

## Engineering &amp; machinery

Belgium

Maintained

## IPTE

Hold

## Challenging outlook for 2008

20/02/08

Maintained

Reuters: IPTE.BR

Price: €10.50

12-mth target: €10.50

- **Although we believe IPTE has the potential to surpass its record FY07 results, we have identified some items that suggest that 2008 could prove more challenging. First, the company's order book decreased slightly from 3Q07 to 4Q07. Second, IPTE is likely to see some de-stocking at Barco, its major client in contract manufacturing. Finally, IPTE itself has reduced inventories, which could indicate flatter short-term expected sales.**

**Record results for 2007, however...** As discussed in yesterday's *Benelux Daily*, IPTE's results came in at an all-time high. While these results are certainly a positive sign of IPTE's strong recovery after several difficult post-bubble years, some factors indicate that 2008 may be more challenging and underline the caution necessary when investing in cyclical stocks in current market conditions.

**A 6% order book reduction** (an 8% decrease in contract manufacturing – CM – more than offsetting a 3% increase in factory automation – FA). While the reduction is clearly limited, we would note that an order book reduction from 3Q to 4Q has not occurred since 2002. Interestingly, there seems to be a seasonal pattern in the 3Q-4Q order book evolution, as illustrated in Figure 1 on the following page. Three factors temper a negative conclusion here. First, the decrease is minor. Second, the order book at the end of 3Q07 was at its highest level for the year (and thus of all time, although a comparison prior to 1Q07 is meaningless given the impact of the Barco Electronics Manufacturing division acquired in 1Q07). Finally, a reduced order book in 4Q02 did not prevent IPTE from generating 33% YoY revenue growth in 2003.

**Barco's intention to reduce its inventories.** Barco is IPTE's major client, representing about 30% of its 2007 total sales. This high sales level may be related to Barco's significant inventory build-up over the period as inventories increased from €138.3m at end-2006 to €204.1m at end-2007. Barco's management recently commented that the company would focus on operational and working capital efficiency during 2008, specifically by reducing its inventories. This may be the foundation of IPTE's slight CM order book decrease and could continue during 1H08.

**IPTE's inventory reduction.** From 3Q07 to 4Q07, IPTE reduced inventories by 16% from €54.8m to €46.2m. While this undoubtedly relates partly to 4Q07's very high sales levels, we would note that the high sales levels of 2Q07 did not prevent IPTE from building inventories up further (Figure 2). We might therefore speculate that the company is expecting softening sales growth.

**Conclusion.** As the arguments above only concern potential indications of more challenging times for 2008, in particular for the first two quarters, the impact on our sales forecasts is minor. We therefore maintain our **HOLD** recommendation and peer analysis-based target price of €10.5.

| 12-month forecast returns (%) |     |
|-------------------------------|-----|
| Share price                   | 0.0 |
| Dividend                      | 0.0 |
| 12m f'cst total return        | 0.0 |

| Forecasts and ratios |       |       |
|----------------------|-------|-------|
| Yr to Dec (€m)       | 2007  | 2008F |
| Turnover             | 255.3 | 273.4 |
| EBITDA               | 16.6  | 18.4  |
| Net profit           | 10.9  | 9.5   |
| Adj EPS (€)          | 1.75  | 1.37  |
| Adj PER (x)          | 6.0   | 7.6   |
| Dividend yield (%)   | 0.0   | 0.0   |
| EV/EBITDA (x)        | 6.1   | 5.5   |
| Price/NAV (x)        | 1.7   | 1.4   |
| ROE (%)              | 33.2  | 20.5  |

| Share data              |        |
|-------------------------|--------|
| No. of shares (m)       | 6.9    |
| Daily turnover (shares) | 61,729 |
| Free float (%)          | 33.9   |
| Enterprise value (€m)   | 100.6  |
| Market cap (€m)         | 72.8   |



Source: ING

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**Fig 1 Order book seasonality – 4Q versus 3Q (%)**



Source: Company data, ING estimates

**Fig 2 2007 quarterly sales and order book evolution (€m)**

|                                 | 1Q07  | 2Q07  | 3Q07   | 4Q07   |
|---------------------------------|-------|-------|--------|--------|
| Sales                           | 62.41 | 66.26 | 58.14  | 68.49  |
| Inventories                     | 49.2  | 52.2  | 54.8   | 46.2   |
| Sales increase/decrease (%)     | -     | 6.17  | -12.25 | 17.80  |
| Inventory increase/decrease (%) | -     | 6.10  | 4.98   | -15.69 |

Source: Company data, ING estimates

## Company profile

### Overview

IPTE (Integrated Production and Test Engineering) is a supplier of production services to the electronics and industrial markets in Europe (Contract Manufacturing – CM) and a global supplier of automated production equipment for the electronics industry (Factory Automation – FA). Its client base includes large electronics manufacturers such as Philips, Siemens, Bosch, Barco, Ericsson, Motorola and Flextronics.

The company was created in 1992 by five former Philips engineers as a test engineering firm. IPTE was listed on the Brussels stock exchange in 2000, and its business model combines organic and acquisitive growth, with recent takeovers including the Barco Electronics Manufacturing division in 1Q07 and Platzgummer GmbH in 1Q08.

Geographical split of sales (2007): Benelux (63%), Europe (33%) and America/Asia (4%).

### Contract Manufacturing (76% of 2007 sales)

The CM division provides electronics production services to OEMs and electronics subcontractors. Activities include the production of cables and cable trees, PCB assembly and testing, production of semi-manufactures and final product assembly. IPTE targets the niche markets of industrial electronics and professional products. Segmental split of sales (2007): industrial products (63%), automotive (14%), telecommunications (11%), medical products (10%) and others (2%).

### Factory Automation (24% of 2007F sales)

The FA division provides full-scale solutions for process automation in the production and testing of PCBs (printed circuit boards) and electronics assembly. IPTE manufactures modular units that can be integrated into flexible assembly lines. Segmental split of sales (2007): automotive (67%), consumer electronics (15%), telecommunications (6%), industrial products (2%), medical products (2%) and others (8%).

### Risks

The main risks for IPTE include a lack of longer-term visibility, the cyclical nature of its business operations and its high sales dependence on Barco (30%).

### SWOT

#### Strengths

Strong position in niche markets. Diverse product mix. Strong client portfolio based on valuable relationships. Significant synergies between business units.

#### Weaknesses

Poor profitability track record versus competition. Client concentration risk. Limited recurring business in FA.

#### Opportunities

Margin enhancement through economies of scale. External growth in Germany. Development of sales activities in Eastern Europe. Development of activities in Asia with Shanghai factory.

#### Threats

Negative cycle. Price war with small competitors in target markets. US\$ strengthening.

## Financials

| Yr to Dec (€m)                               | 2007   | 2008F | 2009F | 2010F |
|--|--------|-------|-------|-------|
| <b>Income statement</b>                      |        |       |       |       |
| Turnover                                     | 255.3  | 273.4 | 289.1 | 303.7 |
| EBITDA                                       | 16.6   | 18.4  | 19.8  | 21.0  |
| Net financial charges                        | (2.7)  | (2.7) | (2.6) | (2.4) |
| Operating exceptionals                       | 0.0    | 0.0   | 0.0   | 0.0   |
| Adj pre-tax profit                           | 9.7    | 10.2  | 11.5  | 12.5  |
| Corporate exceptionals                       | 0.0    | 0.0   | 0.0   | 0.0   |
| Profit/loss on sale of tangible fixed assets | 0.0    | 0.0   | 0.0   | 0.0   |
| Amortisation of goodwill                     | 0.0    | 0.0   | 0.0   | 0.0   |
| Pre-tax profit                               | 9.7    | 10.2  | 11.5  | 12.5  |
| Taxes  | 1.2    | (0.6) | (0.9) | (1.5) |
| Extraordinary items (net)                    | 0.0    | 0.0   | 0.0   | 0.0   |
| Minorities                                   | 0.0    | (0.1) | (0.1) | (0.1) |
| Preference dividend                          | 0.0    | 0.0   | 0.0   | 0.0   |
| Net profit                                   | 10.9   | 9.5   | 10.5  | 10.9  |
| <b>Balance sheet</b>                         |        |       |       |       |
| Total fixed assets and L/T investments       | 23.3   | 25.5  | 27.5  | 29.2  |
| Working capital                              | 48.7   | 53.9  | 58.4  | 62.7  |
| L/T non-interest-bearing liabilities         | 2.0    | (0.6) | (0.6) | (1.5) |
| Enterprise net assets                        | 70.0   | 80.1  | 86.5  | 93.5  |
| Group equity                                 | 41.7   | 51.3  | 61.9  | 72.9  |
| Net debt                                     | 28.3   | 27.8  | 22.6  | 17.6  |
| Capital employed                             | 70.0   | 79.1  | 84.5  | 90.5  |
| <b>Cash flow</b>                             |        |       |       |       |
| Operating cash flow                          | 19.2   | 13.2  | 15.4  | 16.6  |
| Cash taxes                                   | 1.2    | (0.6) | (0.9) | (1.5) |
| Net financial charges (CF)                   | (2.7)  | (2.7) | (2.6) | (2.4) |
| Gross cash flow                              | 17.6   | 9.8   | 11.9  | 12.7  |
| Capital expenditures (net of disposals)      | (23.5) | (9.3) | (6.8) | (7.7) |
| Free cash flow                               | (5.9)  | 0.6   | 5.1   | 5.0   |
| <b>Ratios (%)</b>                            |        |       |       |       |
| EBITDA margin                                | 6.5    | 6.7   | 6.9   | 6.9   |
| Operating margin                             | 4.9    | 4.7   | 4.9   | 4.9   |
| Net debt/equity                              | 68.0   | 54.1  | 36.6  | 24.2  |
| ROACE  |        | 15.5  | 14.7  | 13.2  |
| ROE  | 33.2   | 20.5  | 18.5  | 16.2  |
| <b>Growth (%)</b>                            |        |       |       |       |
| Turnover                                     | 84.6   | 7.1   | 5.7   | 5.1   |
| EBITDA                                       | 178.2  | 10.8  | 7.8   | 5.8   |
| Net profit                                   | 485.4  | -12.4 | 9.9   | 4.5   |
| <b>Valuation</b>                             |        |       |       |       |
| EV/EBITDA (x)                                | 6.1    | 5.5   | 4.8   | 4.3   |
| Adj EPS (€)                                  | 1.75   | 1.37  | 1.51  | 1.58  |
| Adj PER (x)                                  | 6.0    | 7.6   | 7.0   | 6.7   |
| Price/NAV (x)                                | 1.7    | 1.4   | 1.2   | 1.0   |
| DPS (€)                                      | 0.00   | 0.00  | 0.00  | 0.00  |
| Dividend yield (%)                           | 0.0    | 0.0   | 0.0   | 0.0   |

Source: Company data, ING estimates

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