CHEUVREUX

15 May 2003

Fuchs Petrolub

Not rated

Lubricants

Company description

Profitable niche player

- FUCHS PETROLUB is a globally operating supplier of high-tech lubricants. It is the world's largest "independent" lubricant manufacturer. Ranked alongside the big mineral oil companies, such as TotalFina, Fuchs is no. 8 worldwide, no. 6 in industrial lubricants, and world market leader in several high-value specialities segments.
- In 2002, the company's sales increased 13% to EUR1.065bn, EBIT rose 39% to EUR70m, and net profit soared 172% to EUR24m.
- FUCHS is currently trading at a P/E of 8.6x based on 2002 earnings. The proposed dividend of EUR4.88 equates to a dividend yield of 5.5%.

Price (pref.)	EUR88.0
Market cap.	EUR206m
Free float	EUR141m
	FPEG_p.DE / FPE3 GR

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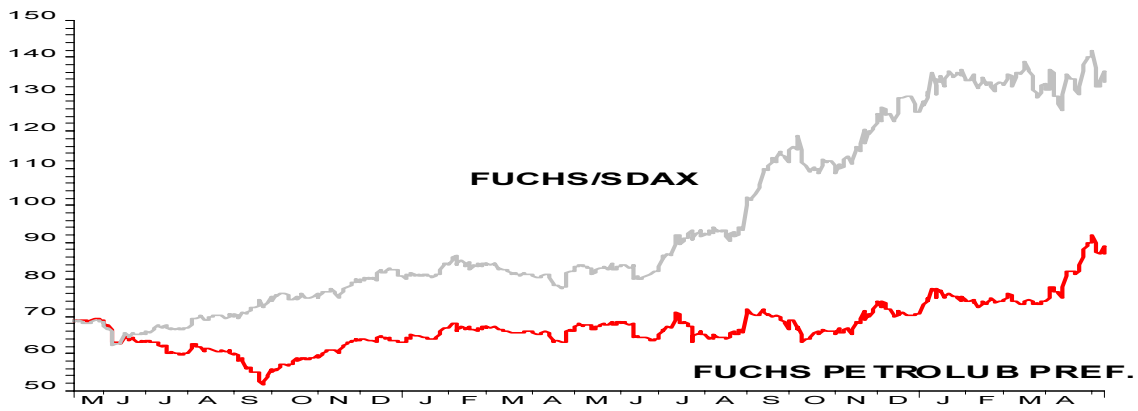
Next event:
Q1 results, 15 May



Shares outstanding	1.178m	SDAX	2081	Perf.	1 mo.	3 mos.	1 Y
Daily volume	26.0			Absolute	13.0%	19.2%	28.7%
				Relative	3.8%	0.1%	60.6%

Major shareholders (ordinary): Fuchs family 49%, Dresdner Bank 4.9%,Gothaer Versicherung 8%, Free float 38%
Major shareholder (preferred): Fuchs family 0.2%, Dresdner Bank 2.9%, Free float 96.9%

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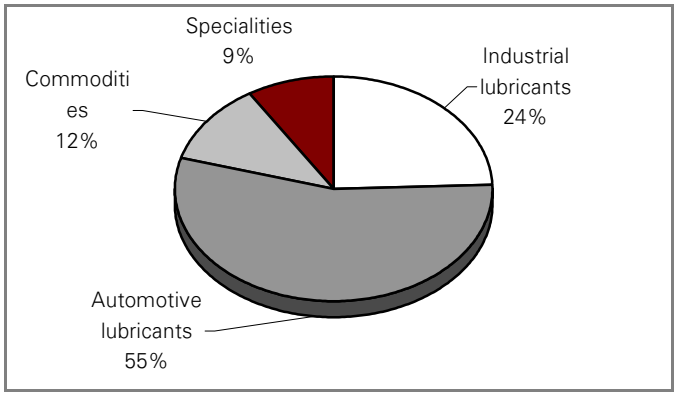
I — Company profile

FUCHS produces high-tech lubricants

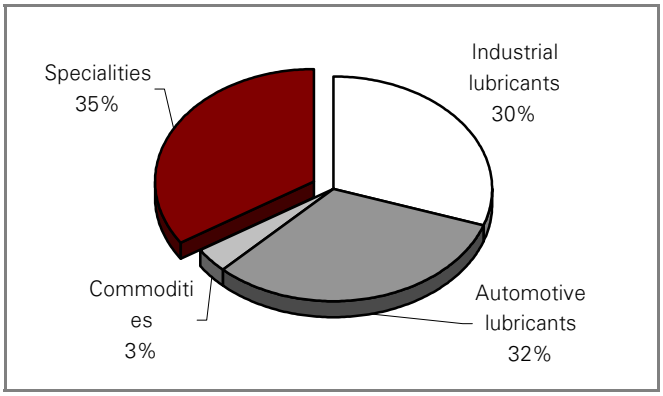
FUCHS PETROLUB AG is a globally operating high-tech lubricants supplier. FUCHS offers lubricants for hundreds of applications - including automotive (32% of sales), industrial (30% of sales) and speciality applications (34% of sales). It is the world's largest "independent" lubricant manufacturer. Ranked alongside the big mineral oil companies, such as TotalFina, Fuchs is no. 8 worldwide, no. 6 in industrial lubricants, and world market leader in several high-value specialities segments.

World market for lubricants (2002)



Source: Fuchs Petrolub

FUCHS sales by division (2002)



Source: Fuchs Petrolub

Specialisation on niches ensures high profitability (RoCE: 15.5%)

FUCHS focuses on niche segments. It tries to avoid price competition by limiting its exposure to commodity businesses. The specialty lubricant division alone accounts for 52% of gross profits. With an operating profit margin of 8.5% and RoCE of 15.5%, FUCHS achieves far better ratios than the market as a whole (operating margin of 4%-5% and RoCE of 7%-9%).

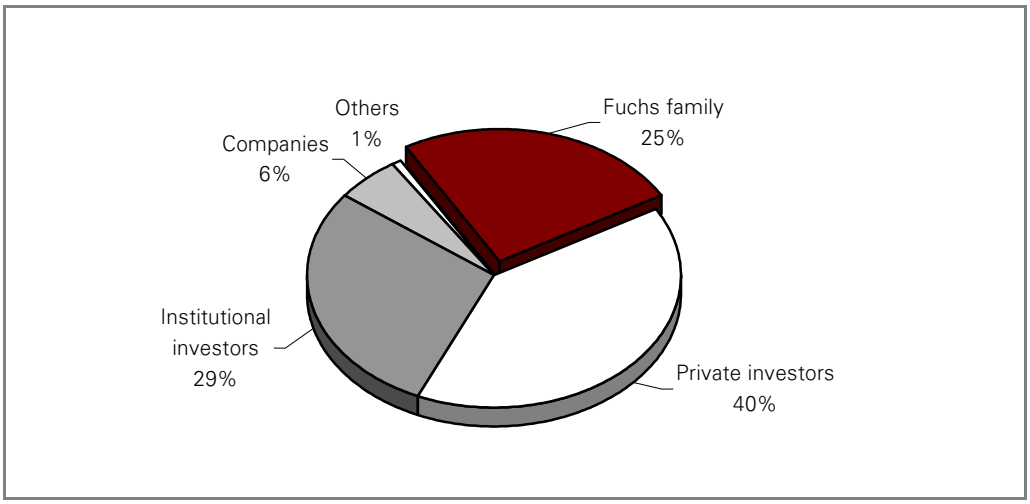
Areas of application for high-tech lubricants

Source: Fuchs Petrolub

Current market cap of EUR206m

The company has a current market cap of EUR206m. It has 1.216m ordinary shares outstanding (49% owned by the Fuchs family, 38% free float) and 1.172m preferred shares outstanding (97% free float). Fuchs clearly outperformed the weak equity markets in 2001 and 2002, with its ordinary shares increasing by 11% (2001) and 7% (2002), and its preferred shares climbing 10% (2001) and 12% (2002) respectively.

FUCHS' shareholder structure (ordinary & prefs)



Source: Fuchs Petrolub, 2003

II — Financial results 2002

In 2002, Fuchs reported according to IAS for the first time. The key P&L figures are outlined in the following table:

Key P&L figures

in EURm	2002	2001	*% change*
Sales	1,065	940	*13%*
EBIT	70	50	*39%*
EBIT margin	*6.6%*	*5.3%*	
Net profit	24	9	*172%*
Net profit margin	*2.3%*	*1.0%*	

Source: Fuchs Petrolub

Margin improvement due to economies of scale and lower tax rate

The sales increase can be broken down to +5.8% organic, +11.3% external growth and -3.8% negative currency effects. The EBIT margin improved to 6.6% (5.3%), mainly due to economies of scale. A reduction in the tax rate to 45% (2001: 65%) led to an impressive increase in net profit. ROE improved to 21.9% (7.4%) and RoCE came in at 15.5% (vs. 10.8% in 2001.)

Impressive free cash flow of EUR47m

The gross cash flow increased by 52% to EUR76m in 2002. The company improved its net working capital to EUR223m (20.9% of sales vs. 21.7% in 2001). Capex as a percentage of sales decreased from 3.7% to 2.7% (EUR29m). In summary, FUCHS generated an impressive free cash flow of EUR47m (up 129% y-o-y).

III — Outlook for 2003 and 2004

Management has given very cautious guidance for 2003, indicating flat sales and earnings. In Q1/03 sales decreased by 1% to EUR263.4m, while gross profit remained stable at EUR118m.

Sales

Fuchs should continue to capture market share

Top-line growth will remain low on the basis of limited market growth. However, we expect the company to win market share from formerly independent competitors, which now belong to large integrated groups (e.g. Castrol), as these groups tend to lend more weight to upstream activities due to their superior return on capital invested.

China is the growth market

The long-term market trend will continue. Growth will come from Asia (especially India and China), while Europe and the US are likely to remain roughly stagnant. Please bear in mind that China has already become the second largest lubricant market after the US, although its per capita consumption is markedly lower than in the western hemisphere.

Earnings

Cautious outlook for 2003

On the earnings side we expect no major change this year, although management pointed out that it regards its target of stagnant earnings as conservative. We have the impression that FUCHS made some provisions in 2002, for restructuring which will be carried out in 2003, e.g. plant closures in the polishing activity (Lippert). We therefore see management's earnings goal as being well within reach.

In 2004, earnings might improve significantly

For 2004 we expect a slight margin improvement on the back of new products and continued cost-saving efforts. The group will also continue to improve its working capital from 21% to around 20% of sales. We have assumed a stable tax rate, although management indicated that it still sees some improvement potential there. If IAS adopts the US GAAP ruling on goodwill treatment, Fuchs' tax rate will probably drop further from 45% to 35%, while its EBIT rises 20% .

Acquisitions likely

The company may make some smaller acquisitions this year, including a minority stake in an East-Asian speciality lubricants company with sales of EUR29m and a very promising product range. The company also sees another potential takeover candidate in India, where an industry merger has left the combined player with too many plants.

IV – Valuation

Peer-group valuation comparison

Fuchs is trading at a discount

We are very much aware that it is difficult to find suitable peers for Fuchs Petrolub. We have used the following companies as a peer group: DSM, Celanese, Bayer, Akzo Nobel, TotalFina, Royal Dutch, Ciba SC and Clariant. We are, however, not entirely satisfied with this. Based on our assumptions for 2004, Fuchs is trading at the following discounts to the peer-group average:

- EV/EBITDA of 3.4 vs. peer-group average of 4.4 — 23% discount
- P/E of 7.3 vs. peer-group average of 12.5 — 40% discount
- P/CF of 2.4 vs. peer-group average of 5.3 — 55% discount

FUCHS' EBITDA margin of 11% is markedly lower than the peer-group average of 16.8%, and this may justify a discount.

Cash flow return on assets

Based on historical asset values of EUR600m, FUCHS generates a cash flow return on assets of some 13%. This is incredibly high compared to the peer-group average of 6%-8%.

Dividend yield

Dividend yield of close to 6%

Based on the suggested dividend distribution of EUR4.88 for last year, the dividend yield amounts to 5.5% for the preferred shares.

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