

Ceramika Nowa Gala

12 November 2010

Improving outlook

Tilemaker				Current price	PLN 3.05*			Buy
Poland				Fair Value	PLN 3.75			Rating maintained
Performance over	1m	3m	12m	FY/e 31.12, PLN m	2009	2010F	2011F	2012F
Absolute %	2.0	9.3	-11.3	Sales	165.5	169.8	184.4	201.7
Rel. WIG20 %	-1.8	-1.5	-22.8	EBITDA	25.1	31.4	40.4	46.5
12m Hi/Lo	PLN 3.44/2.74			EBIT	6.7	13.1	21.0	26.8
Reuters	CERM.WA			Net Profit	5.2	9.3	14.8	19.7
Bloomberg	CNG PW			EPS (PLN)	0.10	0.18	0.29	0.38
Market Cap	€ 39.9m			P/E	31.1	16.9	10.6	7.9
Next corporate event				DPS (PLN)	0.00	0.00	0.07	0.00
3Q10 report on 15 November				Yield (%)	0.0%	0.0%	2.4%	0.0%
PLN / €	3.92			EV/EBITDA (x)	9.7	7.4	5.4	4.6

Source: CNG, KBC Securities

*priced at close of business 10/11/2010

After a dire 2009 and subscale 1H10, we expect CNG to show an earnings rebound in 2H10 and 2011 as the revival of the Polish construction materials market becomes more visible. We also expect the firm to increase its capacity utilization (currently a modest 70%) as it is successfully seeking out new sales markets in Europe. We believe CNG offers stable cash flow, has a relatively undemanding valuation, and is likely to pay out dividends in the years ahead. To reflect the evolving economic environment, we have set our net profit estimates at PLN 9.3m (up 78.3% y/y) for 2010, PLN 14.8m (up 58.2% y/y) for 2011 and PLN 19.7m (up 33.3% y/y) for 2012. We have raised our fair value estimate by 24.9% to PLN 3.75 per share, which implies 24.9% upside. We maintain our Buy rating on the stock.

Buy maintained

- **Sales to rise in 2010:** The Polish market is stabilizing after the price war in 2009/beginning of 2010, which forced producers to sell their products at minimal margins. The recovery on the construction material market began in June 2010 and should be visible in CNG's earnings as early as 3Q10.
- **Strong 3Q10 results:** The recovery of the construction material market should have lasted through to the end of the peak season, enabling CNG to deliver decent earnings in 3Q10. We expect sales to both the property market and wholesalers to have increased in 3Q10. According to the biggest wholesaler chain PSB, sales rose 2% y/y in July, 20% y/y in August, and 7% y/y in September.
- **Raw materials hike not so painful:** More than half of CNG's raw material costs (41% of total costs) are linked to € and US\$. We expect the stronger PLN versus US\$ and (to some extent) € to cushion the expected hike in raw material prices indicated recently by management.
- **Strong cash flow expected:** Despite a serious drop in earnings in the past year, CNG's cash flow should remain strong as a result of very low capital expenditures and working capital needs. We forecast the free cash flow yield at 7.2% in 2010. CNG's leverage is reasonable with net debt/EBITDA at 2.3x at the end of 2010 (down from 3.2x at the end of 2009) and is expected to fall further to 1.5x in 2011.
- **Potential upside from M&A activity:** CNG is currently negotiating the acquisition of a brownfield site in Moldova as part of a joint project with the EBRD. The project has a target capacity of around 3.7m sqm of tiles annually. We do not include this production in our model since the negotiations are still pending and the outcome is not yet certain. There is still a possibility of CNG stepping back from the deal.
- **Undemanding valuation:** CNG has underperformed the WIG20 index by 1.5% in the past three months. On a 2011F EV/EBITDA multiple of 5.4x, CNG trades at an almost 43% discount to Cersanit, whereas we believe 29% would be a fair discount. While we agree that CNG has weaker growth prospects than Cersanit, we believe this has been exaggerated. CNG also trades at a more than 17.8% discount to international tilemakers.

Important Polish Disclosure

Belgian Banking and Finance Commission is exercising the Supervision over KBC Securities NV Branch in Poland.

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The definitions of terms applied in the publication:

EBITDA = EBIT + amortization and depreciation

EPS = Net profit / No of shares outstanding

DPS = Dividend per Share

NBV per share = Net Book Value / No of shares outstanding

EBITDA margin = EBITDA / Revenue

EBIT margin = EBIT / Revenue

CFPS = Cash flow / No of shares outstanding

Net Financial Debt = Financial debt – Cash equivalents

ROE = Net profit / Average Equity

EV = Market Capitalization + Net Financial Debt

P/E = Stock Price / EPS

P/CF = Stock Price / (Net Profit + amortization and depreciation)

P/BV = Stock Price / NBV per share

P/S = Market Capitalization / Revenue

Gross Dividend Yield = Dividend per share / Stock

The list of recommendations concerning Ceramika Nowa Gala issued by KBC Securities NV Branch in Poland during the last 6 months

	Valuation	Market price	Recommendation	The date of issuing
Ceramika Nowa Gala	5.33	4.20	Buy	6 May 2008
Ceramika Nowa Gala	3.00	2.66	Buy	10 June 2009
Ceramika Nowa Gala	3.75	3.05	Buy	12 November 2010

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22 BUY	48%
15 HOLD	33%
9 SELL	20%

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