

Wednesday, April 22, 2020 | update

Cognor: hold (reiterated)

COG PW; COGP.WA | Steel, Poland

Bracing for Deadlock

The coronavirus crisis is having an immense negative impact on the steel industry, creating a global glut evidenced by growing stockpiles in China (currently at over 20mmt vs. a five-year high of 15mmt recorded this time of the year). As rebar prices fall, so do the profit margins of steelmakers. In addition, in Q1 2020, electric arc furnaces (EAF) of the kind used by Cognor lost much of their previous cost advantage over basic oxygen furnaces (BOF). We update our FY2020 forecasts for Cognor to assume a 9% decrease in sales volumes due to weaker demand, accompanied by a PLN 138m reduction in operating profit driven by lower sales prices. Further, with no state compensation offered this year for high electricity prices, expected to rise 7% relative to 2019, Cognor faces additional costs of a projected PLN 17m. On the upside, the Company might achieve savings thanks to lower prices of graphite electrodes used in EAF steel making (PLN 60m), improved performance after investments (PLN 31m), and lower costs of payroll and services incurred on lower sales (PLN 30m). Nevertheless we see FY2020 EBITDA as falling 30% to PLN 70m, resulting in a higher-but-still-safe leverage ratio of 3.5x. Regardless, Cognor will probably put shareholder distributions on hold for the foreseeable future. After updating FY2020 estimates, we lower our target price for COG from PLN 1.25 to PLN 0.94 per share, and we maintain a hold rating on the stock.

Financial results for Q4 2019

Cognor's 2019 fourth-quarter financials missed our forecasts as well as falling short of official guidance. On higher-than-expected sales, recurring EBITDA showed a 19% miss relative to our target. Net debt for FY2019 ended up close to our PLN 218m forecast at PLN 225m. Cognor said it would not pay dividends from 2019 profit due to challenges faced amid the ongoing epidemic.

2020 kicked off on an upbeat note

Cognor reported experiencing favorable market conditions in the initial weeks of 2020, with more orders coming in from previously less active buyers after steel plant closures in Italy, and uninterrupted rebar deliveries to construction sites all through the winter thanks to warm weather. As a result, Cognor is guiding for a similar EBITDA result in Q1 2020 as the PLN 25m posted a year earlier. The Company decided not to recognize provisions related to planned capacity upgrades on a quarterly basis (previously these charges ranged from PLN 10-15m) – instead, these expenses will be booked upon completion of the repairs, i.e. usually in the third quarter.

(PLN m)	2018	2019	2020E	2021E	2022E
Revenue	2,081.8	1,901.6	1,630.0	1,828.3	1,943.6
EBITDA (adj.)	200.0	92.9	70.0	67.0	64.1
EBITDA margin (adj.)	9.6%	4.9%	4.3%	3.7%	3.3%
EBIT (adj.)	156.2	46.7	22.1	20.1	19.2
Net profit (adj.)	93.7	11.2	2.1	0.5	-0.2
P/E (adj.)	1.8	14.8	79.2	-	-
P/CE	1.5	2.5	3.3	3.5	3.7
P/B	0.6	0.6	0.6	0.6	0.6
EV/EBITDA (adj.)	2.0	4.4	6.2	6.3	6.4
DPS	0.07	0.21	0.00	0.00	0.00
Dividend Yield	10.5%	21.7%	0.0%	0.0%	0.0%

*2018-2022E ratios assume full dilution

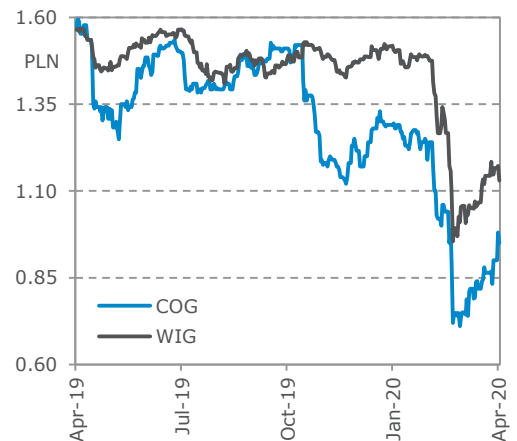
Current Price	PLN 0.95
Target Price	PLN 0.94
Market Cap	PLN 166m
Free Float	PLN 39m
ADTV (3M)	PLN 0.2m

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.



Company	Target Price		Rating	
	new	old	new	old
Cognor	0.94	1.25	hold	hold

Company	Current Price	Target Price	Upside
Cognor	0.95	0.94	-1.6%

Forecast Update	2020E	2021E	2022E
Revenue	-9.5%	-9.0%	-9.6%
EBITDA	-4.7%	-9.4%	-10.0%
Net profit	-62.7%	-94.3%	-
Sales volume	-1.0%	+0.7%	+1.1%
Sales prices	-9.2%	-9.6%	-10.3%
Costs of scrap	+3.7%	+1.8%	0.0%

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Key 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 as adjustment 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 because, where local steel industries enjoy backing and protections from their respective governments. Since 2016 the pressures are being mitigated by higher duties on steel imports into the EU.

Cognor purchased approximately 10% of required emission allowances at market prices through to the end of 2019. 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 furnaces.

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 prolonger 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.

Stock Dilution

Bondholders currently hold an estimated EUR 17.4m 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 at around PLN 1.61 per share, the current conversion price of the equity warrants that would be issued to the convertible bondholders when they decide 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 since been able to reduce these proportions, with no one customer accounting for more than 10% of sales at either plant.

The Coronavirus Epidemic

Global lockdown measures introduced to contain the spread of the coronavirus epidemic have included closures of car manufacturing plants, which are the second-largest buyer of steel in the world. The resulting fall-off in orders has forced steelmakers to drastically cut back production – a prospect which Cognor might come up against in the near future.

Valuation

We used two valuation methods to determine the value of Cognor: the Discounted Cash Flow method, indicating a per-share valuation of PLN 0.96, and the Relative Valuation method, yielding a value of PLN 0.53 per share.

(PLN)	weight	price
Relative Valuation	20%	0.53
DCF Analysis	80%	0.96
		price 0.87
	9M target price	0.94

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.

Note that we reduced the weight of relative valuation in the final outcome from 50% to 20% to reflect extreme volatility in financial markets.

Relative Valuation

	Country	P/E			EV/EBITDA		
		2019E	2020E	2021E	2019E	2020E	2021E
AK STEEL HOLDING CORP	USA	5.8	17.4	12.2	6.0	7.7	7.5
ALUMETAL SA	Poland	11.6	13.5	10.9	6.5	7.3	6.5
ARCELORMITTAL	Luxembourg	25.6	-	6.0	4.2	6.2	3.9
BAOSHAN IRON & STEEL CO-A	China	9.1	8.8	7.7	4.1	4.1	3.6
COMMERCIAL METALS CO	USA	8.0	8.7	9.2	5.7	5.0	4.8
HESTEEL CO LTD-A	China	9.1	10.4	10.4	-	-	-
HITACHI METALS LTD	Japan	12.5	-	41.8	6.2	22.6	7.7
HYUNDAI STEEL CO	S. Korea	22.2	25.5	8.1	6.2	6.8	5.8
JFE HOLDINGS INC	Japan	2.6	-	-	4.9	9.7	9.5
JSW STEEL LTD	India	5.3	12.0	10.2	4.4	7.5	7.0
KLOECKNER & CO SE	Germany	-	-	365.2	6.3	8.8	4.3
METALURGICA GERDAU SA-PREF	Brazil	7.6	7.2	6.2	-	-	-
NIPPON YAKIN KOGYO CO LTD	Japan	3.0	4.6	4.2	-	-	-
NUCOR CORP	USA	9.1	20.2	13.1	5.5	8.0	6.9
OLYMPIC STEEL INC	USA	42.8	-	16.7	8.5	-	-
OSAKA STEEL CO LTD	Japan	-	-	-	-	-	-
OUTOKUMPU OYJ	Finland	-	-	10.6	8.7	8.6	5.1
POSCO	South Korea	6.7	10.1	6.8	3.7	4.3	3.6
SALZGITTER AG	Germany	-	-	8.0	3.8	4.3	3.7
SSAB AB-A SHARES	Sweden	12.1	-	10.5	4.7	8.6	4.6
STEEL AUTHORITY OF INDIA	India	4.6	-	4.1	6.1	1.2	0.7
STEEL DYNAMICS INC	USA	7.8	13.8	11.0	4.7	7.2	6.5
TATA STEEL LTD	India	3.7	14.1	16.9	4.8	7.8	7.9
THYSSENKRUPP AG	Germany	-	-	34.6	4.4	11.8	6.0
UNITED STATES STEEL CORP	USA	-	-	-	6.0	-	8.3
VOESTALPINE AG	Austria	8.2	-	-	4.7	7.2	7.8
Maximum		42.8	25.5	365.2	8.7	22.6	9.5
Minimum		2.6	4.6	4.1	3.7	1.2	0.7
Median		8.1	12.0	10.5	5.2	7.4	6.0
Cognor		14.8	79.2	-	4.4	6.2	6.3
premium / discount		82.5%	559.6%	-	-15.4%	-16.7%	4.8%

Implied Valuation

Median	8.1	12.0	10.5	5.2	7.4	6.0
Discount	20%	20%	20%	20%	20%	20%
Multiple weight		50%			50%	
Year weight	0%	50%	50%	0%	50%	50%

Value per share (PLN) 0.53

Additional Assumptions

Historical sales of Ferrostal steel rebar unit and future projections

Sales volumes (1,000t)	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
Billet	169.9	104.1	85.3	119.2	81.8	110.3	93.7	145.3	159.8
Plain bars	35.7	32.3	29.3	30.0	30.3	30.9	26.3	29.4	32.4
Flat bars	64.2	60.2	61.4	48.1	44.1	39.9	33.9	38.0	41.8
Squares	13.7	11.0	7.7	6.5	8.3	8.7	7.4	8.3	9.2
Rebar	41.6	82.5	188.1	202.1	213.7	211.1	190.0	212.8	234.0
Angles	30.1	32.2	24.9	17.5	22.3	22.0	18.7	21.0	23.1
Other	1.2	6.3	6.6	3.1	1.1	1.5	1.2	1.4	1.5
Avg. spread (PLN/t)	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
Steel billet	869	803	718	878	1,046	920	898	935	948
Plain bars	1,081	1,088	1,121	1,069	1,365	1,408	1,369	1,407	1,424
Flat bars	1,084	1,110	1,158	1,075	1,386	1,401	1,362	1,400	1,417
Squares	1,068	1,083	1,131	1,048	1,342	1,331	1,294	1,333	1,348
Rebar	880	772	823	937	1,151	1,101	1,093	1,130	1,145
Angles	1,122	1,092	1,170	1,050	1,397	1,403	1,364	1,402	1,419
Other	1,732	1,323	1,421	1,117	1,892	1,643	1,595	1,635	1,653

Source: mBank

Historical sales of HSJ rolled steel unit and future projections

Sales volumes (1,000t)	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
Billet	18.1	28.1	40.5	66.2	58.7	74.7	89.6	104.8	106.9
Bars	144.6	150.3	153.7	156.5	175.6	157.6	133.9	140.6	143.4
Thick sheet	5.8	16.4	5.7	7.7	1.6	3.7	3.5	3.7	3.8
Thin sheet	0.9	1.1	0.6	0.5	0.7	0.5	0.4	0.5	0.5
Other	0.5	0.7	0.6	0.3	0.5	0.5	0.4	0.4	0.4
Avg. spread (PLN/t)	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
Billet	1,873	1,341	979	1,176	1,486	1,145	1,060	1,146	1,161
Bars	1,746	1,687	1,553	1,709	2,192	2,115	1,984	2,094	2,116
Thick sheet	1,912	1,530	1,885	1,742	3,446	2,589	2,436	2,557	2,583
Thin sheet	10,049	9,922	10,284	9,897	10,307	9,970	9,474	9,771	9,849
Other	23,149	22,629	20,891	24,078	22,173	19,436	18,499	19,023	19,167

Source: mBank

Steel Market Assumptions

	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
Price of rolled sheet steel (PLN/t)	2,142	1,960	1,919	2,417	2,588	2,463	2,100	2,127	2,143
Price of HEB sections (PLN/t)	2,336	2,204	2,240	2,282	2,614	2,593	2,400	2,410	2,426
Price of rebar (PLN/t)	2,328	2,200	2,170	2,139	2,439	2,275	2,050	2,046	2,062
Steel production in Poland (mmt)	8.6	9.1	8.9	10.3	10.3	9.1	8.2	8.6	8.8
Cognor's market share	6.1%	5.8%	6.8%	6.4%	6.2%	7.3%	7.3%	8.2%	8.6%
USD/PLN	3.15	3.74	3.94	3.78	3.61	3.84	4.00	3.60	3.60
Coke price (US\$/t)	126	102	119	179	193	170	150	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	260	280	280
BOF (US\$/t)	302	198	212	282	299	319	273	272	272
EAF (US\$/t)	371	241	239	315	383	326	290	312	312
BOF-EAF (US\$/t)	-69	-44	-28	-33	-83	-7	-17	-40	-40
BOF (PLN/t)	951	740	835	1,066	1,081	1,225	1,090	978	978
EAF (PLN/t)	1,168	903	944	1,190	1,381	1,251	1,160	1,124	1,124
Scrap price (PLN/t)	1,048	810	847	1,067	1,238	1,084	1,040	1,008	1,008

Source: mBank

Historical and projected debt of Cognor

(PLN m)	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
Factored accounts receivable (excluded from fin. statements)	0.0	55.6	110.7	121.9	139.0	157.7	157.7	157.7	157.7
Factored accounts receivable	33.4	20.7	21.7	14.7	21.0	42.2	42.2	42.2	42.2
Bonds	423.1	382.2	384.2	363.1	0.0	0.0	0.0	0.0	0.0
Reverse factoring	56.3	9.8	10.5	4.2	2.7	0.9	0.0	0.0	0.0
Pre-financing of scrap	0.0	14.3	12.3	0.0	0.0	0.0	0.0	0.0	0.0
Other debt	80.2	69.0	87.8	59.8	280.6	304.0	300.0	300.0	300.0
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	32.0	21.6	19.5	19.5	19.5
%	9.2%	10.3%	9.3%	11.0%	11.3%	7.1%	6.5%	6.5%	6.5%
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	4.70	4.30	4.30

Source: mBank

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 flow is discounted as of early May 2020.
- Net debt is as at year-end 2019 plus dividends paid in early 2020 (PLN 0.28 per share).

DCF Model

(PLN m)	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P	2028P	2029P	+
Revenue	1,630.0	1,828.3	1,943.6	2,018.4	2,085.3	2,127.6	2,170.8	2,186.2	2,201.7	2,212.2	2,222.8
change	-14.3%	12.2%	6.3%	3.8%	3.3%	2.0%	2.0%	0.7%	0.7%	0.5%	0.5%
EBITDA	70.0	67.0	64.1	79.5	76.4	72.4	72.0	72.4	73.5	71.7	69.6
EBITDA margin	4.3%	3.7%	3.3%	3.9%	3.7%	3.4%	3.3%	3.3%	3.3%	3.2%	3.1%
D&A expenses	47.9	46.9	44.9	43.6	42.7	42.5	42.9	43.8	44.0	44.1	44.1
EBIT	22.1	20.1	19.2	35.9	33.7	29.9	29.1	28.7	29.5	27.6	25.5
EBIT margin	1.4%	1.1%	1.0%	1.8%	1.6%	1.4%	1.3%	1.3%	1.3%	1.2%	1.1%
Tax on EBIT	0.5	0.1	-0.1	3.1	2.7	2.0	1.8	1.7	1.9	1.5	1.1
NOPLAT	21.6	20.0	19.3	32.8	31.0	27.9	27.3	26.9	27.6	26.1	24.3
CAPEX	-50.0	-33.0	-34.5	-35.2	-36.3	-37.7	-39.6	-42.9	-42.9	-43.1	-43.2
Working capital	-20.6	-0.2	-0.9	-3.4	-3.1	-1.9	-2.0	-0.7	-0.7	-0.5	-0.5
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF	-1.1	33.6	28.7	37.7	34.4	30.8	28.6	27.1	28.0	26.5	24.8
WACC	6.7%	6.8%	6.8%	6.9%	6.9%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
discount factor	0.95	0.89	0.83	0.78	0.73	0.68	0.63	0.59	0.55	0.52	0.48
PV FCF	-1.0	30.0	24.0	29.3	25.0	20.9	18.1	16.1	15.5	13.7	12.0

WACC	6.7%	6.8%	6.8%	6.9%	6.9%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
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	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Net debt / EV	59.8%	58.5%	57.6%	55.6%	55.1%	54.8%	54.5%	54.3%	54.0%	54.0%	54.2%
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	496.4
Present value of terminal value	256.7
Present value of FCF in the forecast period	191.6
Enterprise value	448.3
Net debt	261.9
Minority interests	18.4
Equity value	168.1
Shares outstanding (millions)	175.0
Equity value per share (PLN)	0.96
9M cost of equity	7.0%
9M target price (PLN)	1.03

EV/EBITDA ('20) at target price	6.4
P/E('20) at target price	85.7
TV / EV	57.3%

Sensitivity Analysis

	FCF growth in perpetuity				
	0.0%	1.0%	2.0%	3.0%	5.0%
WACC +1.0 p.p.	0.30	0.43	0.60	0.84	1.80
WACC +0.5 p.p.	0.43	0.58	0.79	1.10	2.44
WACC	0.58	0.77	1.03	1.42	3.40
WACC -0.5 p.p.	0.75	0.98	1.31	1.84	5.00
WACC -1.0 p.p.	0.95	1.24	1.67	2.39	8.22

2019 Fourth-Quarter Results

Cognor's 2019 fourth-quarter quarterly **revenue** topped our forecast by 10% at PLN 424m after flat year over year growth. In terms of volumes, sales of steel products were a beat and scrap sales were a miss relative to our expectations.

EBITDA missed our forecast by 16% at PLN 14.2m after falling 41% on the year. The actual result also missed Cognor's guidance range of PLN 17-24m. One-time earnings boosts were small in Q4 at just about PLN 0.5m. The FIFO effect was negative at PLN 10m vs. positive effect of PLN 0.4m recorded in Q4 2018.

After all this, Cognor reported a fourth-quarter **net loss** of PLN 5.1m against our expectations of PLN 3.1m net profit. After stripping one-time gains in the amount of PLN 1.2m, the quarterly net loss widens to PLN 6.7m.

2019 Q4 actuals vs. expectations

(PLN m)	4Q'19	4Q'18	change	4Q'19E	difference
Revenue	466.1	471.2	-1.1%	424.3	9.8%
EBITDA	14.2	24.0	-41.1%	16.9	-16.1%
margin	3.0%	5.1%	-	4.0%	-
EBIT	2.6	13.0	-80.4%	5.4	-52.6%
Net profit	-5.1	-5.0	-	3.1	-

Source: Cognor, E- mBank estimates

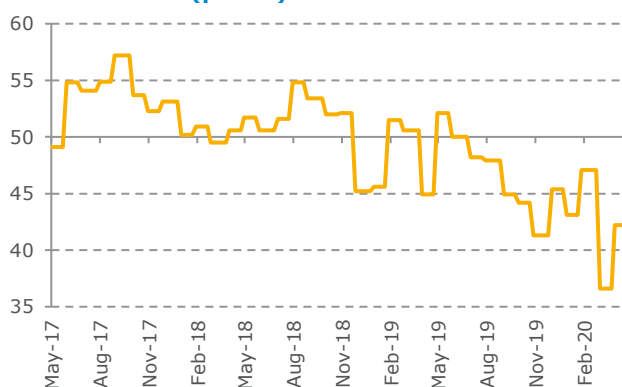
Operating cash flow amounted to PLN 81m in Q4 2019 vs. PLN 111m in Q4 2018. Cognor ended FY2019 with net debt of PLN 225m (2.2x EBITDA).

Market Outlook

China's Purchasing Managers' Index for the steel industry came out at **42** for March, which means it has been below the 50-point mark which separates growth from contraction since mid-2019. The CSLPC said in its comment that "the explosive growth in the COVID-19 confirmed cases has and will hurt both steel demand and supply worldwide, which will impose more pressure on the global steel market and further dampen China's steel exports for the rest of 2020."

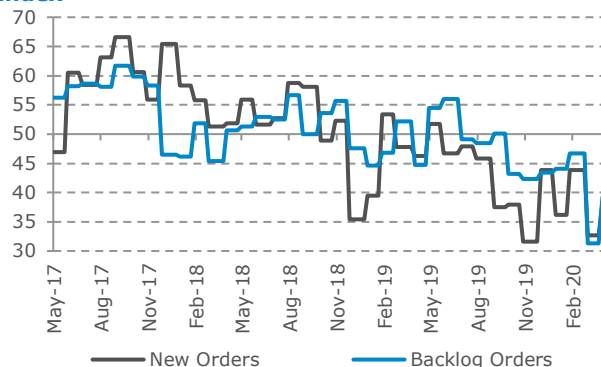
The sub-indexes for new steel orders and production hovered around 39 for March.

China Steel PMI (points)



Source: Bloomberg, mBank

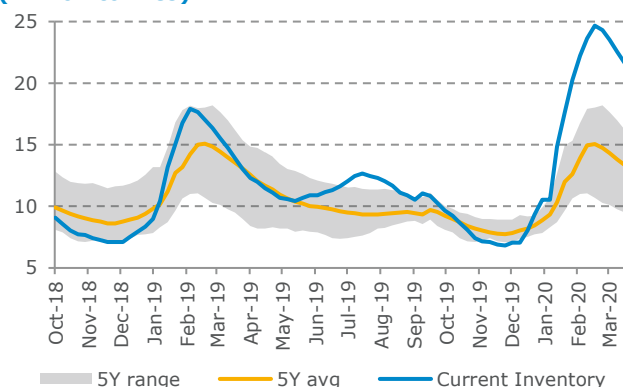
China Steel PMI production index and new orders index



Source: Bloomberg, mBank

At the end of, March China's steel **inventories** reached 25 million tonnes, a much higher level than seen in the same period in the last five years. As of today, the stockpile has been reduced slightly to upwards of 20mmt. Chinese producers are having to **curb production** as supply continues to exceed demand.

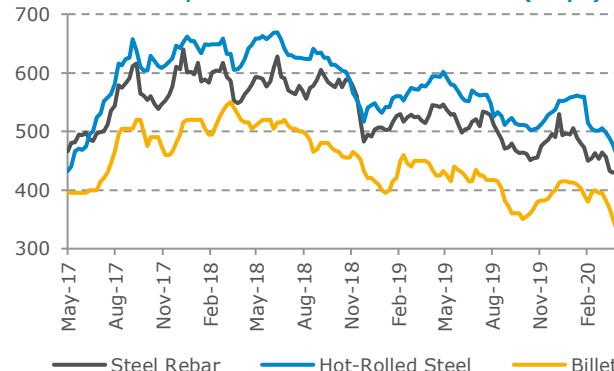
China steel inventories vs. historical averages (million tonnes)



Source: Bloomberg, mBank

In an oversupplied market, **steel prices have been on a downward trajectory since the end of 2018**, exerting a squeeze on the profit margins of producers.

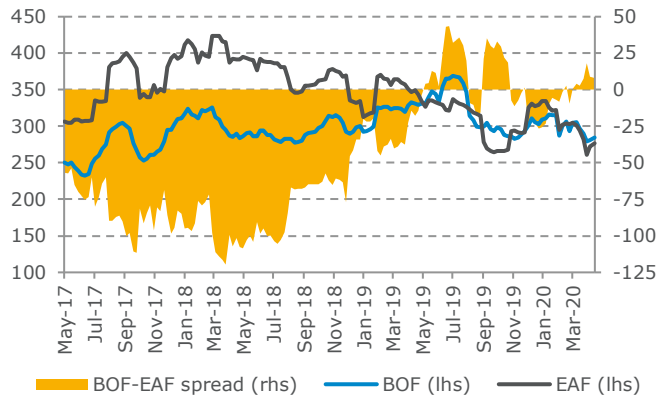
Prices of rebar, billet- and hot-rolled steel (US/t)



Source: Bloomberg, mBank

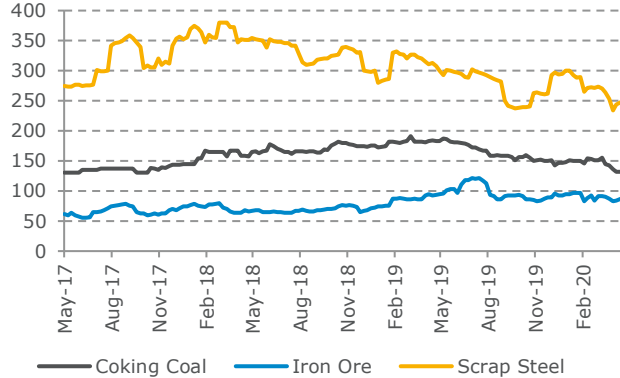
In 2020, an earlier **cost advantage** enjoyed by scrap-based **electric arc furnace** steelmakers over coal-fired basic oxygen furnaces has been **wiped out** due to a downward shift in prices of coking coal while scrap metal is resisting sliding below \$250/t.

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



Source: Bloomberg, mBank

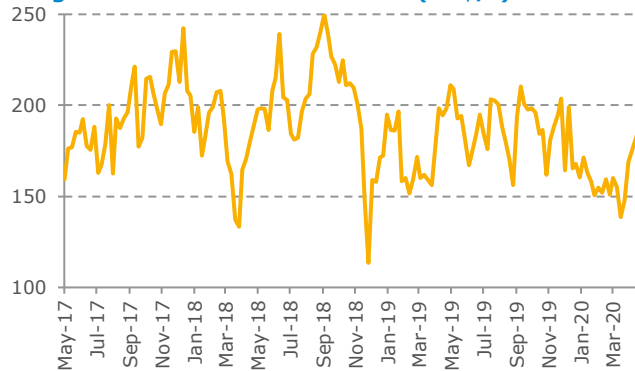
Price comparison: coking coal vs. iron ore and scrap steel (US\$/t)



Source: Bloomberg, mBank

Prices of **steel rebar** were seen to retreat at the beginning of 2020, with negative effects on the sales margins of EAF producers, but they have **rebounded** since and as of this writing they are seen to have climbed higher.

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

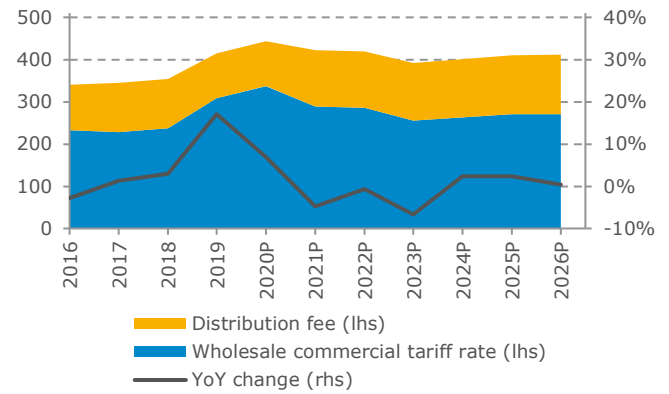


Source: Bloomberg, mBank

In **Poland**, another major challenge faced by the metallurgical industry is an **increase in the costs of electric power**, projected to average 7% in 2020 (next year power prices will most likely decline by about 5%).

For **Cognor**, assuming a 9% decline in sales, this implies **additional costs of roughly PLN 17m**. At the same time, however, we predict that the Company can **save as much as PLN 91m** this year on costs of graphite electrodes, and thanks to efficiency upgrades completed last year.

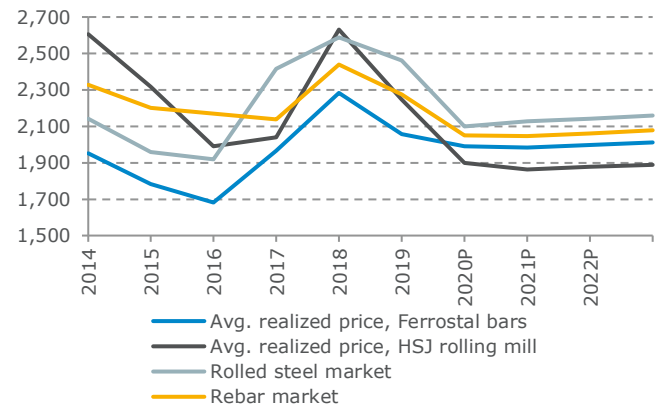
Polish power price tariff for commercial end users (PLN/MWh)



Source: Bloomberg, mBank

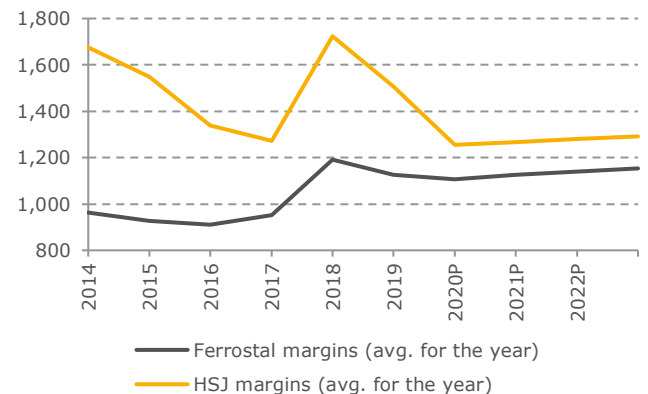
We assume that the **prices of Cognor's steel products** will follow the trends in global markets this year, and after an implied **contraction in margins** we predict that the Company's **EBITDA** for the year will post a decrease of PLN 138m from FY2019.

Comparison of market prices for rolled steel and rebar against prices realized by Cognor's steel plants (PLN/t)



Source: Cognor, Rynek Stali, P - mBank projection

Forecast of average sales margins of Cognor steel plants (PLN/t)



Source: Cognor, Rynek Stali, P - mBank projection

Income Statement

(PLN m)	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
Revenue	1,422.5	1,364.8	1,352.4	1,789.3	2,081.8	1,901.6	1,630.0	1,828.3	1,943.6
change	9.9%	-4.1%	-0.9%	32.3%	16.4%	-8.7%	-14.3%	12.2%	6.3%
Ferrostal	695.5	586.2	678.4	838.8	916.6	872.9	739.4	904.5	1,002.2
HSJ	442.7	455.2	400.2	471.8	623.7	532.3	432.7	465.7	478.5
Złomrex Metal	100.1	119.0	95.0	130.9	172.8	141.8	144.7	147.6	150.5
Other	190.2	223.3	202.3	323.4	393.0	364.5	325.5	327.1	329.5
D&A expenses	34.8	35.3	37.9	41.3	43.9	45.6	47.1	46.0	44.0
Materials & utilities	895.9	799.4	747.2	1,129.9	1,364.5	1,229.5	1,065.4	1,199.4	1,281.6
of which scrap metal	590.1	510.5	527.3	761.9	807.6	725.1	635.5	722.4	771.7
of which electricity	114.8	124.3	126.0	130.2	144.5	146.3	162.9	182.8	194.6
Third-party services	200.4	203.4	228.4	152.5	170.6	177.0	165.9	191.6	206.4
Taxes and fees	11.8	15.0	9.2	10.8	11.9	10.0	10.7	10.4	10.1
Payroll	109.0	128.1	136.2	161.3	183.6	181.6	170.0	190.9	211.1
Other costs	4.9	4.8	4.3	4.7	6.2	7.1	6.0	6.4	6.5
Cost of goods sold	158.9	158.1	148.8	201.8	227.2	192.9	162.7	163.6	164.8
Change in inventories	58.4	-7.2	14.4	13.0	79.5	-10.2	20.0	0.0	0.0
COGS	1,275.9	1,269.0	1,209.7	1,573.0	1,805.5	1,730.6	1,607.9	1,808.2	1,924.4
Selling expenses	43.0	47.8	50.0	65.8	76.7	75.3	70.5	81.5	87.8
Administrative expenses	38.5	34.6	37.9	50.5	46.0	48.1	49.1	50.1	51.1
Other operating gains/losses	0.9	-0.2	1.7	-0.7	2.6	6.9	0.0	0.0	0.0
One-time events	1.0	2.4	3.4	-5.2	0.0	7.9	0.0	0.0	0.0
EBIT	65.4	13.1	56.5	99.2	156.2	54.6	22.1	20.1	19.2
change	132.6%	-79.9%	329.9%	75.5%	57.5%	-65.1%	-59.5%	-9.0%	-4.4%
EBIT margin	4.6%	1.0%	4.2%	5.5%	7.5%	2.9%	1.4%	1.1%	1.0%
EBIT (adj.)	64.4	10.8	53.1	104.4	156.2	46.7	22.1	20.1	19.2
EBITDA (adj.)	99.5	46.6	91.2	145.7	200.0	92.9	70.0	67.0	64.1
Net financing gains/losses	-67.3	-30.3	-63.0	-31.2	-62.8	-30.8	-19.5	-19.5	-19.5
Interest expenses	55.7	55.0	45.9	52.0	38.3	20.9	19.5	19.5	19.5
Income from bond repurchase	-10.6	26.7	-10.5	20.8	-25.1	0.0	0.0	0.0	0.0
FX gains / losses									
Pre-tax profit	3.3	-17.3	-6.4	68.1	92.8	22.3	2.6	0.6	-0.3
Tax	-6.4	3.3	7.9	18.1	20.7	2.6	0.5	0.1	-0.1
Minority interests	0.0	0.9	0.1	2.3	3.5	0.7	0.0	0.0	0.0
Net profit	5.7	-14.8	1.5	47.6	68.5	19.1	2.1	0.5	-0.2
change	-	-	-	--	44.0%	-72.1%	-89.0%	-76.5%	-
margin	0.4%	-1.1%	0.1%	2.7%	3.3%	1.0%	0.1%	0.0%	0.0%
Net profit (adj.)	15.3	-43.9	8.6	31.9	93.7	11.2	2.1	0.5	-0.2
D&A expenses	35.1	35.9	38.1	41.3	43.9	46.2	47.9	46.9	44.9
EBITDA	100.5	49.0	94.6	140.5	200.1	100.8	70.0	67.0	64.1
change	54.1%	-51.2%	93.0%	48.6%	42.4%	-49.6%	-30.5%	-4.4%	-4.3%
EBITDA margin	7.1%	3.6%	7.0%	7.9%	9.6%	5.3%	4.3%	3.7%	3.3%
Shares outstanding at eop (millions)	66.2	69.9	75.3	175.0	175.0	175.0	175.0	175.0	175.0
EPS	0.1	-0.2	0.0	0.3	0.4	0.1	0.0	0.0	0.0
CEPS	0.6	0.3	0.5	0.5	0.6	0.4	0.3	0.3	0.3
ROAE	3.4%	-10.1%	1.1%	21.1%	24.6%	7.4%	0.8%	0.2%	-0.1%
ROAA	0.6%	-1.8%	0.2%	5.0%	6.8%	1.8%	0.2%	0.0%	0.0%

Balance Sheet

(PLN m)	2014	2015	2016	2017	2018	2019	2020 P	2021 P	2022P
ASSETS	940.5	846.3	895.3	950.7	1,001.4	1,051.7	950.2	992.2	1,016.0
Fixed assets	422.7	408.5	424.9	398.5	379.3	487.2	481.3	459.4	445.5
Intangible assets	11.3	10.8	11.9	13.0	18.0	22.3	27.0	30.1	33.3
Property, plant and equipment	289.6	278.0	292.8	285.9	284.6	375.6	373.8	357.7	345.1
Equity value	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	40.9	40.9	40.9	40.9
Noncurrent investments	17.0	16.7	8.1	3.4	2.8	1.3	1.3	1.3	1.3
Noncurrent prepayments	81.9	82.0	92.1	70.2	50.6	47.2	38.3	29.4	25.0
Current assets	517.9	437.8	470.4	552.2	622.1	564.5	468.9	532.8	570.6
Inventory	283.1	263.5	297.7	277.5	377.0	297.0	254.6	285.6	303.6
Current receivables	187.4	127.4	137.0	171.9	168.0	188.3	161.4	181.1	192.5
Current investments	11.7	9.7	8.7	0.0	0.0	0.1	0.1	0.1	0.1
Cash	35.6	36.9	25.0	102.0	76.5	79.0	52.7	66.0	74.3
Current prepayments	0.0	0.3	1.9	0.8	0.7	0.0	0.0	0.0	0.0
EQUITY & LIABILITIES	940.5	846.3	895.3	950.7	1,001.4	1,051.7	950.2	992.2	1,016.0
Equity	166.0	147.1	142.1	225.3	278.2	258.8	260.9	261.4	261.2
Share capital	132.4	139.7	150.5	177.9	180.6	185.9	185.9	185.9	185.9
Supplementary capital	202.2	194.9	184.6	221.0	86.7	87.0	87.0	87.0	87.0
Retained earnings	-168.1	-187.5	-193.1	-173.6	10.8	-14.2	-12.1	-11.6	-11.8
Minority interest	21.3	21.6	13.8	16.5	17.7	18.4	18.4	18.4	18.4
Non-current liabilities	452.8	433.0	410.7	388.8	258.4	279.3	329.6	329.6	329.6
Debt	408.9	386.4	376.4	358.0	229.2	249.7	300.0	300.0	300.0
Current liabilities	282.7	234.4	319.3	316.6	435.9	481.9	329.8	369.9	393.2
Trade payables	188.3	169.6	223.7	247.4	379.2	426.7	329.8	369.9	393.2
Debt	94.4	64.7	95.6	69.1	56.7	55.2	0.0	0.0	0.0
Provisions for liabilities	6.5	3.7	3.1	3.4	4.4	0.2	0.2	0.2	0.2
Other	11.2	6.5	6.3	0.1	6.8	13.1	11.3	12.6	13.4
Debt	503.3	451.2	472.0	427.1	285.9	304.8	300.0	300.0	300.0
Net debt	455.9	414.2	447.0	325.1	209.4	225.9	247.3	234.0	225.7
Net Debt / Equity	274.6%	281.6%	314.5%	144.3%	75.3%	87.3%	94.8%	89.5%	86.4%
Net Debt/ EBITDA	4.5	8.5	4.7	2.3	1.0	2.2	3.5	3.5	3.5
Net debt /EBITDA (adj.)	4.6	8.9	4.9	2.2	1.0	2.4	3.5	3.5	3.5
Factoring	56.3	9.8	10.5	20.0	20.0	0.9	0.0	0.0	0.0
Factored accounts receivable (excluded from fin. statements)	0.0	55.6	110.7	110.7	110.7	157.7	157.7	157.7	157.7
Pre-financing of scrap	0.0	14.3	12.3	15.0	15.0	0.0	0.0	0.0	0.0
Net debt / EBITDA (adj.)	5.2	10.6	6.4	3.2	1.8	4.1	5.8	5.8	6.0
BVPS	2.5	2.1	1.9	1.3	1.6	1.5	1.5	1.5	1.5

Cash Flow*

(PLN m)	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
Cash flow from operating activities	51.8	101.3	91.6	145.4	232.2	142.5	48.1	65.7	62.4
Net profit	5.7	-14.8	1.5	47.6	68.5	19.1	2.1	0.5	-0.2
D&A expenses	35.1	35.9	38.1	41.3	43.9	46.2	47.9	46.9	44.9
Working capital	-0.3	63.1	6.3	10.8	43.6	61.2	-20.6	-0.2	-0.9
Other	11.3	17.1	45.7	45.7	76.2	15.9	18.7	18.6	18.6
Cash flow from investing activities	0.6	-3.1	-27.1	-15.4	-37.6	-56.2	-50.0	-33.0	-34.5
CAPEX	-7.8	-5.6	-29.0	-15.9	-37.8	-56.2	-50.0	-33.0	-34.5
Equity investments	8.5	2.5	1.9	0.5	0.2	0.1	0.0	0.0	0.0
Cash flow from financing activities	-38.5	-105.8	-83.8	-52.6	-195.6	-83.8	-24.3	-19.5	-19.5
Debt	6.2	-64.6	-28.2	-36.0	-113.2	-59.4	-4.8	0.0	0.0
Dividends/Buyback	0.0	0.0	0.0	0.0	-11.9	-36.0	0.0	0.0	0.0
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	-20.9	-19.5	-19.5	-19.5
Other	-0.5	-0.4	-10.6	-4.4	-1.3	32.4	0.0	0.0	0.0
Change in cash	13.9	-7.6	-19.3	77.4	-1.0	2.5	-26.3	13.3	8.3
Cash at eop	28.7	21.1	1.8	79.3	76.5	79.0	52.7	66.0	74.3
DPS (PLN)	0.00	0.00	0.00	0.00	0.07	0.21	0.00	0.00	0.00
FCF	92.3	106.5	71.9	122.9	179.5	101.9	-1.1	33.6	28.7
CAPEX / Sales	-0.6%	-0.4%	-2.1%	-0.9%	-1.8%	-3.0%	-3.1%	-1.8%	-1.8%

*Assuming full dilution

Trading Multiples*

	2014	2015	2016	2017	2018	2019	2020P	2021P	2022P
P/E	11.1	-4.5	46.9	3.5	2.4	8.7	79.2	-	-
P/E (adj.)	4.1	-1.5	8.3	5.2	1.8	14.8	79.2	-	-
P/CE	1.5	3.2	1.8	1.9	1.5	2.5	3.3	3.5	3.7
P/B	0.4	0.5	0.5	0.7	0.6	0.6	0.6	0.6	0.6
P/S	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
FCF/EV	17.8%	22.2%	13.9%	25.0%	47.8%	26.0%	-0.3%	8.4%	7.3%
EV/EBITDA	5.4	10.2	5.6	3.6	2.0	4.1	6.2	6.3	6.4
(adj.) EV/EBITDA		11.3	6.1	3.5	2.0	4.4	6.2	6.3	6.4
EV/EBIT	8.3	38.2	9.4	5.1	2.5	7.5	19.6	20.8	21.4
EV/S	0.4	0.4	0.4	0.3	0.2	0.2	0.3	0.2	0.2
OCF/EBITDA	52%	207%	97%	103%	116%	141%	69%	98%	97%
CFO/skor. EBITDA	52%	217%	100%	100%	116%	153%	69%	98%	97%
Dividend Yield	0.0%	0.0%	0.0%	0.0%	10.5%	21.7%	0.0%	0.0%	0.0%
Price (PLN)	0.95	0.95	0.95	0.95	0.95	0.95	0.95	0.95	0.95
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)	62.9	66.4	71.5	166.2	166.2	166.2	166.2	166.2	166.2
Minority interest (PLN m)	21.3	21.6	13.8	16.5	17.7	18.4	18.4	18.4	18.4
EV (PLN m)	540.1	502.2	532.3	507.8	393.4	410.5	431.9	418.6	410.3

*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

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

recommendation	hold	hold	hold	accumulate	hold	accumulate	accumulate	verweight	równoważ
date issued	2019-12-06	2019-12-05	2019-11-04	2019-09-05	2019-07-25	2019-07-03	2019-06-14	2019-06-03	2019-05-09
target price (PLN)	1.25	1.25	1.55	2.00	1.84	1.84	1.79	-	-
price on rating day	1.20	1.17	1.52	1.65	1.75	1.77	1.64	1.60	1.59

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