

Ter Beke

23 September 2005

Marketing campaigns hit 1H05 results

Food Producers & Processors

Current price €69.15

Outperform

Belgium

Target price €80.00

Rating Unchanged

Performance over	1m	3m	12m
Absolute	1%	2%	18%
Rel. BEL20	0%	-3%	-4%
Relative to sector	-2%	-7%	-8%
12m Hi/Lo	€70.20/58.45		
Reuters	TERB.BR		
Bloomberg	TERB BB		
Market Cap	€94m		
Next corporate event			
Trading update: mid-November			

FY/e 31.12	2004	2005E	2006E	2007E
Sales (€m)	200.0	240.0	249.6	259.6
EBITDA (€m)	20.9	22.1	23.2	24.4
Net earnings (€m)	5.0	6.0	6.3	6.7
Current EPS* (€)	4.97	4.40	4.60	4.88
Published EPS (€)	3.69	4.40	4.60	4.88
Dividend per share (€)	2.00	2.10	2.20	2.30
P/E (x)	11.5	15.7	15.0	14.2
Dividend yield (%)	3.5%	3.0%	3.2%	3.3%
EV/EBITDA (x)	4.3	5.5	5.2	4.9

Source: KBC Securities

*Adjusted for goodwill and exceptionals

EBITDA reached € 9.3m (-6.3%) in 1H05 versus our forecast of € 10.1m. The conversion of the Automatically Convertible Debentures (ACD) shaved € 1.5m off annual financial costs¹. Management decided to invest this amount in additional marketing and advertising efforts to promote its chilled Mediterranean meals and more specifically the Come a Casa brand. We assumed that € 1.0m would be spent in 1H05. The actual figure reached € 2m however. Note that the EBITDA margin would have equalled 9.7% in 1H05 versus 9.8% in 1H04 if marketing and advertising costs had been stable. This underlines Ter Beke's ability to maintain solid margins in spite of difficult market conditions. During 2H05, advertising costs are expected to be € 0.5m lower y/y.

We have changed our spreadsheets to reflect IFRS. Our FY05 net profit forecast is unchanged at € 6.0m. Market conditions remain tough as a result of the sluggish market, rising price pressure from the food retailers and the impact of increasing oil prices on energy and packaging costs. Ter Beke's results have nevertheless been resilient so far because the company is able to meet the increasingly stringent requirements (e.g. food safety, logistics, IT integration, product specification) in the food sector.

We maintain our Outperform rating based on the promising outlook for the chilled Mediterranean ready meals sector and the slicing/packaging business. More and more food retailers are outsourcing their processed meat slicing and packaging activities. Ter Beke is well positioned to win major contracts in this field following the acquisition of Langeveld/Sleegers. An acquisition of a Spanish chilled pasta meal producer could also trigger the share price.

1H05 results

Sales rose by 15.6% thanks to the acquisition of Langeveld/Sleegers (LS). Pre-packaged processed meats continue to gain market share from over-the-counter products. For the full year, we assume that LS will contribute € 34m to group sales. Ter Beke's turnover in chilled Mediterranean ready meals was stable despite the loss of a contract in Spain.

¹ Financial cost under Belgian GAAP but subtracted from equity under IFRS.

Ter Beke (€m)					
	1H04 Belgian GAAP	1H04 IFRS	1H05 IFRS	% change	KBC forecast
Sales	102.7	100.0	115.5	+15.6%	116.3
EBITDA	10.0	9.9	9.3		10.1
EBITA margin	9.7%	9.9%	8.1%		8.7%
Operating profits	5.4	4.7	3.9	-16.7%	4.7
Operating margin	5.2%	4.7%	3.9%		4.1%
Financial result	-1.7	-0.4	-0.6	-57.3%	-0.8
Pretax result	3.7	4.3	3.3	-23.4%	3.9
Taxes	-1.3	-1.9	-1.2	-37.9%	-1.7
Tax rate	36.2%	44.8%	36.2%		44.8%
Net profits	2.3	2.4	2.1	-11.5%	2.2

Source: Ter Beke, KBC Securities

The 1H05 EBITDA margin would have been almost flat if advertising expenses over the period had remained stable. Overall raw material prices (e.g. meat, tomatoes, cheese) were stable in 1H05. For 2H05 we have assumed a 60bp decline in EBITDA margin to be on the prudent side. Packaging costs (e.g. plastic foils) are rising on the back of higher oil prices. Ter Beke has been able to offset this to some extent by exercising more pressure on suppliers. Moreover, the group's purchasing power has increased following the Langeveld/Sleegers acquisition. The group is also taking advantage of the liberalisation of the energy sector. Energy costs represent 1% of sales in 2005.

Depreciation increased by € 0.9m in 1H05 as a result of the LS acquisition and the group's investment program. Last year group capex reached 9% of sales. During 1H05, the group invested approximately € 5m. Ter Beke completed the expansion and modernisation of its production halls in Alby (F) while the maturing and drying facilities at the salami factory in Waarschoot and the pasta line in Marche-en-Famenne were renewed. For the full year, capex should reach € 12.5m. The FY04 IFRS results included a € 1.75m goodwill impairment charge related to the French operations. This charge was divided equally between 1H04 and 2H04 in accordance with the assessment under IFRS. Net financial costs rose by € 0.2m as a result of the capex program and the acquisition of Langeveld/Sleegers. The group's financial gearing reached 77% at the end of 1H05.

Luxembourg captive

Ter Beke has been appealing supplementary income tax charges totalling € 6.1m for the financial years 1997-2001. The dispute relates to the tax deductibility of insurance premiums paid to a Belgian insurance company that reinsures part of the risk through a Luxembourg reinsurance company belonging to the Ter Beke group. Insurance premiums of € 8m paid over 2002-2004 could lead to additional levies up to € 3.4m. Under IFRS, the annual tax charge includes deferred taxes on the Luxembourg captive. Moreover, the entire historical deferred tax liability related to this captive is included in the balance sheet, for an amount of +/- € 10m on 30 June 2005. Ter Beke initiated legal proceedings against the Belgian Government to dispute the totality of these tax charges. Management is confident it has a strong case. But since the outcome could create an important precedent, we believe it may well end up in the Court of Appeal and the Supreme Court. The definitive ruling might therefore take many years.

FY04: IFRS impact

2004 sales are € 6m lower under IFRS versus Belgian GAAP because of the elimination of some sales-repurchase transactions (e.g. slicing contracts with third parties). Operating profits equal € 10.2m under IFRS versus € 10.4m under Belgian GAAP. The net financial charge equalled € 0.8m under IFRS versus € 2.2m under Belgian GAAP. Unlike Belgian GAAP, IFRS classifies automatically convertible debentures (ACDs) under equity. The interest on these bonds is therefore not regarded as financial charges. To calculate EPS04 under IFRS, we use the total number of shares including those resulting from the conversion of the ACDs. Under Belgian GAAP, the average number of shares excludes the new shares for the EPS04 calculation as the conversion took place at the end of 2004. The IFRS net financial charge excludes the amortisation of goodwill. Net profits (€5.0m) are equal under Belgian GAAP and IFRS. The positive adjustments related to goodwill amortization and interests on ACD are offset by the negative impact of the one-off impairment charge (€1.75m in FY04) and a deferred tax charge related to the group's reinsurance business. Our current EPS04 figure excludes the impairment charge (€1.75m before and after tax).

Switch Belgian GAAP-IFRS (€m)

	FY04 Belgian GAAP	FY05E Old Belgian GAAP	FY06E Old Belgian GAAP	FY04 IFRS	FY05E IFRS	FY06E IFRS
Sales	206.3	242.2	252.2	200.0	240.0	249.6
% change	+8.5%	+17.5%	+4.0%		+20.0%	+4.0%
EBITDA	20.9	23.0	24.1	20.9	22.1	23.21
EBITDA margin %	10.1%	9.5%	9.6%	10.4%	9.2%	9.3%
Operating profits	11.4	12.9	13.5	10.2	10.7	11.3
Operating margin %	5.5%	5.3%	5.4%	5.1%	4.5%	4.5%
Goodwill	-1.3	-1.7	-1.7	0	0	0
Financial result	-2.2	-1.7	-1.7	-0.8	-1.2	-1.3
Current pretax profit	7.9	9.5	10.1	9.4	9.5	10.0
Exceptionals	0.1	0	0	0	0	0
Pretax profits	8.0	9.5	10.1	9.4	9.5	10.0
Taxes	-3.0	-3.6	-3.7	-4.3	-3.5	-3.7
Tax rate	36.9%	37.9%	37.0%	46.2%	36.7%	37.0%
Net profits	5.0	6.0	6.3	5.0	6.0	6.3

Source: Ter Beke, KBC Securities

Outlook

Management has confirmed its objective of higher net profits in FY05, although this assumes no deterioration of market conditions. Langeveld/Slegers should contribute € 34m to group sales this year and organic sales are expected to increase by € 6m despite the loss of a Spanish contract. New product launches and the advertising efforts in 1H05 should have a positive impact on Come a Casa's sales in 2H05. In 2H05, Come a Casa's marketing campaigns will focus on in-store promotions rather than expensive TV campaigns. For 2H05, we expect a strong increase in operating profits because marketing costs will be € 0.5m lower (y/y). Furthermore, the 2H04 results were hit by an € 875,000 impairment charge which showed up above the operating profit line under IFRS. A trading update will be released at the beginning of November.

Half year results (IFRS)(€m)						
	1H04	2H04	2004	1H05	2H05E	2005E
Sales	100.0	100.0	200.0	115.5	124.5	240.0
% change				+15.6%	+24.4%	+20.0%
EBITDA	9.9	11.0	20.9	9.3	12.8	22.1
EBITDA margin %	9.9%	10.9%	10.4%	8.0%	10.3%	9.2%
Impairment charge	-0.9	-0.9	-1.8	0	0	0
Depreciation	-4.6	-4.6	-9.3	-5.6	-6.0	-11.6
Provisions	0.3	0	0.3	0.2	0	0.2
Operating profits	4.7	5.5	10.2	3.9	6.8	10.7
Operating margin %	4.7%	5.5%	5.1%	3.4%	5.5%	4.5%
Financial result	-0.4	-0.4	-0.8	-0.6	-0.6	-1.2
Pretax profit	4.3	5.1	9.4	3.3	6.2	9.5
Taxes	-1.9	-2.4	-4.3	-1.2	-2.3	-3.5
Tax rate	44.8%	47.5%	46.2%	36.2%	37.0%	36.7%
Net profits	2.4	2.7	5.1	2.1	3.9	6.0

Source: Ter Beke, KBC Securities

Investment case

We maintain our Outperform rating based on the following:

- Ter Beke has proven during 1H05 that it is able to generate solid results despite higher input costs, sluggish demand and price pressure in the food retail sector.
- The company's expertise in processed meat slicing/packaging opens up significant growth opportunities as more and more food retailers are outsourcing this activity. Ter Beke is ideally positioned to benefit from this trend following the acquisition of Langeveld/Sleegers.
- In recent years, the company has invested heavily in its state-of-the-art production facilities. Thanks to these efforts, it can satisfy the increasingly stringent requirements of the food retailers. Food safety, flexibility and efficient supply chains have become paramount.
- Demand for chilled ready meals should continue to grow in our cash rich/time poor society. Furthermore, penetration of chilled ready meals is still low in countries like Spain. Ter Beke sells its products in Spain but still has no production facilities there. Given the strong growth potential offered by this market, we believe a Spanish acquisition would lift the share price.
- Ter Beke has recently entered the foodservice sector, a channel that offers additional growth opportunities.

Financial data (IFRS)

Income statement (€m)	2004	2005E	2006E	2007E
Sales	200.0	240.0	249.6	259.6
EBITDA	20.9	22.1	23.2	24.4
EBITA	10.2	10.7	11.3	12.1
EBIT	10.2	10.7	11.3	12.1
Pre-tax earnings	9.4	9.5	10.0	10.6
Net earnings	5.0	6.0	6.3	6.7
Current earnings before goodwill	6.8	6.0	6.3	6.7
Current cash flow	17.5	17.4	18.2	19.0
Balance sheet (€m)	2004	2005E	2006E	2007E
Goodwill and other intangible assets	12.6	20.2	20.2	20.2
Tangible assets	52.6	61.5	64.6	67.3
Associates and other financial assets	1.4	1.9	1.9	1.9
Net working capital	-6.1	-2.1	-2.2	-2.2
Net debt	13.7	29.4	29.0	27.9
Provisions and other liabilities	5.7	6.8	6.8	6.8
Minorities	0.0	0.0	0.0	0.0
Equity	41.1	45.4	48.8	52.5
Capital employed, incl. cum goodwill	68.7	89.1	92.1	94.8
Balance sheet total	111.9	141.8	147.3	153.2
Cash flow statement (€m)	2004	2005E	2006E	2007E
Cash flow from operations	15.9	14.0	18.3	19.0
Net capital expenditure	-19.8	-12.5	-15.0	-15.0
Free cash flow (before acquisitions)	-4.0	1.5	3.3	4.0
Acquisitions and disposals	0.1	-12.0	0.0	0.0
Dividend payments	-1.6	-1.7	-2.9	-3.0
Shares issues	0.0	0.0	0.0	0.0
Other	-0.3	0.0	0.0	0.0
Change in net debt	5.8	15.7	-0.4	-1.0
Performance criteria	2004	2005E	2006E	2007E
Sales growth	5.2%	20.0%	4.0%	4.0%
EBITDA margin	10.4%	9.2%	9.3%	9.4%
EBITA margin	5.1%	4.5%	4.5%	4.7%
EBIT margin	5.1%	4.5%	4.5%	4.7%
Net debt / equity	33.3%	64.7%	59.4%	53.3%
Net debt / EBITDA	0.7	1.3	1.2	1.1
EBITDA / net interest	25.4	18.2	17.1	15.9
Pay-out ratio	33.5%	47.7%	47.8%	47.1%
Net return on equity (avg.)	12.6%	13.9%	13.3%	13.1%
Return on capital employed (avg.)	9.3%	7.6%	7.7%	8.0%
Per share data (€)	2004	2005E	2006E	2007E
Weighted average number of shares (m)	1.36	1.36	1.36	1.36
Published EPS	3.69	4.40	4.60	4.88
Current EPS, before GW	4.97	4.40	4.60	4.88
Current CFPS	12.81	12.74	13.33	13.90
Free cash flow per share	-2.90	1.12	2.39	2.96
Net book value per share	30.15	33.32	35.82	38.50
Current EPS (before GW): y/y growth	-16.4%	-11.5%	4.5%	6.1%
Current CFPS: y/y growth	-27.6%	-0.6%	4.7%	4.3%
Current EPS (before GW), fully diluted	4.97	4.40	4.60	4.88
Dividend per share (€)	2.00	2.10	2.20	2.30
Valuation data	2004	2005E	2006E	2007E
Reference share price (€)	57.44	69.15	69.15	69.15
Reference market capitalisation (€m)	78.3	94.3	94.3	94.3
Enterprise value (€m)	90.6	121.7	121.3	120.3
P/E	11.5	15.7	15.0	14.2
P/CF (x)	4.5	5.4	5.2	5.0
P/NBV (x)	1.9	2.1	1.9	1.8
Dividend yield (%)	3.5%	3.0%	3.2%	3.3%
EV/sales (x)	0.5	0.5	0.5	0.5
EV/EBITDA (x)	4.3	5.5	5.2	4.9
EV/Capital employed (x)	1.3	1.4	1.3	1.3

Source: KBC Securities

*Historic valuation data are based on historic prices

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