

October 26, 2016

## BESALCO

### 3Q16 Results: EBITDA showed a double-digit decline, once again

The company posted weak results. EBITDA was down 18.6% YoY, while margins remained at 15.1%. This was mainly due to sharp declines in the activity of the Real Estate Business (-42.3% YoY) and Machinery business (-21.3% YoY). We highlight that margins in the Machinery business remain at historical lows (gross margins: -1,446 bps to 1.9% vs. ~12% historical), affected by the negative operating leverage, as demand in this segment remains weak. A positive point in the report was the increase in the Construction backlog, which showed growth of 8.7% QoQ and 10% YtD in the quarter. We continue to believe that the bulging balance sheet will limit room for the company's growth, particularly in the energy business. The company's alternatives to achieve faster growth are: i) potential sale of energy stations; and/or ii) the sale of non-core assets (concessions), but the outlook for either move seems fuzzy. We reiterate our HOLD recommendation.

- ▶ **EBITDA showed a double-digit decline, once again.** EBITDA was down 18.6% YoY, while margins remained at 15.1%. This was mainly due to sharp declines in the activity of the Real Estate Business (-42.3% YoY) and Machinery business (-21.3% YoY), which explained ~85% of the top line decline during the quarter (-17.5% YoY vs. -18.6% YoY EBITDA decline). We highlight that margins in the Machinery business remain at historical lows (gross margins: -1,446 bps to 1.9% vs. ~12% historical), affected by the negative operating leverage, as demand in this segment remains weak. In addition to this dynamic, we point out that the Construction business started showing a margin contraction (-225 bps to 6.8%) and its margin remains at a level consistent with normal civil works contracts in the industry (~6-8%).
- ▶ **The fastest-growing business line has started to slow down.** In the last few quarters, the Real Estate business line was the main contributor to top line growth. In fact, this business line has increased its participation in the company's business mix (19% current vs. 27% 2Q16 vs. ~12% historical). In the last quarter we considered that we should be cautious about this rapid growth because: i) it was coming with lower gross margins (12.7% vs. ~16.5% historical) and; ii) it was increasing leverage indicators (which is typical in this business as it is capital-intensive). In this quarter, the company reported lower dynamism in this segment (-42.3% YoY), while maintaining margins (gross margins: 19.2% vs. ~16.5% historical). We consider that this could be the first sign of the lower dynamism in the sector after the "pre-sales party", the main impacts of which will start to be seen in 2017, when demand will adjust to its normal levels.
- ▶ **At least the Construction backlog is showing a recovery.** The backlog in the Construction activity showed an increase of 8.7% QoQ and 10.0% YtD. New contracts are coming mainly from the civil works segments, which indicates that margins in the range of 6-8% are here to stay. In the coming quarters, we should pay attention to contract management, as these contracts have higher budgetary risks and a loss event could damage company's leverage profile.
- ▶ **The balance sheet remains a concern.** The balance sheet showed no major improvements, as net debt increased 5.8% vs. 4Q15. In this context, Net Debt/EBITDA increased to 5.1x (vs. 4.5x in 2015 vs. ~2.5x historical). In our view, the only way to accelerate the deleveraging process is to sell non-core assets, such as mature concessions or energy stations, but the outlook for either move seems fuzzy at this point.

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Table 1: 3Q16 Income Statement

CLP MM	3Q16 A	3Q15 A	Var. A/A
<b>Revenues</b>	<b>84.242</b>	<b>102.151</b>	<b>-17,5%</b>
<b>Gross Income</b>	<b>7.932</b>	<b>13.460</b>	<b>-41,1%</b>
Gross Margin	9,4%	13,2%	
SG&A	-3.846	-4.221	-8,9%
% Revenues	-4,6%	-4,1%	
<b>Operating Income</b>	<b>4.087</b>	<b>9.239</b>	<b>-55,8%</b>
Operating Margin	4,9%	9,0%	
<b>EBITDA</b>	<b>12.716</b>	<b>15.626</b>	<b>-18,6%</b>
EBITDA Margin	15,1%	15,3%	
<b>Net Income</b>	<b>2.000</b>	<b>4.579</b>	<b>-56,3%</b>
Net Margin	2,4%	4,5%	

Source: Company Reports and Research Department LarrainVial.

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