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Equity Market in 2020: An Investment Strategy, an excerpt

## Cognor hold (reiterated)

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Cognor faces a sustained rise in costs of electricity (+PLN 30.8m) and labor (+PLN 3.5m) in 2020, underpinned by a challenging steel market. Consequently, according to our estimates the Company will see a 29% fall in EBITDA for the year, and as a result its net debt/EBITDA ratio as of next December will increase to 2.9x, restricting the capacity for dividends. We expect next year's payout to drop to PLN 0.11 per share from this year's PLN 0.28. We have cut our FY2019 earnings estimates for Cognor based on downgraded fourth-quarter guidance, and we have revised the forecasts for 2020-2021 to reflect higher costs and more conservative assumptions for market spreads. Accordingly, we reduce our target price for COG from PLN 1.55 to PLN 1.25 per share, and we maintain a hold rating for the stock.

<b>Current Price</b>	1.17 PLN	<b>Upside</b>
<b>9M Target Price</b>	1.25 PLN	<b>+6.8%</b>

	rating	target price	issued
<b>new</b>	<b>hold</b>	<b>1.25 PLN</b>	<b>2019-12-05</b>
<b>old</b>	hold	1.55 PLN	2019-11-04
<b>Key Metrics</b>		<b>COG PW</b>	<b>vs. WIG</b>
Ticker	COG PW	1M Price Chng	-17.6% -12.2%
ISIN	PLCNTSL00014	YTD Price Chng	-11.4% -8.6%
Outst. Stock (m)	175.0	ADTV 1M	PLN 0.1m
MC (PLN m)	204.7	ADTV 6M	PLN 0.1m
EV (PLN m)	440.5	EV/EBITDA 12M fwd	3.6 +2.1%
Free Float	-	EV/EBITDA 5Y avg	3.5 premium

### Earnings Projections

(PLN m)	2017	2018	2019P	2020P	2021P
Revenue	1,789	2,082	1,860	1,802	2,009
EBITDA adj.	146	200	103	74	74
EBITDA margin	8.1%	9.6%	5.5%	4.1%	3.7%
EBIT adj.	104	156	56	23	25
Net income adj.	32	94	29	6	9
P/E adj.	6.4	2.2	7.0	36.3	23.4
P/B	0.9	0.7	0.7	0.8	0.8
EV/EBITDA adj.	3.7	2.2	4.3	5.9	5.7
DPS	0.00	0.07	0.21	0.07	0.03
DYield	0.0%	5.8%	17.6%	6.3%	2.2%
<b>Forecast Update (% change)</b>			<b>2019P</b>	<b>2020P</b>	<b>2021P</b>
Revenue			-3.1%	+0.2%	-0.5%
EBITDA			-6.8%	-25.8%	-22.8%
Net income			-17.1%	-78.6%	-67.0%
Sales volume			+3.0%	+3.9%	+3.6%
Product prices			+0.1%	-1.1%	-1.6%
Scrap prices			-1.4%	+3.5%	0.0%

### Financial Highlights

(PLN m)	2017	2018	2019P	2020P	2021P
Ferrostal volume (k tons)	426	401	381	350	424
HSJ volume (k tons)	231	237	231	255	277
Złomrex volume (k tons)	131	173	152	155	158
Ferrostal spread (PLN/t)	953	1,191	1,175	1,090	1,128
HSJ spread (PLN/t)	1,272	1,723	1,763	1,619	1,607
<b>Operating cash flow</b>	<b>145</b>	<b>232</b>	<b>97</b>	<b>85</b>	<b>64</b>
D&A	41	44	47	50	49
Working capital	11	44	26	13	-7
<b>Investing cash flow</b>	<b>-15</b>	<b>-38</b>	<b>-50</b>	<b>-50</b>	<b>-35</b>
CAPEX	16	38	50	50	35
<b>Financing cash flow</b>	<b>-53</b>	<b>-196</b>	<b>-9</b>	<b>-79</b>	<b>-53</b>
Dividends/Buyback	0	-12	-36	-13	-5
FCF	123	179	72	36	30
FCF/EBITDA	87%	90%	70%	48%	41%
OCF/EBITDA	103%	116%	94%	115%	87%

### Key Balance Sheet Figures

(PLN m)	2017	2018	2019P	2020P	2021P
Assets	951	1,001	1,003	935	943
Fixed assets	398	379	401	393	370
Equity	225	278	275	267	272
Minority interests	225	278	275	267	272
Net debt	325	209	218	213	202
Net debt/EBITDA (x)	2.3	1.0	2.1	2.9	2.7
Net debt/Equity (x)	1.4	0.8	0.8	0.8	0.7

### Relative Valuation Summary

	P/E			EV/EBITDA		
	19P	20P	21P	19P	20P	21P
Minimum	4.6	5.9	4.8	3.9	2.9	3.3
Maximum	125.5	276.4	53.6	10.8	10.6	7.6
Median	11.1	12.6	10.5	6.5	6.8	5.8
Weight	0%	25%	25%	0%	25%	25%

### DCF Analysis

(PLN m)	19P	20P	21P	22P	23P	24P	25P	26P	27P	28P	+
Sales volume	612	605	701	749	778	803	817	832	834	836	836
Product prices	2,285.9	2,154.9	2,145.9	2,180.8	2,192.8	2,204.2	2,213.7	2,223.1	2,238.4	2,253.7	2,261.3
Scrap prices	1,084	1,003	990	1,008	1,008	1,008	1,008	1,008	1,008	1,008	1,008
Revenue	1,860	1,802	2,009	2,151	2,228	2,298	2,343	2,388	2,411	2,433	2,444
EBITDA	103	74	74	71	77	76	75	73	79	85	83
EBITDA margin	5.5%	4.1%	3.7%	3.3%	3.5%	3.3%	3.2%	3.1%	3.3%	3.5%	3.4%
EBIT	56	23	25	24	31	30	29	27	31	37	35
Tax	6	1	2	2	3	4	3	3	4	5	5
CAPEX	-50	-50	-35	-36	-37	-39	-40	-43	-46	-47	-47
Working capital	26	13	-7	-6	-6	-5	-3	-3	-2	-2	-1
FCF	72	36	30	27	30	28	28	24	27	33	32
PV FCF	72	33	26	21	23	20	18	15	15	17	
WACC	7.2%	7.2%	7.2%	7.3%	7.3%	7.4%	7.4%	7.4%	7.5%	7.5%	7.5%
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%

### DCF Summary

(PLN m)	
Beta	1.2
FCF perp. growth rate	2.0%
PV FCF	259
Net debt	245
Other adj.	18
Value per share (PLN)	1.71

### Valuation Summary

(PLN)	Weight	Price
Relative Val.	50%	0.63
DCF Val.	50%	1.71
Implied Price		1.17
Cost of equity (9M)		7.0%
<b>9M Target Price</b>		<b>1.25</b>

**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

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**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**

<b>Cognor</b>										
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

**Comparable Companies Used In Relative Valuation Models**

**Cognor** AK Steel, Alumental, ArcelorMittal, Baoshan Iron & Steel, Commercial Metals, HeSteel, Hitachi Metals, Hyundai Steel, JFE Holdings, JSW Steel, Kloeckner & Co, Metalurgica Gerdau, Nippon Yakin Kogyo, Nucor, Olympic Steel, Outokumpu, POSCO, Salzgitter, SSAB, Steel Authority Of India, Steel Dynamics, Tata Steel, thyssenkrupp, United States Steel Corp, voestalpine

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