Quarterly Results Preview

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Ceramika Nowa Gala

Sector: Construction materials
Fundamental rating: Hold (→)
Market relative: Underweight (→)
Price: PLN 3.39
12M EFV: PLN 3.2 (↑)

Market Cap.: US$ 67 m
Reuters code: CERM.WA
Av. daily turnover: US$ 0.05 m
Free float: 75%
12M range: PLN 1.95-3.69

Quarterly results corner; 3Q09E preview

CNG is to publish its 3Q09 financial results on November 16, 2009. The results will be weak, in our view, with yoy drop at both sales and NP lines. However, we expect lower results deterioration than it was visible in the previous two quarters.

We forecast CNG's 3Q09 consolidated sales at PLN 52 million, 7% down yoy. We believe that the main reason of the Company's poor performance at the top line level was weak exports, especially to CEE countries; however, the Company's management claims that a downward trend of exports has started to lose its momentum. Moreover, the demand on construction materials in Poland, although stronger than on export markets, was also weaker than a year ago in 3Q09. Due to lower demand, product prices did not follow costs growth. Moreover, the economy slowdown affected the product mix, with the demand shifting towards cheaper products. Thus, we expect yoy drop of the average product price at CNG in 3Q09. Moreover, we expect also yoy drop of volume sold. Although the capacity utilisation, during the seasonal demand peak, was, more likely, full, we do not expect it to exceed the 75% threshold for FY09.

With sales slide, we expect yoy profitability deterioration. We forecast the Company's 3Q09 consolidated EBIT margin at 13.1% vs. 15.9% in 3Q08. Assuming flat yoy effective tax rate (at c. 15%), we forecast the Company's 3Q09 consolidated NP at PLN 5 million, 30% down yoy.

Financial forecasts

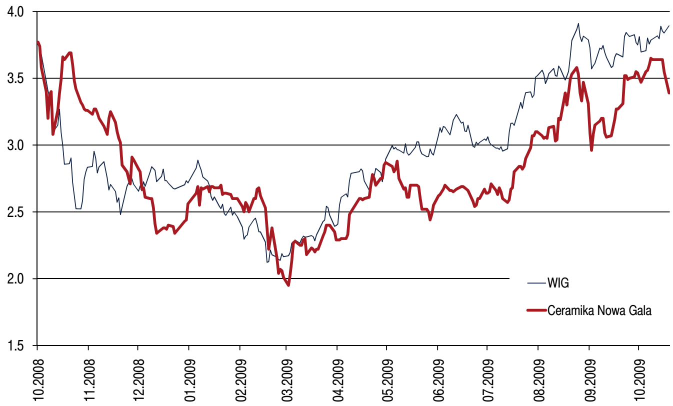
Incorporation of 1-3Q09E projections into our financial forecasts resulted in a small adjustment of our financial forecasts for the Company, mainly stemming from slightly revised depreciation level. Nevertheless, we still forecast FY09 consolidated sales and NP at PLN 164 million and PLN 12 million, respectively. However, it should be remembered that instability of demand on construction materials in CEE countries make the forecasts for the Company quite fragile. Around 20% of the Company's output is directed to the commercial clients. Although this part of the market still looks decent, plunging number of new constructions does not look encouraging (it might be visible in the Company's results next year, we believe). In the mid-term, the results should improve, due to finally rising demand and lower supply of ceramic tiles on the market. Therefore, we increase our mid-term profitability assumptions for CNG.

Key data

IFRS consolidated		2008	2009E	2010E	2011E
Sales	*PLN m*	192.0	164.2	187.0	220.0
EBITDA	*PLN m*	47.1	37.2	42.9	48.7
EBIT	*PLN m*	28.0	19.0	23.9	29.2
Net income	*PLN m*	21.0	11.9	15.9	21.0
EPS	*PLN*	0.37	0.21	0.29	0.38
EPS yoy change	*%*	44	-42	34	33
FCFF	*PLN m*	4.6	19.4	21.0	14.5
Net debt	*PLN m*	80.1	72.5	58.9	50.0
P/E	*x*	9.2	15.8	11.8	8.9
P/CE	*x*	4.8	6.3	5.4	4.6
EV/EBITDA	*x*	5.8	7.0	5.8	4.9
EV/EBIT	*x*	9.8	13.7	10.3	8.2
Gross dividend yield	*%*	2.9	0.0	2.5	3.4
Number of shares	*ths.*	57,038	55,482	55,482	55,482

Source: Company, DM IDMSA estimates

Stock performance



Source: ISI

Upcoming events

1. Release of 3Q08 consolidated results: November 16, 2009

Catalysts

1. Expected restructuring effects

Risk factors

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

Valuation

Aforementioned financial forecast revision, movement the valuation forward to keep 12M EFV and incorporation of updated risk-free rate resulted in 12M EFV for CNG shares at PLN 3.2 per share (up from 2.7 per share previously).

Recommendation

With 12M per share EFV close to the Company's current share market price we maintain our Hold LT fundamental recommendation

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

for the Company's shares. CNG's prosperity depends mainly on the demand on the CEE markets. Part of the demand on construction materials stems from the primary construction market, however c. 70-80% constitutes the refurbishment demand which depends in a higher degree on the disposable income growth, which – in turn – is a derivative of the economy growth. The Company sells c. 20% of its production to the commercial clients, which seem less vulnerable than the retail customers. Although this part of the marker is still relatively strong, we see significant risk of its drop next year. Based on our forecasts, the Company trades at forward P/E and EV/EBITDA multiples of 16x and 7x, respectively, which does not seem to be excessive. Nevertheless, it should be kept in mind that we expect weak financial performance for 3Q09; therefore, we maintain our Underweight ST market-relative bias for CNG's shares.

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

The recommendation tracker presents the performance of DM IDMSA's recommendations. A recommendation expires on the day it is altered or on the day 12 months after its issuance, whichever comes first. Relative performance compares the rate of return on a given recommended stock in the period of the recommendation's validity (i.e. from the date of issuance to the date of alteration or – in case of maintained recommendations – from the date of issuance to the current date) in a relation to the rate of return on the benchmark in this time period. The WIG index constitutes the benchmark. For recommendations that expire by an alteration or are maintained, the ending values used to calculate their absolute and relative performance are: the stock closing price on the day the recommendation expires/ is maintained and the closing value of the benchmark on that date. For recommendations that expire via a passage of time, the ending values used to calculate their absolute and relative performance are: the average of the stock closing prices for the day the recommendation elapses and four directly preceding sessions and the average of the benchmark's closing values for the day the recommendation expires and four directly preceding sessions.

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*	-	*11.01.2009*	-38%	5%	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	↓
-	→	-	*29.10.2008*	-	-	-	3.27	4.40	→
-	→	-	*19.11.2008*	-	-	-	3.05	3.90	↓
-	→	-	*30.11.2008*	-	-	-	2.89	3.90	→
Hold	→	*11.01.2009*	-	*Not later than 11.01.2010*	27%	-10%	2.67	3.90	→
-	→	-	*29.01.2009*	-	-	-	2.60	3.30	↓
-	→	-	*08.02.2009*	-	-	-	2.50	3.30	→
-	→	-	*26.02.2009*	-	-	-	2.06	2.70	↓
-	→	-	*08.03.2009*	-	-	-	2.28	2.70	→
-	→	-	*05.04.2009*	-	-	-	2.30	2.70	→
-	→	-	*28.04.2009*	-	-	-	2.75	2.70	→
-	→	-	*17.05.2009*	-	-	-	2.70	2.70	→
-	→	-	*08.06.2009*	-	-	-	2.66	2.70	→
-	→	-	*08.07.2009*	-	-	-	2.68	2.70	→
-	→	-	*22.07.2009*	-	-	-	2.82	2.70	→
-	→	-	*02.08.2009*	-	-	-	3.10	2.70	→
-	→	-	*31.08.2009*	-	-	-	3.31	2.70	→
-	→	-	*12.10.2009*	-	-	-	3.64	2.70	→
-	→	-	*19.10.2009*	-	-	-	3.39	3.20	↑

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*	-	*30.11.2008*	4.15	25%
-	→	-	*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	-
-	→	-	*29.10.2008*	-	3.27	-
-	→	-	*19.11.2008*	-	3.05	-
Neutral	↓	*30.11.2008*	-	*28.04.2009*	2.89	-6%
-	→	-	*11.01.2009*	-	2.67	-
-	→	-	*29.01.2009*	-	2.60	-
-	→	-	*08.02.2009*	-	2.50	-
-	→	-	*26.02.2009*	-	2.06	-
-	→	-	*08.03.2009*	-	2.28	-
-	→	-	*05.04.2009*	-	2.30	-
Underweight	↓	*28.04.2009*	-	*Not later than 28.04.2010*	2.75	-14%
-	→	-	*17.05.2009*	-	2.70	-
-	→	-	*08.06.2009*	-	2.66	-
-	→	-	*08.07.2009*	-	2.68	-
-	→	-	*22.07.2009*	-	2.82	-
-	→	-	*02.08.2009*	-	3.10	-
-	→	-	*31.08.2009*	-	3.31	-
-	→	-	*12.10.2009*	-	3.64	-
-	→	-	*19.10.2009*	-	3.39	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	15	30	17	1	0
Percentage	24%	48%	27%	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	1	1	0
Percentage	29%	43%	14%	14%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	22	24	16	1	0
Percentage	35%	38%	25%	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	1	1	0
Percentage	43%	29%	14%	14%	0%

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