

# Ceramika Nowa Gala

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Sector: Construction materials  
**Fundamental rating:** Hold (→)  
**Market relative:** Overweight (→)  
**Price:** PLN 3.89  
**12M EFV:** PLN 5.17 (↑)

**Market Cap.:** US\$ 99 m  
**Reuters code:** CERM.WA  
**Av. daily turnover:** US\$ 0.13 m  
**Free float:** 81%  
**12M range:** PLN 3.38-7.40

## Quarterly results corner; 2Q08 review

Ceramika Nowa Gala 2Q08 financial results, announced last Friday before the session, are in line with both our expectations and the market consensus (please refer to *Figure 1* on the next page regarding the details). The Company's 2Q08 consolidated sales reached PLN 52 million, 54% up yoy. The sales growth stemmed mainly from changes in the Group structure with (Ceramika Gres consolidation), but was also due to organic development supported by product mix improvement with higher yoy average product price. Additionally, CNG managed to increase its product prices. The Company's top line was driven mainly by good condition of domestic ceramic tiles market – the domestic sales went up by 68% yoy in 2Q08 with slower exports growth – up by 15% yoy.

With visible effects of product price enhancement, changes in the product mix towards higher sales of high end products, as well as emergence of synergy and scale effects, the Company's consolidated EBITDA margin improved from 18.8% in 2Q07 to 24.7% in 2Q08 with EBITDA more than doubled yoy (we forecasted 2Q08 consolidated EBITDA at PLN 12.6 million). The gross margin on domestic sales went up from 32.2% in 2Q07 to 39.4% in 2Q08, while the margin on exports went down from 27.4% to 22.5%.

With doubled ND position, the Company reported higher yoy financial costs and therefore the dynamics at the pre-tax level were lower than at the operating line. With effective tax rate close to statutory level (19% in 2Q08; the tax rate was close to a zero in 2Q07), CNG's 2Q08 consolidated bottom line reached PLN 4.9 million, 66% up yoy, broadly in line with our forecast of PLN 5.3 million.

The Company completed its small capacity increase (by 0.5 million sq m of ceramic tiles p.a.) in 2Q08, which caused production breaks – we expected the additional costs connected with production breaks at c. PLN 1.5 million in the quarter, while they reached PLN 1.4 million. Simultaneously, the Company made additional service works, which cost PLN 0.6 million.

## Financial forecasts

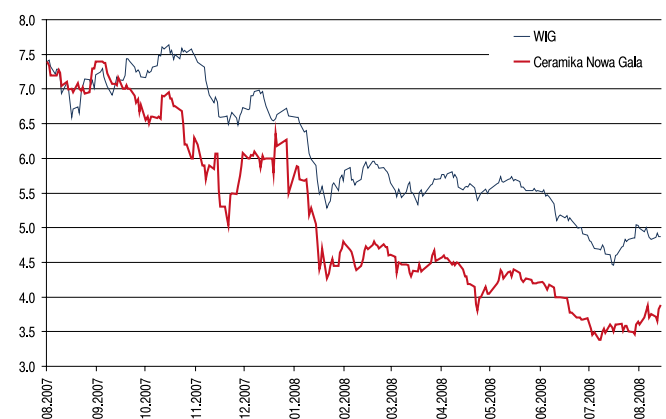
With 2Q08 consolidated results in line with our expectations, we do not see any particular reasons to change our financial forecasts for the Company at the moment (regarding the details, please refer to our research report *44/2008/RP (105)* of April 21, 2008). We forecast the Company's FY2008 consolidated sales and NP at PLN 217 million and PLN 24 million, respectively. Hence, given 45% and 41% realization of our FY forecasts in 1H08, we feel comfortable with our current FY targets. The Company

### Key data

IFRS consolidated		2007	2008E	2009E	2010E
Sales	PLN m	141.0	216.8	244.3	275.5
EBITDA	PLN m	34.4	50.4	55.3	60.3
EBIT	PLN m	21.2	32.2	35.0	37.1
Net income	PLN m	15.0	23.7	27.0	29.8
EPS	PLN	0.26	0.42	0.48	0.52
EPS yoy change	%	3	59	14	10
FCFF	PLN m	-33.7	19.7	22.0	19.9
Net debt	PLN m	68.8	54.8	43.3	34.3
P/E	x	14.8	9.3	8.2	7.4
P/CE	x	7.9	5.3	4.7	4.2
EV/EBITDA	x	6.1	5.5	4.8	4.2
EV/EBIT	x	10.0	8.6	7.6	6.9
Gross dividend yield	%	0.0	2.6	3.9	4.5
Number of shares	ths.	57,038	56,711	56,711	56,711

Source: DM IDMSA estimates

### Stock performance



Source: www.money.pl

## Upcoming events

1. Release of 1H08 consolidated results: September 30, 2008
2. 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
3. Announcement of new projects

## Risk factors

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

faces gas and energy prices growth as well as pressure on salaries. It seems, however, that these negative factors will be, at least partially, offset by product prices growth and changes in the product mix (new investment should allow to produce more expensive ceramic tiles with average price of c. PLN 35 per sq m).

We would like to stress that our financial model assumes capacity increase by 4 million sq m in the following years. The Company has been considering further investments (the decision should

be taken by the end of this year). It is likely that CNG's management will decide to increase capacity by 2 million sq m of high-end ceramic tiles.

### Valuation

A downward adjustment of the definite period risk-free rate assumption (to the current level of LT Treasuries' market yields) results in a slight increase of our 12M EFV for the Company – from PLN 5.07 to PLN 5.17 per share.

### Recommendation

We maintain our Hold recommendation for the Company's shares. CNG's prosperity depends mainly on the demand on the local market, which was strong in 1H08. 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 – rising production costs with increased salaries, 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. To develop in the following years, the Company needs to make next investments (we expect that current capacity utilization is close to 90% threshold).

We keep an Overweight ST market-relative stance vs. CNG's shares. Company's strong 1H08 financial results 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 only 20% of its consolidated sales in 2Q08. Additionally, the profitability of the domestic sales was higher than exports. Moreover, given high import of raw materials, CNG's FX exposure was very limited. Although PLN strengthening made prices of imported tiles more competitive, CNG's products were still much cheaper which, given strong demand on the local market, allowed for price increases. The Company's 2Q08 financial results are in line with our expectations and the market consensus, they are however the best among the WSE-listed ceramic tile producers.

### 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 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) =  $365 / (\text{sales} / \text{average A/R})$

**Inventory turnover** (in days) =  $365 / (\text{COGS} / \text{average inventory})$

**A/P turnover** (in days) =  $365 / (\text{COGS} / \text{average A/P})$

**Current ratio** =  $(\text{current assets} - \text{ST deferred assets}) / \text{current liabilities}$

**Quick ratio** =  $(\text{current assets} - \text{ST deferred assets} - \text{inventory}) / \text{current liabilities}$

**Interest coverage** =  $(\text{pre-tax profit before extraordinary items} + \text{interest payable}) / \text{interest payable}$

**Gross margin** =  $\text{gross profit} / \text{sales}$

**EBITDA margin** =  $\text{EBITDA} / \text{sales}$

**EBIT margin** =  $\text{EBIT} / \text{sales}$

**Pre-tax margin** =  $\text{pre-tax profit} / \text{sales}$

**Net margin** =  $\text{net profit} / \text{sales}$

**ROE** =  $\text{net profit} / \text{average equity}$

**ROA** =  $(\text{net income} + \text{interest payable}) / \text{average assets}$

**EV** =  $\text{market capitalization} + \text{interest bearing debt} - \text{cash and equivalents}$

**EPS** =  $\text{net profit} / \text{no. of shares outstanding}$

**CE** =  $\text{net profit} + \text{depreciation}$

**Dividend yield** (gross) =  $\text{pre-tax DPS} / \text{stock market price}$

**Cash sales** =  $\text{accrual sales corrected for the change in A/R}$

**Cash operating expenses** =  $\text{accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes}$

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.

## 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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## Banks

**Net Interest Margin (NIM)** =  $\text{net interest income} / \text{average assets}$

**NIM Adjusted** =  $(\text{net interest income adjusted for SWAPs}) / \text{average assets}$

**Non interest income** =  $\text{fees \& commissions} + \text{result on financial operations (trading gains)} + \text{FX gains}$

**Interest Spread** =  $(\text{interest income} / \text{average interest earning assets}) / (\text{interest cost} / \text{average interest bearing liabilities})$

**Cost/Income** =  $(\text{general costs} + \text{depreciation} + \text{other operating costs}) / (\text{profit on banking activity} + \text{other operating income})$

**ROE** =  $\text{net profit} / \text{average equity}$

**ROA** =  $\text{net income} / \text{average assets}$

**Non performing loans (NPL)** = loans in 'substandard', 'doubtful' and 'lost' categories

**NPL coverage ratio** =  $\text{loan loss provisions} / \text{NPL}$

**Net provision charge** =  $\text{provisions created} - \text{provisions released}$

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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.

*LT fundamental recommendation tracker*

Recommendation		Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/reiteration (PLN)	12M EFV (PLN)	
<b>Ceramika Nowa Gala</b>									
Hold	-	28.01.2008	-	Not later than 28.01.2009	-10%	2%	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	↑

*Market-relative recommendation tracker*

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/reiteration (PLN)	Relative performance
<b>Ceramika Nowa Gala</b>						
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 21.04.2009	4.15	10%
-	→	-	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	-

*Distribution of IDM's current recommendations*

	Buy	Hold	Sell	Suspended	Under revision
Numbers	22	21	2	1	0
Percentage	48%	46%	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	3	2	0	1	0
Percentage	50%	33%	0%	17%	0%

*Distribution of IDM's current market relative recommended weightings*

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	18	18	9	1	0
Percentage	39%	39%	20%	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	4	0	1	1	0
Percentage	67%	0%	17%	17%	0%

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