	2007 ^F	2008 ^F	CAGR 04-08 ^F
Net Fixed Assets	151	140	169	167	166	166	4%
Financial Assets	89	86	44	44	44	44	-15%
Inventories	128	102	135	140	143	154	11%
ST Receivables	524	588	656	718	794	875	10%
Cash&Equivalents	213	279	196	270	349	428	11%
Net Assets	1 140	1 226	1 232	1 371	1 528	1 698	8%
Equity & Minorities	337	396	318	388	462	538	8%
MLT Liabilities	72	69	60	55	50	45	-10%
o.w. Debt	72	69	60	55	50	45	-10%
ST Liabilities	676	709	819	892	978	1 075	11%
o.w. Debt	11	12	9	8	7	5	-19%
Equity +Min.+ Liab.	1 140	1 226	1 232	1 371	1 528	1 698	8%

Cash Flow Statement

(€ mn)	2003	2004	2005 ^F	2006 ^F	2007 ^F	2008 ^F
+ EBIT	87	112	142	158	175	192
+ Dep. & Amort.	22	21	20	22	23	25
- Changes Working Capital	2	-10	-35	4	8	8
= Operating Cash Flow	112	123	127	184	206	225
- Capex	6	-10	-18	-20	-22	-24
- Net Financial Inv.	-10	3	11	0	0	0
= Cash Flow after Investments	107	115	120	164	184	201
- Net Fin. Expenses	5	3	5	0	2	4
- Taxes Paid	-18	-22	-39	-43	-48	-53
- Dividends Paid	-16	-25	-80	-42	-50	-62
- Other	6	-2	-19	-1	-1	-1
+ Equity Increase	20	0	-104	0	0	0
= Change in Net Debt	-105	-69	117	-78	-87	-89

Source: Indra, BPI Equity Research (F).

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INVESTMENT RATINGS AND RISK CLASSIFICATION (TOTAL RETURN IN 12-18 MONTHS):

	Low Risk	Medium Risk	High Risk
Buy	> 15%	>20%	>25%
Accumulate	>10% and < 15%	>10% and < 20%	>15% and < 25%
Hold	>0% and < 10%	>0% and < 10%	>0% and < 15%
Reduce	>-15% and < 0%	>-20% and < 0%	>-25% and < 0%
Sell	< -15%	< -20%	< -25%

These investment ratings are not strict and should be taken as a general rule.

INVESTMENT RATINGS STATISTICS

As of 30th November BPI Equity Research's investment ratings were distributed as follows:

	%
Buy / Speculative Buy	17%
Accumulate	20%
Hold	31%
Reduce	12%
Sell	7%
Under Revision	12%
Accept Bid	1%
Total	100%

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