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Cognor – Q2'19 Results

Rating: hold | target price: PLN 1.84 | current price: PLN 1.68

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Cognor Group reports surprisingly good Q2'19 results. Sales rose on the previous year in terms of volume despite a weakened steel industry environment in Europe. In addition, in Q2'19, the Group recognised PLN 14m in compensation for higher energy costs for the whole H1'19. In our opinion, the compensation is to be treated as a one-off event (the reimbursement will be paid only for H1'19 and will later be replaced by a less favourable support scheme), yet its impact on Cognor will be worth approx. PLN 0.11 per share. Excluding the compensation, the results would have been close to our expectations. Moreover, the group reported strong operating cash flows and a decrease in net debt.

- **Sales amounted to PLN 516m in Q2'19**, exceeding our forecast by 6%. Analysts had expected Q2 sales to be between PLN 487m and PLN 492m. It is worth stressing that Cognor Group **managed to improve last year's sales volumes** despite a high base for comparison and an unfavourable steel industry environment in H1'19 with European steelworks cutting production.
- The Group reported a **year-on-year decrease in spreads on steel billets** (semi-products) in both Ferrostal and Huta Stali Jakościowych steelworks. **Spreads on products** increased on the same period last year in Ferrostal, but went down in Huta Stali Jakościowych.
- In Q2'19, the company recognised **a negative impact of FIFO inventory valuation** of PLN -9.5m (compared with PLN -0.7m in Q2'18). The figure was close to our expectations.

- **Adjusted EBITDA stood at PLN 36m in Q2'19** and was significantly higher than we had forecast. In addition, in Q2'19, the company recognised **PLN 14m in compensation for higher energy costs**. The parliament decided to reimburse the industry for higher energy costs in H1'19 and to offer energy-intensive sectors a less favourable support scheme in the following periods. The PLN 14m received as compensation reduced the Group's costs in Q2'19, which had a positive effect on its result (we had not considered this effect in our forecasts). Excluding the compensation, EBITDA would have amounted to PLN 22m and would have been only slightly better than we had forecast.
- Cognor **changed the method of accounting for modernisations** in Q2'19. Before the change, it recognised modernisation provisions in each quarter of the year (with modernisations usually taking place in Q3 and Q4). From now on, the company will incur these costs at the time of recognising investment expenses. The change added PLN 5m to Q2'19 EBITDA. This amount is included in the above-mentioned adjusted EBITDA.
- **Net profit stood at PLN 16.1m in Q2'19** or PLN 13.9m adjusted for one-off events. Analysts had expected PLN 4.1-9.8m.
- **Operating cash flows** amounted to PLN 81m in Q2'19 improving considerably on the same period last year (up from PLN 39m). As a consequence, **net debt** decreased by PLN 46m to PLN 286m over the quarter (1.9x EBITDA). Excluding the accounting changes under IFRS16, net debt would have amounted to PLN 233m (1.6x EBITDA) at the end of Q2'19.

2019 Q2 actuals vs. expectations

(PLN m)	Q2'19	Q2'18	change	Q2'19E	differ.	2019E	2018	change	YTD
Revenue	516.3	535.7	-3.6%	487.4	5.9%	2,004.2	2,081.8	-3.7%	51.7%
EBITDA	42.9	62.1	-30.8%	21.0	104.3%	108.5	200.1	-45.8%	64.3%
EBITDA margin	8.3%	11.6%	-	4.3%		5.4%	9.6%		
EBIT	31.6	51.0	-38.1%	9.5	231.5%	61.7	156.2	-60.5%	75.6%
Net profit	16.1	16.0	0.7%	4.1	292.4%	33.9	68.5	-50.5%	73.4%

Source: Cognor, E - estimates by Dom Maklerski mBanku

List of abbreviations and ratios contained in the report:

EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – Earnings Before Interest, Taxes, 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 payments + 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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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.

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