KBC Securities

# Flash

# Bekaert

29 July 2003

## Excellent 1H, outlook uncertain

**Engineering & Machinery**

**Belgium**

**Current price** € 44.25

**Target price** € 45.00

**Neutral**

Rating unchanged

| Performance over | 1m | 3m | 12m |
|---|---|---|---|
| Absolute | 9% | 9% | -7% |
| Rel. BEL20 | 6% | 2% | -1% |
| Rel. sector | -3% | -7% | -16% |
| 12-m- Hi/Lo | € 49.90/31.30 | | |
| Reuters | BERTt.BR | | |
| Bloomberg | BEKB BB | | |
| Market Cap | € 987m | | |
| Next corporate event | | | |
| Results 3Q 03 on 14 November 2003 | | | |

| FY/e 31.12 | 2002 | 2003E | 2004E | 2005E |
|---|---|---|---|---|
| Sales (€m) | 1,863 | 1,766 | 1,875 | 1,968 |
| EBITDA (€m) | 209 | 251 | 263 | 272 |
| Pre-Tax* (€m) | 42 | 92 | 110 | 118 |
| Adj EPS* (€) | -1.55 | 4.34 | 4.90 | 5.08 |
| EPS (€) | -2.24 | 3.53 | 4.51 | 4.70 |
| DPS (€) | 1.68 | 1.75 | 1.95 | 1.90 |
| P/E* (x) | - | 10.2 | 9.0 | 8.7 |
| Yield (%) | 3.8 | 4.0 | 4.4 | 4.3 |
| EV/EBITDA (x) | 6.7 | 5.5 | 5.3 | 5.1 |

*Source: KBC Securities* **Adjusted for goodwill and exceptionals*

**Bekaert's net result (group share) reached € 43.7m versus our € 50m forecast. As the operating result and contribution from associates exceeded our estimates, the differences are due to pension fund provisions and non-operating charges (impairment on Handling division and translation differences). With an operating margin at a historical high of 7.3% (7.8% before restructuring) in a very challenging environment, the overall impression must be positive. However, the outlook remains highly uncertain with the current order book below the level observed 12 months ago.**

## Earnings review

Against a 18.7% decline of the USD in the 1H03 -compared to the 1H02-, consolidated sales declined by 5.4% to € 932.7m (€ 939.3m anticipated) but would have increased by 3.4% at constant currencies. Including associates, "combined" sales declined by 10.4% to € 1,363m but, according to Bekaert, would have remained flat at constant currencies. The net change in consolidation perimeter (consolidation of Drôtovňa Drôty & Kordy net of divestments/closures) might be expected to have had a positive impact on sales of about 1%.

**Sales per business unit (€ m)**

| | 2001 | 1H02 | 2002 | 1H03 | 2003E |
|---|---|---|---|---|---|
| Wire | 675 | 367 | 674 | 319 | 580 |
| Steel cord | 597 | 306 | 605 | 308 | 617 |
| Fencing | 388 | 218 | 392 | 217 | 388 |
| Advanced Materials | 164 | 113 | 220 | 106 | 207 |
| Others / Intersegment | -26 | -18 | -26 | -17 | -26 |
| **Total** | **1,796** | **986** | **1,863** | **933** | **1,766** |

*Source: Company data, KBC Securities*

Sales in **Wire** were down 13.2% and even by 17.9% at the combined sales level. The decrease is explained by Bekaert as due to the lower $, low demand in Germany and North America and the elimination of lower margin business. On the other hand, Bekaert referred to sustained demand in LatAm and good progress in China. Consolidated sales in **Fencing** decreased by 0.3% (regional business, no USD effect). The optimisation program put through in the 2H02 and which resulted in the closure of 3 out of 14 production units and a headcount reduction of approximately 20% of the BU's workforce has been implemented successfully. Bekaert again mentioned the performance at the 'Handling' division as unsatisfactory. The company took a € 5.8m impairment on this business. As such, we wouldn't be surprised if Bekaert was to divest this business sooner than later.

Consolidated sales in **Advanced Materials** declined by 6.2% to € 106m (11.4% of sales). Combined sales, excluding solar cells, were down 4.7% but would have increased by 5.7% at constant currencies. BSF' (Specialised Films) sales were temporarily affected by strong winter conditions and delayed governmental orders in North America. Remember that Bekaert acquired BSF in June 2001 for $ 122m in cash. Since then, BSF does not really seem to have lived up to Bekaert's expectations. At the time of the acquisition, one was speaking of an operating margin around 15% and "double-digit" growth. We can only wonder how BSF is performing now… However, Bekaert stressed (after some hesitation) that an impairment at BSF is not an issue (for now).

With consolidated sales increasing by 0.8% to € 308m (33% of sales), despite the lower $, trading of **Steel Cord** remained very strong. The combined sales increased by 0.5% but would have made a 13% jump at constant currencies. Worldwide, demand for steel cord remained very strong. In China, Bekaert can't follow demand and will further speed-up its investments. Remember that Bekaert is to invest € 180-200m over 2003-05 to increase its capacity in China from currently about 45,000 to 100,000 tons. In the 1H03, Drôtovňa Kordy (capacity of 10,000 tons) was fully consolidated, adding about € 6m.

**1H03 results**

| | 2001 | 1H02 | 2002 | 1H03 | 2003E |
|---|---|---|---|---|---|
| Sales | 1,796 | 986 | 1,863 | 933 | 1,766 |
| Growth | +2.3% | +5.9% | +3.8% | -5.4% | -5.3% |
| Comparable op. result | 60.3 | 68.3 | 123.8 | 72.7 | 128.0 |
| Margin | 3.4% | 6.9% | 6.6% | 7.8% | 7.3% |
| Operating result | 59.5 | 20.8 | 64.2 | 68.3 | 118.0 |
| Financial result | -30.4 | -20.7 | -32.9 | -18.3 | -30.9 |
| Other | 5.0 | | -100.6 | -9.5 | -9.5 |
| Taxes | 4.6 | -0.9 | 7.4 | -9.3 | -18.5 |
| Equity consolidated | 12.5 | 11.8 | 19.1 | 18.0 | 28.9 |
| Net profit group share | 47.6 | 9.4 | -49.5 | 43.7 | 78.1 |
| EPS – reported | 2.15 | 0.43 | -2.24 | 1.98 | 3.53 |
| EPS* | 2.76 | 0.87 | -1.37 | 2.17 | 3.91 |
| EPS** | 3.20 | 0.51 | -1.55 | 2.60 | 4.34 |

*Source: Company data, KBC Securities* ** before goodwill amortisation ** before goodwill amortisation and exceptionals*

The **result from operations** increased from € 20.8m to € 68.3m implying a margin of 7.3%. Before restructuring, the operating result increased from € 68.3m to € 72.7m (€ 61.4m anticipated) or a comparable margin improving from 6.9% to a record-high 7.8%! This is the key element in Bekaert's 1H03 statement and illustrates in a still very challenging environment a structural improvement in profitability. A better product mix, following divestments of lower margin, low (no) growth business and increased weight of the higher margin Steel Cord and Advanced Materials, stricter cost control and successful implementation of the optimisation measures are clearly paying-off. Anyway, 12 to 18 months ago, probably nobody would have believed that Bekaert could already post a margin between 7 - 8% (LT-target) in 2003!

The contribution of **associates** also made a quite spectacular jump from € 11.8m to € 18.0m (€ 14.5m anticipated). This is to be explained by the elimination of losses at the solar cells (following the divestment for $ 6m in May) but also by a very good performance of the Latin-American joint ventures (despite that combined sales in Latin America dropped by 18.7%!).

Even though the result from operations as well as contribution from associates exceeded our expectations, the net result (€ 43.7m) came short of our € 50m forecast. This is due to **pension fund provisions** at the financial level **and** several **non-operating charges**. With more than 70% of Bekaert's financial debt USD-denominated and as such a lower net debt at € 412m (gearing at 46.8%), coming from € 463m, the financial charges increased from € 14.9m to € 18.3m. This is explained by lower interest charges of about € 10-11m with the balance ("non cash") pension fund provisions. In the 2H03 one should count on a similar pension fund provision. The "other operating income & expenses" stood at € -9.5m while we were counting on a $ 6m "capital gain" on the solar cells. The reason behind this is that the $ 6m "capital gain" has been offset by a € 5.8m impairment on the Handling business, by € 6m translation differences on dividends from associates and by about € 3m smaller "other charges".

According to Bekaert, working capital improved from € 422 to € 412m or 20.5% of sales. The EBITDA rose from € 101m to € 131m and the net cash flow ended at € 114m compared to € 92m. The equity, group share, stood at € 837.9m or € 37.9 per share.

## Outlook

With regard to 2H03, Bekaert remains very **prudent** (as usual) referring to the difficult macro-economic conditions and $-impact. While demand for several products in North America and Europe comes under pressure, demand for steel cord remains "good". At the analyst meeting, Bekaert also gave the impression that the current order book stands lower than 12 months ago. In May, the order book was still up more than 10% y-o-y meaning that the situation deteriorated sharply since then. Some prudence is therefore necessary with regard to 2H. However, one should not forget that Bekaert was very prudent at the meeting following the 1H02 results (excellent 2H02) and the meeting following the FY02 results (excellent 1H03); Bekaert might be trying to keep consensus low.

We expect a 5.1% drop in sales in 2H03 to € 833m with a comparable operating margin at 6.6% (7.8% in 1H03, 6.3% in 2H02) and a result from operations at € 49.7m. Our forecasts include a financial result (including pension fund provisions) at € -12.6m, no non-operating charges and taxes at € 9.2m (tax rate at 24.6% compared to 18.6% over the 1H03). With a contribution of associates at € 10.9m, this brings us to a net result group share at € 34.4m compared to € 43.7m over the 1H03 and € -59m in the 2H02 (impairment on solar cells).

For the full year, this brings us to a result from operations at € 118m (up 83.7% y-o-y), a contribution from associates at € 28.9m and a result, group share, at € 78m or € 3.53 per share (revised from € 3.85 per share). Following the 1H03 results, we increased our estimate for the adjusted EPS 03 from € 4.13 to € 4.34.

## Investment opinion

The 1H03 results clearly showed an improved profitability resulting from the optimisation measures and better product mix. As Bekaert already realises an operating margin between 7-8% in the current economic environment, one might speak about a strong **structural improvement**, which seems promising for 2004-05 once the economy really starts to pick-up.

However, the stock price anticipated already to a certain extent good 1H03 results and is now to focus on the uncertain outlook. As such, we maintain our rating at 'hold' with a target price of € 45 per share. Our DCF scenario, which takes into account a structural improvement in margins (normalisation at a margin of 7.4% in 2010), points to a theoretical fair price of € 49.3 per share.

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