

Monday, January 17, 2022 | Investment Strategy 2022, an excerpt

Cognor hold (downgraded)

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2021 was a record year for Cognor; unfortunately, it may also turn out to be the last record year ever.

Cognor benefitted from high prices for steel products in 2021 while generating high margins that it may not be able to maintain in the future.

EAF producers had an advantage over blast furnace production last year due to high iron ore and coking coal prices, but coking coal prices may come under pressure this year due to increased supply and weakening momentum in the steel industry. Iron ore prices have already dropped.

In our opinion, lower prices of steel inputs and weaker demand for steel will lead to lower prices of the products offered by Cognor. Moreover, high prices of scrap steel, which account for about 50% of the company's operating expenses, may be much more resistant to declines. The demand for scrap does not seem to be weakening and, in the long term, with the transition to more environmental steel production, the demand for scrap will increase.

Taking this into account, we expect weaker results in 2022 compared to 2021 but higher than in our initial forecasts.

Note that Cognor might be offering significantly higher dividends this year; at the assumed 50% payout ratio the DPS would be PLN 0.68, with dividend yield of ca. 17% implied by a share price of PLN 3.9.

Nevertheless, after taking into account the shifting steel market trends and the expected profit slowdown, we downgrade COG from buy to hold with a lower target of PLN 4.1.

Financial Highlights

(PLN m)	2019	2020	2021P	2022P	2023P
Ferrostal volume (k tons)	424	424	427	419	426
HSJ volume (k tons)	237	238	247	252	257
Zlomrex volume (k tons)	142	137	152	155	158
Ferrostal spread (PLN/t)	1,127	1,022	1,520	1,175	1,060
HSJ spread (PLN/t)	1,508	1,265	1,695	1,358	1,303
Operating cash flow	142	206	166	217	115
D&A	46	48	50	50	48
Working capital	61	98	-140	38	19
Investing cash flow	-56	-57	-50	-50	-39
CAPEX	56	57	50	50	39
Financing cash flow	-84	-127	-103	-131	-73
Dividends/Buyback	-36	0	-26	-118	-60
FCF	102	157	195	168	76
FCF/EBITDA	101%	138%	56%	81%	72%
OCF/EBITDA	141%	180%	47%	104%	108%

DCF Analysis

(PLN m)	21P	22P	23P	24P	25P	26P	27P	28P	29P	30P	+
Sales volume	674	672	683	690	696	703	701	699	696	696	696
Product prices	2,955	2,715	2,219	2,146	2,148	2,149	2,155	2,160	2,162	2,162	2,162
Scrap prices	1,855	1,834	1,331	1,206	1,188	1,170	1,152	1,152	1,152	1,152	1,152
Revenue	2,702	2,509	2,074	2,015	2,030	2,046	2,046	2,049	2,047	2,051	2,055
EBITDA	472	208	106	84	97	112	124	125	128	125	121
EBITDA margin	17.5%	8.3%	5.1%	4.2%	4.8%	5.5%	6.1%	6.1%	6.3%	6.1%	5.9%
EBIT	412	158	58	37	50	66	77	78	82	76	73
Tax	76	28	9	5	7	10	12	13	13	12	12
CAPEX	-50	-50	-39	-40	-42	-43	-46	-46	-46	-46	-48
Working capital	-140	38	19	3	-1	-1	0	0	0	0	0
FCF	195	168	76	42	47	58	65	66	69	67	63
PV FCF	190	149	62	31	32	36	36	34	32	28	
WACC	9.2%	9.4%	9.4%	9.4%	9.5%	9.6%	9.7%	9.7%	9.7%	9.7%	9.7%
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%
PV FCF	629.0
Net debt	164.0
Other adj.	19.3
Value per share (PLN)	4.52

Valuation Summary

(PLN)	Weight	Price
Relative Val.	50%	3.14
DCF Val.	50%	4.52
Implied Price		3.83
Cost of equity (9M)		7.2%
9M Target Price		4.10

Current Price

4.15 PLN

Downside

9M Target Price

4.10 PLN

-1.2%

	rating	target price	issued
new	hold	4.10 PLN	2022-01-17
old	buy	5.05 PLN	2021-10-07
Key Metrics		COG PW	vs. WIG
Ticker	COG PW	1M Price Chng	+9.5%
ISIN	PLCNTSL00014	YTD Price Chng	+7.8%
Outst. Stock (m)	175.0	ADTV 1M	0.8 mln PLN
MC (PLN m)	726.1	ADTV 6M	2.0 mln PLN
EV (PLN m)	831.9	EV/EBITDA 12M fwd	4.4 +19.6%
Free Float	21.6%	EV/EBITDA 5Y avg	3.7 premium

Earnings Projections

(PLN m)	2019	2020	2021P	2022P	2023P
Revenue	1,902	1,733	2,702	2,509	2,074
EBITDA adj.	93	92	345	208	106
EBITDA margin	4.9%	5.3%	12.8%	8.3%	5.1%
EBIT adj.	47	44	295	159	59
Net income adj.	11	10	229	119	38
P/E adj.	64.7	72.0	3.2	6.1	19.2
P/B	2.8	2.5	1.5	1.5	1.5
EV/EBITDA adj.	10.4	9.9	2.4	3.8	7.5
DPS	0.21	0.00	0.15	0.68	0.34
DYield	5.0%	0.0%	3.5%	16.3%	8.2%
Forecast Update (% change)			2021P	2022P	2023P
Revenue			+2.7%	+5.8%	+3.6%
EBITDA			-2.5%	+2.7%	-38.9%
Net income			-3.0%	+3.9%	-59.1%
Sales volume			0.0%	-1.2%	-0.5%
Product prices			-1.2%	+1.9%	-1.5%
Scrap prices			+5.8%	+8.4%	+12.1%

Key Balance Sheet Figures

(PLN m)	2019	2020	2021P	2022P	2023P
Assets	1,052	1,031	1,258	1,244	1,134
Fixed assets	487	515	496	492	484
Equity	259	288	498	499	478
Minority interests	259	288	498	499	478
Net debt	226	164	87	51	48
Net debt/EBITDA (x)	224%	144%	25%	24%	45%
Net debt/Equity (x)	87%	57%	17%	10%	10%

Relative Valuation Summary

	P/E			EV/EBITDA		
	21P	22P	23P	21P	22P	23P
Minimum	1.8	2.8	4.4	1.4	1.1	1.0
Maximum	22.5	48.7	26.4	28.0	9.2	8.8
Median	4.5	5.7	7.7	3.8	3.3	4.2
Weight	17%	17%	17%	17%	17%	17%

List of abbreviations and ratios used by mBank:

EV (Enterprise Value) – Equity Value + Net Debt; **EBIT** – Earnings Before Interest and Taxes; **EBITDA** – EBIT + Depreciation & Amortisation; **Net Debt** – Borrowings + Debt Securities + Interest-Bearing Loans - Cash and Cash Equivalents; **P/E** (Price/Earnings) – Price Per Share Divided by Earnings Per Share; **P/CE** (Price to Cash Earnings) – Price Per Share Divided by Earnings + Depreciation & Amortisation; **P/B** (Price to Book Value) – Price Per Share Divided by Book Value Per Share; **P/CF** (Price to Cash Flow) – Price Divided by Cash Flow from Operations; **ROE** (Return on Equity) – Earnings Divided by Shareholders' Equity; **ROCE** (Return on Capital Employed) – EBIT x (Average Assets - Current Liabilities); **ROIC** (Return on Invested Capital) – EBIT x (1-Tax Rate) / (Average Equity + Minority Interest + Net Debt); **FCFF** (Free Cash Flow to Firm) – Cash Flow from Operations - CAPEX - Lease Payments; **FCFE** (Free Cash Flow to Equity) – Free Cash Flow to Firm - Net Interest Expense (incl. Debt + Leases) - Lease Payments

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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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%

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

Cognor

Rating	hold	buy	accumulate	buy	hold	buy	buy
Rating date	2022-01-17	2021-10-07	2021-08-31	2021-06-18	2021-04-09	2021-03-05	2021-02-10
Target price	4.10	5.05	5.05	4.30	3.19	3.19	2.89
Price on rating	4.15	3.93	4.52	3.57	3.16	2.55	2.15

Comparable Companies Used In Relative Valuation Models

Cognor AK Steel, Alumetal, ArcelorMittal, Baoshan Iron & Steel, Commercial Metals, HeSteel, Hitachi Metals, Hyundai Steel, JFE Holdings, JSW Steel, Kloeckner & Co, Metalurgica Cerdau, 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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