

Friday, December 06, 2019 | update

Cognor: hold (reiterated)

COG PW; COGP.WA | Steel, Poland

Steel Sector Pickup Outweighed By Costs

The steel sector has recently offered reasons for cautious optimism, owing to a pickup in China, where the steel PMI moved higher in November, accompanied by a reduced inventory and upward-trending prices. Nevertheless the operating conditions remain challenging, and in a tight market Cognor faces additional pressures in 2020 stemming from rising costs of electricity (+PLN 30.8m) and labor (+PLN 3.5m). Consequently, according to our estimates, Cognor's EBITDA next year might fall by as much as 29% relative to 2019, in turn driving the net debt/EBITDA ratio for the year to 2.9x, and potentially restricting the capacity for dividends; our assumption (based on shares currently outstanding) is that the 2020 payout will be cut to PLN 0.11 per share from PLN 0.28 offered this year. We changed our recommendation for Cognor to hold, and revised our target price to PLN 1.25 per share, in our 2020 Investment Strategy issued on 5 December. In this report, we provide a more extensive analysis of the factors behind our current outlook.

Signs of recovery in steel

China's steel PMI was reported to have bounced by 4 points in November from a record-low to 45 points, accompanied by a continued decline in domestic inventories, currently standing at about 7mmt (the lowest November level in five years) compared to 12.7mmt reported in the summer. As inventories run lower, steel prices in China are seen to be moving higher. The recovering Chinese steel market can be viewed as a harbinger of an imminent stabilization in the global market.

Increasing costs drag profits

Cognor faces a boost to electricity costs to the tune of PLN 30.8m in 2020, driven by an expected 7% rise in the tariff rates for commercial consumers, this time not likely to be offset again by state-mandated refunds under a mechanism which in 2019 reimbursed Cognor to the tune of PLN 22m. At the same time, the Company's labor costs next year are expected to increase by PLN 3.5m after a 5% hike in average pay.

Slowdown in Q4 2019

Cognor gave a guidance range of PLN 17-24m for 2019 Q4 EBITDA. Our assumption a month ago was for a repeat in Q4 of the year-ago EBITDA result of PLN 24m, however we have since adopted a more conservative outlook which indicates a figure closer to the low end of the guidance range.

Reduced competitive pressures

Cognor stands to benefit from reduced competitive pressures after the planned temporary closure of a rival steel furnace in Krakow, which accounts for 18% of Poland's total installed capacity and uses as much as 200,000t of scrap per year.

(PLN m)	2017	2018	2019E	2020E	2021E
Revenue	1,789.3	2,081.8	1,859.9	1,801.9	2,009.4
EBITDA adj.	145.7	200.0	102.9	73.5	73.9
EBITDA margin adj.	8.1%	9.6%	5.5%	4.1%	3.7%
EBIT adj.	104.4	156.2	56.1	23.2	24.6
Net profit adj.	31.9	93.7	29.4	5.6	8.7
P/E adj.	6.4	2.2	6.9	36.0	23.2
P/CE	2.3	1.8	2.6	3.6	3.5
P/BV	0.9	0.7	0.7	0.8	0.7
EV/EBITDA adj.	4.0	2.3	4.6	6.4	6.2
DPS	0.00	0.07	0.21	0.07	0.03
DYield	0.0%	8.6%	17.7%	6.4%	2.2%

*2018-2021E ratios assuming full dilution

Current Price	PLN 1.16
Target Price	PLN 1.25
Market Cap	PLN 203m
Free Float	PLN 47m
ADTV (3M)	PLN 0.3m

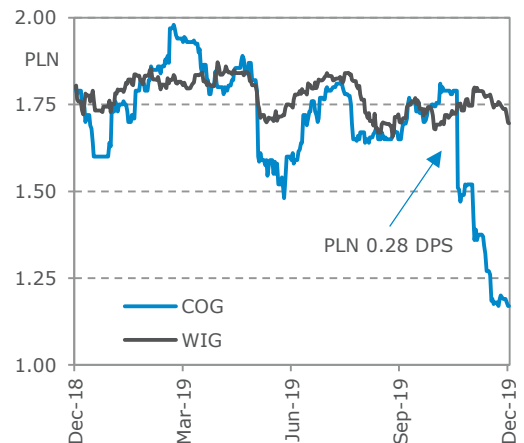
Ownership

PS HoldCo Sp.z o.o	74.90%
Others	25.10%

Business Profile

Cognor is a Polish steel producer with a share of 6% overall in the domestic market and a 15% share in EAF steelmaking. The company owns two steel mills: 'Ferrostal Łabędy' focuses on the production of round and square billets in electric arc furnaces, and 'Huta Stali Jakościowych' produces billets and ingots from quality steel. Cognor's total production capacity is 636,000 tonnes, set to increase to 850,000 in 2020. Cognor operates its own scrap buying centers which cover about 50% of its steel scrap needs.

COG vs. WIG



Company	Target Price		Rating	
	new	old	new	old
Cognor	1.25	1.25	hold	hold

Company	Current Price	Target Price	Upside
Cognor	1.16	1.25	+8.9%

Forecast Update	2019E	2020E	2021E
Revenue	0.0%	0.0%	0.0%
EBITDA	0.0%	0.0%	0.0%
Net profit	0.0%	0.0%	0.0%
Sales volume	0.0%	0.0%	0.0%
Sales prices	0.0%	0.0%	0.0%
Costs of scrap	0.0%	0.0%	0.0%

Analyst:

Jakub Szkopek
+48 22 438 24 03
jakub.szkopek@mbank.pl

Investment Risks

Cyclicality in the Steel Sector

Steel is a cyclical industry, highly sensitive to economic fluctuations. Steelmakers that use the basic oxygen process do not have option to quickly put furnaces on idle to adjust to demand shocks, and as a result they tend to sell off production at any price they can get during periods of slowdown. This can put a squeeze on global prices and have destructive consequences for the profitability of other producers, including EAF-based steel, as well as negatively impacting distributors.

Environmental Regulations

Increasing restrictions on emissions of greenhouse gases and pollution into the atmosphere have put pressure on European steel producers over the recent years, underpinned by competitive pressures coming from China and the former Soviet Republics, where local steel industries enjoy government backing and protections. Since 2016, the pressures are being mitigated by higher duties on steel imports into the EU.

Cognor will purchase approximately 10% of required emission allowances at market prices until 2020. At a EUR 1 price per tonne of carbon emissions, the cost per tonne of end-product is approximately 1 zloty, subject to fluctuations in line with price movements in the emissions trading market. The CO₂ emissions generated by the scrap-based EAF technology of steelmaking are currently 4 times less than the amount of carbon dioxide released by basic oxygen facilities that use ores.

Competitive Pressures

Whenever there is a downward shift in the prices of iron ore and met coal, which serve as feedstocks for BOF steel production, through reduced costs BOF-made steel products can gain a competitive price advantage over EAF steel.

Undersupply of Feedstocks

During extended periods of high margins on scrap-fed steel production, producers might feel encouraged to eliminate bottlenecks and ramp up their scrap-processing capacities, potentially causing upward pressure on the prices of secondary steels through higher demand.

Stock Dilution

Bondholders currently hold an estimated EUR 18m in convertible bonds of Cognor. If a substantial part of the bonds are converted at once, this could have a negative effect on the price of the Company's shares. We see resistance around PLN 1.61 per share, the current conversion price of the equity warrants that would be issued to the convertible bondholders if they decided to convert.

Excessive Leverage

In the past, Cognor has been known to use sizable debt issues to finance M&A deals as part of ambitious growth plans. A policy of financing growth with debt could lead to excessive leverage if Cognor decides to take advantage of acquisition opportunities in the future.

Increasing Energy Costs

Electricity accounts for about 10% of Cognor's total annual operating expenses, but this proportion could increase in the event of any upward shifts in the energy market.

Over-Reliance On One Customer

In 2013, Cognor's two steel plants, HSJ and Ferrostal, at times generated from 11% to as much as 20% of their revenues from one single customer. The Company has been able to subsequently reduce these proportions, with no one customer accounting for more than 10% of sales at either plant in the 2014-2016 period.

Valuation

We used two valuation methods to determine the value of Cognor: the Discounted Cash Flow method, indicating a per-share valuation of PLN 1.71, and the Relative Valuation method, yielding a value of PLN 0.63 per share.

(PLN)	weight	price
Relative Valuation	50%	0.63
DCF Analysis	50%	1.71
	price	1.17
9M target price		1.25

Relative Valuation

We compared Cognor's trading multiples with the multiples of comparable international steel producers and distributors. The peer group also includes the Polish aluminum producer Alumetal which also uses recycled metal as its feedstock material. We applied a 20% discount to Cognor's valuation vs. the peer group to reflect convertible bonds and the volatility of the Company's earnings depending on the performance of steel scrap and metal markets.

Multiples Comparison

	Country	P/E			EV/EBITDA		
		2019E	2020E	2021PE	2019E	2020E	2021PE
AK STEEL HOLDING CORP	USA	9.6	22.8	14.5	6.9	8.1	7.5
ALUMETAL SA	Poland	12.5	10.9	9.7	8.1	7.4	6.8
ARCELORMITTAL	Luxembourg	81.6	10.3	6.4	5.6	4.6	3.9
BAOSHAN IRON & STEEL CO-A	China	9.6	9.0	8.3	4.4	4.0	3.6
COMMERCIAL METALS CO	USA	10.9	9.3	10.5	7.0	5.6	5.6
HESTEEL CO LTD-A	China	12.2	11.9	12.0	-	-	-
HITACHI METALS LTD	Japan	17.6	-	20.6	7.9	10.6	7.4
HYUNDAI STEEL CO	South Korea	23.0	12.2	9.8	6.7	6.1	5.6
JFE HOLDINGS INC	Japan	5.1	18.1	10.0	6.1	8.9	6.9
JSW STEEL LTD	India	8.2	14.9	11.8	5.7	8.5	7.2
KLOECKNER & CO SE	Germany	-	276.4	35.8	7.6	6.0	5.0
METALURGICA GERDAU SA-PREF	Brazil	11.1	9.0	8.5	-	-	-
NIPPON YAKIN KOGYO CO LTD	Japan	4.6	5.9	4.8	-	-	-
NUCOR CORP	USA	12.8	14.5	13.8	7.4	8.0	7.6
OLYMPIC STEEL INC	USA	79.4	17.4	18.7	10.8	-	-
OUTOKUMPU OYJ	Finland	-	22.7	9.3	9.3	6.6	5.2
POSCO	South Korea	8.4	7.7	7.1	4.3	4.1	3.7
SALZGITTER AG	Germany	-	9.8	6.7	3.9	2.9	3.3
SSAB AB-A SHARES	Sweden	13.6	13.4	10.6	5.3	5.0	4.3
STEEL AUTHORITY OF INDIA	India	6.4	13.5	5.8	6.6	7.8	6.2
STEEL DYNAMICS INC	USA	11.2	13.0	13.0	6.5	7.5	7.6
TATA STEEL LTD	India	5.4	9.9	7.5	5.4	6.9	5.8
THYSSENKRUPP AG	Germany	-	-	12.6	6.3	6.8	5.3
UNITED STATES STEEL CORP	USA	125.5	-	53.6	6.6	8.3	6.9
VOESTALPINE AG	Austria	10.2	19.2	12.2	5.3	6.8	5.8
Maximum		125.5	276.4	53.6	10.8	10.6	7.6
Minimum		4.6	5.9	4.8	3.9	2.9	3.3
Median		11.1	12.6	10.5	6.5	6.8	5.8
Cognor		7.1	37.3	24.0	4.7	6.5	6.3
premium / discount		-35.7%	195.6%	129.1%	-28.4%	-5.0%	8.1%

Implied Valuation

Median	9.9	11.3	9.4	6.3	6.4	5.6
Discount	20%	20%	20%	20%	20%	20%
Multiple weight		50%			50%	
Year weight	0%	50%	50%	0%	50%	50%

Value per share (PLN) 0.63

Additional Assumptions

Historical sales of Huta Ferrostal steelmaking unit and future projections

Sales volumes (1,000t)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Billet	169.9	104.1	85.3	119.2	81.8	79.2	72.9	113.0	124.3
Plain bars	35.7	32.3	29.3	30.0	30.3	32.4	29.8	33.4	36.8
Flat bars	64.2	60.2	61.4	48.1	44.1	41.5	38.2	42.8	47.1
Squares	13.7	11.0	7.7	6.5	8.3	9.9	9.1	10.2	11.2
Rebar	41.6	82.5	188.1	202.1	213.7	192.1	176.7	197.9	217.7
Angles	30.1	32.2	24.9	17.5	22.3	24.1	22.1	24.8	27.3
Other	1.2	6.3	6.6	3.1	1.1	1.5	1.4	1.6	1.7
Avg. spread (PLN/t)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Billet	869	803	718	878	1,046	1,059	979	1,024	1,042
Plain bars	1,081	1,088	1,121	1,069	1,365	1,358	1,264	1,313	1,337
Flat bars	1,084	1,110	1,158	1,075	1,386	1,367	1,273	1,323	1,346
Squares	1,068	1,083	1,131	1,048	1,342	1,297	1,206	1,255	1,277
Rebar	880	772	823	937	1,151	1,117	1,035	1,081	1,100
Angles	1,122	1,092	1,170	1,050	1,397	1,368	1,273	1,323	1,347
Other	1,732	1,323	1,421	1,117	1,892	1,459	1,361	1,412	1,437

Source: Dom Maklerski mBanku

Historical sales of HSJ steelmaking unit and future projections

Sales volumes (1,000t)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Billet	18.1	28.1	40.5	66.2	58.7	68.9	82.7	96.8	98.7
Bars	144.6	150.3	153.7	156.5	175.6	157.6	167.0	175.4	178.9
Thick sheet	5.8	16.4	5.7	7.7	1.6	3.7	3.9	4.1	4.2
Thin sheet	0.9	1.1	0.6	0.5	0.7	0.5	0.5	0.6	0.6
Other	0.5	0.7	0.6	0.3	0.5	0.4	0.4	0.4	0.4
Avg. spread (PLN/t)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Billet	1,873	1,341	979	1,176	1,486	1,241	1,188	1,238	1,260
Bars	1,746	1,687	1,553	1,709	2,192	2,407	2,299	2,368	2,410
Thick sheet	1,912	1,530	1,885	1,742	3,446	3,719	3,549	3,639	3,704
Thin sheet	10,049	9,922	10,284	9,897	10,307	10,304	9,823	10,018	10,197
Other	23,149	22,629	20,891	24,078	22,173	22,427	21,375	21,763	22,154

Source: Dom Maklerski mBanku

Steel Market Assumptions

	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Prices of rolled sheet steel (PLN/t)	2,142	1,960	1,919	2,417	2,588	2,463	2,366	2,404	2,447
Price of HEB sections (PLN/t)	2,336	2,204	2,240	2,282	2,614	2,593	2,441	2,477	2,521
Price of rebar (PLN/t)	2,328	2,200	2,170	2,139	2,439	2,275	2,178	2,221	2,262
Steel production in Poland (mmt)	8.6	9.1	8.9	10.3	10.3	9.2	9.0	9.4	9.6
Cognor's market share	6.1%	5.8%	6.8%	6.4%	6.2%	6.7%	6.7%	7.4%	7.8%
USD/PLN	3.15	3.74	3.94	3.78	3.61	3.84	3.72	3.60	3.60
Coke price (US\$/t)	126	102	119	179	193	170	145	155	155
Iron ore price (US\$/t)	98	57	59	72	70	97	80	75	75
Scrap price (US\$/t)	333	216	215	282	343	292	270	275	280
BOF (US\$/t)	302	198	212	282	299	319	272	271	272
EAF (US\$/t)	371	241	239	315	383	326	301	307	312
BOF-EAF (US\$/t)	-69	-44	-28	-33	-83	-7	-29	-36	-40
BOF (PLN/t)	951	740	835	1,066	1,081	1,225	1,009	975	978
EAF (PLN/t)	1,168	903	944	1,190	1,381	1,251	1,118	1,104	1,124
Scrap price (PLN/t)	1,048	810	847	1,067	1,238	1,084	1,003	990	1,008

Source: Dom Maklerski mBanku

Historical and projected debt of Cognor

(PLN m)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Factored accounts receivable (excluded from fin. statements)	0.0	55.6	110.7	110.7	110.7	110.7	110.7	110.7	110.7
Factored accounts receivable	33.4	20.7	21.7	21.7	21.7	21.7	21.7	21.7	21.7
Bonds	423.1	382.2	384.2	338.6	215.0	212.5	212.5	212.5	212.5
Reverse factoring	56.3	9.8	10.5	20.0	20.0	20.0	20.0	20.0	20.0
Pre-financing of scrap	0.0	14.3	12.3	15.0	15.0	15.0	15.0	15.0	15.0
Other debt	80.2	69.0	87.8	80.0	160.0	85.0	35.0	0.0	0.0
Debt resulting from conversion	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest expenses	51.3	49.0	45.9	47.2	37.3	19.8	16.3	13.8	13.8
%	9.2%	10.3%	9.3%	10.4%	9.1%	6.0%	5.8%	5.6%	5.6%
Banking and transaction charges	4.4	6.0	5.7	4.8	7.1	0.0	0.0	0.0	0.0
EUR/PLN (eop)	4.26	4.26	4.42	4.18	4.30	4.25	4.25	4.25	4.25

Source: Dom Maklerski mBanku

DCF Valuation

Assumptions:

- Beta = 1.2; the higher value is related to the high cyclicality of activity conducted by Cognor. In addition, a higher discount is warranted by the substantial equity overhang if bondholders convert warrants to shares.

- Future cash flows are discounted to as of early December 2019.
- Net debt is as at year-end 2018 plus 2019 dividends (PLN 0.28 per share).

DCF Model

(PLN m)	2019P	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P	2028P	+
Revenue	1,859.9	1,801.9	2,009.4	2,150.6	2,228.4	2,298.5	2,342.9	2,388.1	2,410.6	2,433.2	2,444.4
change	-10.7%	-3.1%	11.5%	7.0%	3.6%	3.1%	1.9%	1.9%	0.9%	0.9%	0.5%
EBITDA	102.9	73.5	73.9	71.2	77.0	75.7	74.7	73.3	78.8	84.9	83.0
EBITDA margin	5.5%	4.1%	3.7%	3.3%	3.5%	3.3%	3.2%	3.1%	3.3%	3.5%	3.4%
D&A expenses	46.8	50.3	49.3	47.4	46.2	45.6	45.6	46.2	47.4	48.0	48.0
EBIT	56.1	23.2	24.6	23.8	30.7	30.1	29.1	27.1	31.3	37.0	35.0
EBIT margin	3.0%	1.3%	1.2%	1.1%	1.4%	1.3%	1.2%	1.1%	1.3%	1.5%	1.4%
Tax on EBIT	6.4	1.3	2.0	1.9	3.5	3.6	3.5	3.1	3.9	5.0	4.6
NOPLAT	49.8	21.9	22.5	21.9	27.3	26.5	25.6	24.0	27.4	32.0	30.4
CAPEX	-50.0	-50.0	-34.6	-36.4	-37.3	-38.6	-40.3	-42.5	-46.2	-46.6	-47.1
Working capital	25.9	13.3	-7.0	-6.4	-6.0	-5.4	-3.4	-3.5	-1.7	-1.7	-0.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0	2.0
FCF	72.5	35.5	30.2	26.5	30.3	28.2	27.5	24.2	26.9	32.6	32.4
WACC	7.2%	7.2%	7.2%	7.3%	7.3%	7.4%	7.4%	7.4%	7.5%	7.5%	7.5%
discount factor	0.99	0.93	0.86	0.81	0.75	0.70	0.65	0.60	0.56	0.52	0.48
PV FCF	72.1	33.0	26.1	21.4	22.7	19.6	17.8	14.6	15.0	16.9	15.6
WACC	7.2%	7.2%	7.2%	7.3%	7.3%	7.4%	7.4%	7.4%	7.5%	7.5%	7.5%
Cost of debt	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%
Risk-free rate	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Risk premium	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Effective tax rate	17.5%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Net debt / EV	50.9%	50.3%	49.0%	48.3%	46.8%	46.0%	45.3%	45.0%	44.0%	42.8%	42.4%
Cost of equity	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.2

FCF growth after the forecast period	2.0%
Terminal value	586.0
Present value of terminal value	303.4
Present value of FCF in the forecast period	259.2
Enterprise value	562.6
Net debt	245.4
Minority interests	17.7
Equity value	299.5
Shares outstanding (millions)	175.0
Equity value per share (PLN)	1.71
9M cost of equity	7.0%
Target Price (PLN)	1.85

EV/EBITDA ('19) at target price	5.4
EV/EBITDA ('19) at target price	9.9
TV / EV	53.9%

Sensitivity Analysis

	FCF growth in perpetuity				
	0.0%	1.0%	2.0%	3.0%	5.0%
WACC +1.0 p.p.	1.05	1.20	1.39	1.66	2.64
WACC +0.5 p.p.	1.19	1.37	1.60	1.93	3.25
WACC	1.35	1.56	1.85	2.27	4.11
WACC -0.5 p.p.	1.54	1.80	2.15	2.69	5.40
WACC -1.0 p.p.	1.75	2.07	2.52	3.24	7.54

2019 Q3 Results

Cognor's 2019 third-quarter **revenue missed our forecast** by 22% at PLN 400m, a decrease of 27% year over year. This on a disappointingly **small sales volume**, which at 132,000 tonnes fell 19% short of our estimate and showed a drop of 23% from Q3 2018. Cognor blames the weak sales on **longer maintenance downtime** on its production facilities, in particular the rolling mill of the HSJ steel smelter. This resulted in the maintenance costs going over budget at PLN 24m versus PLN 15m originally budgeted. Most of the maintenance work was performed in August and September.

2019 Q3 actuals vs. expectations

(PLN m)	3Q'19	3Q'18	change	3Q'19E	differ.
Revenue	399.5	550.7	-27.4%	510.3	-21.7%
EBITDA	16.9	56.2	-69.9%	24.4	-30.7%
margin	4.2%	10.2%	-	4.8%	
EBIT	5.4	45.3	-88.1%	12.9	-58.3%
Net profit	-0.7	32.3	-102.1%	6.9	-109.9%

Source: Cognor, E - estimates by Dom Maklerski mBanku

EBITDA for Q3 2019 was **reported** at PLN 16.9m, a miss of 30% relative to our estimate and a figure 70% lower than in the comparable year-ago period. Recurring EBITDA approximated PLN 12.9m vs. PLN 52.6m in Q3'18, however if we adjust further for the new accounting approach to maintenance expenses adopted this year (this includes cost recognition in the periods in which they are incurred, rather than provisioning throughout the year), and for FIFO accounting impacts (up to PLN -7.8m in Q3'19 from PLN -3.4m the year before), combined with power price compensation (PLN -7.9m), the **comparable EBITDA** figured to PLN 36m vs. the year-ago result of PLN 60.9m. The reported figure at PLN 16.9m also missed Cognor's own PLN 25-30m guidance range by a wide margin.

Cognor reported a **net loss** of PLN 0.7m in Q3'19 vs. a net profit of PLN 32m generated in the same period last year.

Operating cash flow approximated PLN 30m in Q3'19 vs. PLN 52m in Q3'18. **Net debt** as of 30 September did not change much relative to June at PLN 286m (2.6x 12M EBITDA).

Market Outlook

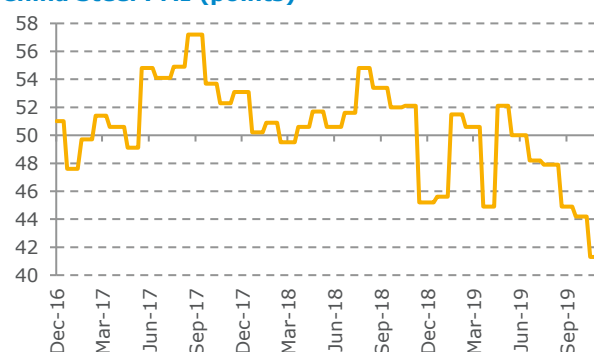
Steel production in EU28 countries in the first nine months of 2019 amounted to **124 million tonnes** after **falling 3%** year over year.

In **Poland**, production **fell at a faster-than-average rate** of 7% at 7mmt, with the pace of contraction accelerating from quarter to quarter to reach 14% in Q3. This was driven by the closure of one of Poland's metallurgical plants, combined with **production curbs** at plants run by Arcelor Mittal in the wake of reduced demand, increased imports, and rising costs of energy and emission allowances. We expect further production declines through the first half of 2020 after ArcelorMittal temporarily idled its 1.5mmt furnace in Krakow, accounting for 18% of Poland's total steel capacity. From the point of view of Cognor, the upside of the Krakow furnace being out of commission is **reduced competition in the domestic market**.

At the same time, **negative trends in the global steel market seem to be shifting**, with a number of producers observing a slower rate of contraction in demand, which seems to have bottomed out in Q3 2019.

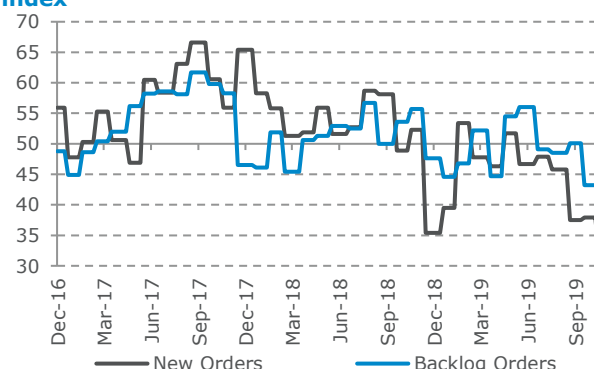
This view is reinforced by recent industry surveys, with the **steel PMI in China** reported to have bounced by 4 points in November to 45 points, accompanied by a rebound in the new orders sub-index by 12 points to 44, and the current output sub-index inching 1pt higher to 43 relative to October. According to one analysis, the recovery was owed to high orders from the housing industry, coupled with lower imports due to weather-driven disruptions and, notably, an increase in **new infrastructure investment**.

China Steel PMI (points)



Source: Bloomberg, Dom Maklerski mBanku

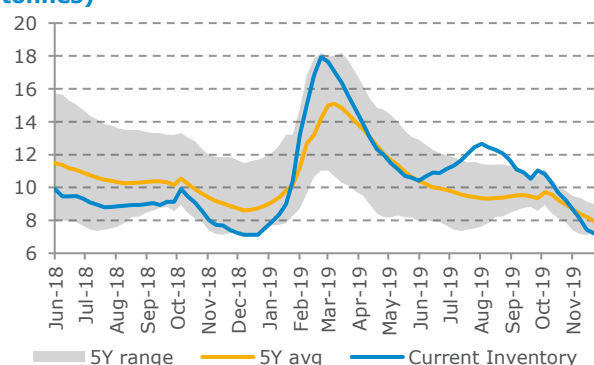
China Steel PMI production index and new orders index



Source: Bloomberg, Dom Maklerski mBanku

As orders increase, China's steel inventory is decreasing at a fast rate, currently standing at about 7mmt (the lowest November level in five years) compared to 12.7mmt reported in the summer.

China steel inventories vs. 5-year average (million tonnes)

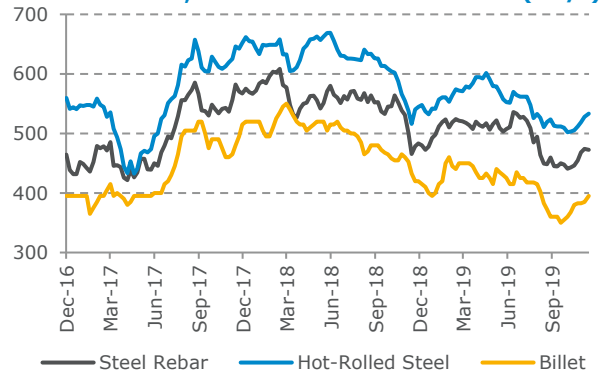


Source: Bloomberg, Dom Maklerski mBanku



As inventories run lower, steel prices in China are seen to be shifting upwards:

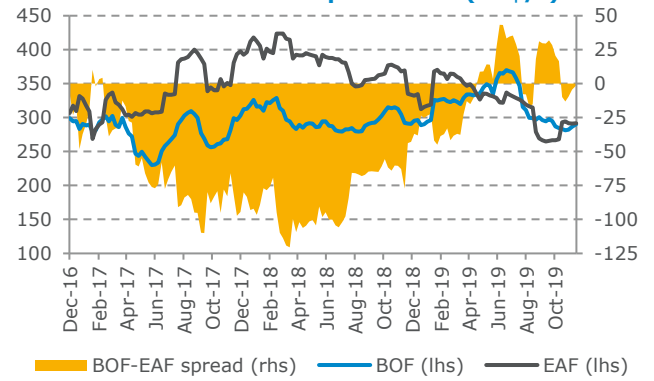
Prices of rebar, billet- and hot-rolled steel (US\$/t)



Source: Bloomberg, Dom Maklerski mBanku

Earlier this year, EAF steelmakers enjoyed a price advantage over BOF producers during the summer months owing to a sharp downturn in the costs of steel scrap inputs, facilitating more attractive pricing for semi-processed product like billet, which boosted sales.

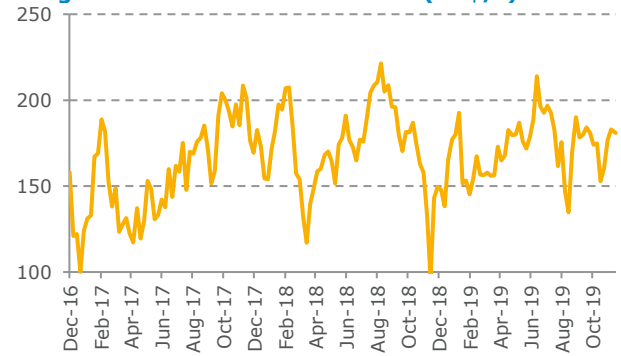
BOF vs. EAF costs of steel production (US\$/t)



Source: Bloomberg, Dom Maklerski mBanku

Cognor's sales mix this year has generated solid margins on steel rebar, while margins on SQ bars, in particular bars for the auto industry, have tightened.

Margins on EAF-based steel rebar (US\$/t)



Source: Bloomberg, Dom Maklerski mBanku

Earnings History and Future Projections

(PLN m)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Revenue	1,422.5	1,364.8	1,352.4	1,789.3	2,081.8	1,859.9	1,801.9	2,009.4	2,150.6
change	9.9%	-4.1%	-0.9%	32.3%	16.4%	-10.7%	-3.1%	11.5%	7.0%
Ferrostal	695.5	586.2	678.4	838.8	916.6	816.3	715.6	876.4	981.4
HSJ	442.7	455.2	400.2	471.8	623.7	582.5	588.0	627.8	651.9
Złomrex Metal	100.1	119.0	95.0	130.9	172.8	151.8	154.9	158.0	161.1
Other	190.2	223.3	202.3	323.4	393.0	363.0	346.0	351.9	358.2
D&A expenses	34.8	35.3	37.9	41.3	43.9	46.0	49.4	48.5	46.6
Materials & utilities	895.9	799.4	747.2	1,129.9	1,364.5	1,215.7	1,177.4	1,338.9	1,444.3
of which scrap metal	590.1	510.5	527.3	761.9	807.6	689.4	662.7	756.5	821.9
of which electricity	114.8	124.3	126.0	130.2	144.5	133.7	164.6	194.2	207.7
Third-party services	200.4	203.4	228.4	152.5	170.6	155.9	158.9	180.5	193.7
Taxes and fees	11.8	15.0	9.2	10.8	11.9	11.7	11.7	11.2	10.9
Payroll	109.0	128.1	136.2	161.3	183.6	194.7	198.2	219.0	241.3
Other costs	4.9	4.8	4.3	4.7	6.2	5.1	5.3	5.5	5.3
Cost of goods sold	158.9	158.1	148.8	201.8	227.2	217.8	207.6	211.1	214.9
Change in inventories	58.4	-7.2	14.4	13.0	79.5	43.1	30.0	30.0	30.0
COGM	1,275.9	1,269.0	1,209.7	1,573.0	1,805.5	1,803.7	1,778.6	1,984.8	2,126.8
Selling expenses	43.0	47.8	50.0	65.8	76.7	83.4	85.0	96.6	103.6
Administrative expenses	38.5	34.6	37.9	50.5	46.0	47.4	48.4	49.4	50.3
Other operating gains/losses	0.9	-0.2	1.7	-0.7	2.6	0.0	0.0	0.0	0.0
One-time events	1.0	2.4	3.4	-5.2	0.0	0.0	0.0	0.0	0.0
EBIT	65.4	13.1	56.5	99.2	156.2	56.1	23.2	24.6	23.8
change	132.6%	-79.9%	329.9%	75.5%	57.5%	-64.1%	-58.6%	5.8%	-3.4%
EBIT margin	4.6%	1.0%	4.2%	5.5%	7.5%	3.0%	1.3%	1.2%	1.1%
EBIT (adj.)	64.4	10.8	53.1	104.4	156.2	56.1	23.2	24.6	23.8
EBITDA (adj.)	99.5	46.6	91.2	145.7	200.0	102.9	73.5	73.9	71.2
Net financing gains/losses	-67.3	-30.3	-63.0	-31.2	-62.8	-16.7	-16.3	-13.8	-13.8
Interest expenses	55.7	55.0	45.9	52.0	38.3	19.8	16.3	13.8	13.8
Income from bond repurchase									
FX gains / losses	-10.6	26.7	-10.5	20.8	-25.1	3.1	0.0	0.0	0.0
Pre-tax profit	3.3	-17.3	-6.4	68.1	92.8	39.4	7.0	10.8	10.0
Tax	-6.4	3.3	7.9	18.1	20.7	6.9	1.3	2.0	1.9
Minority interests	0.0	0.9	0.1	2.3	3.5	0.0	0.0	0.0	0.0
Net profit	5.7	-14.8	1.5	47.6	68.5	32.5	5.6	8.7	8.1
change	-111.7%	-361.8%	-110.3%	3019.5%	44.0%	-52.6%	-82.7%	55.1%	-7.7%
margin	0.4%	-1.1%	0.1%	2.7%	3.3%	1.7%	0.3%	0.4%	0.4%
Net profit (adj.)	15.3	-43.9	8.6	31.9	93.7	29.4	5.6	8.7	8.1
D&A expenses	35.1	35.9	38.1	41.3	43.9	46.8	50.3	49.3	47.4
EBITDA	100.5	49.0	94.6	140.5	200.1	102.9	73.5	73.9	71.2
change	54.1%	-51.2%	93.0%	48.6%	42.4%	-48.6%	-28.6%	0.5%	-3.7%
EBITDA margin	7.1%	3.6%	7.0%	7.9%	9.6%	5.5%	4.1%	3.7%	3.3%
Shares outstanding at eop (millions)									
EPS	66.2	69.9	75.3	175.0	175.0	175.0	175.0	175.0	175.0
CEPS	0.1	-0.2	0.0	0.3	0.4	0.2	0.0	0.0	0.0
	0.6	0.3	0.5	0.5	0.6	0.5	0.3	0.3	0.3
ROAE									
ROAA	3.4%	-10.1%	1.1%	21.1%	24.6%	11.8%	2.1%	3.2%	2.9%

Balance Sheet

(PLN m)	2014	2015	2016	2017	2018	2019P	2020 P	2021 P	2022 P
ASSETS	940.5	846.3	895.3	950.7	1,001.4	1,003.3	935.2	942.9	971.0
Fixed assets	422.7	408.5	424.9	398.5	379.3	401.4	393.1	370.4	355.9
Intangible assets	11.3	10.8	11.9	13.0	18.0	22.7	27.4	30.6	34.0
Property, plant and equipment	289.6	278.0	292.8	285.9	284.6	310.9	306.8	289.8	276.3
Goodwill	15.3	15.2	15.2	15.2	8.9	8.9	8.9	8.9	8.9
Noncurrent receivables	22.8	20.9	20.1	26.0	23.3	23.3	23.3	23.3	23.3
Noncurrent investments	17.0	16.7	8.1	3.4	2.8	2.8	2.8	2.8	2.8
Noncurrent prepayments	81.9	82.0	92.1	70.2	50.6	41.7	32.8	23.9	19.5
Current assets	517.9	437.8	470.4	552.2	622.1	601.9	542.1	572.5	615.2
Inventory	283.1	263.5	297.7	277.5	377.0	336.8	326.3	363.8	389.4
Current receivables	187.4	127.4	137.0	171.9	168.0	150.1	145.4	162.1	173.5
Current investments	11.7	9.7	8.7	0.0	0.0	0.0	0.0	0.0	0.0
Cash	35.6	36.9	25.0	102.0	76.5	114.5	69.8	45.9	51.5
Current prepayments	0.0	0.3	1.9	0.8	0.7	0.6	0.6	0.6	0.7
(PLN m)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
EQUITY & LIABILITIES	940.5	846.3	895.3	950.7	1,001.4	1,003.3	935.2	942.9	971.0
Equity	166.0	147.1	142.1	225.3	278.2	274.7	267.3	271.5	273.5
Share capital	132.4	139.7	150.5	177.9	180.6	180.6	180.6	180.6	180.6
Supplementary capital	202.2	194.9	184.6	221.0	86.7	86.7	86.7	86.7	86.7
Retained earnings	-168.1	-187.5	-193.1	-173.6	10.8	7.3	-0.1	4.1	6.1
Minority interest	21.3	21.6	13.8	16.5	17.7	17.7	17.7	17.7	17.7
Non-current liabilities	452.8	433.0	410.7	388.8	258.4	241.7	241.7	241.7	241.7
Debt	408.9	386.4	376.4	358.0	229.2	212.5	212.5	212.5	212.5
Current liabilities	282.7	234.4	319.3	316.6	435.9	458.7	398.2	401.0	426.7
Trade payables	188.3	169.6	223.7	247.4	379.2	338.7	328.2	366.0	391.7
Debt	94.4	64.7	95.6	69.1	56.7	120.0	70.0	35.0	35.0
Provisions for liabilities	6.5	3.7	3.1	3.4	4.4	4.4	4.4	4.4	4.4
Other	11.2	6.5	6.3	0.1	6.8	6.1	5.9	6.6	7.0
Debt	503.3	451.2	472.0	427.1	285.9	332.5	282.5	247.5	247.5
Net Debt	455.9	414.2	447.0	325.1	209.4	218.0	212.7	201.6	196.0
Net debt / Equity	274.6%	281.6%	314.5%	144.3%	75.3%	79.4%	79.6%	74.3%	71.7%
Net Debt/ EBITDA	4.5	8.5	4.7	2.3	1.0	2.1	2.9	2.7	2.8
Net debt /EBITDA (adj.)	4.6	8.9	4.9	2.2	1.0	2.1	2.9	2.7	2.8
Factoring	56.3	9.8	10.5	20.0	20.0	20.0	20.0	20.0	20.0
Factored accounts receivable (excluded from fin. statements)	0.0	55.6	110.7	110.7	110.7	110.7	110.7	110.7	110.7
Pre-financing of scrap	0.0	14.3	12.3	15.0	15.0	15.0	15.0	15.0	15.0
Net debt / EBITDA (adj.)	5.2	10.6	6.4	3.2	1.8	3.5	4.9	4.7	4.8
BVPS	2.5	2.1	1.9	1.3	1.6	1.6	1.5	1.6	1.6

Cash Flow*

(PLN m)	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
Cash flow from operating activities	51.8	101.3	91.6	145.4	232.2	97.2	84.6	63.9	62.0
Net profit	5.7	-14.8	1.5	47.6	68.5	32.5	5.6	8.7	8.1
D&A expenses	35.1	35.9	38.1	41.3	43.9	46.8	50.3	49.3	47.4
Working capital	-0.3	63.1	6.3	10.8	43.6	25.9	13.3	-7.0	-6.4
Other	11.3	17.1	45.7	45.7	76.2	-8.0	15.4	12.9	12.9
Cash flow from investing activities	0.6	-3.1	-27.1	-15.4	-37.6	-50.0	-50.0	-34.6	-36.4
CAPEX	-7.8	-5.6	-29.0	-15.9	-37.8	-50.0	-50.0	-34.6	-36.4
Equity investments	8.5	2.5	1.9	0.5	0.2	0.0	0.0	0.0	0.0
Cash flow from financing activities	-38.5	-105.8	-83.8	-52.6	-195.6	-9.2	-79.3	-53.3	-19.9
Debt	6.2	-64.6	-28.2	-36.0	-113.2	46.6	-50.0	-35.0	0.0
Dividends/Buyback	0.0	0.0	0.0	0.0	-11.9	-36.0	-13.0	-4.5	-6.1
Share issue	0.0	0.0	0.0	39.8	-1.1	0.0	0.0	0.0	0.0
Interest on convertible bonds	-2.6	-5.3	-5.3	0.0	0.0	0.0	0.0	0.0	0.0
Interest expenses	-41.7	-35.5	-39.7	-52.0	-68.2	-19.8	-16.3	-13.8	-13.8
Other	-0.5	-0.4	-10.6	-4.4	-1.3	0.0	0.0	-0.0	0.0
Change in cash	13.9	-7.6	-19.3	77.4	-1.0	38.0	-44.6	-24.0	5.7
Cash at eop	28.7	21.1	1.8	79.3	76.5	114.5	69.8	45.9	51.5
DPS (PLN)	0.00	0.00	0.00	0.00	0.07	0.21	0.07	0.03	0.03
FCF	92.3	106.5	71.9	122.9	179.5	72.5	35.5	30.2	26.5
CAPEX/Sales	-0.6%	-0.4%	-2.1%	-0.9%	-1.8%	-2.7%	-2.8%	-1.7%	-1.7%

*Assuming full dilution

Trading Multiples*

	2014	2015	2016	2017	2018	2019P	2020P	2021P	2022P
P/E	13.6	-5.5	57.2	4.3	3.0	6.2	36.0	23.2	25.2
P/E (adj.)	5.0	-1.8	10.1	6.4	2.2	6.9	36.0	23.2	25.2
P/CE	1.9	3.9	2.2	2.3	1.8	2.6	3.6	3.5	3.7
P/B	0.5	0.6	0.6	0.9	0.7	0.7	0.8	0.7	0.7
P/S	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
FCF/EV	17.3%	21.5%	13.5%	23.3%	43.5%	17.2%	8.5%	7.5%	6.6%
EV/EBITDA	5.5	10.5	5.8	3.9	2.1	4.3	5.9	5.7	5.9
(adj.) EV/EBITDA		11.6	6.3	4.0	2.3	4.6	6.4	6.2	6.3
EV/EBIT	8.5	39.3	9.7	5.5	2.8	7.8	18.6	17.2	17.5
EV/S	0.4	0.4	0.4	0.3	0.2	0.2	0.2	0.2	0.2
OCF/EBITDA	52%	207%	97%	103%	116%	94%	115%	87%	87%
CFO/EBITDA (adj.)	52%	217%	100%	100%	116%	94%	115%	87%	87%
Dividend yield	0.0%	0.0%	0.0%	0.0%	8.6%	17.7%	6.4%	2.2%	3.0%
Price (PLN)	1.16	1.16	1.16	1.16	1.16	1.16	1.16	1.16	1.16
Shares at eop (millions)	66.2	69.9	75.3	175.0	175.0	175.0	175.0	175.0	175.0
MC (PLN m)	76.8	81.0	87.3	203.0	203.0	203.0	203.0	203.0	203.0
Minority interest (PLN m)	21.3	21.6	13.8	16.5	17.7	17.7	17.7	17.7	17.7
EV (PLN m)	554.0	516.8	548.1	544.5	430.1	438.7	433.4	422.3	416.6

*Assuming full dilution

List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

Recommendations of Dom Maklerski mBanku:

A recommendation is valid for a period of 9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:

BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
 Recommendations are updated at least once every nine months.

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Economic profits – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

Discounted Dividends (DDM) – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.

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mBank issued the following investment recommendations for Cognor in the 12 months prior to this publication

Rating	hold	hold	accumulate	hold	accumulate	accumulate	overweight	neutral	underweight	neutral
Rating date	2019-12-05	2019-11-04	2019-09-05	2019-07-25	2019-07-03	2019-06-14	2019-06-03	2019-05-09	2019-03-05	2018-12-05
Target price (PLN)	1.25	1.55	2.00	1.84	1.84	1.79	-	-	-	-
Price on rating day	1.17	1.52	1.65	1.75	1.77	1.64	1.60	1.59	1.94	1.80

Dom Maklerski mBanku

Senatorska 18
00-082 Warszawa
<http://www.mbank.pl/>

Research Department

Kamil Kliszcz
director
+48 22 438 24 02
kamil.klischcz@mbank.pl
energy, power generation

Jakub Szkopek
+48 22 438 24 03
jakub.szkopek@mbank.pl
industrials, chemicals, metals

Aleksandra Szklarczyk
+48 22 438 24 04
aleksandra.szklarczyk@mbank.pl
construction, real-estate development

Michał Marczak
+48 22 438 24 01
michal.marczak@mbank.pl
strategy

Paweł Szpigiel
+48 22 438 24 06
pawel.szpigiel@mbank.pl
media, IT, telco

Piotr Poniatowski
+48 22 438 24 09
piotr.poniatowski@mbank.pl
industrials

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl
banks, financials

Piotr Bogusz
+48 22 438 24 08
piotr.bogusz@mbank.pl
retail, gaming

Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl
banks, financials

Sales and Trading**Traders**

Piotr Gawron
director
+48 22 697 48 95
piotr.gawron@mbank.pl

Adam Prokop
+48 22 697 47 90
adam.prokop@mbank.pl

Krzysztof Bodek
+48 22 697 48 89
krzysztof.bodek@mbank.pl

Magdalena Bernacik
+48 22 697 47 35
magdalena.bernacik@mbank.pl

Tomasz Jakubiec
+48 22 697 47 31
tomasz.jakubiec@mbank.pl

Andrzej Sychowski
+48 22 697 48 46
andrzej.sychowski@mbank.pl

Sales, Foreign Markets

Bartosz Orzechowski
+48 22 697 48 47
bartosz.orzechowski@mbank.pl

Jędrzej Łukomski
+48 22 697 49 85
jedrzej.lukomski@mbank.pl

Private Client Sales

Kamil Szymański
director
+48 22 697 47 06
kamil.szymanski@mbank.pl

Jarosław Banasiak
deputy director
+48 22 697 48 70
jaroslaw.banasiak@mbank.pl