ABN·AMRO

Tuesday 1 August 2006

Change of recommendation

Bekaert

Upgrade to Buy, lower estimates

Key forecasts

	FY04A	FY05A	FY06F	FY07F	FY08F
Revenue (€m)	2173.2	1914.3	2093.8	2159.5	2236.9
EBITDA (€m)	307.7	257.4	260.8▼	268.9▼	281.5▼
Reported net profit (€m)	167.6	189.9	141.3	144.1▼	151.1▼
Normalised net profit (€m)	170.8	135.7	141.3	144.1▼	151.1▼
Normalised EPS (€)	7.78	6.18	6.44	6.57▼	6.89▼
Dividend per share (€)	2.00	3.00	2.50	2.75	3.00
Dividend yield (%)	2.78	4.17	3.47	3.82	4.17
Normalised PE (x)	9.25	11.6	11.2	11.0	10.5
EV/EBITDA (x)	6.48	7.39	7.12	6.44	6.25
EV/invested capital (x)	1.17	1.09	1.02	0.95	0.93
ROIC - WACC (%)	11.1	5.37	6.11	6.05	3.92

Source: Company data, ABN AMRO forecasts
Accounting Standard: IFRS
year to Dec, fully diluted

Quick summary

Bekaert's 1H06 result was strong, as expected. EBIT and net profit were in line with our estimates but some 7% above consensus. Margin pressure was stronger than expected as a result of its rapid expansion in China. Consequently, we are forced to lower our estimates by some 4%. Nonetheless, we like Bekaert's fundamentals and ongoing focus on expansion in emerging markets. Furthermore, Bekaert shares have come down by 30% in recent months. On our new estimates, the shares trade at 11.0x PE 07F, which compares to a peer group average of 13.5x. Our new target price of €87 is based on 13.5x projected earnings and provides some 21% upside potential. Therefore, we upgrade our rating from Add to Buy. This is mainly a valuation call.

As expected: strong 1H06 results

Bekaert's 1H06 results were in line with our estimates and above consensus. Consolidated sales were €1,009m vs our expectation of €994m. EBIT arrived at €76m, fully in line with our estimates. Net profit came in at €75.5m, in line with our expectations but 7% above consensus.

We will briefly describe the main developments in Bekaert's divisions in 1H06.

Advanced Wire Products (sales: +4%, EBIT: -19%)

Europe and North America remained weak in the Advanced Wire products segment. Competition increased, especially in the passenger tyres division in Europe. Bekaert is shifting capacity to low-wage countries, like its clients.

The ongoing expansion in China could be seen in the numbers with a 38% increase in sales. Wire Latin America also performed well, with a 21% increase. The only disappointment in the Advanced Wire products was the decrease in the

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Priced at close of business 31 July 2006. Use of ▲▼ indicates that the line item has changed by at least 5%.

Gustav Mahlerlaan 10, 1082 PP Amsterdam, Netherlands

Buy (from Add)

Absolute performance

n/a

Short term

Overweight

Market relative to region

Engineering & Machinery

Belgium

Price

€72.00

Target price

€87.00 ▼

Market capitalisation

€1.55bn

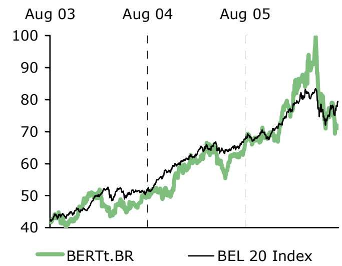
Avg (12mth) daily turnover

€3.36m

Reuters	Bloomberg
BERTt.BR	BEKB BB

Asset allocation	
Equities	Overweight
Cash	Neutral
Bonds	Underweight

Price performance	(1M)	(3M)	(12M)
Price (€)	75.1	91.1	64.8
Absolute %	-4.1	-20.9	11.0
Rel market %	-6.5	-18.5	-5.6
Rel sector %	-5.9	-17.8	-21.5



Stock borrowing: n/a
Volatility (30-day): 31.02%
Volatility (6-month trend): ↑
52-week range: 102.60-64.70
BEL 20 Index: 3795.91
Europe Engineering: 242.04

Source: ABN AMRO, Bloomberg

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EBIT margin to 10.0% (from 12.6% yoy). This could be attributed to the increase in sales in lower–margin China (15% of sales) in order to gain market-share and the higher energy prices.

The company disclosed that it gained market share at the expense of margins in the Chinese Steelcord market. Its competitors are small, privately owned companies and the company must prevent them gaining market power. CEO, De Graeve, estimated a growth for the Chinese steelcord market of 25% in China vs a 38% sales increase for the company.

Regarding its expansion plans in Russia, Mr De Graeve disclosed that the talks with market leader Uralkord (20-25% market share) continue, but are unlikely to lead to any conclusion soon. Bekaert considers Russia as a fast-growing market for tyre reinforcement and is willing to use the Uralkord joint venture as a spring board to consolidate here.

Furthermore, Bekaert has decided to expand its production capacity for advanced wire products in Indonesia. The company wants to anticipate the rapidly growing demand from the paper industry in South-East Asia.

All in all, the mature markets of Europe and North America remain difficult going forward, but Bekaert's focus on emerging markets is paying of. The company's clients are shifting from developed markets to emerging and Bekaert anticipates moving with them. We estimate sales of €1,796m (from €1,640m) this year and a €166m EBIT (€171m), which equals a 9.2% EBIT margin (1H06: 10.0%). The lower EBIT margin in 2H06F compared with 1H06 is due to seasonality.

Advanced Materials (sales: +17%, EBIT: +20%)

The Advanced Materials division has done well with a 17% increase in sales. Recurring EBIT came in at €6m (up from €5m). In the fibre technology (+34%), the acquisition of Southwest Screens & Filters contributed for the first time. The company is one of the world's leading players in metal fibre-based industrial process filters and Southwest contributed €7m to sales in 1H06. If we take into account this acquisition, which should add 18% to sales this year on a stand-alone basis, the fibre division should show strong organic growth of 16% in current operations.

Furthermore, in November 2005, Bekaert announced the takeover of Shell's 25% stake in their combustion technology JV, which generated €25m in annual sales. Results in Combustion Technology were poor with a 4% decline in sales, despite this acquisition. Bekaert blames the poor results to fewer projects in the paper industry in 1H06.

The remaining Composites showed a 34% increase in sales, in line with our estimates. It is very difficult to make profits in this segment, as competition is extremely keen, according to management.

In 1H06, Advanced Materials generated sales of €74m. For FY06, we forecast sales of €159m (from €141m in FY05) and a €10m EBIT (from €5m in FY05). EBIT margin should be 6.3% compared with 8.1% in 1H06 (and 3.7% in FY05).

Advanced Coatings (sales: +2%, EBIT: finally positive)

Bekaert's smallest division benefited from the opening of a new plant in China in November 2005. Specialised Films showed good results with a yoy increase of 13%. The company announced it will further focus on developing window films for buildings and vehicles.

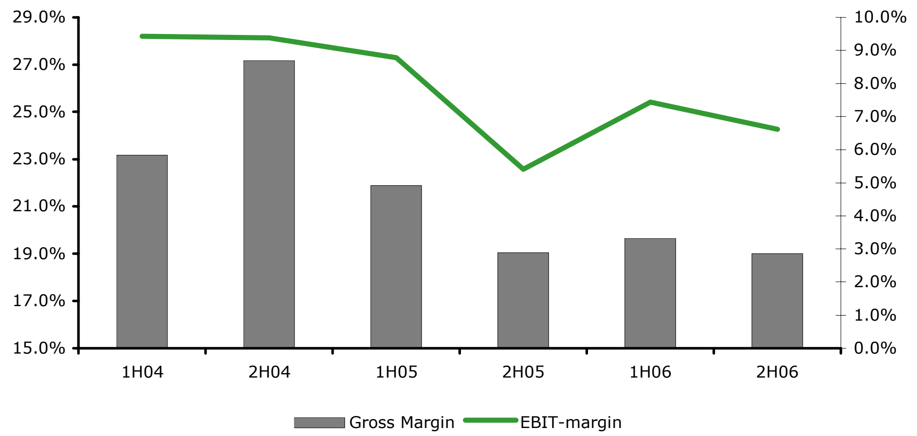
It said it recorded a difficult start in Industrial Coatings (sales: -13%), due mainly to the low level of project-driven activity in sputter products. Global sales of CDs and DVDs slowed.

In 1H06, Bekaert generated sales of €68m in this division. For FY06, we estimate sales of €139m (from €132m in FY05) and an EBIT of €4m (from -€4m in FY05).

Implications for our estimates

Bekaert's margins are currently under pressure. We were looking for a group EBIT margin of 7.7%, but the company realised a 7.5% margin, as a result lower gross margin. This margin pressure has forced us to lower our estimates for the rest of this year by some 4%. We foresee gaining market share in the Chinese Steelcord market as the only way to create a strong foothold in this market. Going forward, the gross margin in this market should stabilise around 20%.

Figure 1 : Gross, EBIT margin development



Source: ABN AMRO, company data

We expect an FY06 gross margin of 19.3% (vs 20% previously) and an EBIT margin of 7.0% (vs 7.2% previously). Our new EPS 06 and 07 forecasts are €6.44 (from €6.75) and €6.57 (€7.04), respectively.

Company outlook

Bekaert has announced it is experiencing increased competition and a further volatility in raw-material prices around the world. Bekaert is still able to pass on raw-material prices to customers, but rising energy costs and volatile raw material prices could be a problem for the company, in our view. Margins could be lower, going forward, but cash generation offers opportunities to invest in emerging markets or acquisitions.

We still believe the long-term view...

We have lowered our EPS estimates for FY06 and beyond, but we remain bullish on the stock. Bekaert's fundamentals are well prepared for growth in emerging markets like China and Russia. EPS growth in 06 should be a modest 4%, but the ongoing focus on expansion should result in the expansion in fast-growing markets. Capacity in China has been increased by 50% this year and should pay off in the next few years. Talks in Russia should, in the end, result in a strong market position in one of the fastest growing markets in the world.

The company has a strong focus on emerging markets and is open to increasing its capex (we expect €160m this year). With its leadership (or No 2 position) in almost every market, we consider Bekaert as excellently positioned in all markets. Cash generation should offer opportunities for add-on acquisitions and expansion in emerging markets.

... and potential threats are already priced in

Bekaert's shares have fallen over 30% since its all-time high in May as a result of the US$ weakening and the potential fear for interest-rate increase as described in our note: *A balanced score-card,* dated 20 June 2006).

Bekaert's main threats, in our opinion, are the potential weakening of the US$ and the possibility of being unable to pass on higher raw-material prices.

Since Bekaert appeared on our radar screen, we have always warned about the company's dollar sensitivity, as more than half of its sales are US$-denominated or are from US$ pegged regions. In the past, Bekaert's net profit has been affected by the depreciation of the US$. For example, in FY03 and FY04, the US dollar negatively impacted net profit by as much as €43m. In 2003, Bekaert lost as much as €26m. In our model, we have pencilled in that the depreciation of the US$ affects Bekaert's net profit €1.4m negatively.

Furthermore, one could argue that Bekaert is experiencing margin pressure as a result of fierce competition. However, we argue that Bekaert still is a market leader and a price setter, especially in its niche markets. We admit it will face margin pressure, but we already take a significant decrease of gross margin into account in our model (from a gross margin of 20.5% in FY05 to 19.6% in FY06F).

Valuation and target price

On Bekaert's historical valuation multiples, we see an average realised PE over the last 10 years of 11.8x. Currently, Bekaert shares trade at a 2007F PE of 11.0x, but since the company is a more specialised one, a higher than historical multiple should be appropriate.

In our peer group, Bekaert seems to be undervalued. We still believe Bekaert deserves a multiple of 13.5x, which we feel is appropriate for Industrial manufacturers. Given our 07 EPS estimate of €6.57, this would imply a share price of €87. When we take a look at the EV/EBITDA multiples, we want to flag the hidden value of the joint ventures (as described in our note *Hidden value: participations,* dated 13 November 2005). At FY05 levels, these JVs are only shown at the participation line and contribute to net profit directly.

All in all, we lower our EPS forecasts, but on valuation grounds upgrade our recommendation from Add to Buy. Our new target price comes in at €87, which implies 21% upside potential, based on 13.5x projected earnings.

BEKAERT: KEY FINANCIAL DATA

Income statement

€m	FY04A	FY05A	FY06F	FY07F	FY08F
Revenue	2173.2	1914.3	2093.8	2159.5	2236.9
Cost of sales	-1559.7	-1401.0	-1575.4	-1627.2	-1684.8
Operating costs	-305.7	-255.8	-257.5	-263.5	-270.7
EBITDA	**307.7**	**257.4**	**260.8**	**268.9**	**281.5**
DDA & Impairment (ex gw)	-122.6	-121.2	-114.0	-117.5	-121.7
EBITA	**185.1**	**136.3**	**146.8**	**151.3**	**159.7**
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	**185.1**	**136.3**	**146.8**	**151.3**	**159.7**
Net interest	-26.6	-26.9	-25.6	-19.0	-18.0
Associates (pre-tax)	n/a	n/a	n/a	n/a	n/a
Other pre-tax items	-3.97	11.7	0.00	0.00	0.00
Reported PTP	**154.5**	**121.0**	**121.3**	**132.3**	**141.7**
Taxation	-28.1	-30.3	-30.3	-33.1	-35.4
Minority interests	-12.4	-12.0	-5.60	-11.2	-11.2
Other post-tax items	53.6	111.1	56.0	56.0	56.0
Reported net profit	**167.6**	**189.9**	**141.3**	**144.1**	**151.1**
Tot normalised items	-3.22	54.2	0.00	0.00	0.00
Normalised EBITDA	307.7	257.4	260.8	268.9	281.5
Normalised PTP	154.5	121.0	121.3	132.3	141.7
Normalised net profit	**170.8**	**135.7**	**141.3**	**144.1**	**151.1**

Source: Company data, ABN AMRO forecasts ***year to Dec***

Balance sheet

€m	FY04A	FY05A	FY06F	FY07F	FY08F
Cash & market secs (1)	57.1	132.2	153.6	279.6	271.6
Other current assets	941.4	959.5	1006.4	925.8	954.4
Tangible fixed assets	791.6	799.8	845.8	888.2	926.5
Intang assets (incl gw)	118.4	125.4	134.6	134.6	134.6
Oth non-curr assets	280.9	214.7	254.9	275.3	275.3
Total assets	**2189.3**	**2231.7**	**2395.2**	**2503.5**	**2562.4**
Short term debt (2)	314.4	246.7	309.5	300.0	260.0
Trade & oth current liab	389.8	311.8	364.2	353.8	361.6
Long term debt (3)	246.5	297.7	212.1	220.0	220.0
Oth non-current liab	280.1	245.3	247.5	274.7	274.7
Total liabilities	**1230.8**	**1101.4**	**1133.4**	**1148.5**	**1116.2**
Total equity (incl min)	958.5	1130.3	1261.9	1355.0	1446.1
Total liab & sh equity	**2189.3**	**2231.7**	**2395.2**	**2503.5**	**2562.4**
Net debt (2+3-1)	503.8	412.1	368.0	240.4	208.4

Source: Company data, ABN AMRO forecasts ***year ended Dec***

Cash flow statement

€m	FY04A	FY05A	FY06F	FY07F	FY08F
EBITDA	307.7	257.4	260.8	268.9	281.5
Change in working capital	-117.1	15.0	-35.6	13.3	-20.9
Net interest (pd) / rec	-26.6	-26.9	-25.6	-19.0	-18.0
Taxes paid	-28.1	-30.3	-30.3	-33.1	-35.4
Other oper cash items	35.0	101.9	50.8	13.5	44.8
Cash flow from ops (1)	**171.8**	**317.1**	**220.1**	**243.7**	**252.0**
Capex (2)	-179.9	-129.7	-160.0	-160.0	-160.0
Disposals/(acquisitions)	0.00	0.00	0.00	0.00	0.00
Other investing cash flow	0.00	0.00	0.00	0.00	0.00
Cash flow from invest (3)	**-179.9**	**-129.7**	**-160.0**	**-160.0**	**-160.0**
Incr / (decr) in equity	-10.2	13.6	0.00	0.00	0.00
Incr / (decr) in debt	61.3	-16.5	-22.8	-1.60	-40.0
Ordinary dividend paid	-38.6	-52.3	-55.0	-55.0	-60.0
Preferred dividends (4)	0.00	0.00	0.00	0.00	0.00
Other financing cash flow	5.49	2.23	39.1	98.9	0.00
Cash flow from fin (5)	**18.1**	**-52.9**	**-38.7**	**42.3**	**-100.0**
Forex & disc ops (6)	0.00	0.00	0.00	0.00	0.00
Inc/(decr) cash (1+3+5+6)	**9.94**	**134.5**	**21.4**	**126.0**	**-8.05**
Equity FCF (1+2+4)	-8.16	187.4	60.1	83.7	92.0

Lines in bold can be derived from the immediately preceding lines. ***year to Dec***
Source: Company data, ABN AMRO forecasts

DISCLOSURES

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 3% or more and a Trading Sell indicates downside of 3% or more. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For listed property trusts (LPT) or real estate investment trusts (REIT) the recommendation is based upon the target price plus the dividend yield, ie total return. A Buy implies a total return of 10% or more, a Hold 5-10% and a Sell less than 5%. For Scandinavian mid- and small-caps a Buy/Sell implies upside/downside of 15% or more, an Add/Reduce 5-15% and a Hold less than 5%. For other European mid- and small-caps a Buy/Sell implies upside/downside of 10% or more, an Add/Reduce 5-10% and a Hold less than 5%.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Sector relative to market: The sector view relative to the market is the responsibility of the strategy team. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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The tables below show the distribution of ABN AMRO's recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where ABN AMRO has an investment banking relationship.

Long Term recommendations (as at 01 Aug 2006)

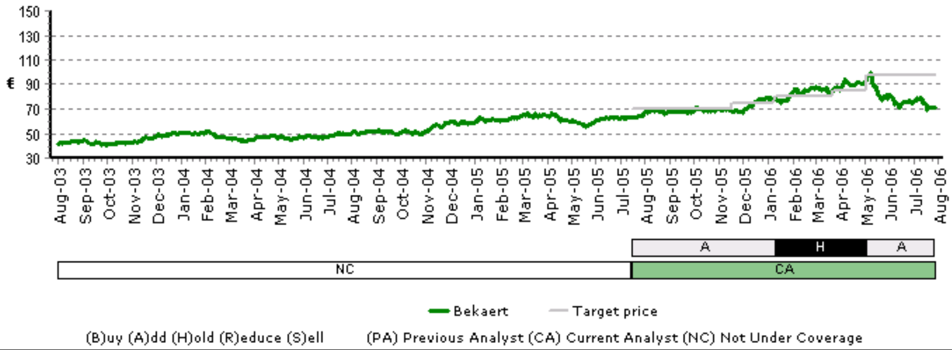
	Global total (IB%)	Europe total (IB%)
Buy	592 (21)	229 (52)
Add	72 (38)	67 (40)
Hold	450 (17)	205 (32)
Reduce	21 (10)	19 (11)
Sell	92 (2)	22 (9)
Total (IB%)	**1227 (19)**	**542 (40)**

Trading recommendations (as at 01 Aug 2006)

	Global total (IB%)	Europe total (IB%)
Trading Buy	11 (36)	9 (44)
Trading Sell	0 (0)	0 (0)
Total (IB%)	**11 (36)**	**9 (44)**

Bekaert

Stock performance, recommendations and coverage (as at 31 Jul 2006)



Trading recommendation history (as at 01 Aug 2006)

Date	Rec	Analyst
	n/a	

ABN AMRO changed the recommendation structure for this stock from one based on absolute performance to sector relative performance on 12 Jul 05
Thijs Hovers started covering this stock on 14 Jul 05
Moved to new recommendation structure between 1 November 2005 and 31 January 2006

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