IDMSA
DOM MAKLERSKI

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Quarterly Results Preview

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Ceramika Nowa Gala

Sector: Construction materials
Fundamental rating: Hold (→)
Market relative: Overweight (→)
Price: PLN 3.26
12M EFV: PLN 4.40 (↓)

Market Cap.: US$ 81 m
Reuters code: CERM.WA
Av. daily turnover: US$ 0.11 m
Free float: 81%
12M range: PLN 3.08-6.95

Quarterly results corner; 3Q08E preview

The Company's 3Q08E financial results, which will be released on November 14, should be decent not only as a result of Ceramika Gres acquisition (the Company was consolidated by slightly more than one month in 3Q07, generating PLN 0.8 million NP) but also due to the organic growth (regarding details, please refer to *Figure 1* on the next page). Due to relatively small exports (<20% of total sales), covered by raw material imports, the Company's exposure to the FX is very limited and CNG should capitalize on still quite strong demand for the construction materials in Poland in 3Q08. However, we do not expect the 3Q08E results of CNG to charm the investors community; although they should be strong, they would be rather in line with expectations, in our view.

We forecast 3Q08 consolidated sales at PLN 58 million, 46% up yoy. CNG's 3Q08 sales were supported by changes in the Group structure (Ceramika Gres was consolidated by slightly more than one month in 3Q07) and the product mix with higher yoy average product price (the Company started sales of products from its newly installed line, with the prices even by c. half higher than the average). Additionally, the product price increases made in 1Q08 should be already fully visible in the Company's 3Q08E results (the Company managed to increase product prices by c. 5% and 10% in Poland and in exports, respectively).

With visible effects of product price enhancement (the Company managed to compensate gas and energy prices growth as well as pressure on salaries by the product prices growth), changes in the product mix towards higher sales of high-end products (there should be visible the first effects of new investment allowing to produce more expensive ceramic tiles) as well as emergence of synergy and scale effects, we forecast consolidated EBIT margin to improve yoy in 3Q08 with EBIT up yoy by 59%. We expect slower growth at the pre-tax level, due to higher ND position. Assuming 3Q08 effective tax rate of 15% vs. a mere 9% in 3Q07, we forecast 3Q08E consolidated bottom line at PLN 8.5 million, 42% up yoy.

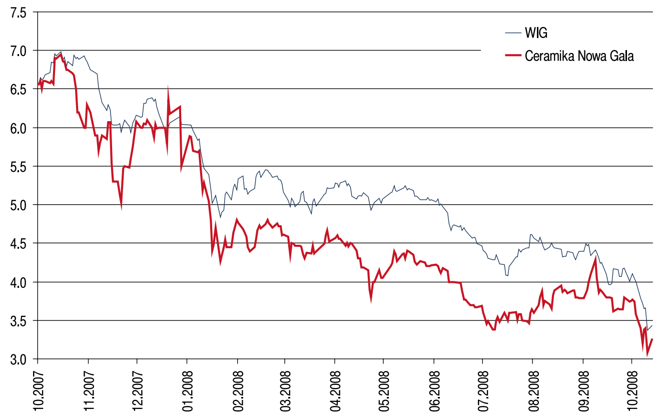
Company's decent 3Q08E financial results would stem mainly from high demand on the local market. The Company's exposure to the domestic market is the highest among the WSE-listed ceramic tile producers – CNG exported 19% of its consolidated sales in 1H08 vs. 24% in 1H07. Additionally, the profitability of the domestic sales is higher than in exports (gross margin on exports reached 25% in 1H08 vs. 38% achieved on the domestic sales; the margins reached 28% and 33%, respectively, in 1H07). Given high imports of raw materials, CNG's FX exposure is very limited.

Key data

IFRS consolidated		2007	2008E	2009E	2010E
Sales	*PLN m*	141.0	216.8	244.0	260.1
EBITDA	*PLN m*	34.4	50.4	54.3	55.9
EBIT	*PLN m*	21.2	32.2	34.7	35.5
Net income	*PLN m*	15.0	23.5	26.7	29.0
EPS	*PLN*	0.26	0.42	0.47	0.52
EPS yoy change	*%*	3	57	13	9
FCFF	*PLN m*	-34.5	19.7	32.4	38.6
Net debt	*PLN m*	68.8	57.0	35.2	7.4
P/E	*x*	12.4	7.8	6.9	6.3
P/CE	*x*	6.6	4.5	4.0	3.8
EV/EBITDA	*x*	5.1	4.8	4.1	3.5
EV/EBIT	*x*	8.3	7.5	6.4	5.5
Gross dividend yield	*%*	0.0	3.1	4.6	5.3
Number of shares	*ths.*	57,038	56,204	56,204	56,204

Source: DM IDMSA estimates

Stock performance



Source: www.money.pl

Upcoming events

1. Release of 3Q08 consolidated results: November 14, 2008

Catalysts

1. Situation in the building materials sector in the region, especially in Poland
2. Financial results improvement

Risk factors

1. GDP slowdown in the region, mainly in Poland
2. Currency risk
3. Gas and energy prices

Financial forecasts

We do not see any particular reasons to change our financial forecasts for the Company for this year at the moment (regarding details, please refer to our research report *44/2008/RP (105)* of April 21, 2008; the minor changes stem from new macroeconomic assumptions and incorporation of shares buy-back programme). We forecast the Company's FY08 consolidated sales and NP at PLN 217 million and PLN 24 million, respectively. Hence, given 71% and 77% realization of our FY forecasts after 1-3Q08E, respectively, we feel comfortable with our FY projections.

Please note that the figures have been removed from this publication intentionally.

Given expected economy slowdown, the Company has decided not to make any further investments, at least for the time being. Our financial model assumed capacity increase by 4 million sq m in the following years. However, due to the aforementioned decision by the Company's management board, we exclude it from our forecasts, decreasing accordingly the capex.

Valuation

Aforementioned changes in the financial forecast and an upward adjustment of the definite period risk-free rate assumption (to the current level of LT Treasuries' market yields) result in a drop of our 12M EFV for the Company – from PLN 5.17 to PLN 4.40 per share.

Recommendation

We maintain our Hold LT fundamental recommendation for the Company's shares. CNG's prosperity depends mainly on the demand on the local market, which was strong in 1-3Q08; however, we are slightly afraid that the demand dynamics might slightly deteriorate in 2009. Although Ceramika Gres acquisition allowed CNG to become less vulnerable to any external hazards, it has to face several problems connected with factory location in Poland, mainly rising production costs with higher gas and energy prices. The question is to what extent these problems will be mitigated by the emergence of the economies of scale and encouraging market conditions allowing for product prices growth. However, it should be admitted that the Company has been handling these problems quite well so far. To develop in the following years, the Company needs to make next investments. However, the decision to postpone the investment in current market circumstances seems to be prudent. Moreover, it should be remembered that after potential capacity increase, the Company will probably have to increase its exports, profitability of which is lower than of the domestic sales. Additionally, we expect that after launch of Cersanit's factories in the Ukraine, the ceramic tiles supply on the domestic market will increase.

We expect Company's strong financial performance for 3Q08, therefore we keep our Overweight ST market-relative bias for CNG's shares. Although we do not expect Company's 3Q08 results to constitute a big surprise to the financial community, it seems that CNG's results will be the best among the WSE-listed ceramic tile producers. The Company's market price should be also supported by two buy-back programs (recently enacted programme allows for buy-back of up to 9.9 million shares at prices in the range of PLN 1 – PLN 5 per share and the Company aims to spend PLN 18 million for this purpose).

Investment story

After acquisition of Ceramika Gres, Ceramika Nowa Gala became the fourth largest producer in Poland in terms of capacity (current capacity stands at 8.9 million sq m p.a.) with c. 10% market share and below 20% of sales exported. With the lack of product diversification (the Company produces exclusively ceramic tiles) and relatively low geographical sales dispersion, Ceramika Nowa Gala's expansion depends mainly on the situation on the local construction materials market.

BASIC DEFINITIONS

A/R turnover (in days) = 365/(sales/average A/R))
Inventory turnover (in days) = 365/(COGS/average inventory))
A/P turnover (in days) = 365/(COGS/average A/P))
Current ratio = ((current assets – ST deferred assets)/current liabilities)
Quick ratio = ((current assets – ST deferred assets – inventory)/current liabilities)
Interest coverage = (pre-tax profit before extraordinary items + interest payable/interest payable)
Gross margin = gross profit on sales/sales
EBITDA margin = EBITDA/sales
EBIT margin = EBIT/sales
Pre-tax margin = pre-tax profit/sales
Net margin = net profit/sales
ROE = net profit/average equity
ROA = (net income + interest payable)/average assets
EV = market capitalization + interest bearing debt – cash and equivalents
EPS = net profit/ no. of shares outstanding
CE = net profit + depreciation
Dividend yield (gross) = pre-tax DPS/stock market price
Cash sales = accrual sales corrected for the change in A/R
Cash operating expenses = accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes

DM IDM S.A. generally values the covered non bank companies via two methods: comparative method and DCF method (discounted cash flows). The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the DCF method is its independence from the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Please note that we also resort to other valuation techniques (e.g. NAV-, DDM- or SOTP-based), should it prove appropriate in a given case.

Banks

Net Interest Margin (NIM) = net interest income/average assets
NIM Adjusted = (net interest income adjusted for SWAPs)/average assets
Non interest income = fees&commissions + result on financial operations (trading gains) + FX gains
Interest Spread = (interest income/average interest earning assets)/ (interest cost/average interest bearing liabilities)
Cost/Income = (general costs + depreciation + other operating costs)/ (profit on banking activity + other operating income)
ROE = net profit/average equity
ROA = net income/average assets
Non performing loans (NPL) = loans in 'substandard', 'doubtful' and 'lost' categories
NPL coverrage ratio = loan loss provisions/NPL
Net provision charge = provisions created – provisions released

DM IDM S.A. generally values the covered banks via two methods: comparative method and fundamental target fair P/E and target fair P/BV multiples method. The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the fundamental target fair P/E and target fair P/BV multiples method is its independence of the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation.

Assumptions used in valuation can change, influencing thereby the level of the valuation. Among the most important assumptions are: GDP growth, forecasted level of inflation, changes in interest rates and currency prices, employment level and change in wages, demand on the analysed company products, raw material prices, competition, standing of the main customers and suppliers, legislation changes, etc.

Changes in the environment of the analysed company are monitored by analysts involved in the preparation of the recommendation, estimated, incorporated in valuation and published in the recommendation whenever needed.

KEY TO INVESTMENT RANKINGS

This is a guide to expected price performance in absolute terms over the next 12 months:
Buy – fundamentally undervalued (upside to 12M EFV in excess of the cost of equity) + catalysts which should close the valuation gap identified;
Hold – either (i) fairly priced, or (ii) fundamentally undervalued/overvalued but lacks catalysts which could close the valuation gap;
Sell – fundamentally overvalued (12M EFV < current share price + 1-year cost of equity) + catalysts which should close the valuation gap identified.

This is a guide to expected relative price performance:
Overweight – expected to perform better than the benchmark (WIG) over the next quarter in relative terms
Neutral – expected to perform in line with the benchmark (WIG) over the next quarter in relative terms
Underweight – expected to perform worse than the benchmark (WIG) over the next quarter in relative terms

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LT fundamental recommendation tracker

Recommendation		Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/ reiteration (PLN)	12M EFV (PLN)	
Ceramika Nowa Gala									
Hold	–	*28.01.2008*	-	*Not later than 28.01.2009*	-24%	12%	4.45	5.10	
-	→	-	*24.02.2008*	-	-	-	4.75	5.10	→
-	→	-	*30.03.2008*	-	-	-	4.52	5.20	↑
-	→	-	*21.04.2008*	-	-	-	4.15	5.24	↑
-	→	-	*29.04.2008*	-	-	-	4.05	5.24	→
-	→	-	*15.05.2008*	-	-	-	4.40	5.24	→
-	→	-	*01.06.2008*	-	-	-	4.21	5.24	→
-	→	-	*29.06.2008*	-	-	-	3.67	5.08	↓
-	→	-	*16.07.2008*	-	-	-	3.50	5.07	↓
-	→	-	*28.07.2008*	-	-	-	3.49	5.07	↓
-	→	-	*17.08.2008*	-	-	-	3.89	5.17	↑
-	→	-	*31.08.2008*	-	-	-	3.79	5.17	→
-	→	-	*28.09.2008*	-	-	-	3.80	5.17	→
-	→	-	*13.10.2008*	-	-	-	3.26	4.40	↓

Market-relative recommendation tracker

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/ reiteration (PLN)	Relative performance
Ceramika Nowa Gala						
Neutral	–	*28.01.2008*	-	*21.04.2008*	4.45	-7%
-	→	-	*24.02.2008*	-	4.75	-
-	→	-	*30.03.2008*	-	4.52	-
Overweight	↑	*21.04.2008*	-	*Not later than 21.04.2008*	4.15	20%
-	→	-	*29.04.2008*	-	4.05	-
-	→	-	*15.05.2008*	-	4.40	-
-	→	-	*01.06.2008*	-	4.21	-
-	→	-	*29.06.2008*	-	3.67	-
-	→	-	*16.07.2008*	-	3.50	-
-	→	-	*28.07.2008*	-	3.49	-
-	→	-	*17.08.2008*	-	3.89	-
-	→	-	*31.08.2008*	-	3.79	-
-	→	-	*28.09.2008*	-	3.80	-
-	→	-	*13.10.2008*	-	3.26	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	20	24	2	1	0
Percentage	43%	51%	4%	2%	0%

Distribution of IDM's current recommendations for companies that were within the last 12M IDM customers in investment banking

	Buy	Hold	Sell	Suspended	Under revision
Numbers	2	3	0	1	0
Percentage	33%	50%	0%	17%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	19	19	8	1	0
Percentage	40%	40%	17%	2%	0%

Distribution of IDM's current market relative recommended weightings for the companies that were within the last 12M IDM customers in investment banking

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	3	2	0	1	0
Percentage	50%	33%	0%	17%	0%

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