

Bekaert (Buy - EUR 109): Building a 4th steel cord plant in China

Partnership with Ansteel to secure position on Chinese growth market.

Facts

Bekaert and Ansteel, a leader in the Chinese steel industry announced they will to set up a 50/50 joint venture. Ansteel and Bekaert will invest a total of EUR 150m in the construction of a new steel cord plant to be built in the Shuangqiao District within the Chongqing Municipality. This investment will, in line with market development, take place in phases. The first phase is scheduled to enter production in 2009 and involves a capital investment of EUR 40m.

Following the announcement of May 26, 2008 on the Memorandum of Understanding outlining the terms for a strong cooperation between Ansteel and Bekaert, the joint venture is a first step in the realization of the strategic partnership.

Our View

Bekaert increased its steel cord capacity in China from 125,000 tonnes in 2005 to 200,000 tonnes at the end of 2006 and 250,000 tonnes at the end of 2007. In Q1 Bekaert posted a revenue growth in China of not less than 75.7%. The group clearly added much more capacity than we expected and announced that it has already 275,000 tonnes steel cord capacity. We expected this capacity would only be reached in Q3. In addition, selling prices were increased significantly. Another driver of the growth acceleration seems the larger than expected part of the steel cord capacity (approximately 25%) is already sold to non-tire manufacturers. As such Bekaert is entering new markets where penetration of its products is low. At the end of 2008, we expect Bekaert will have a steel cord capacity in China of 325,000 tonnes.

Since capacity in exiting plants is coming close to the optimal size, it should not come as a surprise that Bekaert starts a 4th plant to supply the Chinese steel cord market, where it has an estimated market share of 35%. The new plant will be located in South-West China, a region where Bekaert is not yet active. In addition, it seems that a large customer (Double Coin) of Bekaert is investing in the same industrial park with a targeted capacity of 40m tyres a year in 2010. The region is also well-know for its automotive production base.

Nevertheless the size of the plant surprises us. According to a newsletter of Steel Business Briefing, the new plant will become the biggest steel cord plant in China. Bekaert does not give details on the expected output, but we estimate based on the investments that capacity will gradually build up to 40,000 tonnes at the end of 2009 and 80,000 tonnes in 2010. This should translate into incremental revenues (for Bekaert's 50% part) of EUR 30m in 2009 (+1.3% on total revenues) and EUR 55m in 2010 (+2.5% on total revenues). Since margins in China are above group average, we expect a larger positive impact on EBIT level. We will increase our capex forecast for 2008 to EUR 220m from EUR 200m and to EUR 180m in 2009 from EUR 140m.

Conclusion

Bekaert continues to use its FCF to expand aggressively in China, where the group generates already 20% of its consolidated revenues. Today's announcement and the letter of intent that the group signed last week with Ansteel, show that Bekaert is committed to extent its presence in China.

The group's high capex is paying off and translates in a significant improvement of its organic growth profile. In Q1, Emerging Markets made up 54% of revenues and we estimate more than 60% of profits. This profile will be further reinforced by more capacity expansions.

Despite the recent strong stock price performance, valuation remains attractive. Bekaert is trading at 12x EPS 2008 and EV/EBITDA 2008 stands at 6.4x, while the group offers a FCF Yield of 8%. In addition, forecasts are likely to be raised further.

We reiterate our Buy rating and our target price of EUR 133 per share.