IDMSA
DOM MAKLERSKI

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Quarterly Results Preview

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Ceramika Nowa Gala

Sector: Construction materials
Fundamental rating: Hold (→)
12M relative: Neutral (→)
Price: PLN 4.45
12M EFV: PLN 5.10 (→)

Market Cap.: US$ 111 m
Reuters code: CERM.WA
Av. daily turnover: US$ 0.22 m
Free float: 81%
12M range: PLN 4.27-8.34

Quarterly results corner; 4Q07E preview

1-3Q07 brought the Company's consolidated sales yoy growth of 30%, driven mainly by sales expansion on the local market; domestic sales went up 38% in 1-3Q07 vs. exports up by 12% (as of August 2007 the Company consolidated Ceramika Gres). This sales profile, with a rising domestic share, allowed the Company's consolidated gross margin on sales to deteriorate only by 3.4 pp with flat gross margin on domestic sales and a massive drop of margin on exports, by 10 pp. The profitability deterioration, stemming from pressure on wages and growth in raw material, gas and energy prices which took place in 1H07, was subdued in 3Q07, when the Company managed to implement growth in product prices (in June 2007). With 1-3Q07 EBITDA growth of 13% yoy, the bottom line improved by 41%, mainly due to a lower effective tax rate.

We forecast 4Q07 sales at PLN 40 million, up 53% yoy, stemming mainly from the consolidation of Ceramika Gres. With visible full effects of product price enhancement, as well as emergence of synergies and scale effects, we expect gross margin on sales to improve in 4Q07. However, due to booking of PLN 2.7 million of other operating income in 4Q06, which elevated 4Q06 operating profitability, we expect the 4Q07E EBIT margin only slightly to increase yoy. Assuming 4Q07 effective tax rate of 12.6%, we forecast the 4Q07 bottom line at PLN 3.8 million, 66% up yoy (regarding the details, please refer to *Figure 1*). The Company's 4Q07 results should not surprise the financial community, in our view.

Our FY2007 forecasts are slightly below those of the Company's management, that is consolidated sales, EBITDA, EBIT and NI of PLN 145 million, PLN 32.8 million, PLN 19.7 million, and PLN 14.6 million, respectively.

Investment story

After acquisition of Ceramika Gres, Ceramika Nowa Gala became the fourth largest producer in Poland in terms of capacity (current capacity 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. Although it is difficult to foresee any spectacular product price growth on the domestic ceramic tile market, where there is significant overcapacity, the Company should benefit from market volume growth.

Drivers

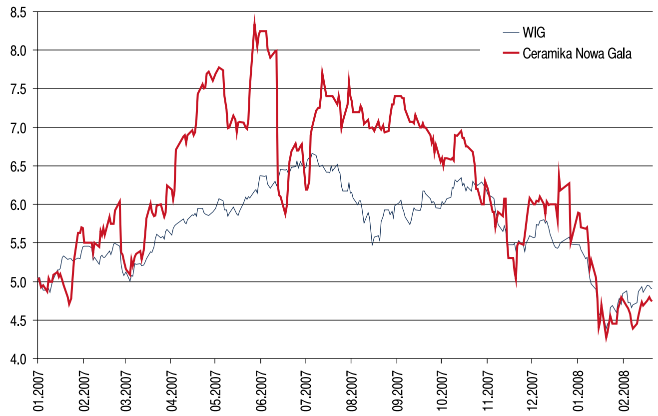
▲ *1. Demand in Poland and in the region; significant dependence on the local market.* Given the Company's domestic sales reaching 79% of total sales in 2007E (after the hike from 72% in 2006) and the location of factories exclusively in Poland, the situation on the domestic construction materials market seems to be particularly important for the Company's development. We believe that the Company will be able to develop in line with the domestic ceramic tiles market. Given overcapacity in the Polish ceramic tiles industry, the construction of a ceramic tiles plant from scratch in Poland is rather unlikely, although it cannot be excluded that producers will increase capacity

Key data

IFRS consolidated		2007E	2008E	2009E	2010E
Sales	*PLN m*	140.8	216.8	241.3	265.5
EBITDA	*PLN m*	32.1	48.2	52.5	56.4
EBIT	*PLN m*	19.0	32.1	34.9	36.7
Net income	*PLN m*	14.3	23.5	27.1	29.8
EPS	*PLN*	0.25	0.41	0.47	0.52
EPS yoy change	*%*	-2%	64%	15%	10%
FCFF	*PLN m*	-38.0	19.9	26.0	21.8
Net Debt	*PLN m*	70.8	48.8	23.8	2.4
P/E	*x*	18.7	11.4	9.9	9.0
P/CE	*x*	9.8	6.8	6.0	5.4
EV/EBITDA	*x*	8.0	6.6	5.6	4.8
EV/EBIT	*x*	13.6	9.9	8.4	7.4
Gross dividend yield	*%*	0.0	0.0	0.0	0.0
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 4Q07 results: February 29, 2008
2. Release of 1Q08 results: May 15, 2008
3. Release of consolidated audited 2007 report: April 11, 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

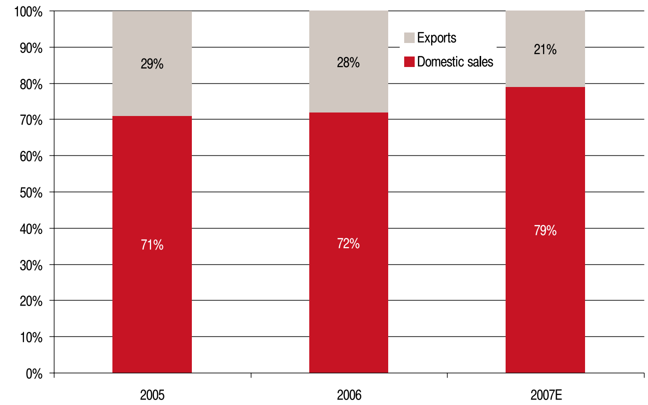
1. GDP slowdown in the region, mainly in Poland
2. Currency risk – appreciation of PLN
3. Gas and energy prices

Fig. 1 *Ceramika Nowa Gala; 4Q07 forecasted results*

IFRS consolidated			yoy change			yoy change	realization of the FY figures in 4Q:	
PLN m	**4Q07E**	**4Q06**		**FY2007E**	**FY2006E**		**2007E**	**2006**
Sales	39.7	25.9	53%	140.8	103.5	36%	28%	25%
EBITDA	9.7	6.2	56%	32.1	26.0	23%	30%	24%
EBITDA margin	*24.5%*	*24.0%*	-	*22.8%*	*25.2%*	-	-	-
EBIT	5.5	3.4	60%	19.0	15.1	26%	29%	23%
EBIT margin	*13.8%*	*13.2%*	-	*13.5%*	*14.6%*	-	-	-
Pre-tax profit	4.4	2.5	74%	16.1	12.0	34%	27%	21%
Pre-tax profit margin	*11.0%*	*9.7%*	-	*11.4%*	*11.6%*	-	-	-
Net profit	3.8	2.3	66%	14.3	9.7	47%	27%	24%
Net profit margin	*9.6%*	*8.9%*	-	*10.2%*	*9.4%*	-	-	-

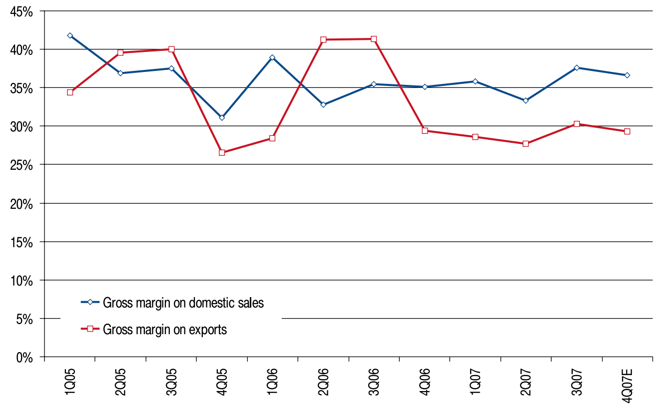
Source: Company, DM IDMSA estimates

Fig. 2 *Ceramika Nowa Gala; Sales profile*



Source: Company, DM IDMSA estimates

Fig. 3 *Ceramika Nowa Gala; Profitability profile*



Source: Company, DM IDMSA estimates

in their current production plants. However, production launches in the factories located on the main export markets might result in additional supply of ceramic tiles on local and Western European markets.

2. Capacity increase – current capacity of 8.9 million sq m p.a., planned to be increased by 0.5 million sq m p.a. in 2008; possible further investments. After the merger with Ceramika Gres, the Company's capacity of 4.7 million sq m p.a. went up by 4.2 million sq m p.a. (at the moment of acquisition Ceramika Gres' capacity was 3.6 million sq m p.a., however production process optimization allowed for an increase by an additional 0.6 million sq m p.a., to 4.2 million sq m p.a.). With capacity utilization of 87% in 2007E, the Company's further growth will depend on its expansion; the Company aims to increase current capacity at Ceramika Nowa Gala by an additional 0.5 million sq m p.a. this year (planned capex on this project is PLN 12 million). Additionally, a new production line installation at Ceramika Gres (with capacity of 2 million sq m) dedicated to premium-segment ceramic tiles production (so far Ceramika Gres produces exclusively tiles in the economy segment) is being considered.

3. Plans to diversify product offer. Although the acquisition of Ceramika Gres supplemented the Company's offer with ceramic tiles from the economy segment, it is still quite homogeneous. Thus, the Company's management has been considering a new project: production of prefabricates for the construction industry.

Financial forecasts

We keep our financial forecasts for the Company unchanged. The Company's capacity is 8.9 million sq m p.a., of which 4.7 million sq m of premium class ceramic tiles and 4.2 million of economy class could be produced (at Ceramika Gres). Based on the assumption that 4 million sq m and 1.2 million sq m of premium and economy class tiles were sold in 2007, which means capacity utilization of 86% and 91%, respectively, and average prices of PLN 29 in premium class and PLN 18 in economy class, we arrived at FY2007 sales of PLN 141 million. We forecast sales of 8.5 million sq m and PLN 9.2 million sq m in 2008 and 2009, which would give capacity utilization of 93% and 98% and translate into PLN 217 million and PLN 241 million, respectively. Expecting almost full current capacity utilization in 2009, we assumed capacity increase by an additional 2 million sq m at Ceramika Gres.

We forecast the Company's consolidated 2008 EBIT margin at 14.8% vs. 13.5% in 2007E. We believe that further pressure on wages and growth in raw material, energy and gas prices will not allow the Company to improve its profitability in the longer run. Expected product price enhancement with placement of products from Ceramika Gres in a higher segment of the market should allow for only partial mitigation of the negative factors mentioned above. Thus, we expect slow profitability deterioration from 2008 onwards.

Although the Company made an acquisition paying PLN 57.8 million for a 100% stake in Ceramika Gres (an additional PLN 19.8 million was paid as dividends to its shareholders), it was financed with an issue of new shares (19 million shares at PLN 3.2 per share; total proceeds of PLN 59 million) allowing the Company's net debt to increase by PLN 35 million at the end of 3Q07 vs. the end of 2006. Thus, we expect higher yoy financial costs in 2008, yet lowering later on.

With higher output from SEZ (where Ceramika Gres is located), we forecast the Company's effective tax rate to grow from 11% in 2007E to 12% in 2008E. Then, we assume a flat level until 2012. Thus, we forecast the Company's 2008 and 2009 bottom line at PLN 23.5 million and PLN 27.1 million, up 64% and 15% yoy, respectively.

Valuation

We have moved the valuation forward to keep 12M valuation horizon, but also applied higher long bond yields for the next 10 years (5.9% vs. previous 5.8%) – these changes in valuation assumptions resulted in 12M EFV of Ceramika Nowa Gala at PLN 5.1 per share, at an intact level.

Recommendation

The Company's 12M absolute-value-based EFV is above the Company's current market price, however we still do not see any drivers which could close the valuation gap. Therefore, we keep a LT fundamental Hold recommendation on Ceramika Nowa Gala shares. In the belief that the Company's FY2007 results will be close to the projections by the Company's management, we do not expect any surprise. We recommend a Neutral market-relative position towards Ceramika Nowa Gala's shares.

Although the recent acquisition should allow Ceramika Nowa Gala to be 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, and unfavourable FX. The question is to what extent these problems will be mitigated by the emergence of the economies of scale and encouraging market conditions. It should also be remembered that production and transportation costs and accessibility of products are significant in the ceramic tiles market, which means that sooner or later imports will be pushed out by local producers, which massively increase the capacity on the Company's export markets.

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) + 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%	1%	4.45	5.1	–
-	→	-	*22.02.2008*	-	-	-	4.70	5.1	→

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*	-	*Not later than 28.01.2009*	4.45	1%
-	→	-	*22.02.2008*	-	4.70	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	20	13	5	0	0
Percentage	53%	34%	13%	0%	0%

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

	Buy	Hold	Sell	Suspend	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	13	18	7	0	0
Percentage	34%	47%	18%	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	2	2	1	0	0
Percentage	40%	40%	20%	0%	0%

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