

Wednesday, February 10, 2021 | update

Cognor: buy (reiterated)

COG PW; COGP.WA | Steel, Poland

Riding Steel Price Rally Into H1 2021

The first half of 2021 might mark a return to form for Cognor looking at upward-trending prices of steel products, including billet and rebar, which in Europe have enjoyed an even stronger rally since the January imposition of export tariffs (up to 13% and 12%, respectively) by Russia. As a result of an unexpected surge in demand, steel in Europe has been in short supply, and the start of the construction season will soon begin drawing near. Under these circumstances, Cognor is benefitting from its vertical integration with Złomrex, the scrap supplier responsible for 25%-50% of all input deliveries that still has cheaply-acquired inventory to draw on. We are expecting Cognor to generate EBITDA of PLN 158 million in FY2021, resulting in a lower ending leverage ratio of 1.0x. If this is correct, in 2022 Cognor would have the means to pay cash dividends of PLN 0.25 per share, offering an implied dividend yield of 12%. Furthermore, in the two years from 2021 to 2022, Cognor has the capacity to generate free cash flow-to-enterprise value higher than 16%, and yet its stock is currently trading at an average discount of 40% relative to peers. In the coming days, COG might register a decline due to an expected conversion of its Exchangeable Notes in the third week of February. Of a total of €17.3m Exchangeable Notes issued, we believe bondholders holding no less than €3m might opt to convert at PLN 1.61 a share, generating downward price pressure which we would use as an opportunity to buy shares in Cognor. We have revised upwards our FY2021 and 2022 earnings forecasts for Cognor, resulting in a higher target price of PLN 2.89 – a target which indicates plenty of upside and still warrants a buy call even after COG doubled in value since our last rating in December.

Forecast of 2020 Q4 Results

We believe Cognor will post its second quarter in a row of growing profits in Q4 2020, with EBITDA up by 10% on the year at an estimated PLN 15.6m. We also expect the Company to declare a cash dividend of PLN 0.13 per share with the FY2020 earnings release that at today's price level implies dividend yield of 6%. This after likely reducing the net debt/EBITDA ratio to 1.8x as of 31 December 2020.

Exchangeable Notes

Cognor's bondholders will probably convert their securities to equity by the end of the month. The Exchangeable Notes are worth €17.3m, and the conversion price is PLN 1.61 per share. Cognor has an option to repurchase the notes to avoid conversion, but in our opinion it will not exercise this option. An equivalent of €5.5-6m of the Notes is owned by Cognor's lead shareholder, Mr. Przemysław Sztuczkowski, €9m is held by two institutional investors, and smaller bondholders are holding ca. €3m. This last group is the most likely to sell their ~8.4 million converted shares on the stock market, creating a temporary overhang that could last a few weeks.

(PLN m)	2018	2019	2020E	2021E	2022E
Revenue	2,081.8	1,901.6	1,737.3	2,267.8	2,203.5
EBITDA (adj.)	200.0	92.9	96.9	157.5	122.2
EBITDA margin (adj.)	9.6%	4.9%	5.6%	6.9%	5.5%
EBIT (adj.)	156.2	46.7	48.9	110.6	77.3
Net profit (adj.)	93.7	11.2	14.7	73.8	46.9
P/E (adj.)	4.0	33.5	25.5	5.1	8.0
P/CE	3.3	5.8	4.4	3.1	4.1
P/B	1.4	1.5	1.3	1.1	1.1
EV/EBITDA (adj.)	3.0	6.7	6.3	3.6	4.4
DPS	0.07	0.21	0.00	0.13	0.25
Dividend Yield	4.7%	9.6%	0.0%	5.9%	11.8%

*2018-2022E ratios assume full dilution

Current Price	PLN 2.15
Target Price	PLN 2.89
Market Cap	PLN 376m
Free Float	PLN 96m
ADTV (3M)	PLN 0.7m

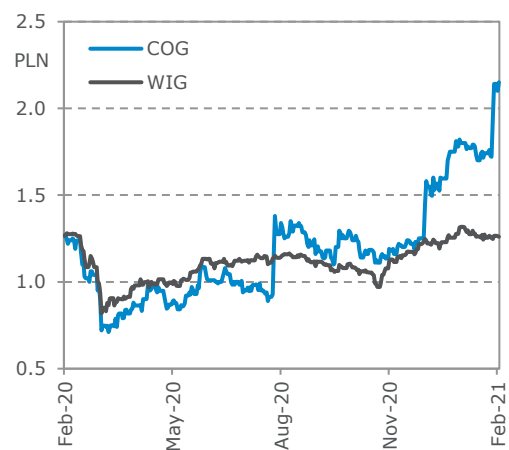
Ownership

PS HoldCo Sp.z o.o	74.58%
Others	25.42%

About

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 bars in electric arc furnaces, and 'Huta Stali Jakościowych' produces long and flat products from quality steel. Cognor's total production capacity is 636,000 tonnes, set to increase to 850,000t in 2021. Cognor operates its own scrap buying centers which cover about 50% of its steel scrap needs.

COG vs. WIG



Company	Target Price		Rating	
	new	old	new	old
Cognor	2.89	2.29	buy	buy

Company	Current Price	Target Price	Upside
Cognor	2.15	2.89	+34.4%

Forecast Revision	2021E	2022E	2023E
Revenue	+20.9%	+15.6%	+5.9%
EBITDA	+41.0%	+5.7%	+0.1%
Net profit	+101.1%	+13.0%	+0.3%
Sales volume	-0.8%	-0.8%	-0.8%
Sales price	+20.6%	+15.2%	+6.1%
Costs of scrap input	+41.3%	+35.5%	+14.8%

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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 to adjust 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 in recent years, underpinned by competitive pressures coming from China and the former Soviet Republics, where local steel industries enjoy backing and protections from their respective governments. Since 2016, the pressures are being mitigated by higher duties placed 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 €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. With this in mind, 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 facilities.

In the future EU producers could benefit from a carbon tax on imports which would be a game changer for local steelmakers from the point of view of competition.

Competitive Pressures

Whenever there is a downward shift in the prices of iron ore and metallurgical 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 extended 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 €17.3m in Exchangeable Notes of Cognor, which, if a substantial part of them is converted at once, 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 bondholders if they decided to convert today.

Excessive Leverage

In the past, Cognor has been known to use sizable debt issues to raise financing for 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 forced steelmakers to drastically cut back production in 2020.

Valuation

We used two valuation methods to determine the value of Cognor: the Discounted Cash Flow method, indicating a per-share valuation of PLN 2.60, and the Relative Valuation method, yielding a value of PLN 2.79 per share.

(PLN)	weight	price
Relative Valuation	50%	2.79
DCF Analysis	50%	2.60
		price 2.70
	9M target price	2.89

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 Alumental, 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.

Multiples Comparison

	Country	P/E			EV/EBITDA		
		2020E	2021E	2022E	2020E	2021E	2022E
ALUMETAL SA	Poland	16.8	14.2	12.6	10.2	8.7	7.9
ARCELORMITTAL	Luxembourg	-	7.4	8.3	8.7	4.3	4.2
BAOSHAN IRON & STEEL CO-A	China	13.1	10.5	9.6	5.1	4.1	3.7
COMMERCIAL METALS CO	USA	9.1	11.5	10.9	5.2	5.6	5.5
HITACHI METALS LTD	Japan	-	-	38.7	20.8	34.3	9.8
HYUNDAI STEEL CO	Korea Pld.	-	21.9	14.2	10.0	7.8	7.0
JFE HOLDINGS INC	Japan	-	-	9.5	9.5	15.7	8.0
JSW STEEL LTD	India	32.8	14.6	11.2	13.2	8.6	7.0
KLOECKNER & CO SE	Germany	-	28.7	16.1	9.7	5.7	4.7
METALURGICA GERDAU SA-PREF	Brazil	24.0	8.3	9.3	5.0	4.1	3.8
NIPPON YAKIN KOGYO CO LTD	Japan	6.1	12.4	10.6	-	-	-
NUCOR CORP	USA	18.0	12.8	16.2	8.3	7.1	7.7
OLYMPIC STEEL INC	USA	-	14.1	19.4	-	-	-
OUTOKUMPU OYJ	Finland	-	21.7	11.2	13.1	6.7	5.4
POSCO	South Korea	16.4	9.3	8.5	5.9	4.5	4.0
SALZGITTER AG	Germany	-	10.4	7.3	16.3	4.7	4.2
SSAB AB-A SHARES	Sweden	-	11.2	10.3	15.4	5.1	4.7
STEEL AUTHORITY OF INDIA	India	-	6.5	6.8	5.2	7.8	5.9
STEEL DYNAMICS INC	USA	14.4	10.2	12.8	8.5	6.6	7.0
TATA STEEL LTD	India	46.7	18.7	8.6	10.9	8.1	6.5
THYSSENKRUPP AG	Germany	-	-	32.2	-	2.7	1.8
UNITED STATES STEEL CORP	USA	-	13.1	89.5	-	6.1	8.5
VOESTALPINE AG	Austria	-	-	15.8	8.8	9.8	6.2
Maximum		46.7	28.7	89.5	20.8	34.3	9.8
Minimum		6.1	6.5	6.8	5.0	2.7	1.8
Median		16.6	12.4	11.2	9.5	6.6	5.9
Cognor		25.5	5.1	8.0	6.3	3.6	4.4
premium / discount		54.0%	-59.0%	-28.3%	-34.1%	-45.9%	-24.6%

Implied Valuation

Median	16.6	12.4	11.2	9.5	6.6	5.9
Discount	20%	20%	20%	20%	20%	20%
Multiple weight		50%			50%	
Year weight	33%	33%	33%	33%	33%	33%

Value per share (PLN) 2.79

Additional Assumptions

Historical sales of Huta Ferrostal steel rebar unit and future projections

Sales volumes (1,000t)	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Billet	85.3	119.2	81.8	110.3	89.9	82.8	76.1	70.0	64.4
Plain bars	29.3	30.0	30.3	30.9	26.2	29.3	29.9	30.5	31.1
Flat bars	61.4	48.1	44.1	39.9	39.9	44.7	45.6	46.5	47.4
Squares	7.7	6.5	8.3	8.7	8.7	9.8	10.0	10.2	10.4
Rebar	188.1	202.1	213.7	211.1	246.2	251.1	256.1	261.2	266.5
Angles	24.9	17.5	22.3	22.0	21.4	24.0	24.5	25.0	25.5
Other	6.6	3.1	1.1	1.5	1.5	1.7	1.7	1.7	1.8
Avg. spread (PLN/t)	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Steel billet	718	878	1,046	920	840	826	827	890	907
Plain bars	1,121	1,069	1,365	1,408	1,266	1,351	1,334	1,362	1,360
Flat bars	1,158	1,075	1,386	1,401	1,233	1,310	1,295	1,325	1,324
Squares	1,131	1,048	1,342	1,331	1,151	1,210	1,197	1,234	1,237
Rebar	823	937	1,151	1,101	973	1,126	1,113	1,106	1,109
Angles	1,170	1,050	1,397	1,403	1,224	1,300	1,285	1,315	1,315
Other	1,421	1,117	1,892	1,643	1,353	1,459	1,438	1,458	1,452

Source: mBank

Historical sales of HSJ rolled steel unit and future projections

Sales volumes (1,000t)	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Billet	40.5	66.2	58.7	74.7	80.1	76.1	77.6	79.2	80.8
Bars	153.7	156.5	175.6	157.6	154.7	165.5	168.8	172.2	175.6
Thick sheet	5.7	7.7	1.6	3.7	3.3	3.4	3.5	3.5	3.6
Thin sheet	0.6	0.5	0.7	0.5	0.6	0.6	0.7	0.7	0.7
Other	0.6	0.3	0.5	0.5	0.5	0.5	0.6	0.6	0.6
Avg. spread (PLN/t)	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Billet	979	1,176	1,486	1,145	1,146	926	929	1,010	1,032
Bars	1,553	1,709	2,192	2,115	1,800	1,704	1,681	1,708	1,703
Thick sheet	1,885	1,742	3,446	2,589	2,772	2,863	2,800	2,747	2,702
Thin sheet	10,284	9,897	10,307	9,970	10,702	12,313	11,924	11,219	10,848
Other	20,891	24,078	22,173	19,436	22,448	26,309	25,437	23,767	22,914

Source: mBank

Steel Market Assumptions

	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Price of rolled sheet steel (PLN/t)	1,919	2,417	2,588	2,463	2,425	2,900	2,800	2,600	2,550
Price of HEB sections (PLN/t)	2,240	2,282	2,614	2,593	2,489	3,000	2,900	2,750	2,600
Price of rebar (PLN/t)	2,170	2,139	2,439	2,275	2,150	2,800	2,700	2,450	2,350
Steel production in Poland (mmt)	8.9	10.3	10.3	9.1	8.0	8.4	8.6	8.7	8.9
Cognor's market share	166	169.0	169.0	159.0	136.6	143	148	149	151
USD/PLN	3.94	3.78	3.61	3.83	3.91	3.60	3.60	3.60	3.60
Coke price (US\$/t)	119	179	193	170	127	155	160	155	155
Iron ore price (US\$/t)	59	72	70	102	106	140	100	85	85
Scrap price (US\$/t)	215	282	343	297	277	445	420	350	320
BOF (US\$/t)	212	282	299	327	303	410	344	303	296
EAF (US\$/t)	239	315	383	331	308	496	468	390	357
BOF-EAF (US\$/t)	-28	-33	-83	-4	-5	-86	-124	-88	-61
BOF (PLN/t)	835	1,066	1,081	1,253	1,186	1,478	1,239	1,089	1,066
EAF (PLN/t)	944	1,190	1,381	1,267	1,206	1,786	1,686	1,405	1,284
Scrap price (PLN/t)	847	1,067	1,238	1,136	1,082	1,602	1,512	1,260	1,152

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.
- Cash flow is discounted as of early February 2021.
- Net debt is as at year-end 2019 plus dividends for FY2020 (PLN 0.28 per share) paid in 2020.

DCF Model

(PLN m)	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P	2028P	2029P	+
Revenue	1,737.3	2,267.8	2,203.5	2,034.2	1,966.5	1,981.9	1,998.5	1,998.4	1,999.0	1,995.2	1,998.3
change	-8.6%	30.5%	-2.8%	-7.7%	-3.3%	0.8%	0.8%	0.0%	0.0%	-0.2%	0.2%
EBITDA	119.1	157.5	122.2	119.1	106.0	101.9	103.5	100.3	96.8	95.6	92.3
EBITDA margin	6.9%	6.9%	5.5%	5.9%	5.4%	5.1%	5.2%	5.0%	4.8%	4.8%	4.6%
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	71.2	110.6	77.3	75.5	63.2	59.4	60.7	56.6	52.8	51.5	48.2
EBIT margin	4.1%	4.9%	3.5%	3.7%	3.2%	3.0%	3.0%	2.8%	2.6%	2.6%	2.4%
Tax on EBIT	9.8	17.3	11.0	10.6	8.3	7.6	7.8	7.0	6.3	6.1	5.5
NOPLAT	61.3	93.3	66.4	64.9	54.9	51.8	52.9	49.5	46.5	45.4	42.8
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	-23.2	-14.8	7.3	7.6	3.0	-0.7	-0.7	0.0	0.0	0.2	-0.1
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF	36.1	92.4	84.0	80.8	64.4	56.0	55.4	50.4	47.6	46.6	43.5
WACC	7.9%	8.2%	8.3%	8.5%	8.6%	8.7%	8.8%	8.9%	8.9%	9.0%	9.0%
discount factor	1.00	0.93	0.86	0.79	0.72	0.66	0.61	0.55	0.51	0.46	0.42
PV FCF	36.1	85.9	72.0	63.6	46.5	37.1	33.6	28.0	24.1	21.6	18.5

WACC	7.9%	8.2%	8.3%	8.5%	8.6%	8.7%	8.8%	8.9%	8.9%	9.0%	9.0%
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	36.4%	30.5%	27.9%	23.9%	22.0%	20.2%	18.1%	16.8%	15.6%	14.3%	13.6%
Cost of equity	9.7%	9.7%	9.7%	9.7%	9.7%	9.7%	9.7%	9.7%	9.7%	9.7%	9.7%
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	618.2
Present value of terminal value	286.5
Present value of FCF in the forecast period	448.7
Enterprise value	735.1
Net debt	261.9
Minority interests	18.4
Equity value	454.8
Shares outstanding (millions)	175.0
Equity value per share (PLN)	2.60
9M cost of equity	7.2%
9M target price (PLN)	2.79

EV/EBITDA ('21) at target price	4.3
P/E('21) at target price	6.6
TV / EV	39.0%

Sensitivity Analysis

	FCF growth in perpetuity				
	0.0%	1.0%	2.0%	3.0%	5.0%
WACC +1.0 p.p.	2.08	2.21	2.37	2.57	3.21
WACC +0.5 p.p.	2.23	2.38	2.56	2.80	3.60
WACC	2.40	2.57	2.79	3.08	4.09
WACC -0.5 p.p.	2.58	2.78	3.05	3.40	4.71
WACC -1.0 p.p.	2.79	3.03	3.34	3.78	5.53

Forecast of 2020 Q4 Results

Compared to the same period a year earlier, the estimated **sales volumes** of Cognor in Q4 2020 increased by 3% for steel bars and other products, and fell 17% for non-ferrous metal scrap. Based on this, we expect quarterly **revenue** to post a 6% decrease to PLN 437m.

On the upside Cognor should be able to **mitigate the revenue loss** with its cost-effective fabrication technology, combined with lower prices of input materials, the zloty's weakness relative to the euro, and a rise in orders from the auto industry. As a result, we see the Company as posting its second quarter in a row of **growing profits**, with EBITDA up by 10% year-on-year at an estimated PLN 15.6m.

2020 Q4 estimates

(PLN m)	4Q'20E	4Q'19	change
Revenue	436.7	466.1	-6.3%
EBITDA	15.6	14.2	10.2%
margin	3.6%	3.0%	
EBIT	3.6	2.6	41.7%
Net income	0.5	-5.1	-

Source: Cognor, E- mBank estimates

Exchangeable Notes

There is anticipation that holders of Cognor's Exchangeable Notes will proceed to **swap them for equity** in the third week of February 2021. The outstanding Notes are worth **€17.3m**, and the **conversion price is PLN 1.61** per share. Cognor has an option to repurchase the Notes to avoid conversion, but in our opinion it will not exercise this option.

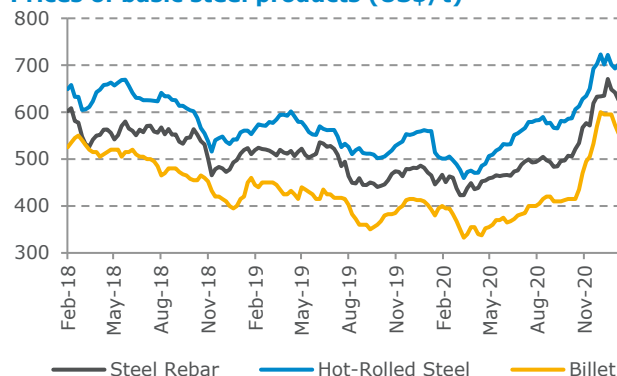
An equivalent of €5.5-6m of the Notes is owned by Cognor's lead shareholder, Mr. Przemysław Sztuczowski, €9m is held by two institutional investors, and **smaller bondholders are holding ca. €3m**. That last group is the most likely to offer converted shares of Cognor on the stock market, rather than selling them via blocks, thus potentially creating a temporary overhang that could last several weeks. We are not worried a fall in COG stock much below the PLN 1.61 conversion price because this would mean losses for the bondholders. In fact, we would **take advantage of any weakness to buy** shares in Cognor and its strong growth prospects for the first half of 2021.

Steel Market Update

Steel prices in the Chinese market have been on the rise since March 2020, though the pace of the upward trend is seen to have slowed at the beginning of 2021 ahead of Lunar New Year holidays which traditionally are a slow period for business activity. China's Purchasing Managers' Index for the steel industry registered a disappointing 44.3 points in January after decreasing by 1.5, with a 7-point fall to 35 in the sub-index of new domestic orders. The general manufacturing PMI showed a decline that reflected slight deceleration in China's growth at the end of 2020, however the sub-index of new export orders registered a rise of 0.8 to 55 points.

During 2020 the export orders PMI prints were seen to fall well below the 50pt growth threshold with demand squashed by the coronavirus pandemic, while domestic orders mostly remained well above 50pt. Internal **demand for steel is expected to bounce back** once Lunar Year celebrations come to an end and China resumes its vast infrastructure development.

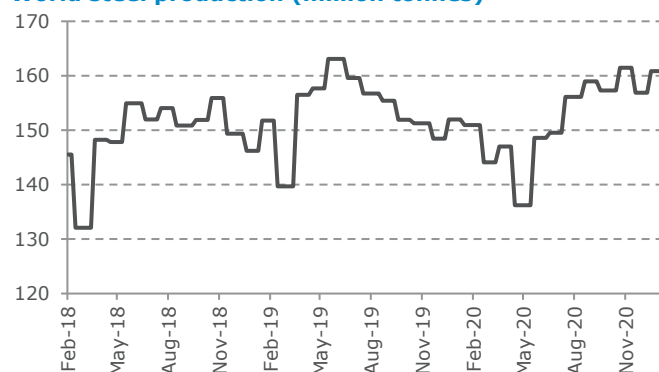
Prices of basic steel products (US\$/t)



Source: Bloomberg, mBank

At the moment Chinese steel prices are back at levels last seen in 2018 – a very good year for global steelmaking. Worldwide, the production of steel in the second half of 2020 exceeded the output produced in 2018, which means a metallurgical plant is working at more than 80% of capacity.

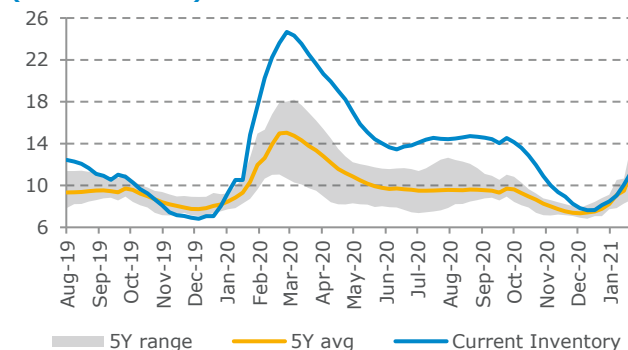
World steel production (million tonnes)



Source: Bloomberg, mBank

Another way China positively influenced global steel prices in 2020 was by **liquidating** much of the **overstock** created in spring in the wake of the Covid outbreak. Today, the steel reserves are seen to be rising ahead of the Lunar Year holiday, however they remain well below the average level seen in the last five years.

China steel inventories vs. historical averages (million tonnes)

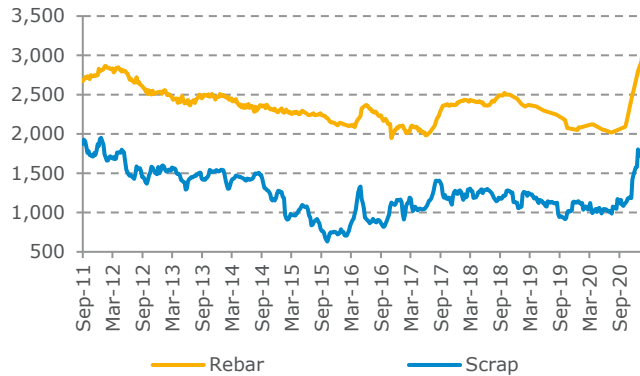


Source: Bloomberg, mBank

In **Poland**, the **price of a tonne** of hot-rolled steel coil has **surged** to PLN 3,400/t – the highest level since we began collecting data. In rebar, prices are the highest in almost a decade at PLN 3,100/t, with February deliveries agreed at upwards of PLN 3,000. The reason why prices in the Polish steel market have been rising at a robust pace is **increased demand** from the manufacturing industry, including from

EU car makers, additionally helped by **Russia's** brand new **export tariffs** on steel scrap (5-15%), billet (up to 13%) and rebar (up to 12%), in force since January. Considering how much of Europe's steel capacity was shut down last year (ca. 40% in Q2 2020), demand in our region has started to exceed supply. Meanwhile, with spring around the corner, it will not take long before construction and infrastructure projects on the continent resume.

Prices of steel rebar and scrap steel in Poland (PLN/t)

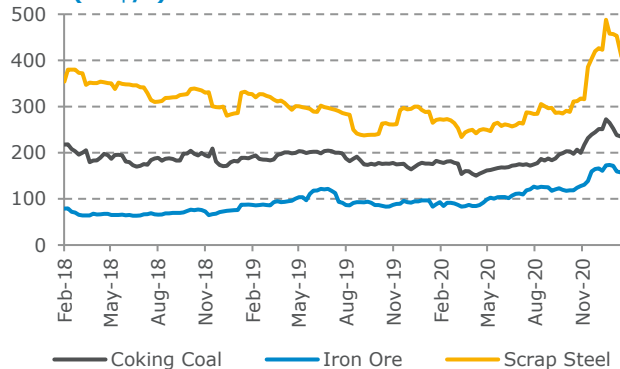


Source: PUDS, mBank

European **steelmakers** are increasingly opting to **bring capacity back on line** to capitalize on the growing demand. Notable examples include ArcelorMittal, which has recently decided to reopen a 2.3mmt plant in Belgium, a 1mmt unit in Spain, and a 1.6mmt furnace in Italy, and VoestAlpine, which restarted an 0.7mmt unit in Austria. There are plans to reopen the third furnace in a 4.5mmt steel plant in Slovakia.

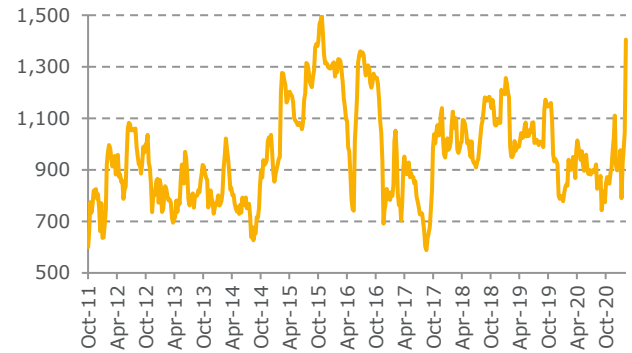
As a result, Europe at the moment is reporting an increasing **need for steel feedstocks**, including coke and scrap metal. In January, **ferrous scrap** at Rotterdam was trading at PLN 1,800 a tonne as compared with PLN 1,110 charged on average in 2020. By now quotes have eased to about PLN 1,500/t, and as **rebar** prices climb the **margins** on their production have grown to the **highest level since 2018**.

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



Source: Bloomberg, mBank

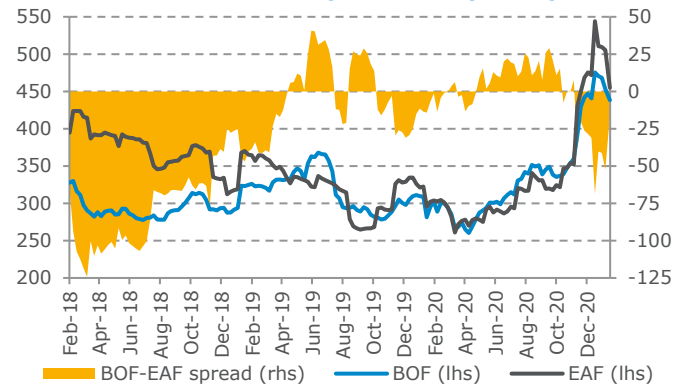
Margins on EAF-based steel rebar (US\$/t)



Source: Bloomberg, mBank

The **cost of making steel** in electric-arc furnaces (EAF) went up towards the end of 2020 on the back of rising costs of secondary steel inputs, but by now, compared to a tonne of billet from basic oxygen furnaces (BOF), **EAF steel is about \$20-30 cheaper to make**. Going forward, amid strong steel demand, we believe the negative effects of higher scrap costs for EAF steelmakers will be outweighed by soaring costs of carbon emissions incurred by BOF-based producers.

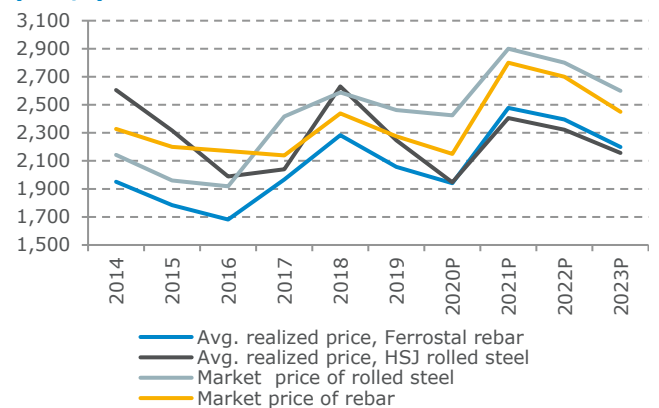
BOF vs. EAF costs of steel production (US\$/t)



Source: Bloomberg, mBank

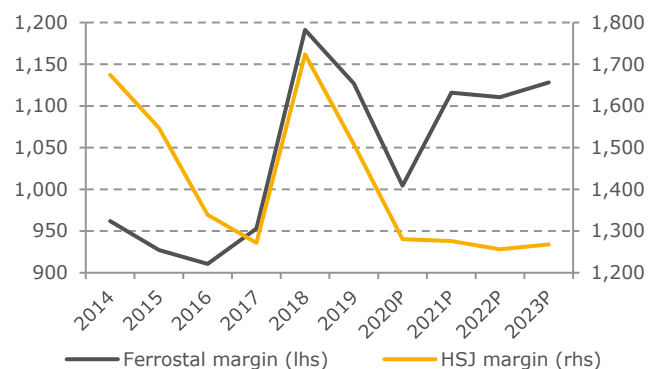
We assume that the **prices of Cognor's steel products this year will rise in line with global trends** and after an implied expansion in profit margins we predict that the Company's **EBITDA for FY2021 will increase to PLN 158m**. We see the Ferrostal rebar unit as a major profit driver in the coming quarters, but we are also anticipating improvement at the HSJ rolled steel unit.

Comparison of market prices of rolled steel and rebar against prices realized by Cognor plants (PLN/t)



Source: Cognor, Rynek Stali, mBank

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

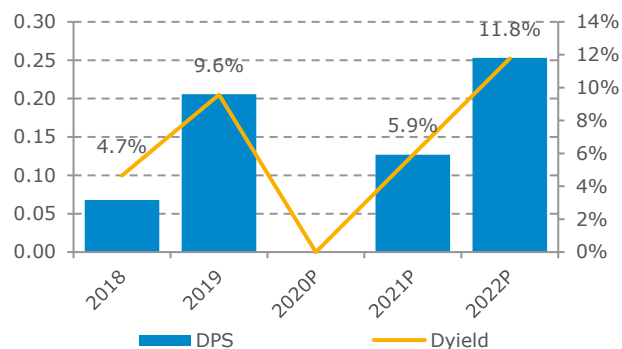


Source: Cognor, Rynek Stali, P – mBank projection

Cognor is expected to have reduced its leverage ratio to 1.8x at the end of 2020, and assuming it opts not to repurchase Exchangeable Notes this would give the Company the **capacity to pay dividends** to its shareholders this year in a projected amount of PLN 0.13 per share, implying **dividend yield of 6%**.

Next year, assuming earnings are as good as expected, we **see dividends as rising** to as much as PLN 0.25 a share with **dividend yield as high as 12%** calculated at the current price level assuming all Exchangeable Notes are converted to equity.

Historical dividends of Cognor and expectations for 2021-2022 DPS PLN, lhs) and dividend yield*



Source: Cognor, P - mBank projection *Assuming full dilution

Earnings History and Future Projections

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Revenue	1,352.4	1,901.6	2,081.8	1,901.6	1,737.3	2,267.8	2,203.5	2,034.2	1,966.5
change	-0.9%	40.6%	9.5%	-8.7%	-8.6%	30.5%	-2.8%	-7.7%	-3.3%
Ferrostal	678.4	838.8	916.6	872.9	842.1	1,098.3	1,063.3	978.9	945.5
HSJ	400.2	471.8	623.7	532.3	465.9	592.1	583.1	552.3	541.7
Złomrex Metal	95.0	130.9	172.8	141.8	126.0	132.3	134.9	137.6	140.4
Other	202.3	454.1	355.5	364.5	316.7	391.0	377.5	350.4	337.0
D&A expenses	37.9	41.3	43.9	45.6	47.1	46.0	44.0	42.7	41.9
Materials & utilities	747.2	1,129.9	1,364.5	1,229.5	1,113.1	1,532.0	1,490.0	1,327.2	1,268.0
of which scrap metal	527.3	761.9	807.6	725.1	720.4	1,121.6	1,067.9	898.6	830.4
of which electricity	126.0	124.4	137.4	124.0	175.4	187.4	195.8	198.7	203.9
Third-party services	228.4	152.5	170.6	177.0	177.2	185.4	190.7	196.4	202.4
Taxes and fees	9.2	10.8	11.9	10.0	10.7	10.4	10.1	9.9	9.8
Payroll	136.2	161.3	183.6	181.6	183.7	186.5	196.0	201.0	206.3
Other costs	4.3	4.7	6.2	7.1	6.0	6.4	6.5	6.3	6.4
Cost of goods sold	148.8	201.8	227.2	192.9	158.4	195.5	188.8	175.2	168.5
Change in inventories	14.4	13.0	79.5	-10.2	20.0	5.0	0.0	0.0	0.0
COGS	1,209.7	1,573.0	1,805.5	1,730.6	1,676.2	2,157.2	2,126.1	1,958.7	1,903.3
Selling expenses	50.0	65.8	76.7	75.3	71.3	74.6	76.8	79.0	81.4
Administrative expenses	37.9	50.5	46.0	48.1	44.8	45.7	46.6	47.5	48.5
Other operating gains/losses	1.7	-0.7	2.6	6.9	10.0	0.0	0.0	0.0	0.0
One-time events	3.4	-5.2	0.0	7.9	22.2	0.0	0.0	0.0	0.0
EBIT	56.5	99.2	156.2	54.6	71.2	110.6	77.3	75.5	63.2
change	329.9%	75.5%	57.5%	-65.1%	30.3%	55.5%	-30.1%	-2.4%	-16.3%
EBIT margin	4.2%	5.2%	7.5%	2.9%	4.1%	4.9%	3.5%	3.7%	3.2%
EBIT (adj.)	53.1	104.4	156.2	46.7	48.9	110.6	77.3	75.5	63.2
EBITDA (adj.)	91.2	145.7	200.0	92.9	96.9	157.5	122.2	119.1	106.0
Net financing gains/losses	-63.0	-31.2	-62.8	-30.8	-25.5	-19.5	-19.5	-19.5	-19.5
Interest expenses	45.9	52.0	38.3	20.9	19.5	19.5	19.5	19.5	19.5
Income from bond repurchase	-10.5	20.8	-25.1	0.0	-6.0	0.0	0.0	0.0	0.0
FX gains / losses									
Pre-tax profit	-6.4	68.1	92.8	22.3	45.7	91.1	57.8	56.0	43.7
Tax	7.9	18.1	20.7	2.6	8.7	17.3	11.0	10.6	8.3
Minority interests	0.1	2.3	3.5	0.7	0.0	0.0	0.0	0.0	0.0
Net profit	1.5	47.6	68.5	19.1	37.0	73.8	46.9	45.4	35.4
change	-110.3%	3019.5%	44.0%	-72.1%	93.5%	99.6%	-36.5%	-3.2%	-21.9%
margin	0.1%	2.5%	3.3%	1.0%	2.1%	3.3%	2.1%	2.2%	1.8%
Net profit (adj.)	8.6	31.9	93.7	11.2	14.7	73.8	46.9	45.4	35.4
D&A expenses	38.1	41.3	43.9	46.2	47.9	46.9	44.9	43.6	42.7
EBITDA	94.6	140.5	200.1	100.8	119.1	157.5	122.2	119.1	106.0
change	93.0%	48.6%	42.4%	-49.6%	18.1%	32.2%	-22.4%	-2.6%	-11.0%
EBITDA margin	7.0%	7.4%	9.6%	5.3%	6.9%	6.9%	5.5%	5.9%	5.4%
Shares outstanding at eop (millions)	75.3	175.0	175.0	175.0	175.0	175.0	175.0	175.0	175.0
EPS	0.0	0.3	0.4	0.1	0.2	0.4	0.3	0.3	0.2
CEPS	0.5	0.5	0.6	0.4	0.5	0.7	0.5	0.5	0.4
ROAE	1.1%	21.1%	24.6%	7.4%	12.5%	21.2%	13.4%	12.5%	9.7%
ROAA	0.2%	5.0%	6.8%	1.8%	3.7%	6.3%	4.0%	4.0%	3.1%

Balance Sheet

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
ASSETS	895.3	950.7	1,001.4	1,051.7	1,009.9	1,173.2	1,162.2	1,139.1	1,128.6
Fixed assets	424.9	398.5	379.3	487.2	481.3	459.4	445.5	438.1	432.6
Intangible assets	11.9	13.0	18.0	22.3	27.0	30.1	33.3	36.5	39.9
Property, plant and equipment	292.8	285.9	284.6	375.6	373.8	357.7	345.1	334.4	325.6
Equity value	15.2	15.2	8.9	8.9	8.9	8.9	8.9	8.9	8.9
Noncurrent receivables	20.1	26.0	23.3	40.9	40.9	40.9	40.9	40.9	40.9
Noncurrent investments	8.1	3.4	2.8	1.3	1.3	1.3	1.3	1.3	1.3
Noncurrent prepayments	92.1	70.2	50.6	47.2	38.3	29.4	25.0	25.0	25.0
Current assets	470.4	552.2	622.1	564.5	528.6	713.9	716.8	701.1	696.0
Inventory	297.7	277.5	377.0	297.0	271.3	354.2	344.1	317.7	307.1
Current receivables	137.0	171.9	168.0	188.3	172.1	224.6	218.2	201.5	194.8
Current investments	8.7	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Cash	25.0	102.0	76.5	79.0	85.0	134.9	154.2	181.7	193.9
Current prepayments	1.9	0.8	0.7	0.0	0.0	0.0	0.0	0.0	0.0
EQUITY & LIABILITIES	895.3	950.7	1,001.4	1,051.7	1,009.9	1,173.2	1,162.2	1,139.1	1,128.6
Equity	142.1	225.3	278.2	258.8	295.8	347.4	350.0	362.5	366.2
Share capital	150.5	177.9	180.6	185.9	185.9	185.9	185.9	185.9	185.9
Supplementary capital	184.6	221.0	86.7	87.0	87.0	87.0	87.0	87.0	87.0
Retained earnings	-193.1	-173.6	10.8	-14.2	22.8	74.4	77.0	89.6	93.2
Minority interest	13.8	16.5	17.7	18.4	18.4	18.4	18.4	18.4	18.4
Non-current liabilities	410.7	388.8	258.4	279.3	329.6	329.6	329.6	329.6	329.6
Debt	376.4	358.0	229.2	249.7	300.0	300.0	300.0	300.0	300.0
Current liabilities	319.3	316.6	435.9	481.9	353.9	461.9	448.8	414.3	400.5
Trade payables	223.7	247.4	379.2	426.7	353.9	461.9	448.8	414.3	400.5
Debt	95.6	69.1	56.7	55.2	0.0	0.0	0.0	0.0	0.0
Provisions for liabilities	3.1	3.4	4.4	0.2	0.2	0.2	0.2	0.2	0.2
Other	6.3	0.1	6.8	13.1	12.0	15.7	15.2	14.0	13.6
Debt	472.0	427.1	285.9	304.8	300.0	300.0	300.0	300.0	300.0
Net debt	447.0	325.1	209.4	225.9	215.0	165.1	145.8	118.3	106.1
Net Debt / Equity	314.5 %	144.3 %	75.3%	87.3%	72.7%	47.5%	41.7%	32.6%	29.0%
Net Debt/ EBITDA	4.7	2.3	1.0	2.2	1.8	1.0	1.2	1.0	1.0
Net debt /EBITDA (adj.)	4.9	2.2	1.0	2.4	2.2	1.0	1.2	1.0	1.0
Factoring	10.5	4.2	2.7	0.9	0.0	0.0	0.0	0.0	0.0
Factored accounts receivable (excluded from fin. statements)	110.7	121.9	139.0	157.7	157.7	157.7	157.7	157.7	157.7
Pre-financing of scrap	12.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net debt / EBITDA (adj.)	6.4	3.1	1.8	4.1	3.8	2.0	2.5	2.3	2.5
BVPS	1.9	1.3	1.6	1.5	1.7	2.0	2.0	2.1	2.1

Cash Flow*

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
Cash flow from operating activities	91.6	145.4	232.2	142.5	80.4	124.5	117.6	115.1	99.7
Net profit	1.5	47.6	68.5	19.1	37.0	73.8	46.9	45.4	35.4
D&A expenses	38.1	41.3	43.9	46.2	47.9	46.9	44.9	43.6	42.7
Working capital	6.3	10.8	43.6	61.2	-23.2	-14.8	7.3	7.6	3.0
Other	45.7	45.7	76.2	15.9	18.7	18.6	18.6	18.6	18.5
Cash flow from investing activities	-27.1	-15.4	-37.6	-56.2	-50.0	-33.0	-34.5	-35.2	-36.3
CAPEX	-29.0	-15.9	-37.8	-56.2	-50.0	-33.0	-34.5	-35.2	-36.3
Equity investments	1.9	0.5	0.2	0.1	0.0	0.0	0.0	0.0	0.0
Cash flow from financing activities	-83.8	-52.6	-195.6	-83.8	-24.3	-41.7	-63.8	-52.3	-51.3
Debt	-28.2	-36.0	-113.2	-59.4	-4.8	0.0	0.0	0.0	0.0
Dividends/Buyback	0.0	0.0	-11.9	-36.0	0.0	-22.2	-44.3	-32.8	-31.8
Share issue	0.0	39.8	-1.1	0.0	0.0	0.0	0.0	0.0	0.0
Interest on convertible bonds	-5.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Interest expenses	-39.7	-52.0	-68.2	-20.9	-19.5	-19.5	-19.5	-19.5	-19.5
Other	-10.6	-4.4	-1.3	32.4	0.0	-0.0	0.0	0.0	0.0
Change in cash	-19.3	77.4	-1.0	2.5	6.1	49.8	19.3	27.5	12.2
Cash at eop	1.8	79.3	76.5	79.0	85.0	134.9	154.2	181.7	193.9
DPS (PLN)	0.00	0.00	0.07	0.21	0.00	0.13	0.25	0.19	0.18
FCF	71.9	122.9	179.5	101.9	36.1	92.4	84.0	80.8	64.4
CAPEX / Sales	-2.1%	-0.8%	-1.8%	-3.0%	-2.9%	-1.5%	-1.6%	-1.7%	-1.8%

*Assuming full dilution

Trading Multiples*

	2016	2017	2018	2019	2020P	2021P	2022P	2023P	2024P
P/E	106.0	7.9	5.5	19.7	10.2	5.1	8.0	8.3	10.6
P/E (adj.)	18.8	11.8	4.0	33.5	25.5	5.1	8.0	8.3	10.6
P/CE	4.1	4.2	3.3	5.8	4.4	3.1	4.1	4.2	4.8
P/B	1.1	1.7	1.4	1.5	1.3	1.1	1.1	1.0	1.0
P/S	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
FCF/EV	11.8%	17.5%	30.6%	16.9%	6.1%	17.1%	16.1%	16.3%	13.3%
EV/EBITDA	6.6	5.1	3.0	6.2	5.1	3.6	4.4	4.3	4.7
EV/EBITDA (adj.)	7.1	5.0	3.0	6.7	6.3	3.6	4.4	4.3	4.7
EV/EBIT	11.0	7.2	3.9	11.4	8.6	5.1	7.0	6.8	7.9
EV/S	0.5	0.3	0.3	0.3	0.4	0.2	0.2	0.3	0.3
OCF/EBITDA	97%	103%	116%	141%	68%	79%	96%	97%	94%
CFO/EBITDA (adj.)	100%	100%	116%	153%	83%	79%	96%	97%	94%
Dividend Yield	0.0%	0.0%	4.7%	9.6%	0.0%	5.9%	11.8%	8.7%	8.4%
Price (PLN)	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15	2.15
Shares at eop (millions)	75.3	175.0	175.0	175.0	175.0	175.0	175.0	175.0	175.0
MC (PLN m)	161.8	376.2	376.2	376.2	376.2	376.2	376.2	376.2	376.2
Minority interest (PLN m)	13.8	16.5	17.7	18.4	18.4	18.4	18.4	18.4	18.4
EV (PLN m)	622.6	717.8	603.3	620.5	609.6	559.7	540.4	512.9	500.7

*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

Recommendations of Biuro maklerskie mBanku:

A recommendation is valid for a period of 9 months, unless a subsequent recommendation is issued in 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	buy	buy	buy	hold
date issued	2020-12-08	2020-09-25	2020-08-04	2020-04-22
target price (PLN)	2.29	2.03	1.98	0.94
price on rating day	1.25	1.10	0.93	0.95

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