

Company Report

Ceramika Nowa Gala

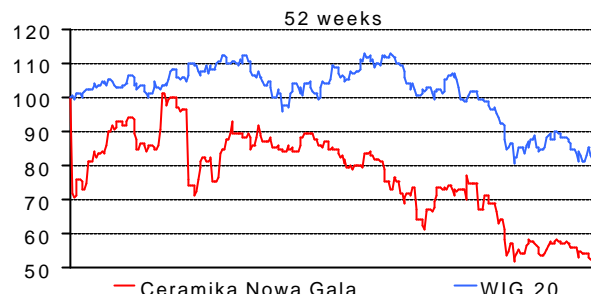
Poland, Construction materials

upgrade to Buy

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PLN mn	2007p	2008e	2009e	2010e
Net sales	141.1	215.2	231.0	245.8
EBITDA	34.2	50.5	53.5	57.0
EBIT	21.0	33.1	34.7	38.0
Net profit	14.6	23.2	25.1	28.2
EPS (PLN)	0.34	0.41	0.44	0.50
CEPS (PLN)	0.69	0.71	0.77	0.83
BVPS (PLN)	3.37	3.67	3.71	3.76
Div/share (PLN)	0.00	0.10	0.41	0.46
EV/EBITDA (x)	9.3	6.2	5.7	5.2
P/E (x)	12.8	10.8	10.0	8.9
P/CE (x)	6.4	6.2	5.7	5.3
Dividend yield	0.0%	2.3%	9.3%	10.5%



Performance	12M	6M	3M	1M
in PLN	-26.7%	-37.6%	-29.3%	-9.0%
in EUR	-19.6%	-33.6%	-27.6%	-7.8%

Share price (PLN)	4.4	Reuters	CERM.WA	Free float	82%
Number of shares (mn)	57.0	Bloomberg	CGN PW	Shareholders	W. Piotrowski (18%)
Market capitalization (PLN mn / EUR mn)	249.2 / 70.6	Div. ex-date	-		--
Enterprise value (PLN mn / EUR mn)	312.3 / 88.4	Target price	6.0	Homepage:	www.nowa-gala.com.pl

Small, but cheap

- In 2008, Ceramika Nowa Gala will digest its acquisition from last year and enjoy a buoyant tile market. Hence, we upgrade our recommendation to Buy with a 12M target price of PLN 6.0 (cut from previous PLN 7.3, without subscription rights).
- CNG is a relatively small company, but it is fundamentally very healthy (low debt, exposure to robust demand) and cheap compared to its peers (P/E of 10.8x for 2008).
- Furthermore, it generates substantial EBITDA of over PLN 50mn and needs no significant capex in the near term. Despite rising labor and energy costs, it aims to edge up its net margin to 11%.
- In light of its strong cash flows, CNG is poised to pay high dividends in the future (this year's yield is only 2.3%), unless it goes hunting in the construction materials market. We believe that this latter scenario is more likely, as management intends to considerably increase the scale of operations in the long run.

Company Report

Investment story

We see CNG as inexpensive exposure to the briskly growing construction material market in Poland. With capacity of 9mn m² of tile, it is the fourth largest player in Poland. Last year's acquisition (Ceramika Gres) will be fully consolidated in 2008, confirming sound net profit and a relatively low valuation (EV/EBITDA of 6.2x). Furthermore, the very robust tile market in Poland will drive the company's volumes (+8% expected) and give room for moderate price hikes.

CNG has no capex needs, apart from PLN 12mn this year to increase capacity in the high-end segment by a mere 0.5mn m². Combined with strong cash flows and a low debt level (D/E at 0.36), either an increase in dividends or further acquisitions are expected. In our opinion, acquisitions of other construction material producers within a three-year horizon are very likely, as management craves an increased scale of operations.

The strengthening of the Polish currency puts pressure on export margins, as CNG's exports account for 33% of sales, but only half is denominated in USD and most of it is naturally hedged via the import of raw materials.

The largest risk is cost base inflation, especially energy (power and gas) and labor. This, in our view, will be offset by price increases and a gradual improvement in the product mix.

Financials

We expect the top line to grow from PLN 191mn (pro forma) in 2007 to PLN 246mn in 2010, driven by:

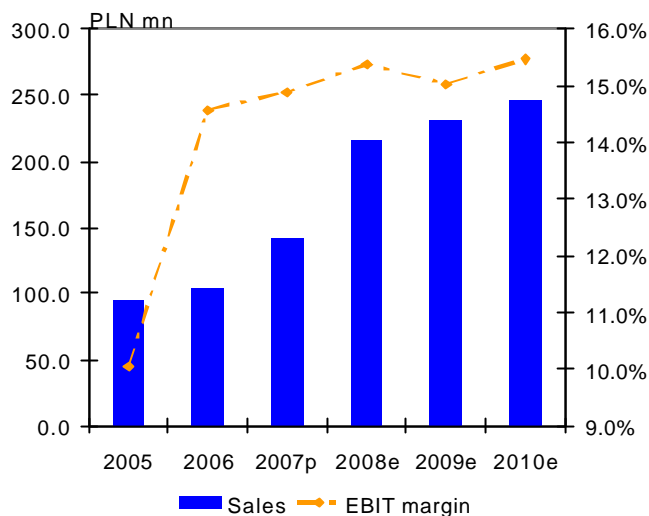
- average annual volume growth of 4.5%
- average annual product price inflation of 3.9%

However, we expect the cost base to balloon significantly, backed by an assumed 20% gas price increase as of April 2008, 6% p.a. growth of wage costs and a 15% jump in power costs. This is offset by constant depreciation, employment levels (economies of scale) and stable PLN prices for raw materials.

All in all, we have a very conservative gross margin calculation of 33.4% for 2008 and 33.5% for 2010. SG&A are envisaged at a sustainable 18% of total sales throughout the forecast period. This yields an EBIT margin just around 15%.

Company Report

Sales



Source: CNG, Erste Bank

The low debt level implies financial costs at above PLN 5mn. Despite high working capital (44% of sales) and with virtually no capex needs in the mid term, CNG will deleverage its balance sheet (without significant payouts or acquisitions).

On balance, the net margin is foreseen hovering close to 11%.

Valuation

Encompassing our assumptions, we employed a DCF valuation tool to estimate the target price for the company. The DCF is calculated using our forecasts for the years 2008-12e. We used a discount rate based on WACC and a terminal value based on perpetuity. The DCF led us to a 12-month target price of PLN 6.0 per share, which in our opinion accurately reflects the value of the company.

Major assumptions:

- Capacities will be filled and the company will produce 9mn m2 of tile
- Prices will grow at a CAGR 07-10 of 3.9%
- Labor costs will grow by 6% p.a.
- Gas prices will leap by 20% as of April 2008, with power prices up 15% in 2008

We discount all free cash flows for the firm on December 31, 2007, and subtract the net debt. We then divide the equity value per number of shares. Afterwards, we compound this by the cost of equity (with the appropriate number of months). We thus arrive at a target price that represents our valuation of the stock price as it is expected to be 12 months into the future. We have also changed our assumption regarding the risk-free rate, which is now 6.3%. The perpetuity growth is set at 1.0%, equity premium at 5% and debt risk premium at 1.5%.

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WACC

	2008e	2009e	2010e	2011e	2012e	beyond 2012e
WACC	10.2%	10.3%	10.4%	10.3%	10.3%	9.1%
Equity cost	11.3%	11.3%	11.3%	11.3%	11.3%	10.0%
Debt cost	6.5%	6.5%	6.5%	6.5%	6.5%	5.3%
Equity weighting	76.2%	78.3%	80.8%	80.0%	78.6%	80.0%
Debt weighting	23.8%	21.7%	19.2%	20.0%	21.4%	20.0%
Risk free rate	6.3%	6.3%	6.3%	6.3%	6.3%	5.0%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.0	1.0	1.0	1.0	1.0	1.0
Debt premium	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Tax rate	17.0%	17.0%	17.0%	17.0%	17.0%	19.0%

Source: Erste Bank

DCF

PLN mn	2008e	2009e	2010e	2011e	2012e	beyond 2012e
EBIT	33.1	34.7	38.0	41.0	42.6	43.0
Tax rate	17%	17%	17%	17%	17%	19%
Tax on EBIT	5.6	5.9	6.5	7.0	7.2	8.2
NOPLAT	27.4	28.8	31.6	34.0	35.4	34.9
Depreciation	-17.4	-18.8	-19.0	-19.4	-20.3	-20.0
Capital expenditures	-17.0	-6.0	-8.0	-15.0	-20.0	-20.0
Change in working capital	11.9	7.3	6.0	6.1	5.8	1.2
Free cash flow	15.9	34.2	36.5	32.3	29.9	33.6
Terminal value						365.8
Value of FCF at 31.12.2007	14.4	28.2	27.2	21.8	18.3	
Sum of DFCF	110.0					
Discounted terminal value	255.7					
Enterprise value at 31.12.2007	365.7					
Non-operating assets	4.2					
Net debt at 31.12.2007	68.8					
Fair value at 31.12.2007	365.7					
Number of shares	57.0					
Fair value per share at 31.12.2007	5.3					
Cost of equity	11%					
Target Price	6.0					
Stock price	4.4					
Premium/discount	37%					

Source: Erste Bank

Company Report

Peers

PLN mn	P/E			EV/Sales			EV/EBITDA			Valuation		
	2007*p	2008e	2009e	2007*p	2008e	2009e	2007*p	2008e	2009e	2007*p	2008e	2009e
Implied fair value	285.8	280.4	243.6	321.7	211.7	191.3	396.5	325.9	260.8			
Number of shares	57.0	57.0	57.0	57.0	57.0	57.0	57.0	57.0	57.0	5.9	4.8	4.1
Implied fair value per share	5.0	4.9	4.3	5.6	3.7	3.4	7.0	5.7	4.6			
12M Target price										6.5	5.3	4.5
Ceramika Nowa Gala	12.8	10.8	10.0	2.3	1.5	1.3	9.3	6.2	5.7			
Median for peer group	13.7	12.1	9.7	2.0	1.3	1.1	9.9	7.8	6.2			
Marazzi Group S.p.A.	8.2	7.4	6.3	0.9	0.7	0.6	4.9	3.8	3.2			
Polcolorit Sa	high	13.0	8.1	2.0	1.3	1.1	25.8	7.8	6.2			
Ricchetti	22.1	11.2	10.4	0.6	0.6	0.6	6.5	5.4	5.2			
Geberit AG	13.7	13.2	12.2	2.5	2.3	2.1	9.9	8.8	8.0			
DJ Euro Stoxx /2/ Construction	10.4	10.0	9.1									

* based on pro forma figures for 2007; Ceramika Gres consolidated for the whole year (sales PLN 191mn, net profit PLN 21mn)

Source: JCF Quant, Erste Bank

The significant discount to peers is unjustified, in our view. CNG is operating in swiftly growing market, has long-term plans to consolidate and is exposed to risks similar to those faced by comparable firms, which also have disadvantages in terms of smaller scale and diversification.

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Income Statement (IFRS, PLN mn, 31/12)	2006	2007p	2008e	2009e	2010e
Sales revenues	103.5	141.1	215.2	231.0	245.8
Cost of goods sold	-68.8	-93.6	-143.4	-154.7	-163.5
Gross profit	34.7	47.4	71.8	76.3	82.3
SG&A	-21.1	-24.8	-38.7	-41.6	-44.2
Other operating, net	1.5	-1.7	0.0	0.0	0.0
EBITDA	26.0	34.2	50.5	53.5	57.0
Depreciation	-11.0	-13.2	-17.4	-18.8	-19.0
EBIT	15.1	21.0	33.1	34.7	38.0
Financial result	-3.1	-4.2	-5.2	-4.5	-4.0
EBT	12.0	16.7	27.9	30.2	34.0
Tax expenses	-2.3	-2.1	-4.7	-5.1	-5.8
Net result after minorities	9.7	14.6	23.2	25.1	28.2
Balance Sheet (IFRS, PLN mn, 31/12)	2006	2007p	2008e	2009e	2010e
Intangible assets	1.0	17.8	17.8	17.8	17.9
Tangible assets	99.7	160.7	160.3	147.6	136.6
Financial assets	5.8	9.3	9.4	9.7	10.1
Total fixed assets	106.5	187.9	187.5	175.2	164.5
Inventories	36.0	56.3	64.5	69.6	73.6
Receivables and other current assets	29.1	43.6	49.5	53.1	56.5
Other assets	0.7	0.7	0.9	0.9	1.0
Cash and cash equivalents	6.3	7.0	2.2	2.3	2.5
Total current assets	72.1	107.6	117.0	126.0	133.6
TOTAL ASSETS	178.7	295.5	304.6	301.2	298.1
Shareholders' equity	118.3	192.0	209.5	211.4	214.6
Interest-bearing LT debts	31.0	39.6	34.1	30.6	26.6
Other LT liabilities	8.9	10.4	10.4	10.4	10.5
Total long-term liabilities	39.9	50.0	44.5	41.0	37.1
Interest-bearing ST debts	8.9	36.2	31.2	27.9	24.3
Other ST liabilities	11.5	17.3	19.4	20.8	22.1
Total short-term liabilities	20.5	53.4	50.5	48.7	46.4
TOTAL LIAB. & EQUITY	178.7	295.5	304.6	301.2	298.1
Cash Flow Statement (IFRS, PLN mn, 31/12)	2006	2007p	2008e	2009e	2010e
Cash flow from operating activities	12.2	21.7	33.8	41.0	45.2
Cash flow from investing activities	-4.1	-59.1	-17.3	-6.4	-8.4
Cash flow from financing activities	-5.5	38.0	-21.4	-34.4	-36.7
CHANGE IN CASH & CASH EQU.	2.6	0.7	-4.8	0.2	0.1
Margins & Ratios	2006	2007p	2008e	2009e	2010e
Sales growth	8.8%	36.3%	52.5%	7.4%	6.4%
EBITDA margin	25.1%	24.3%	23.4%	23.1%	23.2%
EBIT margin	14.6%	14.9%	15.4%	15.0%	15.5%
Net profit margin	9.4%	10.4%	10.8%	10.8%	11.5%
ROE	8.5%	9.4%	11.5%	11.9%	13.3%
ROCE	6.1%	6.8%	8.4%	8.9%	10.2%
Equity ratio	66.2%	65.0%	68.8%	70.2%	72.0%
Capital employed	160.8	271.2	283.1	278.1	273.5
Net debt	33.6	68.8	63.1	56.2	48.4
Inventory turnover	2.0	2.0	2.4	2.3	2.3

Source: Company data, Erste Bank estimates

Company Report

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Rating History

Date	Product	Rating	Price	Target price
1. Jun 07	CR	downgrade to Accumulate	8.10	9.10

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Company	Disclosure	Comment
Ceramica Nowa Gala	--	--

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Buy	> +20% to target price
Accumulate	+10% < target price < +20%
Hold	0% < target price < +10%
Reduce	-10% < target price < 0%
Sell	< -10% to target price

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