Thursday, July 25, 2019 | update

Cognor: hold (downgraded)

COG PW; COGP.WA | Steel, Poland

Hold For the Time Being

Cognor's adjourned Annual General Meeting is scheduled to reconvene on 26 July 2019 to discuss the size and timing of this year's dividend payout. The Company's shareholders in June had agreed to postpone the vote on the Management Board's original DPS proposal of PLN 0.30 (implying Dyield of 17%) until an official statement from Poland's Energy Ministry specifying the eligibility and size of planned compensations to commercial electricity users to make up for the upcoming hikes in utility energy prices. Shares in Cognor experienced a sharp rise during the past two months, but sentiment could turn in a matter of days if shareholders resolve to cut dividends in the face of insufficient compensation. On top of that, Cognor is expected to report marked earnings deterioration in Q2 2019. For these reasons, we would hold off investment in Cognor until the 14 August earnings release. When it comes to prospects in the longer term, Cognor looks poised to bounce back from a sub-par second quarter in the second half of 2019 looking at the increasing advantage of the more cost-efficient EAF steel producers over BOF steelmaking, coupled with expectations that the global steel industry will regain momentum in the second half of the year. With the 9-month price target intact at PLN 1.84 per share, we downgrade COG from accumulate to hold.

2019 Q2 earnings hit bottom

Cognor is set to report the year's weakest quarterly results for Q2 2019, showing declines vis-à-vis the year-ago levels as well as compared to the previous quarter, led by lower sales volumes (-3% y/y) and prices, combined with higher costs of energy and labor. To be fair, the Company had warned of the profit drop in May. Looking at the increasing cost advantage of EAF steel producers over BOF producers, with the global steel industry expected to regain momentum in the second half of the year, Cognor's prospects after the sub-par second quarter are looking much brighter. The 2019 Q2 earnings release is slated for August 14th.

EAF vs. BOF steelmaking

Due to increasing prices of iron ore inputs, basic oxygen (BOF) steelmaking has lost its cost advantage over electric arc furnace (EAF) technology which has been able to put out a tonne of steel billet about $50 cheaper than the alternative for several weeks now – the biggest gap since early 2017, and a shift which greatly improves the prospects of EAF steelmakers like Cognor.

(PLN m)	2017	2018	2019E	2020E	2021E
Revenue	1,789.3	2,081.8	2,004.2	1,900.4	2,086.3
EBITDA adj.	145.7	200.0	108.5	99.9	106.4
EBITDA margin adj.	8.1%	9.6%	5.4%	5.3%	5.1%
EBIT adj.	104.4	156.2	61.7	49.6	57.0
Net profit adj.	31.9	93.7	33.9	27.0	35.0
P/E adj.	9.6	3.3	9.0	11.4	8.7
P/CE	3.4	2.7	3.7	4.0	3.6
P/BV	1.4	1.1	1.1	1.1	1.0
EV/EBITDA adj.	4.7	2.8	5.4	5.6	5.1
DPS	0.00	0.07	0.21	0.13	0.11
DYield	0.0%	5.7%	11.8%	7.2%	6.2%

*Ratios in full dilution scenario

Current Price	PLN 1.75
Target Price	PLN 1.84
Market Cap	PLN 306m
Free Float	PLN 71m
ADTV (3M)	PLN 0.29m

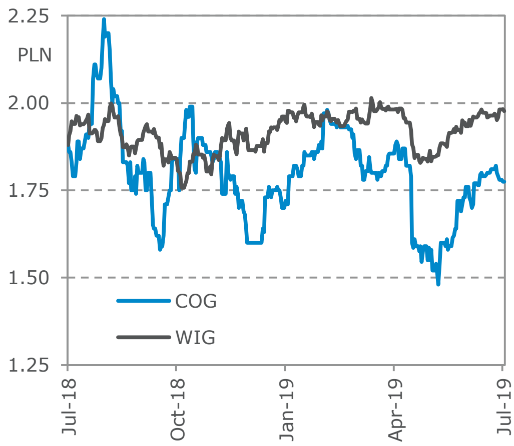
Ownership

PS HoldCo Sp.z o.o	76.76%
Others	23.24%

Business profile

The Cognor Group has about 6% share in domestic steel production and about 15% share in the production of steel by means of electric arc (EAF). 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. The total production capacity of the company is 636 thousand tonnes, which in 2020 will rise to the level of 850 thousand tonnes. The Cognor Group has its own scrap buying centres, which can supply about 50% of the steel scrap needed.

COG vs. WIG



Company	Target Price new	Target Price old	Rating new	Rating old
Cognor	1.84	1.84	hold	accumulate

Company	Current Price	Target Price	Upside
Cognor	1.75	1.84	+5.1%

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%

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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
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HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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NAV - valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

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

Rating	accumulate	accumulate	overweight	neutral	underweight	neutral
Rating date	2019-07-03	2019-06-14	2019-06-03	2019-05-09	2019-03-05	2018-12-05
Target price (PLN)	1.84	1.79	-	-	-	-
Price on rating day	1.77	1.64	1.60	1.59	1.94	1.80

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