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THE WALL STREET

Lafarge, Saint-Gobain Face Threat From U.S. Slowdown

Investor Haven From Tech Turmoil Is at Risk

Decline In Construction Likely to Hurt French Building-Materials Giants

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PARIS — Investors can be forgiven for flocking to Old Economy names such as Lafarge SA and Saint-Gobain SA.

The French cement and building-supply companies are among the world's biggest building-materials groups, and the construction sector has been buoyant while the Internet and telecommunications sectors have taken a beating. But part of the foundation of these companies — the U.S. construction business — is looking shaky.

Both companies make about 25% of their sales in the U.S., with most of the remainder from European operations. Last year construction on offices and schools in the U.S. rose more than 11%. The European construction market hasn't been bad either, with France posting 5.5% growth due to tax breaks for new homes and property repairs, and Europe recording 2.7% growth despite Germany's sluggish economy.

So it isn't a surprise that Lafarge and Saint-Gobain posted healthy revenue growth of 16% and 26%, respectively, last year and caught the interest of investors.

Shares in Lafarge and Saint-Gobain recently were 38% and 23% higher, respectively, than their 12-month lows.

But a predictor of a slowdown that is appearing in the U.S. construction sector and threatening to spread to Europe could chip away at these gains.

Though June's U.S. housing starts were high, building permits slid 3.3%, a sign that slower economic activity is beginning to bite into the construction market.

"Construction always lags the U.S. economy by 12 months," said Mike Betts, an analyst at J.P. Morgan. "The lack of jobs now will impact next year's output."

That's particularly bad news for Saint-Gobain, which is more exposed to the U.S. and cyclical home-construction and renovation sectors around the world.

The company makes at least half of its €28.8 billion in revenue from home, office and retail construction and renovation, where many of its windows and window frames are used. Its two largest markets, France and North America, each contribute about a quarter of Saint-Gobain sales.

So a 4% slide in U.S. housing starts next year — as projected by U.S. industry association Portland Cement — and a nearly 50% drop in French construction growth —

as forecast by the European Construction Industry Federation as the result of expiring tax breaks and subsidies — could hit the stock hard.

A little over a week ago, Saint-Gobain blamed a 25% drop in its first-half net profit on a weak U.S. building market — a sector it says already is starting to bounce back. With the stock's rebound recently, investors took the company's cue.

"Since April, we sense a rebound, particularly in renovation, where we are more exposed," Philippe Crouzet, chief financial officer of Saint Gobain said. "There's been more stocking up."

However, he did concede that Europe is experiencing slower growth.

"The outlook isn't excellent but it's not awful either. The sector is holding up well," he said.

But as more Internet companies fail and investment banks lay off staff, the construction outlook in the U.S. is darkening. In July, Portland Cement cut its forecast for office building development to a 10% contraction from earlier forecasts of a 0.4% contraction.

French construction sentiment and consumer confidence are at their lowest levels in over a year. And French real-estate agencies such as Century 21 note falling property prices.

Additionally, Saint-Gobain was hurt in its first half by a severe drop in sales of its high-performance materials to the electronics industry.

Potential price wars in the flat glass market are an additional cause of worry.

Investors fret, too, over the company's strategy. Last year the company shifted its focus to distribution, a strategy that some analysts believe isn't working.

"We'd like to see Saint-Gobain do a few more strategic things" such as streamlining its corporate structure before focusing on new businesses, said Mr. Betts of J.P. Morgan. "They need to get rid of some (of the company's eight business) divisions."

That's already led to a few downgrades. Last week two banks cut their buy ratings on Saint-Gobain — Merrill Lynch to reduce and French brokerage firm Aurel Leven to accumulate — on worries of a slowdown in the U.S. And Deutsche Bank downgraded the cement-and-building materials sectors in July to neutral from buy on negative news that may emerge from an impending slowdown.