Madrid, October 9, 2002

EL.EN

STRONG BUY

Laser Empowered

PRESENT PRICE: €11.08
TARGET PRICE: €42.35

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Basic Figures, September 20, 2002

Reuters code:	ELN.MI
Market capitalisation (€ mn):	51.0
Number of shares (mn):	4.6
Average daily volume (€ mn):	0.14
52-week range (€):	10.00-15.36
Free float (%):	28
2002E ROE (%):	4.9
2002E P/BV (x):	0.94
2001-04F PEG:	0.47

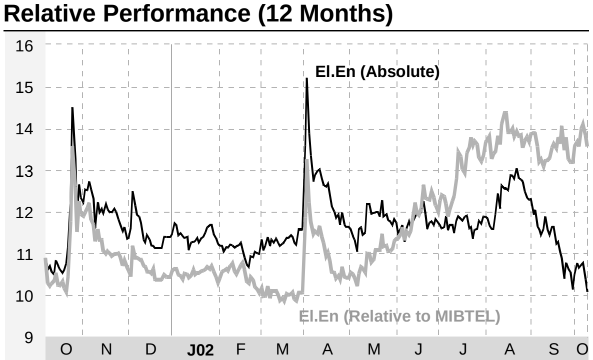
Source: Reuters and SCH Bolsa estimates and forecasts.

Estimates and Fundamental Ratios

	2001	2002E	2003F	2004F
Net profit (€ mn):	2.3	2.4	4.0	6.9
% change:	-24.2	7.5	61.7	73.5
Cash flow (€ mn):	3.6	4.8	7.6	12.1
% change:	-18.3	33.8	58.4	59.6
P/E (x):	22.4	20.8	12.9	7.4
EPS (€):	0.49	0.53	0.86	1.49
% change:	-24.2	7.5	61.7	73.5
P/CF (x):	14.2	10.6	6.7	4.2
CF/S (€):	0.78	1.04	1.65	2.63
EV/EBITDA (x):	5.1	4.6	3.3	1.9
GDY (%):	0.0	0.0	0.0	0.0
DPS (€):	0.00	0.00	0.00	0.00

Source: Company data and SCH Bolsa estimates and forecasts.

Relative Performance (12 Months)



Source: Datastream.

El.En designs, assembles and sells laser equipment for industrial and medical applications. Its net profit grew at a 44% CAGR in 1998-2001 and we expect it to accelerate to around 60% in 2002E-05F. As in the past, El.En should grow faster than the industry due to: (1) its business structure (fully integrated process with all in-house technology); (2) the renewal of its product catalogue; (3) the recovery in margins already achieved in 1Q02; and (4) geographical expansion.

The two laser industry segments in which El.En operates, with a combined size of US$7.0bn, should enjoy 10%-12% growth rates. New laser applications for the medical segment are constantly being discovered, from dentistry and ophthalmics to non-invasive surgery. Increasingly sophisticated industrial processes are opening up new fields for laser (from micro-machinery to surface cleaning and precision instruments). As the market develops, the after-sales service, maintenance and replacement businesses also grow.

El.En's past organic growth was almost exclusively based on its success in Italy and the EU. However, the recent acquisition of Cynosure in the US for US$11mn gives El.En access to the US$1.4bn laser market for medical applications, the largest market in the world (62% of the total).

This expanding market has a highly fragmented supply and many loss-making players are bound to disappear, leaving their market share to be snapped up by the most dynamic players. In the long run, El.En could supplement its strong organic growth with acquisitions.

While the market is currently reluctant to consider micro stocks, we propose El.En as a Strong Buy at a 5.0x 2005F prospective P/E, with the downside limited by its 2002E P/BV of just 0.94x.

BRIEF COMPANY DESCRIPTION

El.En produces laser equipment for medical and industrial uses

El.En (which stands for Electronic Engineering) engages in the design, production and commercialisation of laser emission sources and laser-related equipment for medical, aesthetic and industrial applications. The company was founded in 1981 as an engineering group making electronic and mechanical equipment for industrial uses. However, as early as 1983, the company developed its first laser systems and in 1984 it started selling kits for therapeutic use.

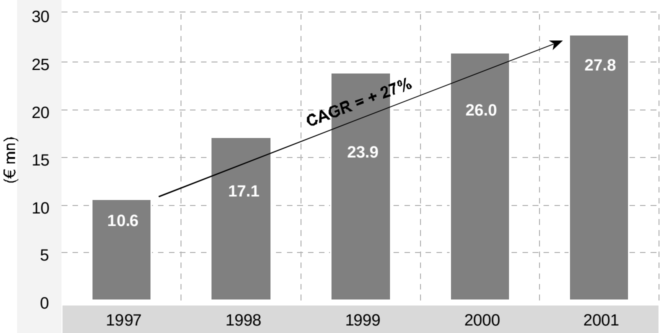
In-house technology and fully integrated

Unlike other companies in the laser industry, which only design and produce optical equipment and then sell it to assemblers, or those that merely assemble optical equipment from external suppliers, El.En is a fully-integrated concern. The company has its own in-house laser design team and produces its own optical equipment, which El.En assembles itself. Obviously, plain support hardware for the laser equipment is outsourced, although strict quality control systems are in place to ensure ISO 9002 qualification.

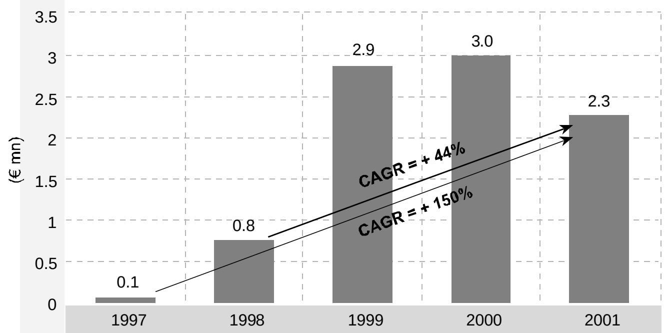
A wide product range and a 27% sales CAGR in 1997-2001

This gives El.En two advantages over competitors: not only does it control the know-how and the entire value-added chain, but it also has the capability to deliver a wide range of products, rather than remaining tied to a limited niche. As a result, El.En has enjoyed impressive top-line growth in the past few years, as evidenced by its 27% sales CAGR in 1997-2001. Likewise, net profits grew at a 150% CAGR in the same period (44% CAGR in 1998-2001), as margins have gradually improved over time.

Figure 1. El.En – Sales Growth, 1997 - 2001



El.En – Net Profit Growth, 1997-2001

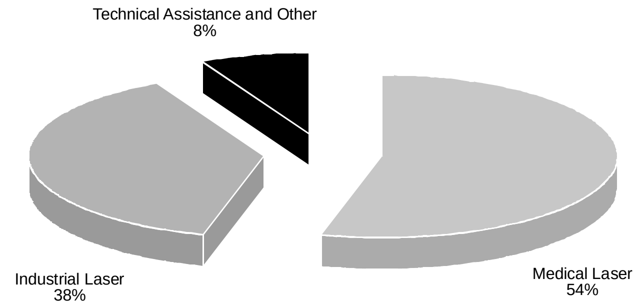


Source: El.En.

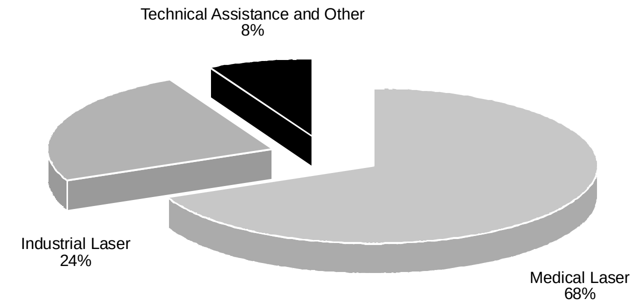
Still mostly a domestic play . . .

As shown in Figure 2 below, in the past most of the revenues were obtained in the domestic market, which represented 52% of El.En's income, while the rest of Europe accounted for 25% and the rest of the world for a mere 23%. El.En's sales breakdown shows a 54% contribution from the medical segment and 38% from industrial applications, while after-sales revenues and other services account for 8% of sales. The latter is a steadily growing source of revenues as El.En's client base expands.

Figure 2. El.En's Sales Breakdown by Sources of Revenue (Prior to Cynosure Acquisition in May 2002)

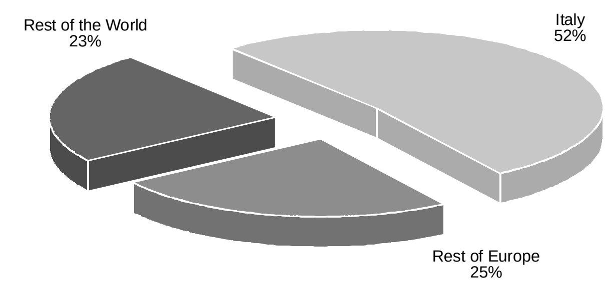


El.En – Sales Breakdown by Sources of Revenue (Following Cynosure Acquisition in May 2002)

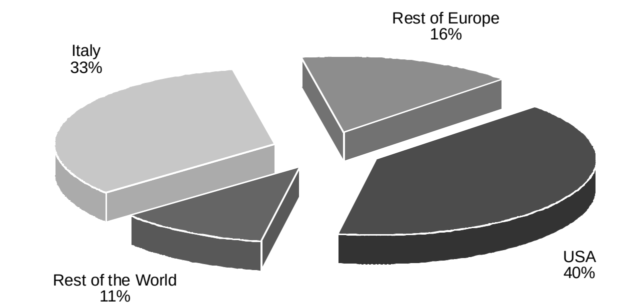


Source: El.En and Santander Central Hispano Bolsa.

Figure 3. El.En – Geographical Sales Breakdown (Prior to Cynosure Acquisition in May 2002)



El.En – Geographical Sales Breakdown (Following Cynosure Acquisition in May 2002)



Source: El.En and Santander Central Hispano Bolsa.

. . . but recently entered the US

On May 6 El.En acquired Cynosure, a US-based laser company mainly focused on specific medical vascular treatments, for US$11mn. Under the deal, US$10mn were paid on signing the agreement and US$2.5mn at the end of 2002, of which US$1.5mn are to stay within Cynosure for restructuring purposes. Cynosure has annual sales of US$23.5mn (€25.8mn), but a negative EBITDA of US$2.0mn (€2.2mn). This deal doubles the size of El.En's turnover, while reducing the group's operating margins from an initial 2002E budget of 14% to 7%. However, a restructuring plan is under way (more details below), aimed at raising Cynosure's margins to the group's original levels.

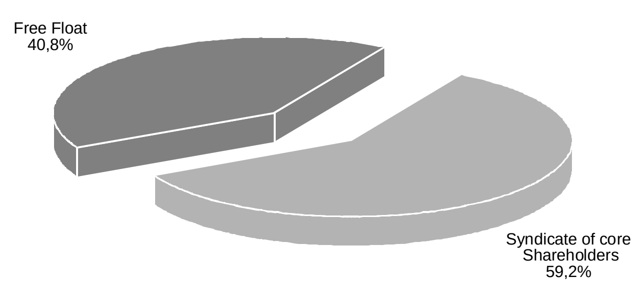
Using cash according to commitments

This acquisition used up part of the €30mn raised by El.En in November 2000, when it was floated in the Nuovo Mercato Italiano. In fact, one of the commitments made by El.En's managers was to supplement the group's organic growth with acquisitions should suitable opportunities arise.

A 41% free float of the company

The company's share capital is 59% in the hands of a syndicate, which groups the core shareholders, mainly El.En's founders. As shown below, the remaining 41% is free float.

Figure 4. El.En's Shareholders



Source: El.En.

THE CORE OF ITS EQUITY STORY

DOING THE RIGHT THING AT THE RIGHT TIME IN THE RIGHT PLACE

At last, a tech company that really sells . . .

Visiting a high-tech company tends to raise one's scepticism considerably, as most firms that claim to be at the cutting edge of technology last very little before their funds run out. However, a company that develops its own technology to create value-added products and where people do not keep telling you how good they are because they are too busy innovating, producing and selling, gives you a different feeling altogether.

. . . a good product, in a growing industry, expanding geographically

We consider El.En to be one of the most appealing stocks that we have seen in the Italian market, as it combines most of the necessary ingredients for a successful equity story, namely a good product in a growing market enjoying strong geographical expansion:

- El.En is engaged in the production of laser systems using its own technology.
- The company is expected to grow at least in line with a steadily expanding sector, driven by new applications.
- El.En should also benefit from surging sales abroad from 2002E. As it was mainly a domestic player, it was virtually absent from the US medical-use laser market – a niche worth US$1.4bn – the largest in the world.

Net profits could post a 61% CAGR in 2002E-05F

As a result, we consider that El.En's sales could grow at a 25% CAGR between 2002E and 2005F (38% between 2001 and 2005F). In the meantime, margins should gradually improve, leading to a CAGR of 61% in net profits and 51% in cash flows over the same period.

A solid financial position to back any expansion plan

The group has limited cash needs and it boasts a net cash position of €20mn (almost 40% of its current market capitalisation) to fund this expansion, even after paying US$10mn for a controlling stake (60%) in Cynosure, a US-based laser company, in May 2002.

Below we give a more detailed analysis of the key ingredients: the product, market trends and geographical expansion.

The Product: What is Laser?

Laser: already in our daily lives

Laser, which conjures up images of science-fiction films with lethal beams of blazing light, is much closer to our daily lives than most would imagine. To name a few examples, your favourite musical hits were recorded on CD using laser beams, the printer two desks away at work uses laser technology, as does the CD ROM where you keep vital company data. Should you be unfortunate enough to fall while skiing and injure ligaments or tendons, you would probably have to visit a physiotherapist who might apply a laser beam to the injury.

Laser: a powerful light transformed into a useful tool . . .

LASER (the acronym for Light Amplification by the Stimulated Emission of Radiation) is obtained from a device that produces a monochromatic and coherent beam of electromagnetic waves. This electro-optical device has a cavity, filled with a certain medium (a gas, liquid, solid or semi-conductor), where the electromagnetic radiation emitted is transformed into a coherent, monochromatic beam. This beam can then be passed through high-power optical fibres or shone onto a reflecting mirror and thus directed to the material to be treated.

In addition to other applications, laser can be used for both medical and industrial purposes, which constitute El.En's scope of activity:

. . . with uses in the medical, aesthetic . . .

Medical and aesthetic applications: laser beams interact with biological tissue in various ways depending on their wavelength and intensity. Laser can be used to cauterise blood vessels, for the bio-stimulation of tissues, as a cutting instrument and in superficial ablation. In the operating theatre, laser provides surgeons with a new form of electromagnetic scalpels and needles that can cut, vaporise or coagulate biological tissues. Thus, laser is increasingly used in dermatology, cosmetic surgery, physiotherapy, dentistry, gynaecology and otolaryngology, among others.

. . . and industrial fields

Industrial applications: laser beams can be focused on extremely small spots to either cut or engrave inert materials, such as metal, wood, plastics, and glass, with the utmost precision.

Market Trends: Where is the Laser Market Expected to Go?

Laser has evolved enormously since the first version in 1960

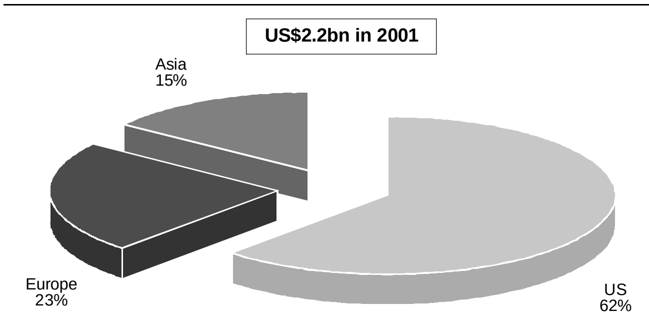
The laser market has evolved rapidly since the first commercial version was introduced in 1960. Today lasers are used in a wide range of applications, mainly grouped in four categories: medical and aesthetic, industrial, scientific and military. El.En basically focuses on the first two segments.

(1) The Laser Market for Medical and Aesthetic Applications

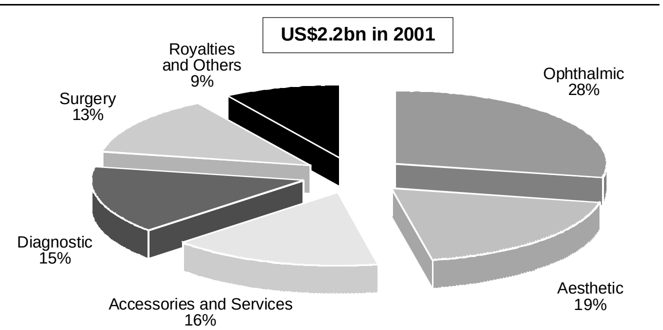
Medical uses for laser represent a US$2.2bn market . . .

In 2001 the world market for medical lasers had an estimated value of US$2.2bn, with a 10% CAGR in 1997-2001 (including a 9% decline in 2001). As shown in Figure 4 below, the US is the largest market for laser medical applications, accounting for some US$1.4bn, or almost 62% of the total demand.

Figure 5. Global Medical Laser Market – Geographical Breakdown, 2001



Global Medical Laser Market Breakdown by Segment, 2001



Source: Spectrum Consulting and "Opto & Laser Europe", February 2002.

. . . which saw a 10% CAGR in 1997-2001

Ophthalmics is the main segment within the medical market and accounts for 28% of sales, followed by the aesthetic segment (19% market share), which experienced a surge following the introduction in 1997 of hair-removal devices using ruby laser technology. In 1998 and 1999, innovative technologies based on diode and alexandrite lasers (with different wavelengths) boosted the sales of laser-based hair removers.

The market for laser in dentistry . . .

According to industry reports (see the Spectrum Consulting report dated February 2002), there are several niches within the medical segment that may be worth considering in terms of growth potential. One is dentistry, which generated sales of €25mn in 2001 but could become the next high-growth segment with the advent of erbium and diode lasers for painless soft- and hard-tissue applications. Low-power, low-cost erbium lasers have reduced the difficulty and enhanced the reliability of certain treatments on enamel and dentin, increasing speed and precision and reducing the use of anaesthetics.

. . . could boast a 68% CAGR in 2001-05F

Around 60mn soft-tissue and 170mn hard-tissue procedures are carried out every year in the US alone. These include the preparation of teeth for implants and the treatment of cavities, which can be performed with greater ease and comfort for the patient using lasers. If just 2% of dentists in the US were to buy one erbium laser unit a year, at an average cost of US$25,000 per unit, the dental market would represent some US$200mn by 2005F, or 9% of the world's total laser market for medical uses, delivering a 68% CAGR in the dentistry niche in 2001-05F.

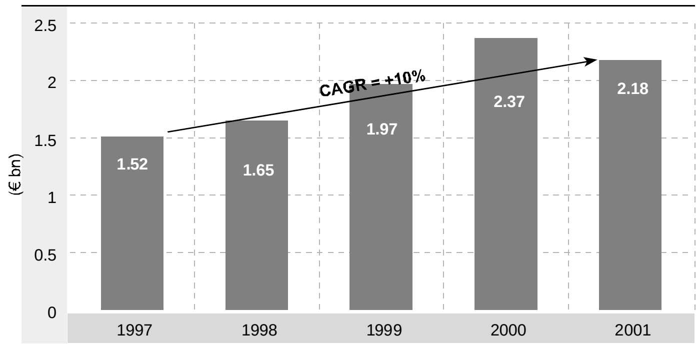
Penetration is still limited, suggesting massive growth potential . . .

On a world-wide scale, the growing use of lasers for medical applications cannot be attributed to any one specific application, but to the numerous new applications and their widespread uses. We have mentioned the case of dentistry, but a similar growth rate may well be seen in the use of laser for non-invasive surgery. In this report we do not detail the large and growing segment of ophthalmological applications, worth US$0.5bn/year in 2000, as it is outside the scope of El.En's activity.

. . . with a 10% CAGR for the market looking credible in the medium run

Our scenario assumes that the laser market for medical uses will continue to grow at roughly the same pace in the next few years as in the recent past. Hence, we are assuming a 10% CAGR for the medium term, including the possibility of a certain contraction in some years, as was the case in 2001. Barring occasional slowdowns, the growing popularity of aesthetic treatments, body care, health and fitness should make laser technology a suitable tool to satisfy growing market demand. El.En stands to profit the most from this situation, as it is primarily positioned in stronger-growth niches, such as hair removal, dentistry and blood-vessel treatments. Cynosure, the company recently acquired by El.En in the US, has a similar focus and possesses complementary technology.

Figure 6. Global Medical Laser Market, 1997-2001



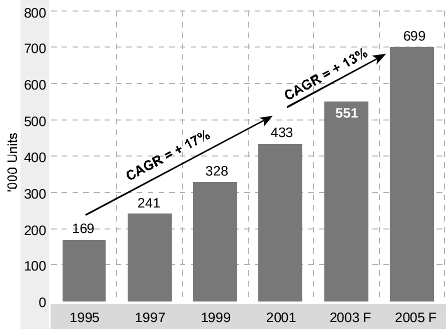
Source: Spectrum Consulting and *"Opto & Laser Europe"*, February 2002.

(2) The Laser Market for Industrial Applications

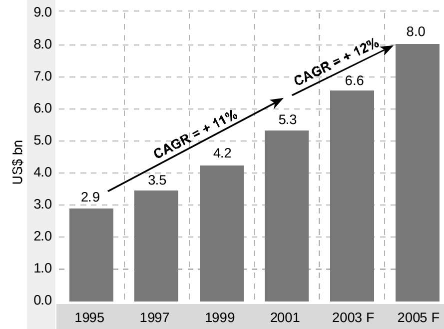
The market for industrial uses is double the size of medical uses

As in the previous section, we concentrate on the segments where El.En is the most active. Hence, we do not cover laser systems for telecoms and optical storage, seen as mass-consumption technology. The laser market for industrial applications was worth roughly US$4.8bn in 2000, 65% more than in 1995. As shown in Figure 6 below, the evolution of this laser market has led to cheaper unit selling prices, making it more accessible to smaller companies as well as big-name corporations, thus leading to a higher penetration of laser.

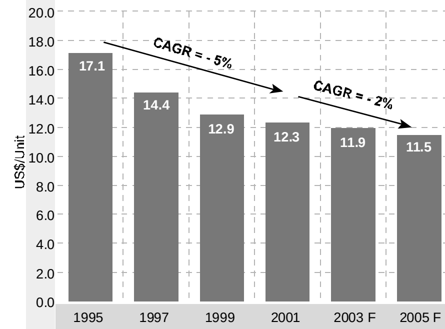
Figure 7. Gloabl Industrial Laser Market – Units 1995-2005F



Global Industrial Laser Market – Revenues, 1995-2005F



Global Industrial Laser Market – Avg Price of Lasersytems, 1995-2005F

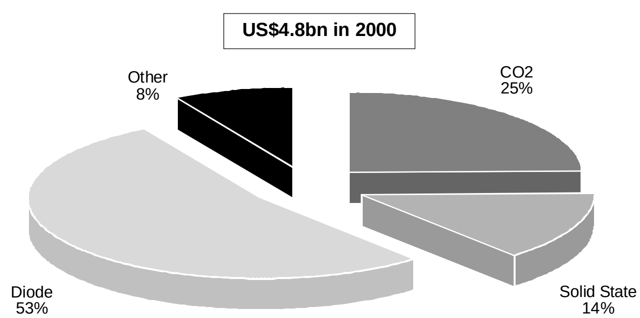


Source: Frost & Sullivan and Santander Central Hispano Bolsa estimates and forecasts.

In industrial applications, niche technologies make a difference . . .

Different types of laser are used in the various industrial processes, depending on the type of conductor used to produce the laser beam. As shown below, the largest segment is diode laser, which accounts for 53% of the total market. This high weighting is largely explained by the evolution of the telecommunications industry. However, its large-consumption profile makes it more appealing to big players (and competitors), leading to narrower margins, as opposed to the more niche-oriented applications: CO_2 and solid medium-based lasers.

Figure 8. Global Industrial Laser Market Breakdown by Laser Type, 2000



Source: Frost & Sullivan.

. . . as they are more suitable for precision tools

The increasingly sophisticated industrial segments call for a high level of precision in the tools and machinery used. As a result, demand for laser is growing fastest in processes that involve cutting, marking and welding hard materials such as metals, plastic, paper, wood, ceramics precious metals, etc. The use of laser is also on the rise in micro-lithography, surface cleaning, annealing, art restoration and micro-machinery.

New uses suggest that the market could grow at a 12% CAGR in the next few years

As is the case of the medical laser market, this growth is mainly due to new applications and the spread of existing ones to a broader customer base. For example, the widespread use of computer systems in most offices or daily production systems implies hectic activity in the software and hardware industries, where lasers are widely used to produce microchips and all kinds of hardware. Consequently, in the next few years we would expect the laser market for industrial uses to grow at roughly the same pace as in the recent past and we assume a 12% CAGR in the medium term.

Geographical Expansion: Where is El.En Moving?

Until now the US only accounted for around 10% of El.En's sales

The recent acquisition of Cynosure in the US should provide El.En with a commercial network straightaway, allowing the company to channel its products to the largest market in the world. Until now, El.En generated 52% of its revenues in Italy and only 23% in non-EU countries. Thus, the bulk of its impressive 27% CAGR in sales is mainly due to the introduction of new products in its local market. However, we estimate that the US only represented around 10% of its sales to date, despite accounting for more than 60% of the world's laser market for medical uses and around 40% of the market for industrial uses, El.En's key segments.

This suggests high growth potential through expansion into the US . . .

Therefore, we consider that El.En has significant growth potential, which should materialise through an increasing penetration of the US market. One of the reasons why El.En was virtually absent from the US market was its lack of commercial presence in this region. In fact, most of the orders from non-EU countries come from clients approaching the company directly, rather than through the efforts of a full-time sales force in these areas.

. . . and the recent acquisition of Cynosure should pave the way

We expect this geographical business mix to gradually change from 2002E thanks to the recent acquisition of Cynosure, which has an interesting customer base and commercial network in the US, the world's largest market. By way of illustration, the partnership agreement in France that led to a local subsidiary in late 1996 gave El.En a commercial presence in that country, boosting the sales of its medical products from €1.5mn in 1997 to €6.3mn in 1998.

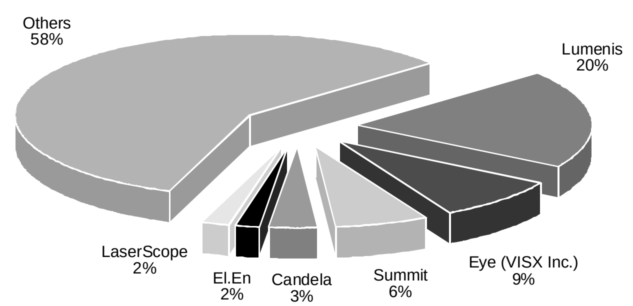
OTHER STRENGTHS, OPPORTUNITIES AND ISSUES AT EL.EN

A Tiny Player in a World of Giants?

Today El.En is only a small player . . .

Given the company's annual sales of around €29mn (€55mn after the acquisition of Cynosure) and the combined size of the laser market where it operates (annual turnover of US$7.0bn), El.En is clearly a small player. As shown in Figure 8 below, El.En accounts for a mere 2% of the world market for medical laser applications.

Figure 9. Medical Laser Market – Mayor Players in the World



Source: Frost & Sullivan and Santander Central Hispano Bolsa.

. . . in a highly fragmented market

The market is even more fragmented in the industrial applications segment as, besides some multinationals, there are approximately 140 players world-wide according to company sources. The majority only assembles or manufactures one type of laser system, and this specialisation has allowed them to create their own niches.

However, rather than a negative, we see El.En's small size as an opportunity for growth:

Even if it doubled in size, El.En's market share would still be small

- Its current size, combined with Cynosure, gives it a maximum market share of 2% in the medical applications segment. Hence, even if the market were to remain flat, increasing El.En's market share to 4% would hardly hurt its competitors, but it would mean double the sales.

Know-how protects El.En from big players

- This is not a capital-intensive industry, where funds would be a barrier to entrance. Having the right technology and know-how is what matters, and El.En has a solid track record on both counts. Thus, it is difficult for the big players to use price wars and other such tactics to force competitors out of the market without hurting themselves even more.

New segments and new markets should boost growth

- El.En's small size is not a measure of its limitations, but a consequence of its presence in a limited number of niches and its focus on the domestic market. The company is now on its way to expanding in both respects. Growth in this industry does not require huge investment; hence, El.En should be able to expand its business through efficient marketing of its high-quality products rather than by pouring cash into its operating structure.

Digesting a Loss-Making Company

El.En recently acquired Cynosure for US$11mn

As already mentioned, on May 6, 2002 El.En acquired a 60% stake in Cynosure (a US laser producer mainly engaged in aesthetic applications) for US$12.5mn (€13.3mn), 80% of which was paid on signing the agreement and the rest at the end of 2002. The balance is to be paid within 12 months provided that Cynosure's YE02 sales reach the same level as in 2001. Otherwise, the amount due would be adjusted on the basis of the actual YE02 sales. However, some US$1.5mn (€1.6mn) of the total consideration is to stay at Cynosure to fund its revamping efforts, bringing the amount actually paid to US$11.0mn (€11.7mn). Cynosure's management team retains a 40% stake, ensuring its continuity in the company.

A broader product range and immediate access to the US market

El.En purchased Cynbosure for two main reasons: (1) to enrich its product portfolio with specific complementary laser technology; and (2) to gain new clients, giving the company an immediate presence in the world's biggest market, where it was only marginally present previously. Cynosure focuses mainly on certain aesthetic uses of laser technology where El.En has virtually no presence in the US, such as hair removal.

Cynosure needs to be turned around

The other side of the coin is that, as shown below, Cynosure reported operating losses of €4.4mn and net losses of €6.3mn on sales of €25.8mn in 2001. These losses were largely due to the tough market conditions in the US medical applications market, which fell by more than 9% last year. By contrast, under the same market conditions, El.En's broader product range enabled it to post a 7% increase in 2001 sales.

Lay-offs, capital reinforcement and commercial optimisation under way

El.En's management is well aware that the sooner it turns Cynosure around, the more the company stands to benefit from placing in the US its portfolio of current products and applications under development. In fact, this strategy is already being implemented:

- Cynosure is cutting 20 jobs, or 14% of its total 140-strong workforce.
- Its capital structure has been reinforced with US$1.5mn of proceeds from the deal, which have been pumped back into the company.
- El.En has started selling its products through Cynosure's network.

A conservative scenario suggests a 17% IRR on the acquisition

A simple financial calculation shows that, provided that Cynosure simply manages to reach an EBITDA margin of 12.7% (ie 75% that of El.En over the next four years), this acquisition will yield an IRR of 17% for El.En in terms of EBTIDA to acquisition cost. Although the outcome of this acquisition should be closely monitored, El.En seems to be on the right track. Figure 9 below sets out the cornerstones of El.En's budget for 2002, before and after the acquisition. The 1Q02 results suggest that these figures are feasible and could even be surpassed.

Figure 9. El.En's Budget for 2002 – Before and After the Cynosure Deal

(%)	Before the Acquisition	After the Acquisition
Total sales growth	+21	+85
Sales growth in medical lasers	+20	+111
Sales growth in industrial lasers	+22	+22
EBITDA margin	17	12
EBIT margin	14	7

Source: El.En.

No Customer Concentration

El.En's client base consists of . . .

Rather than focusing on large accounts, El.En avoids the risk of customer concentration. Although the company's top five customers account for around 30% of its revenues, they are laser equipment distributors to the medical and aesthetic segments, with numerous customers in different geographical areas.

. . . numerous small customers

Within the industrial sector, the group's main customers are small businesses that work with materials like plastic, metals or wood, and use laser equipment as their main production tool. As regards medical uses, El.En's laser equipment is sold to small private companies or individual professionals in the case of dental or hair removal applications. Laser equipment for surgical use (eg, oncology, orthopaedics, gynaecology and urology) is usually sold to public entities, given the hefty investment required.

Signs of a Market Turnaround

Despite the tough environment, El.En's 2001 sales grew by 7% . . .

Although 2001 was a difficult year in the global economy, El.En managed to increase revenues by 7% to €27.8mn despite a 3% decline in the income from the medical segment, which accounts for around 54% of the total. This is quite an achievement considering that the world medical laser market contracted by 9% in 2001, according to Spectrum Consulting, a firm specialising in studies for the laser industry.

. . . thanks to good performance in the industrial segment

The industrial segment, representing around 38% of El.En's total sales, performed very well with revenues up 28% in 2001. Nevertheless, El.En could not avoid a 24% fall in its 2001 net profit to €2.3mn, as it charged all the R&D expenses related to products intended for sale in the medical market to its P&L. The company had expected this segment to grow by 10% in 2001, but it actually shrank by 9% on a global basis.

1Q02 results point to stronger revenues . . .

However, the 1Q02 results suggest a turning point, with a PBT of €1.0mn (+24%) on sales of €7.6mn (+27%) and rising revenues in the two main sources of business. In fact, the medical segment reported revenues of €3.5mn (+16%), as renewed demand allowed the company to place the products already developed. Moreover, growth in revenues from the healthy industrial market accelerated to €2.0mn in 1Q02, a 50% increase versus 1Q01 thanks to orders from the Far East.

. . . allowing the company to reiterate a promising budget for YE02

Since a large part of these sales related to products for which R&D expenses had already been charged, growth at the EBITDA and EBIT levels reached an impressive 74% and 81%, respectively. El.En does not expect such operating growth rates to be sustained, as R&D expenses are bound to be incurred for new products. However, the company prefers to take a prudent stance and maintain its initial budget for the group (ex-Cynosure), with 21% sales growth and an EBITDA margin of 17% in 2002E compared with 14% in 2001.

Focus on High-Growth Segments – R&D and New Product Strategy

Laser still to be implemented in many industrial processes

Given the long-term prospects for industrial segments likely to make increasing use of technology and precision instruments in their production processes, the outlook for El.En's products in this area seems promising. Moreover, we expect demand from the sectors that already use laser technology (engraving, cutting, etc) but need to replace their existing systems in order to improve efficiency.

New fields in the medical arena

However, the company is convinced that rapid growth in demand for laser tools should mainly come from new applications in the medical field. Consequently, much of El.En's R&D effort is devoted to this area. Additionally, there are a number of large medical fields where the group is not present yet, but has a strategy to gradually penetrate them.

Steady R&D effort

El.En has a total workforce of 129 employees (excluding Cynosure), of whom 15 are devoted to R&D projects full time and another 25 on a part-time basis. This calls for an annual R&D investment of some €2.0mn-3.0mn, normally equivalent to 9%-12% of the group's annual revenues. These costs are fully charged to El.En's P&L account each year rather than being capitalised.

El.En's product pipeline should boost future revenues

As a result, El.En is building an interesting pipeline of new products to increase its market share over the next few years, especially in the medical field. In 2002 year-to-date, sales in the medical field are already benefiting from El.En's new system for non-invasive cellulite removal and the company has a number of products on their way to the market, including:

- New therapeutic systems for orthopaedics
- Laser systems for minimally invasive microsurgery and reinforcement of drug-induced localised effects
- Cartilage repair therapy
- New system for the treatment of psoriasis, with sales starting in 2Q02
- Beams and optical components for laser systems in art repair works and physiotherapy
- New laser-based system for electronic microchip implants

The Pros and Cons

Figure 10. El.En – The Pros and Cons of the Investment Case

Pros	Cons
In-house technology and integrated production makes El.En present in the entire value-added chain. A flexible product portfolio.	Very small market capitalisation: some investors may disregard the stock since the impact of a position in El.En in a given portfolio may be limited in the short term.
Focus on two segments with growth prospects of 10%-12% per annum due to increasing laser applications for medical and industrial use.	Limited liquidity: patience may be required to build a position.
Recent entry into the US market for medical applications – the world's largest with an annual turnover of US$1.4bn, 62% of the world's total demand and over 25x El.En's 2002E sales.	While the recent acquisition of Cynosure gives El.En access to the large US medical market, it also brings the challenge of absorbing a loss-making venture. Management's efforts to turn Cynosure around should be closely monitored.
Dynamic company in a market with a fragmented supply, in which know-how is the key to expansion.	Not immune to cyclicality. El.En's long-term growth prospects may be credible, but they are not necessarily free from the impact of a general economic decline. The demand from industrial segments should suffer less given the sector's growing need for enhanced efficiency, but it could slow in certain years. The same could happen on the medical front: more purchases of more sophisticated equipment could be pushed back to better times.
No customer concentration risk.	
Sustained promotion of R&D efforts. Focus on higher-than-average growth segments: orthopaedics, dentistry, non-invasive surgery, electronic microchip implants, art repair works, etc.	

Source: Santander Central Hispano Bolsa.

Estimates for El.En

Earnings Should Grow at a 60% CAGR in 2001-05F

Our forecasts aim to identify clear growth potential

In this document we are intentionally using very simplified models, since our aim is to identify stocks whose market capitalisation could potentially surge in the future, rather than obtain very accurate forecasts. Moreover, in the case of some very dynamic companies like El.En, changes occur at such speed that our figures could easily become outdated in a relatively short period of time. However, we would highlight the stock's substantial growth potential.

We assume 19% annual sales growth, below El.En's 44% track record

The starting point for our sales model is the sales budget revised by El.En's management for 2002E following the purchase of Cynosure. Based on that figure, we forecast a 19% CAGR in sales in 2002E-05F, excluding the Cynosure acquisition effect, which may seem aggressive. However, we have assumed this scenario based on the following factors:

- Bright prospects for the laser market, for which we expect high annual organic growth rates in the medium and long term: 12% in the industrial field and 10% in the medical segment.
- El.En has an even more impressive track record of top-line growth in recent years, although its activity was basically restricted to the domestic market.
- A determined effort by the company to achieve further penetration of its European markets and expand into new regions where El.En only has a marginal presence so far (eg, the Far East and the US).
- New products in the pipeline, which at the launch should benefit from co-ordinated commercial efforts in Europe (El.En) and the US (Cynosure).

Once Cynosure has been turned around . . .

As regards margins, again our starting point is El.En management's budget for 2002E. If we strip out El.En's original budget on a standalone basis, we conclude that management expects a considerable turnaround in Cynosure in 2002E. We estimate that Cynosure should post 2002E sales of €17.8mn (-30%) and EBITDA of €0.5mn (3% on sales) versus EBITDA losses of €2.2mn in 2001 (-8% on sales). This should deliver the average 12% EBITDA expected for the combined group in 2002E.

Figure 11. Cynosure – Turnaround Expected in 2002E

		El.En's Budget for 2002E		Cynosure's Performance	
(€ mn)	El.En in 2001	Before Cynosure	After Cynosure	2002E	2001
Sales	27.8	33.6	58.7	25.0	25.8
YoY growth (%)	7.3	21.0	111.0	0.0	NA
EBITDA	3.9	5.7	7.0	1.3	-2.2
As % of sales	14.0	17.0	12.0	5.3	-8.5
EBIT	2.6	4.7	4.1	-0.6	-4.4
As % of sales	9.4	14.0	7.0	-2.4	-17.2

Source: El.En and Santander Central Hispano Bolsa estimates.

. . . we estimate 19% EBIT margins by 2005F

Most of this 2002E turnaround should basically be achieved through lay-offs at Cynosure, while the effects of commercial synergies should make themselves felt in the next few years. Consequently, we estimate that the low average 2002E EBIT margin of 7% should gradually move towards the levels expected for El.En on a standalone basis in 2002E. However, in our model we assume that this level will only be reached in 2005F.

2002E-05F CAGR of some 60% expected in net profits

Depreciation charges should remain similar to current levels or even decline in absolute terms, as no major investments are planned and all the R&D expenses are charged to the P&L rather than being capitalised. The combination of expanding revenues and steadily improving margins should cause net profits to rise from €2.4mn (+7%) in 2002E to €10.2mn in 2005F, implying an excellent CAGR of 45% in 2001-05F, but of just above 60% in 2002E-05F.

Figure 12. El.En – Profit and Loss Account, 2000-05F

(€ mn)	2000	2001	2002E	2003F	2004F	2005F	CAGR 2001-05F (%)
- Medical uses	15.6	15.1	31.9	48.8	57.6	67.9	45.6
- Industrial uses	8.3	10.6	13.0	14.3	16.9	19.9	16.9
- Other	2.0	2.1	6.7	7.9	10.0	12.7	57.0
Net sales	**26.0**	**27.8**	**51.6**	**71.0**	**84.5**	**100.6**	**37.9**
YoY growth (%)	8.7	7.3	85.2	37.6	19.0	19.0	–
Other operating income	0.2	0.3	0.6	0.9	1.0	1.2	–
Total revenues	26.1	28.2	52.2	71.8	85.5	101.8	–
COGS	-8.8	-11.9	-24.5	-34.5	-38.5	-45.6	–
Gross profit	**17.3**	**16.3**	**27.7**	**37.4**	**47.0**	**56.2**	**36.2**
Personnel expenses	-3.3	-4.3	-6.6	-9.6	-11.3	-11.7	–
Other operating expenses	-6.4	-8.1	-15.1	-17.2	-18.0	-19.4	–
EBITDA	**7.6**	**3.9**	**6.0**	**10.6**	**17.8**	**25.1**	**59.3**
Depreciation and trade provisions	-1.4	-1.3	-2.2	-3.3	-4.9	-5.9	–
EBIT	**6.2**	**2.6**	**3.8**	**7.2**	**12.8**	**19.2**	**65.1**
As a % of sales	24.1	9.3	7.4	10.2	15.2	19.1	–
Financial income (expense)	0.2	1.2	1.0	0.7	0.8	1.0	–
Goodwill amortisation	0.0	0.0	-0.1	-0.3	-0.3	-0.3	–
Ordinary profit	**6.5**	**3.8**	**4.7**	**7.7**	**13.3**	**19.9**	**51.1**
Extraordinary gains (losses)	0.0	0.0	0.0	0.0	0.0	0.0	–
Profit (loss) before taxes	**6.5**	**3.8**	**4.7**	**7.7**	**13.3**	**19.9**	**50.8**
Taxes	-2.9	-1.2	-1.8	-3.1	-5.5	-8.4	–
Tax rate (%)	45.5	31.5	39.0	40.0	41.0	42.0	–
Minority interests	-0.5	-0.4	-0.4	-0.6	-1.0	-1.4	–
Net profit (loss)	**3.0**	**2.3**	**2.4**	**4.0**	**6.9**	**10.2**	**45.4**
YoY growth (%)	4.3	-24.2	7.5	61.7	73.5	48.5	–
Net cash flow	**4.4**	**3.6**	**4.8**	**7.6**	**12.1**	**16.4**	**46.3**
YoY growth (%)	28.2	-18.3	33.8	58.4	59.6	35.3	–

Source: Company data and Santander Central Hispano Bolsa estimates and forecasts.

Figure 13. El.En – Summarised Cash Flows, 2000-05F

(€ mn)	2000	2001	2002E	2003F	2004F	2005F
Net profit	**3.0**	**2.3**	**2.4**	**4.0**	**6.9**	**10.2**
Depreciation	1.4	1.3	1.7	2.6	4.1	4.9
Operating provisions	0.4	0.1	0.5	0.7	0.8	1.0
Goodwill amortisation	0.0	0.0	0.1	0.3	0.3	0.3
Net cash flow	**4.8**	**3.7**	**4.8**	**7.6**	**12.1**	**16.4**
Capex	0.0	-1.5	-2.9	-4.3	-5.5	-7.1
Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Change in working capital	0.0	-3.4	-4.0	-2.8	-3.9	-5.0
Other	0.0	-1.4	-11.6 [1]	0.0	0.0	0.0
Net increase in cash (debt)	**4.8**	**-2.6**	**-13.7**	**0.4**	**2.7**	**4.3**

(1) US$11mn net payment for Cynosure: US$10mn on signing, US$2.5mn at year-end and US$1.5mn retained in Cynosure for restructuring.
Source: El.En annual reports and Santander Central Hispano Bolsa estimates and forecasts.

Figure 14. El.En – Balance Sheet, 2000-05F

(€ mn)	2000	2001E	2002F	2003F	2004F	2005F
Net fixed assets	6.7	6.9	19.7	21.3	22.7	24.9
Inventories	6.7	9.1	19.1	26.3	30.4	35.7
Trading debtors	7.2	8.4	17.3	23.8	27.5	32.3
Non-trading debtors	1.5	2.8	6.4	3.2	3.3	3.7
Cash and equivalents	35.9	32.5	18.8	19.2	21.9	26.2
Total assets/liabilities	**58.0**	**59.7**	**81.3**	**93.9**	**105.9**	**122.8**
Shareholders' equity	43.7	45.0	54.0	57.9	64.8	75.0
Minorities	1.3	1.7	2.2	2.8	3.8	5.2
Provisions and deferred income	1.9	2.1	2.2	2.3	2.4	2.5
Long-term interest-bearing debt	3.0	2.2	2.2	2.2	2.2	2.2
Other long-term liabilities	0.0	0.0	0.0	0.0	0.0	0.0
Long-term liabilities	3.0	2.2	2.2	2.2	2.2	2.2
Short-term interest-bearing debt	0.4	0.4	0.4	0.4	0.4	0.4
Trade creditors	6.1	6.2	18.2	25.1	29.0	34.0
Other current liabilities	1.6	2.0	2.1	3.2	3.3	3.5
Current liabilities	8.1	8.6	20.7	28.6	32.7	37.8
Net debt (cash)	-32.4	-29.9	-16.2	-16.6	-19.3	-23.6
Net debt/equity (%)	**-74.2**	**-66.3**	**-30.0**	**-28.7**	**-29.8**	**-31.4**
RoE (%)	**6.9**	**5.1**	**4.9**	**7.1**	**11.2**	**14.6**

Source: Company data and Santander Central Hispano Bolsa estimates and forecasts.

Valuation

Cheap Considering the High Growth Prospects

We valued El.En using a comparison with peers and a DCF model . . .

We valued El.En by averaging the results obtained from two methods, which yielded quite different figures. One approach involved a comparison with other quoted companies in the laser industry, while the other consisted of a DCF model. Although in El.En's case a DCF approach would better reflect the company's strong and sustained growth prospects for sales and earnings in the short and long term, we are well aware that, in the current market conditions, investors are likely to be more inclined to look at comparables.

. . . which yielded a fair value of €191.0mn . . .

As shown in Figure 15 below, the combination of these approaches yields a valuation of €191.0mn, or €42.35/share, with an upside potential of almost 260% from current prices. Note that we are not applying any illiquidity discount, since all the stocks included in our set of comparables are already small or even micro caps with a similar – or even smaller – capitalisation than El.En's and this would imply a double penalisation of the stock.

. . . although upward revisions could occur

Conversely, we consider that El.En's current prospects for growth could be revised upwards. Indeed, El.En could become one of the leaders of an eventual consolidation in the industry, in which much of the business is in the hands of unprofitable players.

Figure 15. El.En – Valuation Summary

Methodology	€ mn	€/Share
DCF	**306.2**	**66.55**
International comparison		
EV/sales	75.9	16.50
EV/EBITDA	72.3	15.71
P/E	68.0	14.77
P/CF	96.2	20.91
PEG	104.7	22.75
Average of multiples	**83.4**	**18.13**
Average of DCF and market multiples	**191.0**	**42.34**
Current share price		11.08
Upside potential (%)		282.1
Relative to current market capitalisation (x)		3.82

Source: Santander Central Hispano Bolsa estimates and forecasts.

A peer comparison penalises the valuation of El.En

The result of the comparison with peers should be seen as a floor valuation, since it reflects the current gloomy outlook for most industries. Moreover, El.En should be trading at a premium to the majority of its peers, since it has some of the highest profitability ratios in the laser industry in the tough operating conditions seen in 2001.

As shown in Figure 15 above, El.En's valuation based on multiples would range from €68mn to €105mn and, given the company's strong growth prospects, we would look at the higher end. Note that our reference valuation is based on El.En's 2003F forecasts in order to better reflect the company's strong growth profile.

Figure 16. El.En – Comparison with Peers' EV/Sales and EV/EBITDA Multiples, 2002E-03F

(€ mn)	Country	Market Cap	EV/Sales 2002E	EV/Sales 2003F	EV/EBITDA 2002E	EV/EBITDA 2003F
Candela	US	45.2	NA	NA	NA	NA
Excel Technology	US	227.8	NA	NA	NA	NA
GSI Lumonics	Canada	271.3	1.59	1.09	-29.0	7.9
Lambda Physik	Germany	41.3	-0.02	0.06	-0.1	0.3
Laser Pacific	US	15.3	NA	NA	NA	NA
Laserscope	US	61.5	NA	NA	NA	NA
LaserSight	US	2.4	NA	NA	NA	NA
Lumenis	US	88.3	0.22	NA	NA	NA
Prima Industrie	Italy	28.6	NA	NA	NA	NA
Quantel	France	8.3	NA	NA	NA	NA
Rofin Sinar Technologies	US	108.6	0.65	0.58	5.3	4.3
Visx Inc	US	432.5	2.15	1.89	4.9	6.2
Wavelight Laser	Germany	22.6	0.84	NA	10.0	NA
Average		**104.1**	**0.91**	**0.91**	**-1.8**	**4.7**
Median		**45.2**	**0.75**	**0.84**	**4.9**	**5.3**
El.En						
Sales, EBITDA			51.6	71.0	6.0	10.6
EV/sales, EV/EBITDA multiples applied		0.75	0.84	4.9	5.3	
Implied valuation			54.8	75.9	45.6	72.3

Source: JCF estimates and forecasts. Santander Central Hispano Bolsa estimates and forecasts for El.En.

Figure 17. El.En – Comparison with Peers' P/E, P/CF and PEG Multiples, 2002E-03F

(€ mn)	Country	Market Cap	P/E 2002E	P/E 2003F	P/CF 2002E	P/CF 2003F	PEG 03F/01
Candela	US	45.2	NA	18.3	NA	NA	NA
Excel Technology	US	227.8	22.9	20.3	NA	NA	0.8
GSI Lumonics	Canada	271.3	-23.0	20.0	82.1	12.7	NA
Lambda Physik	Germany	41.3	78.7	22.5	12.4	7.9	0.9
Laser Pacific	US	15.3	NA	NA	NA	NA	NA
Laserscope	US	61.5	NA	NA	NA	NA	NA
LaserSight	US	2.4	NA	NA	NA	NA	NA
Lumenis	US	88.3	5.3	4.2	NA	NA	NA
Prima Industrie	Italy	28.6	NA	NA	NA	NA	NA
Quantel	France	8.3	NA	NA	NA	NA	NA
Rofin Sinar Technologies	US	108.6	22.2	9.6	9.4	6.0	1.4
Visx Inc	US	432.5	20.7	16.1	10.6	12.7	NA
Wavelight Laser	Germany	22.6	11.1	7.5	-8.5	108.1	0.2
Average		**104.1**	**19.7**	**14.8**	**21.2**	**29.5**	**0.8**
Median		**45.2**	**20.7**	**17.2**	**10.6**	**12.7**	**0.8**
El.En							
EPS, CFPS, EPS GACR 03F/01			0.53	0.86	1.04	1.65	31.8
P/E, P/CF, PEG multiples applied			20.7	17.2	10.6	12.7	0.8
Implied valuation (€ /share)			11.02	14.77	11.06	20.91	22.75

Source: JCF estimates and forecasts. Santander Central Hispano Bolsa estimates and forecasts for El.En.

Our valuation of €306mn using a DCF model . . .

Our DCF yielded a valuation of €306mn (€66.55/share), significantly higher than the peer comparison. The multiples comparison covers a very short period (2002E-03F), when most of the peers are just starting to recover from a poor 2001. Furthermore, the market values some of these companies as having limited possibilities of remaining in business.

. . . better reflects El.En's growth prospects

The DCF, however, considers a much longer period (2002E-10F), in which El.En should be able to realise its outstanding prospects for growth and returns for shareholders. Note that our valuation considers a WACC of 11.2%, including a 5.5% risk-free rate, a 4% market risk premium, a *beta* of 1.50x and a long-term growth rate (*g*) of 2.25%.

Figure 18. El.En – DCF Valuation

	€ mn
DCF (2002E-10F)	62.6
PV of terminal value	213.7
Total leveraged value	**276.3**
Plus/less net cash (debt)	29.9
Total equity value	306.2
Fair price (€/share)	**66.55**

Source: Santander Central Hispano Bolsa estimates and forecasts.

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Key to Investment Codes (12- to 18-Month Horizon)

Strong Buy	Expected to outperform the market by more than 15% AND Upside potential at least 25% above the 10-year applicable bond yields.
Buy	Expected to outperform the market by 5%-15% AND Upside potential at least 10% above the 10-year applicable bond yields.
Hold	Expected to perform within a range of 5% above or below the local market.
Underperform	Expected to underperform the market by 5%-15%.
Sell	Expected to underperform the market by more than 15%

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