

# Bekaert

2 August 2005

## Excellent first-half, challenging outlook

Engineering &amp; Machinery

Current price € 67.25

**Neutral**

Belgium

Target price € 68.00

Rating Downgraded

Performance over	1m	3m	12m
Absolute	8%	13%	35%
Rel. BEL20	4%	6%	3%
Relative to sector	3%	-1%	12%
12m Hi/Lo	€ 67.25/48.90		
Reuters	BERTI.BR		
Bloomberg	BEKB BB		
Market Cap	€ 1,444m		
Next corporate event			
Results 3Q05	14 November 2005		

FY/e 31.12	2004	2005E	2006E	2007E
Sales (€ m)	2,173.2	1,856.9	1,934.0	2,006.1
EBITDA (€ m)	316.7	253.0	248.1	258.7
Net earnings (€ m)	167.6	182.0	128.6	133.1
Current EPS* (€)	6.54	5.75	5.99	6.20
Published EPS (€)	7.66	8.40	5.99	6.20
Dividend per share (€)	2.00	2.00	2.00	2.15
P/E (x)	7.7	11.7	11.2	10.9
Dividend yield (%)	4.0%	3.0%	3.0%	3.2%
EV/EBITDA (x)	4.8	6.5	6.4	6.0

Source: KBC Securities

\*Adjusted for goodwill and exceptionals

Bekaert released excellent first-half results beating ours and market expectations. For the second half, Bekaert repeats its cautious guidance referring to a slowdown in incoming orders due to the weakening of the economic environment and uncertainty in the raw materials' markets. In a step to optimise its balance sheet, Bekaert purchased # 550k shares, corresponding to about € 1.55 per share, most of which to be cancelled early August. Although we were positively surprised by the published results and highly welcome the share buybacks as value creative, we decided to increase our target price from € 66 to € 68 but cut our rating to neutral. The rating revision follows the recent rally in the shares, limiting upwards potential, and anticipates on a more challenging second-half.

### Bekaert 1H05 results

	1H04 (restated)	1H05	y/y
Sales	859.8	970.6	12.9%
Gross profit	201.1	212.6	5.7%
Gross margin	23.4%	21.9%	
Comparable operating result	74.8	94.1	25.9%
Margin	8.7%	9.7%	
Result from operations	71.2	85.3	19.8%
Interest income & expenses	-8.0	-11.2	
Non-operating income & expenses	0.4	3.3	
Associates	24.0	27.7	15.7%
Taxes	-18.6	-21.6	
Minorities	-5.4	-7.3	
Consolidated net result, group share, from continuing operations	63.7	76.2	19.6%
Discontinued operations	15.1	54.1	
Consolidated net result, group share	78.8	130.3	
<b>EPS from continuing operations</b>	<b>2.89</b>	<b>3.47</b>	<b>20.1%</b>
<b>EPS - reported</b>	<b>3.58</b>	<b>5.94</b>	<b>65.9%</b>

Source: Bekaert

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### Slowdown in sales growth in 2Q

Over the first-half, Bekaert realised a 13% growth in consolidated sales to € 971m (vs. € 981.5m expected) and 16% in combined sales (including associates) to € 1,514m. Pricing reflecting the sharp increase in raw materials' prices over 2004 mainly drove the strong growth in sales. The consolidated sales' increase was 14% from organic growth and 1% from the net movement in acquisitions and divestments, offset by adverse currency movements of 2%.

Consolidated sales of **advanced wire products** increased by 11% over 1H to € 840m. In 1Q, growth has been reported at 18.6% meaning that growth has slowed down to 5.3% over 2Q. Evolution in sales growth is quite normal taking into account that sales are driven by the price increases over 2004. For the same reason, the comparison basis for 2H will be challenging, to say the least.

Looking at the several segments within the Advanced wire products business unit illustrates quite a mixed evolution. While small declines were recorded in wire Europe (-2%) and wire North America (-1%), wire Latin America (+24%) and wire Asia (+12%) recorded double-digit growth figures. Spectacular growth was recorded in steel cord with steel cord others up 24% and steel cord China up 28%.

**Advanced materials'** sales increased by 17% to € 63m. While sales in fibre technologies were stable, major sales increase was recorded in combustion technologies (+42%) with the acquisition of Solaronics. Sales of composites firmed by 10%. **Advanced coatings'** sales decreased by 1% to € 67m. In industrial coatings, sales in the sputter products business, which is strongly project-driven, decreased. At the same time, Bekaert prepared for growth in diamond-like coatings, with new facilities in the US. The market in the US for specialised films remained stable, while new technological developments were recently introduced successfully into the market. Furthermore, business activities were extended, mainly in Asia. However, adverse currency movements offset these effects.

### Impressive operating management

Result from operations amounted to an impressive € 85.3m (vs. € 72.1m expected) or margin at 8.8%. Before non-recurring items, totalling to € 9m in 1H, operating margin amounted to an impressive 9.7%. Contribution from associates increased by 7% to € 27.7m vs. € 30.9m expected. As a reminder, sales from Latin America (mainly related to the associates) increased by 22% over 1H. The consolidated net result, group share, from continuing operations increased from € 63.7m to € 76.2m. After the capital gain on the disposal of the fencing business (€ 54.1m), the net consolidated result, group share, amounts to € 130.3m vs. € 123.1m anticipated.

### Optimising capital and asset structure

At the end of June, equity represented 48% of total assets, compared to 44% at the end of December. Net debt amounted to € 357m, compared to € 409m or a gearing of 34%, compared to 43% at the end of December. Over 1H, Bekaert has purchased # 550k shares for € 33.2m in total or about € 1.55 per share. Most of these shares will be cancelled (about 2.5% of the current number of outstanding shares) early August bringing the number of outstanding shares to # 21,469,541. We highly welcome this share buyback programme as value creative, optimising the balance sheet. Net financial debt was a bit higher than expected. Main rationale, besides the share buybacks, is the higher working capital requirements related to the growing business in China.

### Prudent outlook

Bekaert remains very prudent for the second-half stating "the slowdown in incoming orders due to the weakening of the economic environment and the uncertainty in raw materials' markets present challenges for the second half". Taking into account the several price increases over 2004 and current evolutions in the raw materials markets, the comparison basis for 2H appears quite challenging. In our scenario, we now count on a 1.6% growth in sales over 2H to € 885m with a net result of € 51.7m. We have slightly revised our scenario upwards and increased our estimates for the 'recurring' EPS from € 5.59 to € 5.75.

### Investment opinion

Bekaert reported an excellent set of first-half results and announced to have completed a value enhancing share buyback programme. The strategy pursued over the past few years is definitely paying off with Bekaert realising an ROCE above its cost of capital. The business mix has improved with the weight of the higher margin steel cord business increasing over the years. High investments are being made in China with the new steel cord capacity gradually coming on full stream. Also in 2H, results should be boosted by increased steel cord production in China. For the near future, new investments in promising markets such as Russia or India are not to be excluded. Taking into account that steel cord China is currently working at full capacity we would even not exclude Bekaert to extend its current investment programme there.

However, in the short term, uncertainty with regard to 2H is increasing while the shares have had an incredible rally. We decided to increase our target price from € 66 to € 68 per share but revise our rating from outperform to neutral as we believe there is insufficient upside potential left. At the other hand, further share buybacks could limit the downside potential.

## Financial data

Income statement (€ m)	2003	2004	2005E	2006E	2007E
Sales	1,797.0	2,173.2	1,856.9	1,934.0	2,006.1
EBITDA	239.1	316.7	253.0	248.1	258.7
EBITA	122.2	194.1	138.0	132.0	141.4
EBIT	111.8	185.1	138.0	132.0	141.4
Pre-tax earnings	68.8	154.5	173.2	116.2	128.0
Net earnings	85.2	167.6	182.0	128.6	133.1
Current earnings before goodwill	102.3	143.1	124.6	128.6	133.1
Current cash flow	219.2	265.7	239.6	244.8	250.4
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	710.6	752.3	785.7
Associates and other financial assets	276.7	312.9	312.9	312.9	312.9
Net working capital	302.1	410.6	443.1	448.2	459.3
Net debt	418.3	458.6	283.0	244.1	201.6
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	1,048.3	1,134.0	1,220.9
Capital employed, incl. cum goodwill	1,541.4	1,494.5	1,677.3	1,586.0	1,632.3
Balance sheet total	1,925.8	2,189.3	2,044.3	2,115.5	2,187.3
Cash flow statement (€ m)	2003	2004	2005E	2006E	2007E
Cash flow from operations	167.6	167.1	188.2	215.4	213.4
Net capital expenditure	-134.9	-166.0	-160.0	-130.0	-125.0
Free cash flow (before acquisitions)	32.7	1.1	28.2	85.4	88.4
Acquisitions and disposals	0.0	0.0	-227.5	0.0	0.0
Dividend payments	-39.8	-41.4	-46.8	-46.4	-46.0
Shares issues	0.0	0.0	0.0	0.0	0.0
Other	33.4	0.0	421.6	0.0	0.0
Change in net debt	-26.3	40.3	-175.5	-39.0	-42.5
Performance criteria	2003	2004	2005E	2006E	2007E
Sales growth	-3.6%	20.9%	-14.6%	4.2%	3.7%
EBITDA margin	13.3%	14.6%	13.6%	12.8%	12.9%
EBITA margin	6.8%	8.9%	7.4%	6.8%	7.0%
EBIT margin	6.2%	8.5%	7.4%	6.8%	7.0%
Net debt / equity	53.7%	50.4%	27.0%	21.5%	16.5%
Net debt / EBITDA	1.7	1.4	1.1	1.0	0.8
EBITDA / net interest	7.4	11.9	11.4	15.7	19.3
Pay-out ratio	45.4%	26.1%	23.8%	33.4%	34.7%
Net return on equity (avg.)	10.6%	19.9%	18.6%	11.8%	11.3%
Return on capital employed (avg.)	6.4%	10.5%	6.4%	6.0%	6.4%
Per share data (€)	2003	2004	2005E	2006E	2007E
Weighted average number of shares (m)	22.12	21.87	21.68	21.47	21.47
Published EPS	3.85	7.66	8.40	5.99	6.20
Current EPS, before GW	4.62	6.54	5.75	5.99	6.20
Current CFPS	9.91	12.15	11.05	11.40	11.66
Free cash flow per share	1.48	0.05	1.30	3.98	4.12
Net book value per share	35.21	41.59	48.36	52.82	56.87
Current EPS (before GW) / y/y growth	47.2%	41.5%	-12.1%	4.2%	3.5%
Current CFPS / y/y growth	1.5%	22.6%	-9.0%	3.1%	2.3%
Current EPS (before GW), fully diluted	4.62	6.54	5.80	5.99	6.20
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	67.25	67.25	67.25
Reference market capitalisation (€ m)	916.2	1,096.7	1,457.7	1,443.8	1,443.8
Enterprise value (€ m)	1,316.3	1,507.6	1,639.1	1,586.3	1,543.8
P/E	9.0	7.7	11.7	11.2	10.9
P/CF (x)	4.2	4.1	6.1	5.9	5.8
P/NBV (x)	1.2	1.2	1.4	1.3	1.2
Dividend yield (%)	4.2%	4.0%	3.0%	3.0%	3.2%
EV/Sales (x)	0.7	0.7	0.9	0.8	0.8
EV/EBITDA (x)	5.5	4.8	6.5	6.4	6.0
EV/Capital employed (x)	0.9	1.0	1.0	1.0	0.9

Source: KBC Securities

\*Historic valuation data are based on historic prices



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