

Wednesday, July 03, 2019 | Monthly Market Outlook, an excerpt

Cognor accumulate (reiterated)

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Cognor's profits are set to fall noticeably this year vis-a-vis the record numbers posted in 2018, led by a general slump in global steel prices. On a likely 2% decline in sales volumes, significantly tightened margins on flat and long steel products might put a dent in 2019 profit to the tune of PLN 46m, exacerbated by an additional squeeze from higher costs of utilities (+PLN 35m) and labor (+PLN 10m). Despite a resulting drop in 2019 EBITDA by a projected 50%, on a positive note, we predict Cognor can generate steady FCF of about PLN 60m a year in the next three years, retaining its capacity to make regular distributions to shareholders. This year, with PLN 0.30 DPS approved by shareholders, investors who buy COG before the September 25th ex-date can count on a dividend yield of over 15%, the highest among all WSE stocks. In 2020 and 2021, assuming average annual EBITDA of ca. PLN 100m, we believe dividend yields can be kept close to 10%. After a still-weak second quarter, Cognor's prospects for the second half of 2019 are lifted by the planned closure by ArcelorMittal of its Polish steel plant in Krakow, and the improving price advantage of EAF steelmaking over BOF producers. After updating our relative valuation model, we raise our target price for Cognor from PLN 1.79 to PLN 1.84 per share, and we maintain an accumulate rating for the Company.

Current Price	1.77 PLN	Upside
9M Target Price	1.84 PLN	+4.2%

	rating	target price	issued
new	accumulate	1.84 PLN	2019-07-03
old	accumulate	1.79 PLN	2019-06-14

Key Metrics			COG PW	vs. WIG
Ticker	COG PW	1M Price Chng	+10.3%	+5.7%
ISIN	PLCNTSL00014	YTD Price Chng	+10.3%	+5.4%
Outst. Stock (m)	175.0	ADTV 1M		PLN 0.1m
MC (PLN m)	308.8	ADTV 6M		PLN 0.2m
EV (PLN m)	551.1	EV/EBITDA 12M fwd	3.6	+17.7%
Free Float	-	EV/EBITDA 5Y avg	3.1	premium

Earnings Projections

(PLN m)	2017	2018	2019P	2020P	2021P
Revenue	1,789	2,082	2,004	1,900	2,086
EBITDA adj.	146	200	108	100	106
EBITDA margin	8.1%	9.6%	5.4%	5.3%	5.1%
EBIT adj.	104	156	62	50	57
Net income adj.	32	94	34	27	35
P/E adj.	9.7	3.3	9.1	11.4	8.8
P/B	1.4	1.1	1.1	1.1	1.0
EV/EBITDA adj.	4.5	2.7	5.1	5.3	4.8
DPS	0.00	0.07	0.21	0.13	0.11
DYield	0.0%	3.8%	11.7%	7.2%	6.1%
Projection Update (% change)			2019P	2020P	2021P
Revenue			0.0%	0.0%	0.0%
EBITDA			0.0%	0.0%	0.0%
Net income			0.0%	0.0%	0.0%
Sales volume			0.0%	0.0%	0.0%
Product prices			0.0%	0.0%	0.0%
Scrap prices			0.0%	0.0%	0.0%

Financial Highlights

(PLN m)	2017	2018	2019P	2020P	2021P
Ferostal volume (k tons)	426	401	393	361	432
HSJ volume (k tons)	231	237	232	253	268
Zlomrex volume (k tons)	131	173	176	180	183
Ferostal spread (PLN/t)	953	1,191	1,147	1,159	1,189
HSJ spread (PLN/t)	1,272	1,723	1,680	1,610	1,598
Operating cash flow	145	232	91	110	92
D&A	41	44	47	50	49
Working capital	11	44	15	17	-5
Investing cash flow	-15	-38	-50	-50	-35
CAPEX	16	38	50	50	35
Financing cash flow	-53	-196	-9	-88	-68
Dividends/Buyback	0	-12	-36	-22	-19
FCF	123	179	66	60	58
FCF/EBITDA	87%	90%	61%	60%	55%
OCF/EBITDA	103%	116%	84%	110%	86%

Key Balance Sheet Figures

(PLN m)	2017	2018	2019P	2020P	2021P
Assets	951	1,001	1,035	970	986
Fixed assets	398	379	401	393	370
Equity	225	278	279	284	300
Minority interests	225	278	279	284	300
Net debt	325	209	225	204	179
Net debt/EBITDA (x)	2.3	1.0	2.1	2.0	1.7
Net debt/Equity (x)	1.4	0.8	0.8	0.7	0.6

Relative Valuation Summary

	P/E			EV/EBITDA		
	19P	20P	21P	19P	20P	21P
Minimum	4.3	5.3	5.2	2.8	2.9	3.0
Maximum	23.3	16.7	14.1	11.9	6.8	6.4
Median	9.0	9.0	8.7	5.8	5.3	4.9
Weight	17%	17%	17%	17%	17%	17%

DCF Analysis

(PLN m)	19P	20P	21P	22P	23P	24P	25P	26P	27P	28P	+
Sales volume	625	614	700	749	778	804	820	836	836	836	836
Product prices	2,304.4	2,213.3	2,198.3	2,209.6	2,220.4	2,231.6	2,243.7	2,255.8	2,267.8	2,279.9	2,291.9
Scrap prices	1,088	1,005	990	990	990	990	990	990	990	990	990
Revenue	2,004	1,900	2,086	2,207	2,286	2,358	2,409	2,462	2,478	2,494	2,510
EBITDA	108	100	106	94	90	86	83	81	81	83	85
EBITDA margin	5.4%	5.3%	5.1%	4.3%	3.9%	3.6%	3.5%	3.3%	3.3%	3.3%	3.4%
EBIT	62	50	57	47	43	40	38	35	34	35	37
Tax	7	6	8	6	6	5	5	5	5	5	5
CAPEX	-50	-50	-35	-36	-37	-39	-40	-43	-46	-47	-47
Working capital	15	17	-5	-5	-6	-5	-4	-4	-1	-1	-1
FCF	66	60	58	47	40	36	34	29	29	31	33
PV FCF	64	54	48	36	29	24	21	16	15	15	
WACC	7.6%	7.6%	7.8%	7.8%	7.9%	7.9%	8.0%	8.0%	8.0%	8.1%	8.1%
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	321
Net debt	209
Other adj.	18
Value per share (PLN)	2.01

Valuation Summary

(PLN)	Weight	Price
Relative Val.	50%	1.43
DCF Val.	50%	2.01
Implied Price		1.72
Cost of equity (9M)		7.0%
9M Target Price		1.84

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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Rating	accumulate	accumulate	overweight	neutral	underweight	neutral
Rating date	2019-07-03	2019-06-14	2019-06-03	2019-05-09	2019-03-05	2018-12-05
Target price (PLN)	1.84	1.79	-	-	-	-
Price on rating day	1.77	1.64	1.60	1.59	1.94	1.80

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 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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