

# Ter Beke

13 June 2005

## A recipe for success

Food Producers &amp; Processors

Current price €66.00

**Outperform**

Belgium

Target price €80.00

Rating Unchanged

Performance over	1m	3m	12m
Absolute	1%	-1%	17%
Rel. BEL20	0%	-2%	-7%
Relative to sector	-2%	-7%	13%
12m Hi/Lo	€68.15/55.50		
Reuters	TERB.BR		
Bloomberg	TERB BB		
Market Cap	€90m		
Next corporate event	Payment dividend FY04 : 15 June 2005		

FY/e 31.12	2004	2005E	2006E	2007E
Sales (€m)	206.3	242.5	252.2	262.3
EBITDA (€m)	20.9	23.0	24.1	25.5
Net earnings (€m)	5.0	6.0	6.3	7.0
Current EPS* (€)	6.92	5.64	5.91	6.38
Published EPS (€)	5.53	4.37	4.64	5.11
Dividend per share (€)	2.00	2.20	2.45	2.70
P/E (x)	8.3	11.7	11.2	10.3
Dividend yield (%)	3.5%	3.3%	3.7%	4.1%
EV/EBITDA (x)	4.6	5.3	5.1	4.8

Source: KBC Securities

\*Adjusted for goodwill and exceptionals

Our analysis of the sector confirms that Ter Beke holds all the ingredients necessary to succeed in the convenience food market. Key strengths include:

- Constant product innovation;
- Cost control through automation and optimised production allocation;
- Balanced customer portfolio;
- Focus on value added products at affordable prices;
- Geographic expansion into markets with growth potential.

We are maintaining our Outperform rating and target price of €80. EV/EBITDA ratios show the stock trading at a 21-27% discount to peers.

Product innovation has been Ter Beke's top line driver. Over the last three years, the group has renewed a major part of its product range. The latest product launches include pasta meals for children, fresh soups and deep pan pizzas. The R&D activities on chilled Mediterranean ready meals have been centralized at the new centre in Marche-en-Famenne (Belgium) to promote innovation. Ter Beke has also been investing aggressively in recent years to build a state-of-the-art production network. Last year investments reached 9.6% of sales versus the sector average of 4%. Ter Beke's customer portfolio is balanced thanks to its geographic spread and exposure to three distribution channels (retail, wholesale and out-of-home). Its product portfolio is also well diversified in terms of price positioning (branded, private label and discount products). Price competition appears to be less fierce in the branded business. For example, in France the price of branded ready meals rose by 1.42% y/y in April 2005 (source: LSA). The prices of private label and discount products on the other hand have declined by respectively 1.77% and 2.14%. Another trump card consists of Ter Beke's focus on value added products and its refusal to compromise on quality. Ter Beke derives 41% of its sales from outside Belgium. Most of its markets still offer significant growth potential in terms of convenience food penetration. The UK is a mature and highly competitive market but Ter Beke's exposure to the UK is limited to 3% of sales. Come a Casa, Ter Beke's retail brand for chilled Mediterranean ready meals is well positioned to reinforce the group's presence abroad. Meanwhile, the company continues to look at takeover opportunities in Spain, one of the most promising markets in Europe for convenience food.

## Peer analysis/sector trends

Our sample contains five peers: Sardus (Sweden), Greencore (Ireland), Uniq (UK), Northern Foods (UK) and Fleury Michon (France). The latter is the most comparable to Ter Beke in terms of business mix and exposure to Continental Europe.

The convenience food sector is characterised by the following trends:

- Demand for convenience food remains strong due to the growing share of smaller households, the success of 'on-the-move snacking' and the growing 'cash-rich time-poor' consumer base;
- Consumers are becoming more health conscious. Food retailers are adapting their product range in response to this trend (e.g. Marks & Spencer's "Eat well" program");
- Hard discounters are expected to continue to gain market share. Suppliers will continue to face price pressure;
- Uniq's management indicated that the Belgian market is becoming more competitive, with retailers increasingly focusing on costs;
- The growing share of the retailers' private label products has led to increased advertising and promotional spending to support branded products. For instance, Fleury Michon doubled its publicity budget between 2000 and 2004 to support its brands while Ter Beke is increasing its marketing budget by € 1.5m this year;
- Quality requirements and product presentation standards are increasing. Ter Beke has taken over Langeveld/Slegers, a Dutch slicing and packaging company, in response to this trend;
- Consolidation in the food retail sector (e.g. Morrisons' acquisition of Safeway) has increased the risk profile of the convenience food producers as they become dependent on a small number of large customers. These players are now entering new channels such as the 'out-of-home' segment in order to reduce their exposure to the food retail sector;
- Several UK producers have recently reviewed their strategy, production allocation and product assortment. This has resulted in plant closures and disposals;
- The penetration of convenience food is very high in the UK and competition is fierce as the market reaches maturity. The Southern European markets are still young and competition is still relatively weak. The Benelux and France lie somewhere in the middle.

Ter Beke's peers put in very mixed performances during FY04. Uniq plc, a convenience foods producer, faced a challenging FY04/05. Operating profits fell 29% due to lost market share in the UK. Its strategy to build a Pan European chilled foods business now looks unsuitable for current conditions as the different markets in which it operates (UK, France, Benelux, Germany and Spain) are converging more slowly than anticipated. The Continental European activities (60% of sales) continue to perform well. "Marie", Uniq's chilled ready meals brand, enjoys 18% market share in France. FY04/05 operating margins reached 3.2% at the group level, 9.1% in Southern Europe and 3.2% in Northern Europe. The group reported an operating loss in the UK. Duke Street Capital, a UK buyout fund, bid 200 pence per share for Uniq, implying an EV/EBITDA multiple of 6.2 if one adds the £ 102m shortfall in pension funding to the EV figures. **If we apply this multiple to our forecast for Ter Beke's EBITDA in 2005, we arrive at a target price of €85 per share.** The deal with Duke Street Capital fell through when the parties failed to agree on the funding of Uniq's pension fund.

Greencore derives 62% of sales and 53% of its EBIT from the production of convenience food. The other division is involved in sugar processing and malt. The group realised an EBITA margin of 6.1% on its convenience food division in FY04. During 1H04/05 the convenience food division realised like-for-like sales growth of 8% and its operating margin improved to 6.6%. Customers other than the multiple food retailers now account for close to 30% of Greencore's convenience food sales.

Northern Foods aims to become the supplier of choice to UK and Irish retailers in added value convenience foods. The group has recently completed a strategic review of its business and a new management team has been installed. Current operating profits of the chilled food division declined by 19% in FY04/05 driven by customer and category mix issues. Marks & Spencer, Northern Foods' largest customer with about 30% of sales, reported a 5.1% fall in UK retail sales in FY04/05, thereby illustrating the need for a balanced customer portfolio.

Sardus (Sweden) is a producer of processed meat, cheese, ready-to-eat sandwiches, salads and frozen foods. Domestic sales represent 84% of the total. Sales growth was limited to 1.5% in 2004 and EBITA fell by 8.6% as a result of increased competition, particularly in export markets such as the UK. Private labels represented 16% of Sardus' processed meat sales. Pretax profits fell sharply in 1Q05 as Sardus failed to pass on higher raw material prices to retailers. The prospects in Continental Europe remain positive however.

Fleury Michon's history is similar to Ter Beke's. This French rival started out as a meat processing company before diversifying into the chilled ready meals sector. Last year, Fleury Michon realized 99% of sales in France. The group continued to perform well in 2004 thanks to innovation and optimisation of its product range. Sales and operating profits rose respectively by 1.4% and 13.7% in 2004. The group realised an operating margin of 4% in processed meats (55% of sales) and 3.5% in chilled ready meals. The group expects a 6% fall in net profits in 2005 due to the non-recurrence of lowered social security charges which were accorded temporarily after the adoption of the 35-hour week.

Based on EV<sup>1</sup>/EBITDA multiples, Ter Beke is trading at a 21-27% discount to peers. This would be even higher if we added the net pension deficit of the UK players to their EV. Northern Foods for instance has a net pension deficit of £ 117m at the end of FY04/05. Based on P/Es, Ter Beke's shares do not offer significant upside potential. EV/EBITDA multiples are more relevant however, given Ter Beke's aggressive investment program and depreciation policy which are currently weighing on net earnings.

#### Key financial parameters

Company	Mkt cap €m	2004 sales €m	2004 EBITDA margin	2004 operating margin	Financial gearing	5 yr sales CAGR	2004 Capex/ sales
Fleury Michon	187	611	7.0%	3.6%	1%	10.8%	6.2%
Greencore	659	1,402	10.2%	7.2%	173%	10.2%	3.7%
Uniq	266	1,316	6.2%	3.2%	30%		3.6%
Northern Foods	1,196	2,120	11.8%	7.2%	102%	4.8%	4.4%
Sardus AB	104	194	12.3%	9.0%	177%	14.5%	3.2%
<b>Average</b>	<b>483</b>	<b>1,129</b>	<b>9.5%</b>	<b>6.0%</b>	<b>97%</b>	<b>10.1%</b>	<b>4.2%</b>
<b>Ter Beke</b>	<b>90</b>	<b>206</b>	<b>10.1%</b>	<b>5.5%</b>	<b>26%</b>	<b>4.8%</b>	<b>9.6%</b>

Source: Companies, Bloomberg, JCF, KBC Securities

#### Valuation multiples and depreciation/tangible assets

Company	P/E 2004	P/E 2005	P/E 2006	EV <sup>1</sup> /EBITDA 2004	EV <sup>1</sup> /EBITDA 2005	EV <sup>1</sup> /EBITDA 2006	Deprec. as % of tangible assets
Fleury Michon	13.7	14.2	12.8	4.4	4.5	4.2	18.0%
Greencore	10.5	10.0	9.6	7.5	7.2	7.1	8.0%
Uniq	10.2	9.4	8.2	5.6	5.1	4.6	14.0%
Northern Foods	12.6	11.8	10.8	6.8	6.5	6.1	9.6%
Sardus AB	10.2	11.6	10.7	7.0	7.1	6.8	12.0%
<b>Average</b>	<b>11.4</b>	<b>11.4</b>	<b>10.4</b>	<b>6.3</b>	<b>6.1</b>	<b>5.7</b>	<b>12.3%</b>
<b>Ter Beke</b>	<b>9.5</b>	<b>11.7</b>	<b>11.2</b>	<b>4.9</b>	<b>4.5</b>	<b>4.3</b>	<b>16.1%</b>

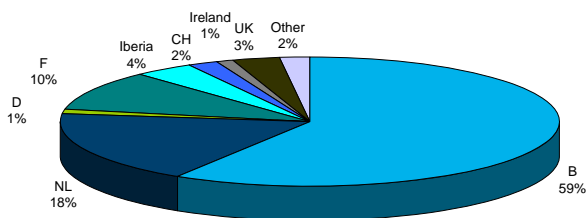
Source: Companies, Bloomberg, JCF, KBC Securities

<sup>1</sup> Market cap today + net debt end 2004

## 2004 sales

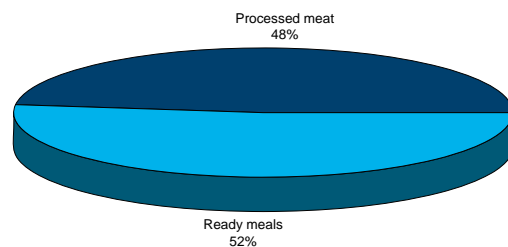
Last year, Ter Beke generated 41% of sales outside its home market. Chilled Mediterranean ready meals represented 52% of turnover, 65% of sales volumes and more than 80% of Ter Beke's international sales. Ter Beke is the European leader in fresh ready lasagne. The processed meats strategy remains essentially focused on the Benelux with the exception of pâté sales in the UK. The group started to sell lasagne in the UK after the pâtés proved successful. Carroll Meats, Ter Beke's distributor in Ireland was taken over by a UK company, following which the Irish distribution contract was renewed. Competition heated up in Switzerland but Ter Beke managed to maintain its position. Germany remains a difficult market because of the strong presence of the discounters.

### Geographic breakdown 2004 sales



Source: Ter Beke

### Divisional breakdown 2004 sales

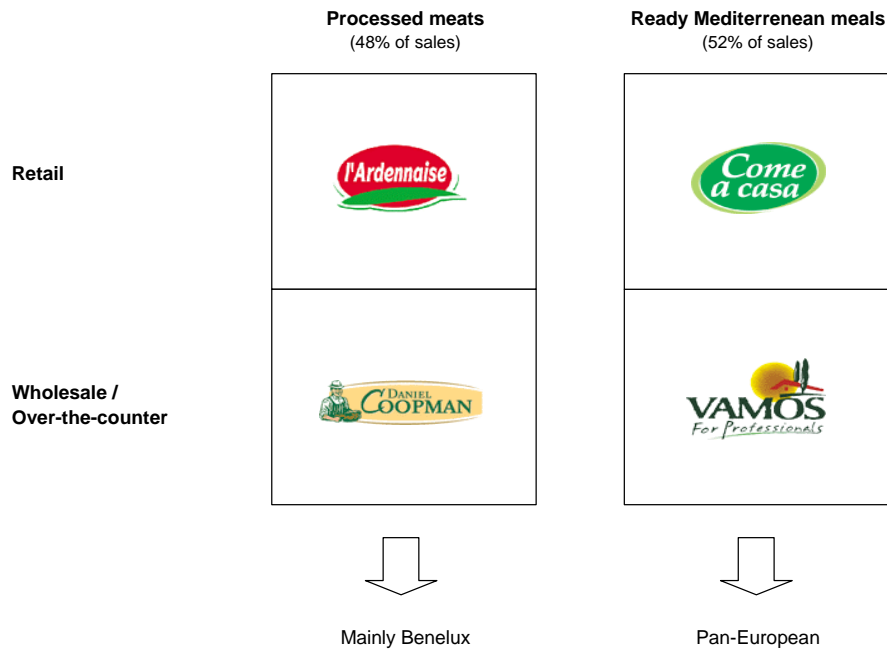


Source: Ter Beke

## Distribution channels

Ter Beke sells its products through three distribution channels: wholesalers in the Benelux, the food retailers in a large number of European countries and the Out-of-Home segment (foodservice) in the Benelux. The traditional segment (wholesaler/butcher/caterer) is under heavy pressure as consumers switch to self-service. Ter Beke is however managing to increase its market share in this segment through innovations and a greater focus on service/commercial support to the wholesalers. The product range for the retail segment includes branded products (Come a Casa, l'Ardennaise), private label and discount products. Ter Beke continues to consolidate its position as supplier to the discounters thanks to an adapted assortment. Since 2003, Ter Beke has entered the foodservice segment which includes schools, hospitals and company canteens. To target this channel, Ter Beke has built a dedicated sales team and developed a specific range of ready meals for professional kitchens under the Vamos brand.

## Ter Beke's brand positioning



Source: Ter Beke

## 1Q05 sees sluggish demand but stable raw material prices

Dwindling consumer confidence created the conditions for a tough 1Q05. Sales improved however in May. The ready meals sector was more affected by sluggish consumer spending than processed meats. Demand for processed meats tends to be stable but within this market, the segment of pre-sliced and pre-packaged products continues to grow. Year-to-date raw material prices were relatively stable. Lower fat prices were offset by higher poultry prices while pork prices were stable. In the past, Ter Beke has proved its ability to pass on gradual increases in raw material prices. Margins are hit however in the event of sharp price hikes because of the necessary time lag before new prices can be implemented.

## Outlook

Management expects to realize higher net profits in 2005 unless market conditions deteriorate. The following table shows our forecasts under **Belgian GAAP**. We'll switch to IFRS when the restated 2004 accounts become available. The 1H05 results (9 September 2005) will be reported under IFRS.

We have slightly lowered our FY05 sales forecast to reflect the slow start to the year. We now project sales growth of 17.5% this year or +3.0% excluding Langeveld Slegers, which was acquired on 31 January 2005. Langeveld Slegers is a leader in the field of slicing and pre-packaging processed meats with annual sales of +/- € 30m.

## Revised forecasts (Belgian GAAP) (€m)

	Old 2005E	New 2005E	Old 2006E	New 2006E	Old 2007E	New 2007E
Sales	249.58	242.52	259.57	252.22	269.95	262.31
% change	+21.0%	+17.5%	+4.0%	+4.0%	+4.0%	+4.0%
EBITDA	24.34	23.01	26.44	24.09	28.36	25.52
EBITDA/sales %	9.8%	9.5%	10.2%	9.6%	10.5%	9.7%
EBITA	12.87	12.91%	13.47	13.49	14.39	14.43
EBITA/sales %	5.2%	5.3%	5.2%	5.4%	5.3%	5.5%
Goodwill	-1.73	-1.73	-1.73	-1.73	-1.90	-1.73
Financial result	-1.51	-1.66	-1.55	-1.70	-1.36	-1.70
Current pretax profit	9.63	9.53	10.19	10.07	11.13	11.00
Exceptionals	0	0	0	0	0	0
Pretax profits	9.63	9.53	10.19	10.07	11.13	11.00
Taxes	-3.63	-3.57	-3.81	-3.74	-4.17	-4.04
Net profits	5.99	5.96	6.38	6.33	6.96	6.97
Current net profits	7.72	7.69	8.10	8.06	8.86	8.70

Source: KBC Securities

In 2004, 46.5% of net profits were generated in 1H. We anticipate that in 2005, the contribution of the first semester will be lower because of the following:

- Ramp up costs at the Alby-sur-Chéran plant. The capacity of this pasta production facility has been expanded significantly, causing some disruption during 1Q05.
- Ter Beke plans to increase advertising and promotional expenses related to Come a Casa by €1.5m this year. Commercial efforts include nationwide campaigns (TV, radio, newspapers) in Belgium and in-store promotions in France and Spain. We expect a large portion of the €1.5m to be expensed during the current semester.

## Scope for further growth

Top line growth will continue to be driven by product innovation, the expansion of production capacity and acquisitions. Ter Beke continues to introduce new products such as Come a Casa's meals for children (Campione), its new deep pan pizza range and soups (Zuppa Fresca). Sales are expected to increase on the back of promotional spending for Come a Casa in Belgium, France and Spain.

The group has been looking at takeover opportunities in Spain to expand its fresh Mediterranean ready-meals activities. This market offers significant growth potential because the penetration of chilled ready meals is still low. So far, Ter Beke has not found the right candidate at the right price.

The group intends to invest €15m this year on top of the Langeveld/Slegers acquisition. Last year, capex was close to €20m. The main investment projects included the new fully-automated pasta line and the extension of pâté production in Marche-en-Famenne and the expansion and modernization of the pasta production facilities at Ably-sur-Chéran. Ter Beke has enough spare land to expand the production sites at Veurne (Belgium), Marche-en-Famenne (Belgium) and Milsbeek (The Netherlands).

## Taking legal action against tax authorities

Ter Beke has been contesting supplementary income tax assessments totaling €6.1m, received in 2000 and 2004, pertaining to the 1997 and 2001 financial years. The company intends to demand that the tax authorities remove the levies, which relate to the tax deductibility of insurance premiums paid to a Belgian insurance company that reinsured part of these risks with a Ter Beke group company in Luxembourg. An objection has already been filed with the competent authorities. These supplementary assessments show up on the balance sheet under "Accounts payable within one year - Taxes" and the contested amount is included under "Other amounts receivable". No provision has been made however because the Board of Directors judged that these levies are unfounded. Potential additional assessments relating to 2002-2004 could reach €3.4m. The total amount could therefore reach €9.5m. The Board of Directors is confident it has a strong case.

## Equity

The following table shows the shareholder structure following the conversion on 29 December 2004 of the automatically convertible debenture. The Coopman family, Seneca and a group of shareholders, who individually hold less than 5%, act in concert and together own 50.24% of the shares. Mercator Verzekeringen reduced its stake from 15.6% at end-2004 to 9.7% on 26 May 2005 and will probably sell its remaining stake, which could have a beneficial impact on the stock's liquidity. Management also indicated during the AGM that the stock will probably be transferred from the double fixing to the continuous market. The number of outstanding warrants amounts to 39,650 or 2.9% of the total number of outstanding shares. They are all in the money. The company intends to adopt further warrant plans in the future, while keeping the total dilution limited to a maximum of 5% of the voting rights. The company owned 893 treasury shares on 26 May 2005.

### Shareholder structure

	31.12.04	26.05.05
Family Coopman (incl. Famcoo Invest NV)	40.1%	40.0%
Seneca (L De Bruykere – Chairman)+ individuals	10.2%	10.2%
Mercator Verzekeringen NV (La Baloise)	15.6%	9.7%
SRIW (Wallonia Region)	6.2%	6.1%
Bois Sauvage (parent co of Banque Degroof)	6.5%	6.5%
Deutsche Bank AG		5.2%
VDK	1.3%	1.3%
Free float	20.1%	21.0%

Source: Ter Beke

## Financial data

<b>Income statement (€m)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>
Sales	178.9	190.2	206.3	242.5	252.2	262.3
EBITDA	18.8	20.6	20.9	23.0	24.1	25.5
EBITA	8.0	9.9	11.4	12.9	13.5	14.4
EBIT	6.9	8.7	10.1	11.2	11.8	12.7
Pre-tax earnings	4.4	6.7	8.0	9.5	10.1	11.0
Net earnings	3.5	4.2	5.0	6.0	6.3	7.0
Current earnings before goodwill	4.7	5.4	6.3	7.7	8.1	8.7
Current cash flow	15.5	16.1	15.8	17.8	18.7	19.8
<b>Balance sheet (€m)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>
Goodwill and other intangible assets	14.5	14.9	13.3	17.3	14.5	11.6
Tangible assets	41.8	41.8	52.4	68.4	73.9	78.9
Associates and other financial assets	0.1	0.0	0.0	0.0	0.0	0.0
Net working capital	-3.2	0.8	0.7	-2.5	-2.8	-3.2
Net debt	32.7	32.7	13.0	26.8	26.1	24.7
Provisions and other liabilities	2.0	2.7	2.7	2.7	2.7	2.7
Minorities	2.0	3.0	4.0	5.0	6.0	7.0
Equity	18.6	22.2	50.8	53.7	56.7	60.0
Capital employed, incl. cum goodwill	58.9	64.5	74.6	86.4	90.4	94.0
Balance sheet total	108.2	104.8	120.3	146.9	151.9	156.5
<b>Cash flow statement (€m)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>
Cash flow from operations	23.0	12.5	15.9	17.7	18.6	19.8
Net capital expenditure	-11.8	-12.3	-19.8	-15.0	-15.0	-15.0
Free cash flow (before acquisitions)	11.2	0.2	-4.0	2.7	3.6	4.8
Acquisitions and disposals	0.4	0.1	0.1	-11.5	0.0	0.0
Dividend payments	-1.2	-1.4	-1.6	-1.8	-3.0	-3.3
Shares issues	-	-	-	-	-	-
Other	-0.2	1.1	-0.3	0.0	0.0	0.0
Change in net debt	-10.1	0.0	-19.7	13.8	-0.6	-1.4
<b>Performance criteria</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>
Sales growth	7.4%	6.3%	8.5%	17.5%	4.0%	4.0%
EBITDA margin	10.5%	10.8%	10.1%	9.5%	9.6%	9.7%
EBITA margin	4.5%	5.2%	5.5%	5.3%	5.4%	5.5%
EBIT margin	3.8%	4.6%	4.9%	4.6%	4.7%	4.8%
Net debt / equity	175.7%	147.3%	25.5%	49.9%	46.1%	41.2%
Net debt / EBITDA	1.7	1.6	0.6	1.2	1.1	1.0
EBITDA / net interest	7.7	9.4	10.0	14.8	15.1	16.0
Pay-out ratio	39.6%	39.0%	36.6%	50.3%	52.8%	52.7%
Net return on equity (avg.)	20.0%	20.6%	13.8%	11.4%	11.5%	11.9%
Return on capital employed (avg.)	-18.0%	-35.7%	-50.7%	-64.6%	-79.4%	-97.0%
<b>Per share data (€)</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>
Weighted average number of shares (m)	0.91	0.91	0.91	1.36	1.36	1.36
Published EPS	3.88	4.62	5.53	4.37	4.64	5.11
Current EPS, before GW	5.15	5.95	6.92	5.64	5.91	6.38
Current CFPS	17.07	17.68	17.35	13.05	13.69	14.52
Free cash flow per share	12.31	0.26	-4.33	1.99	2.67	3.50
Net book value per share	20.49	24.37	55.63	39.40	41.60	44.01
Current EPS (before GW): y/y growth	268.1%	15.4%	16.3%	-18.4%	4.8%	7.9%
Current CFPS: y/y growth	48.2%	3.6%	-1.9%	-24.8%	4.9%	6.1%
Current EPS (before GW), fully diluted	5.15	5.95	6.92	5.64	5.91	6.38
Dividend per share (€)	1.53	1.80	2.00	2.20	2.45	2.70
<b>Valuation data</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005E</b>	<b>2006E</b>	<b>2007E</b>
Reference share price (€)	40.22	46.54	57.44	66.00	66.00	66.00
Reference market capitalisation (€m)	36.6	42.4	78.3	90.0	90.0	90.0
Enterprise value (€m)	72.0	78.9	96.0	122.5	122.9	122.4
P/E	7.8	7.8	8.3	11.7	11.2	10.3
P/CF (x)	2.4	2.6	3.3	5.1	4.8	4.5
P/NBV (x)	2.0	1.9	1.5	1.7	1.6	1.5
Dividend yield (%)	3.8%	3.9%	3.5%	3.3%	3.7%	4.1%
EV/sales (x)	0.4	0.4	0.5	0.5	0.5	0.5
EV/EBITDA (x)	3.8	3.8	4.6	5.3	5.1	4.8
EV/Capital employed (x)	1.2	1.2	1.3	1.4	1.4	1.3

Source: KBC Securities

\*Historic valuation data are based on historic prices

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