

DESCRIPTION

Lafarge is the world largest cement producer and one of the largest in the concrete and gypsum segments. The company is present in 78 countries, with 76,000 employees. Total cement production capacity is 215mt, with 125 plants and 44,250 employees in 49 countries. Lafarge's largest markets are in North America, France, UK and in a myriad of emerging countries (from Egypt to Philippines, South Africa, Brazil, Ukraine and Iraq). In 2007, Lafarge accelerated its development in emerging markets with the acquisition of Orascom Cement for €8.8 bn. This resulted in a sharp increase of Lafarge's indebtedness, which became a big problem as the financial crisis unfolded. Since then, Lafarge's strategy has mainly been focused on non-strategic assets disposals and the improvement of cash generation, which is still an ongoing process. Although Lafarge's finances are stretched, the presence of large stable shareholders is a strong driver for financial performance improvement. Key businesses are, based on 2010 figures cement (60% of sales; 91% of EBIT), aggregates & concrete (32%) and gypsum (8%).

Market profile

High 52 weeks 22.90€
Low 52 weeks 48.76€
Average volume 1.8m

Free float 64.9%
Insiders 35.1%

Shareholders

Gpe Bruxelles Lambert 21.1%
NNS Holding (Sawiris) 14.1%
Public 64.8%

Valuation ratios

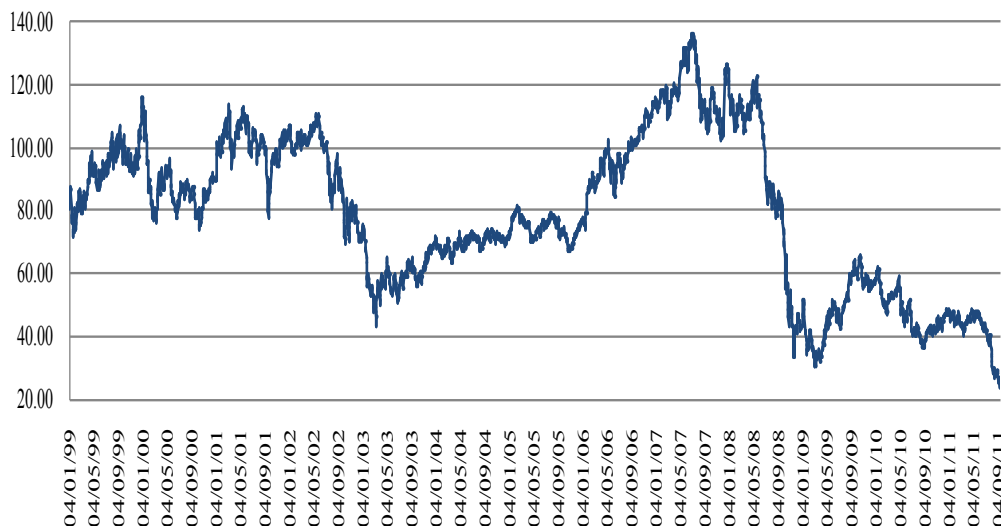
P/E 2011e/2012e 9.4x/6.8x
P/CF 2011e/2012e 2.5x/2.1x
P/B 2011e/2012e 0.4x/0.4x
EV/EBIT 2011e/2012e 10.5x/8.4x
Earnings Yield 10.6%/14.8%
Dividend Yield 3.9%/3.9%
FCF Yield 2011e/2012e 1.6%/4.4%
Gearing 2011e/2012e 85%/73%

5 year-forecast (CAGR)

Revenue 4.2%
EBIT 9.2%
Earnings per share (EPS) 22.1%
Dividend per share (DPS) 25.7%

Share Price €25.95
Nb of shares 287m
Market Capitalization €7,443m
Net Debt 2011e €14,260m
Enterprise Value €21,703m

FAIR @ ~23€
Valuation Range
[€28.9-€37.8]



Why hold/buy the share ?

Lafarge remains highly sensitive to the economic cycle. 1H results confirmed this fact with a 230pb decline in operating margin and a 34% fall in net profit, while several observers speculated the world economy could be headed into a recession (again). This doesn't bode well for Lafarge which needs to reach a more sustainable debt level. Due to the cyclicity of its businesses, the uncertainty over revenue and margin evolution, and a very high risk aversion regarding equities (especially in Europe), Lafarge has been on the short list for quite some time. We're not sure what the future looks like. Taking into account somewhat cautious forecasts for 2011-12, we think that around an all-time low of €22.9 recently, the share presents some margin of safety, although the share could still suffer from heavy stress in the market.

Catalysts

- 1) Organic growth, pricing power return and ROCE improvement are the main catalysts on the P&L side;
- 2) Ability to unleverage the balance sheet with the ongoing disposal program (on track for €2bn this year)

Risks

- 1) Breach of debt covenants (for 2011/2012: ; currently at 4.1x LTM EBITDA)
- 2) Sensitivity to the economic cycle, especially in emerging market where significant investment in infrastructure are subject to credit restriction and tighter monetary policies (due to the acceleration of inflation in recent years)
- 3) Insufficient cash and ROCE trend; destroying value since 2009.

Valuation

We derived our €23 fair value estimate thanks to 3 approaches: DCF estimate of €34.4 (wacc of 6.4%); DDM €28.9; Anchorage value of €37.8. The average is €33.7.

We applied to this number a margin of safety of 30%, justified by 1. the cyclicity of the business; 2. the uncertainty regarding the macro-economic scenario; 3. the volatility of Lafarge's earnings in the last 12 years.