

Bekaert

22 March 2005

Strong margins in challenging environment

Engineering & Machinery

Current price € 62.70

Outperform

Belgium

Target price € 68.00

Rating Unchanged

Performance over	1m	3m	12m
Absolute	0%	8%	40%
Rel. BEL20	0%	2%	8%
Relative to sector	-3%	-7%	3%
12m Hi/Lo	€ 66.55/43.85		
Reuters	BERTt.BR		
Bloomberg	BEKB BB		
Market Cap	€ 1,371m		
Next corporate event	General Assembly 04 : 11 May 2005		

FY/e 31.12	2004	2005E	2006E	2007E
Sales (€ m)	2,173.2	1,816.9	1,895.4	1,965.7
EBITDA (€ m)	316.7	235.0	244.4	254.9
Net earnings (€ m)	167.6	168.0	124.7	129.1
Current EPS* (€)	6.54	5.30	5.70	5.90
Published EPS (€)	7.66	7.68	5.70	5.90
Dividend per share (€)	2.00	2.00	2.00	2.15
P/E (x)	7.7	11.8	11.0	10.6
Dividend yield (%)	4.0%	3.2%	3.2%	3.4%
EV/EBITDA (x)	4.8	6.2	5.8	5.4

Source: KBC Securities

*Adjusted for goodwill and exceptionals

Bekaert reported record results for 2004, a year in which the company successfully pushed through sharp increases in raw material prices and maintained uninterrupted supplies to its customers. Consolidated sales increased by 20.9% to € 2,173m while combined sales, including the share in Latin American JVs, passed the € 3bn mark with a 20.1% surge to € 3,144m. Double-digit growth was recorded across the board with advanced wire products, fencing, advanced materials and advanced coatings recording respectively 20.9%, 18.4%, 13.0% and 12.8% growth in consolidated sales.

Operating profit surged from € 112m to an impressive € 185m. However, this included € 14.3m in non-recurring charges and inventory revaluations of € 35m and € 11m at the advanced wire products and fencing systems business segments. Despite year-start concerns of margin pressure, Bekaert managed to further improve its margin (adjusted for non-recurring elements and inventory revaluation) from the previous record-high of 6.8% at year-end 2003 to a solid 7.1% in 2004. The disposed Fencing business contributed a healthy € 52m to the operating results and far exceeded our expectations. In contrast, Advanced materials and Advanced coatings business failed to meet expectations.

Joint ventures and associated companies outstripped expectations with an impressive € 53.6m contribution to the result. Combined with an exceptionally low tax (about € 20m below our and consensus estimates), this explains the surge in the net result to € 167.6m or reported EPS of € 7.66. Adjusted for goodwill, exceptionals and the inventory revaluation, recurring EPS is estimated at € 6.54. Bekaert is proposing to increase its dividend from € 1.75 to € 2.00 per share, including a bonus dividend of € 0.125 for the 125th anniversary of the company. The company gave little guidance on strategy following the divestment of the Fencing business and did not respond to market speculation on a one-off bonus dividend to optimise the balance sheet in the short-term.

We revised our 05 and 06 EPS estimates from € 5.53 and € 6.45 to respectively € 5.30 and € 5.70. Our current DCF estimate points to € 71.9 per share. We confirm our rating and target price at € 68 per share but agree the main catalysts for outperformance (the disposal of fencing, record results and dividend expectations) are now behind us.

Record results

Bekaert reported excellent FY 04 results, comfortably outpacing our own and market expectations. The net result, group share, amounted to € 167.6m vs. our € 129.0m estimate. The result can be explained by a much-higher-than-expected contribution from Latin American joint ventures and associates and lower-than-expected taxes and inventory revaluations, adding € 46m to the operating result.

Bekaert key figures

	2H03	2003	1H04	2H04	2004
Sales	864	1,797	1,096	1,077	2,173
Growth	-1.5%	-3.6%	+17.5%	+24.6%	+20.9%
Comparable op. result	49.0	121.7	81.3	72.1	153.4
Margin	5.7%	6.8%	7.4%	6.7%	7.1%
Operating result	43.5	111.8	103.3	81.8	185.1
Financial result	-14.0	-32.3	-13.7	-12.9	-26.6
Other	0.0	-10.7	-2.7	-1.4	-4.0
Taxes	1.1	-8.16	-26.7	-1.4	-28.1
Equity consolidated	14.1	32.0	24.0	29.6	53.6
Net profit group share	42.7	85.2	78.8	90.2	167.6
EPS – reported	1.93	3.85	3.57	4.09	7.66

Source: Bekaert

- Bekaert reported **20.9% growth in consolidated sales** to € 2,173m and 20.1% growth in combined sales to € 3,144m. Organic growth amounted to 22%, while net movement in acquisitions & divestments and adverse currency movements amounted to 3% and 4%. Double-digit growth was recorded in all business segments with advanced wire products, fencing, advanced materials and advanced coatings recording 20.9%, 18.4%, 13.0% and 12.8% growth in consolidated sales. According to the company, about half of the growth in sales was volume driven.
- **Advanced wire products:** Combined sales increased by 21.3%. Of particular note was the 32% growth surge in Latin America and the moderate 1% growth of steel cord in China. However, at constant currencies, steel cord China would have witnessed 12% growth. By the end of the year, growth in China had picked-up again.
- **Fencing systems:** Combined sales increased by 18.6% reflecting a good season, substantial volume growth in industrial fences and further expansion of the project business.
- **Advanced materials:** Combined sales were up by 13%. Substantial growth was recorded in fibre technologies (+ 7%) and combustion technologies (+ 53%), the latter being boosted by the acquisition of Solaronics. In contrast, sales of composites were down 24% following the withdrawal of the composite profiles. Combined sales of **advanced coatings** were up by 7.4%. Sales of industrial coatings grew by a solid 15% on firm demand. Growth in specialised films was only 2% on stable US business in \$-terms but strong growth in Europe and Asia.

Sales per business unit

	Consolidated sales		Combined sales	
Advanced wire products	1,500	+ 20.9%	2,411	+ 21.3%
Fencing systems Europe	453	+ 18.4%	454	+ 18.6%
Advanced materials	117	+ 13.0%	117	+ 13.0%
Advanced coatings	127	+ 12.8%	127	+ 7.4%
Intersegment and others	-24		35	
TOTAL	2,173	+ 20.9%	3,144	+ 20.1%

Source: Bekaert

Operating profit soared from € 111.8m to € 185.1m after € 14.3m in non-recurring charges and a € 46m revaluation of inventories. Adjusted for the revaluations and non-recurring items, operating profit climbed from € 121.7m to € 153.4m, equivalent to an improvement in the adjusted margin from 6.8% to 7.1%. This is an excellent performance not only from a historical perspective but especially taking into account the dramatic surge in steel rod prices.

- **Advanced wire products:** Pre-exceptional operating profit surged from € 124m to € 185m, including a € 35m inventory revaluation. Adjusted for non-recurring items and inventory revaluation, the adjusted operating margin improved from 10.0% to 11.3%.
- **Fencing systems:** Pre-exceptional operating profit increased from € 27m to € 52m, including an € 11m inventory revaluation. Adjusted for non-recurring items and inventory revaluation, the adjusted operating margin rose from 7.1% to 9.1%.
- **Advanced materials:** Pre-exceptional operating profit was flat at € 10m compared to € 9m in 2003. The margin declined slightly from 8.7% to 8.5%.
- **Advanced coatings:** This division failed to meet expectations, posting a € 2m recurring operating loss, compared to break-even in 2003. A € 6m impairment was applied to one of the niche applications of specialised films. In addition, Bekaert allocated € 4m in R&D expenses to this business unit for which we have not made an adjustment.

Non-operating income and expenses included an impairment of € 4.6m on the handling business and a positive € 3.6m on financial instruments. Interest income and expenses were in-line with expectations at € 26.6m. The big surprise here though was the tax of only € 28.1m, which was about € 20m below expectations. The normal level in 2004 would have been € 49m with Bekaert posting around € 22m in tax adjustments in 2H04. For the current year, Bekaert is guiding for a tax rate between 20% and 25%.

The contribution of joint ventures and associates climbed steeply from € 34.5m to € 53.6m. The book value of investments accounted under the equity method amounts to a very conservative € 219.7m. In our DCF valuation, we applied a value of € 350m to the JVs, which is still conservative. In the combined sales, Latin American sales climbed a strong 26.2% to € 847m or 27% of total sales.

Disposal Fencing

Early this year, Bekaert sold the Fencing business to Gilde for a total enterprise value of € 281.5m, based on € 118m of debt, € 54m in pension fund liabilities and the balance in cash. The capital gain on the sale will add € 56m to 2005 net earnings.

We are quite enthusiastic about the deal since it will further raise Bekaert's growth profile, which should result in a revaluation on the stock market. Bekaert Fencing was the business with the lowest growth potential and the group can now move into top gear with the expansion of its Advanced Wire Products division. We see Bekaert consolidating its world leadership position and entering new geographical markets, possibly including Russia.

Gearing should now have dropped dramatically, given the € 118m in debt from the Fencing division that will now disappear from the balance sheet, cash proceeds of close to € 110m and a € 56m increase in equity. We were therefore slightly disappointed by the absence of acquisition plans in the guidance. We were also hoping for a higher one-off dividend in order to optimise the balance sheet structure in the short term.

Outlook

After an exceptionally strong financial year in 2004, Bekaert has made a good start to 2005. However, the company is yet to quantify its growth targets or offer guidance on the order book. The group will pursue further sustainable profitable growth in 2005 by improving performances across the board and supporting growth by targeted R&D and investments. Capex will remain close to the 2004 level of € 166.2m, including about € 10m related to the Fencing business.

We revised our 05 and 06 EPS estimates from € 5.53 and € 6.45 to respectively € 5.30 and € 5.70. We now count on 2005 operating profit of € 122.4m and a contribution from associates of € 48.2m. We have applied a corporate tax rate of 25%, at the upper end of the guidance range. Net profit, group share, is expected at € 168.0m, including a € 56m capital gain on the disposal of the Fencing business.

Valuation

Our current DCF valuation points to a fair value of € 71.9 per share. This values the associates at a conservative € 350m. Following the outstanding 2004 results, the disposal of the Fencing business and the dividend announcement, there now looks to be a shortage of upside triggers capable of lifting the share in the short term. We nevertheless believe Bekaert will benefit from a revaluation following the success of its strategy, which has boosted margins and raised the growth profile after the disposal of the more mature Fencing business. In the short term, part of this revaluation potential has already materialised as Bekaert is trading at higher multiples since the deconsolidation of the Fencing business. Much will now depend on how Bekaert uses its cash and available credit lines for further growth.

Financial data

Income statement (€ m)	2003	2004	2005E	2006E	2007E
Sales	1,797.0	2,173.2	1,816.9	1,895.4	1,965.7
EBITDA	239.1	316.7	235.0	244.4	254.9
EBITA	122.2	194.1	122.4	130.7	140.0
EBIT	111.8	185.1	122.4	130.7	140.0
Pre-tax earnings	68.8	154.5	159.2	120.8	132.2
Net earnings	85.2	167.6	168.0	124.7	129.1
Current earnings before goodwill	102.3	143.1	115.8	124.7	129.1
Current cash flow	219.2	265.7	228.5	238.4	244.0
Balance sheet (€ m)	2003	2004	2005E	2006E	2007E
Goodwill and other intangible assets	70.9	76.0	76.0	76.0	76.0
Tangible assets	806.1	834.1	677.5	717.0	748.5
Associates and other financial assets	276.7	312.9	312.9	312.9	312.9
Net working capital	302.1	410.6	357.8	371.4	379.6
Net debt	418.3	458.6	179.0	151.1	108.7
Provisions and other liabilities	215.2	216.4	162.4	162.4	162.4
Minorities	43.3	48.8	48.8	48.8	48.8
Equity	779.0	909.7	1,034.0	1,114.9	1,197.0
Capital employed, incl. cum goodwill	1,541.4	1,494.5	1,677.3	1,467.9	1,520.9
Balance sheet total	1,925.8	2,189.3	1,973.4	2,050.6	2,121.7
Cash flow statement (€ m)	2003	2004	2005E	2006E	2007E
Cash flow from operations	167.6	167.1	259.0	204.7	214.2
Net capital expenditure	-134.9	-166.0	-160.0	-130.0	-125.0
Free cash flow (before acquisitions)	32.7	1.1	99.0	74.7	89.2
Acquisitions and disposals	0.0	0.0	-227.5	0.0	0.0
Dividend payments	-39.8	-41.4	-46.8	-46.8	-46.8
Shares issues	0.0	0.0	0.0	0.0	0.0
Other	33.4	0.0	455.0	0.0	0.0
Change in net debt	-26.3	40.3	-279.6	-27.9	-42.3
Performance criteria	2003	2004	2005E	2006E	2007E
Sales growth	-3.6%	20.9%	-16.4%	4.3%	3.7%
EBITDA margin	13.3%	14.6%	12.9%	12.9%	13.0%
EBITA margin	6.8%	8.9%	6.7%	6.9%	7.1%
EBIT margin	6.2%	8.5%	6.7%	6.9%	7.1%
Net debt / equity	53.7%	50.4%	17.3%	13.5%	9.1%
Net debt / EBITDA	1.7	1.4	0.8	0.6	0.4
EBITDA / net interest	7.4	11.9	12.3	24.7	32.7
Pay-out ratio	45.4%	26.1%	26.0%	35.1%	36.4%
Net return on equity (avg.)	10.6%	19.9%	17.3%	11.6%	11.2%
Return on capital employed (avg.)	6.4%	10.5%	5.8%	6.1%	6.8%
Per share data (€)	2003	2004	2005E	2006E	2007E
Weighted average number of shares (m)	22.12	21.87	21.87	21.87	21.87
Published EPS	3.85	7.66	7.68	5.70	5.90
Current EPS, before GW	4.62	6.54	5.30	5.70	5.90
Current CFPS	9.91	12.15	10.44	10.90	11.16
Free cash flow per share	1.48	0.05	4.52	3.42	4.08
Net book value per share	35.21	41.59	47.27	50.97	54.72
Current EPS (before GW): y/y growth	47.2%	41.5%	-19.1%	7.6%	3.6%
Current CFPS: y/y growth	1.5%	22.6%	-14.0%	4.4%	2.3%
Current EPS (before GW), fully diluted	4.62	6.54	5.30	5.70	5.90
Dividend per share (€)	1.75	2.00	2.00	2.00	2.15
Valuation data	2003	2004	2005E	2006E	2007E
Reference share price (€)	41.42	50.14	62.70	62.70	62.70
Reference market capitalisation (€ m)	916.2	1,096.7	1,371.5	1,371.5	1,371.5
Enterprise value (€ m)	1,316.3	1,507.6	1,448.8	1,420.9	1,378.6
P/E	9.0	7.7	11.8	11.0	10.6
P/CF (x)	4.2	4.1	6.0	5.8	5.6
P/NBV (x)	1.2	1.2	1.3	1.2	1.1
Dividend yield (%)	4.2%	4.0%	3.2%	3.2%	3.4%
EV/sales (x)	0.7	0.7	0.8	0.7	0.7
EV/EBITDA (x)	5.5	4.8	6.2	5.8	5.4
EV/Capital employed (x)	0.9	1.0	0.9	1.0	0.9

Source: KBC Securities

*Historic valuation data are based on historic prices

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