

Bekaert (Add - EUR 105): Strong operating results offset by weaker Latam

Facts

- Revenues came in at EUR 1,065m, exactly in line with forecasts. Organically revenues were up by 6% vs + 5% expected. Key driver was once more China with revenues up in H1 by 53%, implying a growth acceleration to 55% in Q2. Also Wire Europe performed well with revenues up by 15% and Building products benefited from the mild winter in Europe and posted a 13% revenue growth. Outside China Steel Cord disappointed with a revenue drop of 9% impacted by forex, price erosion and the closing of a plant.
- Gross profit increased by 8% yoy to EUR 214m, slightly ahead of our EUR 213m forecast. SG&A reached EUR 128m or 3% below forecasts despite a heavy R&D program (EUR 30.6m vs EUR 26.8m expected). This leads to an EBIT of 86.4m, up 13.8% yoy and 5.4% ahead of our forecasts and ahead of consensus estimates.
- Financial charges were higher than expected at EUR -16.7m vs EUR -15.5m expected, but this was offset by lower than anticipated taxes.
- The equity consolidated companies, mostly Latin America, posted a profit of EUR 23.4m, 8% below our forecasts. Bekaert indicates that margins remain strong but that export out of Latam becomes less easy given the USD weakening, while Asian imports increase in Latam. On the other hand, dividend from the associates, which is the only cash that Bekaert receives, were up from EUR 13.2m to EUR 27m significantly ahead of the EUR 15m expected.
- Minorities came in at EUR -5.8m vs EUR -1.5m expected. This is almost due to the recovery of the Turkish operations.
- Net profit came in at EUR 72.6m, 1.8 below our forecasts. As the number of shares were lower than expected driven by the sizeable share buy back program, EPS reaches EUR 3.60 or 1.8% below our forecast.
- Outlook: As usual, no real outlook is provided.

Our View

Bekaert posted very strong operating results. Despite high energy, high raw material prices and a 20% increase in its R&D costs, the group expands EBIT margin to 8.1% from 7.5% last year. This implies that the strong revenue in China is profitable and expanding margins. Within its Advanced Wire business operating margins improved from 10.8% to 11.7%.

While Bekaert's consolidated business is performing strongly, associates had a weaker than expected H1. However, we believe that the weaker than expected P&L contribution is offset by the important dividend flow out of the associates. Given the absence of debt at the associates, we believe that payout will remain at higher level than we have seen in the past years. We pencilled in a payout ratio of 75% for the next years. We believe that the significant increase of dividends paid Bekaert's joint ventures is next step in the group's shareholder value creation as it should unlock the value of these assets.

Conclusion

Overall results are in line with forecasts, while FCF generation is ahead of forecasts. The group's strategy is simple and clear: expanding steel cord capacity in regions where the underlying demand is strong such as China. Bekaert has the financial strengths to expand fast and aggressive, while its worldwide leadership in steel cord provides cost leadership. Thanks to its aggressive expansion the group takes significant market share and regained its market leadership in China.

A combination of a DCF for Bekaert's activity and a DDM for the joint ventures, leads to a fair value for the group of EUR 122 per share. Bekaert is still trading at attractive multiples. The group offers a FCF yield of 7.3% in 2008 and 8% in 2009. On an EV/EBITDA basis, Bekaert trades at 7.1x 2007 and 6x 2008. At our EUR 122 target price, Bekaert would be trading at 8.2x EBITDA 2007 and 7x EBITDA 2008.

Add reiterated with TP of EUR 122.

	H1'06	H1'07e	H1'07
Revenues	1,009	1,061	1,065
Cost of sales	(811)	(848)	(851)
Gross profit	198.2	213.6	213.9
Selling expenses	(50.4)	(51.9)	(48.9)
General & Administration costs	(49.4)	(50.8)	(47.3)
R&D	(25.5)	(26.8)	(30.6)
Other operating revenues	12.4	10.0	8.4
Other operating costs	(9.3)	(12.0)	(9.2)
SG&A	(122.3)	(131.6)	(127.5)
EBIT	76.0	82.0	86.4
Depreciations	56.5	60.0	58.0
EBITDA	132.4	142.0	144.4
Financial result	(13.6)	(15.5)	(16.7)
Other non-operating income & exp	1.3	0.0	(0.1)
Associates	27.8	25.6	23.4
Taxes	(15.5)	(16.6)	(14.9)
Minorities	(0.5)	(1.5)	(5.8)
Net profit	75.5	74.0	72.6
Net adjusted earnings	75.5	74.0	72.6
avg n° of shares outstanding	21.55	20.39	20.20
EPS in EUR	3.50	3.63	3.60

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