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Bekaert (EUR 24.85 - Hold) - 2012 a lost year, but what about 2013?

Sawing wire market dead

- During Friday's analyst meeting, Bekaert management, post factum, extensively highlighted the implosion of the sawing wire market in 2011.
- While the Photo Voltaic market still grew in 2011, it is clear that the margin and volume collapse, as from mid Q2 2011, is due to a huge capacity increase in sawing wire in 2011 in China.
- On the back of excessive operating margins, in 2010 and Q1 2011, a huge number of new competitors flooded the market. As a result, the sawing wire market is currently facing more than 200% overcapacity.
- Even if demand continues to grow, as expected, it will take several years for excess capacity to be absorbed.

But what about Chinese tire cord?

- While most of these sawing wire market issues were well known in the meantime, the key issue will be the negative spill-over effects on the tire cord market.
- About 50% of the sawing wire producers are tire cord producers and these producers risk to re-allocate part of production to the tire cord segment at a point in time demand for truck tires has been slowing.
- This additional capacity in tire cord production will put at risk margins in the tire cord market. In the sawing wire market, operating margins were negative in H2 and we estimate tire cord margins in China have come close to 10%. Over time, Bekaert estimates that sawing wire margins should be similar to tire cord margins. However, it's clear that barriers to entry are higher in tire cord compared to sawing wire.

But also other regions performed badly

- Not only China and not only sawing wire performed very weak but also Europe, US and Brazil had a very difficult H2.
- In the US, REBIT declined from EUR 28m in H1 to EUR 4m in H2 mainly due to lower capacity utilization, maintenance shut downs, forex and volatile raw material prices.
- The big shock came from Europe with REBIT declining EUR 40m H2 vs. H1. About EUR 20m delta is explained by FIFO adjustments but the remaining EUR 20m mainly comes from a heavy cost overrun at the "Aalter" factory where Bekaert invested heavily in new sawing wire technologies at a point in time the market collapsed. The Aalter factory is the main part of the Belgian restructuring program implying 600 people in total.

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What will 2013 bring?

- The only positive takeaway is probably the fact that margins have hit bottom in H2 2011. While the Aalter restructuring will mainly have its impact as from 2012 there might be some first benefits in H2 and the Chinese restructuring (1,200 people left) should already show some impact in 2012. The additional EUR 100m savings target should structurally improve margin again as from 2014.
- With restructuring cash costs estimated at around EUR 70m, keeping net debt stable would already be good according to management.
- 2012 is clearly a lost year. REBIT will be supported by the consolidation of the Peruvian and Chilean business (EUR 300m sales / EBIT margin 7%-9%) but we expect a group REBIT margin of 5%.

For 2013, we expect an EBIT margin 7.1%. On our 2013 estimates, the shares trade at 8.8x earnings and 8.0x EV/EBIT. Given the limited visibility, especially on long term Chinese tire cord margins, we see better value for risk in the market and keep our Hold rating with target price of EUR 25.0 from EUR 27.0 before.

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