PETERCAM
Industrials

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Bekaert (Buy - EUR 96.9): China in your hands

Facts: Bekaert is clearly winning market share in H1 in China

Xingda, Bekaert's key competitor in the Chinese tire cord market, announced poor H1 results.

- Revenues increased by 8.5% in H1. This implies that Xingda significantly underperformed Bekaert which posted a revenue increase in tire cord of 53% in H1. Volumes were up by 20%, driven by a 31% growth in low margin passenger car tires. In the high margin truck tire segment, Xingda's volumes were up by 15%.
- The higher dependence on passenger tires and price pressure led to decline of gross margins from 29% to 25%. Combined with higher transportation costs and increasing SG&A leaded to EBIT margin erosion from 20% in H1'06 to 15.8%.
- Xingda reiterates its intention to increase production capacity by 30,000 to 40,000 tons per year in the coming 4 years. The group will also improve its quality control.

Entering Stainless steel market in India

- Yesterday Bekaert signed a strategic cooperation agreement with the Indian steel company Mukand. Both partners will set up a 50/50 joint venture and invest EUR 18m in a new factory to be built in Maharashtra (India) for the production of stainless steel wires. These wire products are used around the world in components for the automotive industry and all sorts of other industrial applications. The new plant will come on stream in January 2009. Targeted revenues are EUR 40m.
- Mukand is a leading producer of alloy and stainless steel long products in India, is a supplier of Bekaert and will provide the new plant with wire rod.
- Bekaert has been active in India for some time, mainly in production of tire cord

Our view

Besides the fact that Xingda is growing at a slower pace than Bekaert, the group seems to struggle to sell its incremental capacity. Xingda increased its production capacity by 12% since the end of 2006 to 218,000 tons, but sold volumes in truck tire cord were flat compared to H2'06 and even down in passenger tires. Given the pressure on prices, Bekaert's volume growth should have exceeded 53% in H1. Xingda is further stepping up its capacity towards 230,000 tons at YE'07 compared to 245,000 tons expected at the end of 2007 for Bekaert. Xingda had only a utilization rate of 80% in H1. Given its strong revenue growth, its Bekaert's utilization rate should be much higher.

Xingda's margins are coming down and are now more in line with other quoted players such as Shougang, which reported an EBIT margin of 16.6% in 2006. We believe that Xingda will face higher transportation costs than Bekaert in the future as Xingda operates from one big plant compared to 3 different production locations for Bekaert. In addition, Xingda's margins suffer in our view from a too low utilisation rate.

The move to India shows that Bekaert is ready to roll out its production platform in this country when market opportunities arise. Bekaert is linking up with an world leading player in Stainless Steel, which could offer more new opportinities. The group has also a steel cord plant in India, a market where tire radialisation is almost non–existing. The group's capacity currently amounts only to 10,000 tonnes, but Bekaert is ready to expand capacity in India if market moves towards steel reinforced tires. As always, government road investments are key leading indicator for the steelcord market development

Conclusion

Thanks to its aggressive expansion, Bekaert is taking significant market share in China and regained its market leadership. 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 steelcord provides cost leadership.

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. Add reiterated.

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