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Special comment

BRE Bank Securities

Steel industry

Poland

Stalprodukt S.A.

STP.PW; STAW.WA

Can It Keep Its Position in the Downturn?

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Current Price: PLN 498.50

In H2'09, Stalprodukt will not be able to keep the high, 50% margin on its main product, cold rolled electrical steel (ca. 36% of sales revenue). According to the Management, the decline will be considerable, to 40% or lower, because of the over 20% reduction in prices stemming from the increase in supply, due to the growth in capacity and the decline in demand. The decline in the price of electrical steel entails lower prices of toroidal cores, which are a complementary product. This situation will surely be reflected by the Company's earnings in the ensuing quarters, in particular in Q3-Q4, because contract prices were negotiated in June, and the Company was forced to cut its prices then. In Q2 2009, margins will remain at 50% thanks to contracts signed before the outbreak of the price war between Polish steel producers.

Q2 and Q3 2009 should, in turn, bring an improvement in cold rolled sections and in service centers vs. Q1 2009 (PLN 162,749 thousand revenues that quarter), mostly due to higher demand from infrastructural constructors. In Q2 and Q3, the demand in the segment will increase by ca. 15%, mostly due to cold rolled sections and steel safety barriers. The increase in cold rolled section sales in Q2 and Q3 will be caused by the exhaustion of stockpiles and the increased demand on the part of the infrastructural sector. Moreover, margins on such products should improve by ca. 5% vs. Q1 due to cheaper feedstock material and the increase in prices driven by higher demand.

The increase in the demand for road barriers will be driven by two factors: (i) big infrastructural road projects in execution or in their final stages, (2) the legal changes concerning technical approval procedures, which are coming next year and whose nature is unclear, prompting buyers to bring their purchases forward to 2009. Margins should remain at the same level as in Q1 2009. As a result, earnings in the segment should improve in Q2-Q3 over Q1, revenue-wise. In Q4, the Company will see a reduction in sales vs. Q2-Q3 due to seasonal patterns (reduced construction activity).

Despite the difficult market situation, Stalprodukt S.A. faces no payment gridlocks, thanks to the Management's consistent risk-management policies. There were no layoffs at Stalprodukt in Q1 2009, and none are being planned for H2. The Company will continue its investment in the expansion of the transformer sheet mill (stage 2) and the launch of a cutting and profiling machine in the sections segment. In Q1 2009, these expenditures amounted to over PLN 36m. For 24 September 2009, the Management promised dividends payment in the amount of over PLN 79m, i.e. PLN 12 per share (gross).

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List of abbreviations and ratios contained in the report.
EV *– net debt + market value (EV – economic value)*
EBIT *– Earnings Before Interest and Taxes*
EBITDA *– EBIT + Depreciation and Amortisation*
PBA *– Profit on Banking Activity*
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*

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