

Ceramika Nowa Gala

Sector: Construction materials
Fundamental rating: Hold (→)
Market relative: Overweight (↑)
Price: PLN 4.15
12M EFV: PLN 5.24 (↑)

Market Cap.: US\$ 110 m
Reuters code: CERM.WA
Av. daily turnover: US\$ 0.31 m
Free float: 81%
12M range: PLN 4.15-8.34

Quarterly results corner; 1Q08E preview

The Company's 1Q08 financial results, which will be released on May 15, should not constitute a big surprise for the investors' community given the management hints on the Company's YTD performance. In a nutshell, CNG's 1Q08 financials, as we see it, should be strong not only as a result of Ceramika Gres acquisition but also due to the organic growth.

We forecast 1Q08 consolidated sales at PLN 43 million, 54% up yoy, with organic growth of 12% and the rest stemming from Ceramika Gres consolidation. CNG's 1Q08 sales were supported by changes in the product mix, with higher yoy average product price. Additionally, in 1Q08 the Company managed to increase product prices – by c. 5% in Poland and c. 10% in exports.

With visible effects of product price enhancement, changes in the product mix towards higher sales of high-end products, as well as appearance of synergy and scale effects, we forecast 1Q08 consolidated EBIT margin to improve yoy with operating profit rising well ahead of revenues (by > 150% yoy). We expect slower growth at the pre-tax level, due to doubled yoy ND position. Assuming 1Q08 effective tax rate of 15% vs. 26% in 1Q07, we forecast 1Q08 consolidated bottom line at PLN 4.6 million, 163% up yoy.

The changes in the Group structure, namely acquisition of Ceramika Gres, make yoy comparison of Company's 1Q08 consolidated financial results difficult. Therefore, it is worth, in our view, to look also at qoq performance (Ceramika Gres was already consolidated in 4Q07); we forecast 1Q08 consolidated sales and NP to increase by 7% and 10% qoq, respectively. Thus, given the seasonality effect (4Q results are usually better qoq), the Company's 1Q08 financial results should be viewed as decent ones, in our opinion.

Fig. 1 Ceramika Nowa Gala; 1Q08 results forecast

IFRS consolidated PLN m	yoy realization		chng of the FY figures in:	
	1Q08E	1Q07	1Q08E	1Q07
Sales	42.7	27.7	54%	20%
EBITDA	11.7	5.6	108%	23%
EBITDA margin	27.4%	20.3%	-	-
EBIT	7.3	2.9	157%	23%
EBIT margin	17.2%	10.3%	-	-
Pre-tax profit	5.4	2.4	129%	20%
Pre-tax profit margin	12.7%	8.6%	-	-
Net profit	4.6	1.7	163%	19%
Net profit margin	10.7%	6.3%	-	-

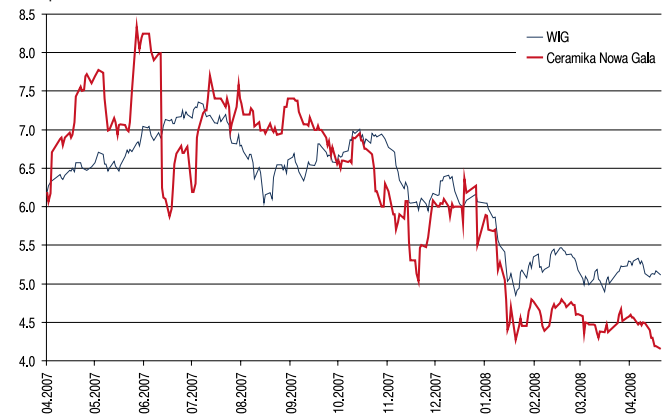
Source: Company, DM IDMSA estimates

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	23.8	27.0	29.8
EPS	PLN	0.26	0.42	0.47	0.52
EPS yoy change	%	3	59	14	10
FCFF	PLN m	-33.5	19.7	22.0	19.9
Net debt	PLN m	68.8	53.6	42.0	33.0
P/E	x	15.8	10.0	8.8	7.9
P/CE	x	8.4	5.6	5.0	4.5
EV/EBITDA	x	6.6	5.8	5.0	4.5
EV/EBIT	x	10.7	9.0	8.0	7.3
Gross dividend yield	%	0.0	2.4	3.7	4.2
Number of shares	ths.	57,038	57,038	57,038	57,038

Source: DM IDMSA estimates

Stock performance



Source: www.money.pl

Upcoming events

1. Release of 1Q08 results: May 15, 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

Company's strong 1Q08 financial results will mainly stem 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 – the Company exports only 25% of its consolidated sales (16% to the East (denominated in US\$) and 9% to the West). Additionally, the profitability of the domestic sales is higher than of exports. Moreover, given high imports of raw materials, CNG's FX exposure is very limited. Although PLN strengthening makes prices of imported tiles more competitive, CNG's products are still much cheaper which, given strong demand on the local market, allows for prices growth.

Financial forecasts

We have incorporated into our financial model the Company's FY2007 audited financial figures. The Company's 1Q08 financial results should be strong, however the Company will bear costs of production suspensions due to installation of additional capacity in 2Q08 (0.5 million sq m p.a.) – it could decrease the Company's 2Q08 bottom line by c. PLN 1 million. The Company faces gas and energy price increases (gas prices will rise by c. 15-16% in May 2008) 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). Taking into account the aforementioned factors, we have revised (upwards) our financial forecasts for the Company only slightly.

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. Previously, we assumed that capacity increase by 2 million sq m of ceramic tiles will cost c. PLN 20-30 million; however, the Company's management claims that it might cost c. PLN 30-40 million. Thus, we have slightly increased our capex forecasts for the following years.

Valuation

Slight revision of our financial forecasts for the Company, a downward adjustment of the definite period risk-free rate assumption (to the current level of LT Treasuries' market yields) and a valuation horizon forward shift result in a minor increase of our 12M EFV for the Company – from PLN 5.20 to PLN 5.24 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 1Q08; however, the dynamics was decelerating from month to month. 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 due to 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 price increases. It should be also remembered that the Company is going to complete its small capacity increase (by 0.5 million sq m of ceramic tiles p.a.) in 2Q08 which will cause production breaks that may adversely affect the Company's 2Q08 financials. To develop in the following years, the Company needs to make next investments (current capacity utilization exceeds 90% threshold).

Nevertheless, we expect Company's strong financial performance for 1Q08; therefore, we upgrade our ST market-relative position for CNG's shares from Neutral to Overweight. Although we do not expect the Company's 1Q08 results to constitute a big surprise to the financial community, it seems that CNG's quarterly results will be the best ones among the WSE-listed ceramic tiles 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 21% 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.

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) + 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	-	Not later than 28.01.2009	-7%	-7%	4.45	5.1 –
-	→	-	24.02.2008	-	-	-	4.75	5.1 →
-	→	-	30.03.2008	-	-	-	4.52	5.2 ↑
-	→	-	21.04.2008	-	-	-	4.15	5.24 ↑

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 21.04.2009	4.15 -

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	20	15	5	0	0
Percentage	50%	38%	13%	0%	0%

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 coverage 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.

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	2	1	0	0
Percentage	40%	40%	20%	0%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	14	16	10	0	0
Percentage	35%	40%	25%	0%	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	1	1	0	0
Percentage	60%	20%	20%	0%	0%

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