Bel Fuse Inc. Class B

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Asset Class: **Equity** Symbol: **BELFB:US** Updated: **4/29/2023** Submitted: **2/23/2023**

Bel Fuse is trading at less than half its peer groups multiple, has expanding margins, and benefits from long-term secular growth trends, but is down 12% on earnings.

AI Selection: SZ North America

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Pricing Details

DIRECTION	LONG
RECENT PRICE	56.88 USD 7/10/23 at 11:59PM
TARGET PRICE	74.00 USD
INITIAL PRICE	33.79 USD 2/23/23 at 12:00AM

Return Performance

RETURN TO DATE	68.33%
EXPECTED RETURN	30.10%
IRR	300.47%
RETURN VS. BENCHMARK (S&P 500)	58.69%

Thesis

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I am going to keep this write-up short because there is already a great write-up over on value investors club detailing the thesis, business, and industry. So, this should be viewed as more of an update on the situation and why the 12% decline today provides a great buying opportunity for the patient investor. Full disclosure I typed this up in a few hours today, mostly from my already existing notes.

Company description:

Bel Fuse is a small-cap electronic components manufacturer. They design, manufacture and market a broad array of products that power, protect and connect electronic circuits. These products are primarily used in the networking, telecommunication, computing, high-speed data transmission, military, commercial aerospace, transportation, e-Mobility and broadcasting industries. Bel's portfolio of products also finds application in the automotive, medical and consumer electronics markets.

Segment Sales Breakdown (FY 2022):

- Magnetic Solutions 27%
- Connectivity Solutions 29%
- Power Solutions and Protection 44%

End Market Sales Breakdown (LTM Q3-22):

- Military and Aerospace 14%
- Industrial and EV 18%
- Distribution 32%
- Network and Cloud 36%

Elevator pitch:

Pretty straightforward, Bel fuse makes good products that customers want, but there was practically no attention to the bottom line under the current CEO's tenure – this led them to actually selling some products at a loss (yes, really). A new CFO was appointed in early 2021 (Farouq Tuweiq) and is now turning that around, with Gross and EBITDA margins expanding to 31%, and 14.8% in the most recent quarter from 26.7% and 10.4% last year, respectively. I'll save you the math that's a 430bps increase to gross margins and a 440bps increase to EBITDA margins year over year.

For FY2022, gross margins increased from 24.7% to 29% (adjusting for surcharges), while EBITDA margins increased from 7.9% to 12.7% with no deterioration to the top line. Yet, Bel fuse is trading below its historical multiples back when EBITDA margins hung around 9% on average and never got over 10% in any given year.

Let's do some back-of-the-napkin math for BELFB:

- 2023E Sales guide of $622M (Flat Y/Y at mid-point)
- $87M EBITDA assuming a 14% Margin (Just to be conservative, and Q1 is seasonally lower).
- $434M Market Cap & EV of $456M.
- 5.2x NTM EBITDA

Compared to peer LFUS:

- 2023E Q1 Sales guide of down 11% organically.
- Consensus ~22.8% EBITDA margins (300bps decline y/y).
- 12.3x NTM Consensus EBITDA

Compared to peer TEL:

- 2023FY Q2 Sales guide of a 2% organic increase.
- Consensus ~22% EBITDA margins (100bps decline y/y).
- 12.5x NTM Consensus EBITDA

Compared to peer CTS:

- 2023FY Sales guide of a 2.5% organic increase.
- Consensus ~22.5% EBITDA margins (Roughly Flat y/y).
- 9.6x NTM Consensus EBITDA

It's important to note that Bel Fuse isn't done expanding margins, and I wouldn't be surprised if the 14% EBITDA margin I'm assuming for 2023E proved to be overly conservative. The above comps do have different end-market exposures and don't have the same mix of products, but they are directionally the correct comp set, and this is cheap enough that it doesn't matter.

Gross Margins are already near TEL level, and there's still work to be done there. The company has recently undergone some restructuring that should add ~$5M in cost savings exiting 2023 which would have added around 70bps to this year's EBITDA margin (bringing full-year margins up to 13.4%). Suppose you add back the surcharge gross margin hit that adds around another 20bps putting you at an "Adjusted" 2022 EBITDA margin of 13.6%. Considering how this quarter's EBITDA margin was 14.8% before these adjustments, I don't see 18% EBITDA margins as unattainable in the next three years, with an upside to 20% not entirely out of the realm of possibility.

Valuation:

Just looking at the peer group above and ignoring some of the multiple contractions that the space has seen recently, I see no reason a company exposed to strong secular tailwinds with 14% EBITDA margins (expanding) should be trading at a 57% discount to its peer group when it should have a similar organic growth profile longer term (With the best comp, LFUS guiding to organic growth **DOWN** 11% in Q1). Belfuse also traded at an average of 7x-8x EV/EBITDA over the last decade (when it was a worst business, selling products at a loss, and had materially lower margins).

Some potential outcomes below – Utilizing the closing price of $33.86 on 2/23/23.

Base Case:

- 2023E Assumptions – Flat Revs, EBITDA margins 14%, EBITDA $87M
- 7x EBITDA – ~$46 or 36% upside
- 7.5x EBITDA - ~$50 or 48% upside
- 8X EBITDA - ~$53 or 57% upside

Bull Case:

- 2023E Assumptions – LSD Rev growth, EBITDA margins 15%, EBITDA $95M
- 8x EBITDA – ~$58.5 or 72% upside
- 9x EBITDA - ~$66 or 95% upside
- 10X EBITDA - ~$73.5 or 117% upside

You can see the valuation starts getting ridiculous without even having to make what I consider aggressive assumptions to margins, revenue growth, or multiple expansion. So what do I think it's worth today? Somewhere in the $50-$60 range seems fair to me, taking the midpoint that's a **62% upside in the next twelve months.** The rerating could take longer of course (already has been obviously), but that's a "risk" I'm willing to live with.

If you start modeling out top-line growth and margin expansion a few years down the line, you can get to a $100+ share price without egregious assumptions. Could Bel fuse trade below 8x? Sure, I suppose, but the upside optionality on this name is absurd, and the downside risk at its current valuation is nil in my opinion.

4/29/23

Positive Update

TARGET ALLOCATION
5% - 10% ➧ 10%+

TARGET PRICE
55.00 ➧ 74.00

Well, to say Bel Fuse just smashed my expectations this quarter would be an understatement. I now believe they can do $115+ EBITDA in 2024 on conservative assumptions versus an enterprise value of ~$550M today. That means Bel fuse trades at just 4.8x EBITDA while the peer group is still around 10x-12x. Furthermore, a gap in valuation this wide makes no sense considering Bel Fuse will soon have comparable margins to its peers while also having similar organic growth and end markets.

Some notes from the quarter:

- EBITDA Margins essentially **doubled** y/y from 8.5% to 16.3% (150bp increase sequentially).
- Let's not forget the fact that Q1 is normally their weakest quarter due to seasonality, and they originally guided margins down sequentially for this quarter.
- Guidance now implies a healthy amount of conservatism and bakes in an MSD revenue decline in the 2nd half of this year after excluding surcharges.

I now believe that 18%+ margins are obtainable in 2024 on the back of the cost-saving initiatives I discussed previously and the fact that Bel Fuse has yet to have a quarter where one segment isn't dragging down the others. This quarter it was Magnetics, which is facing inventory issues that will eventually clear up but have led to a 670bp decline in GM sequentially in the interim. This isn't related to a demand problem however, but rather a bottleneck some of their customers are facing. As an example, Cisco might have enough Bel Fuse RJ45 connectors for their servers but can't get enough power supplies from Bel Fuse to get the product out the door – so once the supply for these missing parts catches up with demand, magnetics should normalize.

Previously I had thought buybacks to be completely out of the question, but I no longer believe this to be the case. Having spoken to management this week, they acknowledged the multiple which the business trades at is nonsensical and has actually managed to decline despite margins doubling and all the positive structural changes that have been implemented. There is, however, some resistance within the organization for now.

As the quarters go by, I also get slightly more and more comfortable with the controlling shareholder and CEO, Daniel Bernstein. The manner in which he speaks about the business seems to have changed from the prior years/decades. It's usually very difficult to "teach an old dog new tricks," but Bernstein has allowed Farouq and others to make some very dramatic changes to the organization over the past two years, and he seems more than happy with those changes.

Daniel Bernstein Q3-2022 Earnings Call:

"I think the key thing we have to give -- I hate to say it, but I have to give Farouq a lot of credit when he came on board 2 years ago to really refocus the company of where we have to be, to be successful.

***And it was my fault.** I think we were too driven to be the $1 billion company from a revenue top line point of position. And maybe we took business in that we should have taken in. So I think with the substantial helpful from Farouq and then teams, have everybody to refocus on where we want to go and how to be strong, that we felt initially we really had to evaluate every part of the business and mostly from margin standpoint where we're selling, a, we had customers that really didn't fit what we had to be and we had SKUs that didn't fit.*

So we spent a great deal of getting first, Farouq, working on the data so each group -- each division manager can look very specifically at each partner to see it was in the red or green or orange levels and refocus our energy.

And then we are (inaudible) with the long lead times where pricing did not become a factor, where most of our customers today are really focused on delivering that pricing. So that gave us a leeway to implement where we do have fair pricing, that our customers are paying a fair amount for what we give them, and I think that's been the major change."

Admitting you're at fault for something is not an easy thing for most people to do; admitting you're at fault on a public earnings call is something entirely different. However, actions speak louder than words, margins continue to improve, Farouq continues to be able to implement the changes that need to be done, and Bernstein doesn't appear to be stepping on anyone's feet. When/if we get a buyback Is up in the air, but I don't think it's entirely out of the realm of possibility, and in the interim, I take comfort knowing Farouq will continue to allocate capital the best way that is available to him.

Updated Valuation:

Base Case:
2024E – Flat Revs in 2023 & LSD growth in 2024, EBITDA margins 17%, $110M EBITDA

- 8X EBITDA – $67 or 66% upside
- 9X EBITDA – $76 or 87% upside
- 10X EBITDA – $84 or 108% upside

Bull Case:
2024E – LSD growth in 2023 & LSD growth in 2024, EBITDA margins 18%, $120M EBITDA

- 8X EBITDA – $73 or 81% upside
- 9X EBITDA – $83 or 104% upside
- 10X EBITDA – $92 or 127% upside

I consider my base case to be a low hurdle for the company and would not be surprised to see my Bull Case beaten in 2024. My assumptions, like my prior ones, will likely prove to be too conservative, but that's fine, as I'm trying to demonstrate a point here – that you don't need to model absurd assumptions to get absurd upside……… In fact, I'm not even giving them credit for incremental cash gen here.

Let's set low expectations here again and throw a $74/sh price target on it today. **That gets us 83% upside looking out just twelve months.**

Last time I mentioned that you could get to a $100+ share price looking a few years out without overly egregious assumptions, and I now believe that goal post has moved to $120+ a share (LSD growth, 19%+ EBITDA margins, credit for incremental cash gen, 10X EBITDA).

In conclusion, I'm more than happy with how the business is performing fundamentally and hope to see the team continue to execute well and beat my expectations.