IDMSA DOM MAKLERSKI

Quarterly Results Preview

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Ceramika Nowa Gala

Sector: Construction materials
Fundamental rating: Buy (↑)
Market relative: Neutral (↑)
Price: PLN 2.84
12M EFV: PLN 3.4 (↑)

Market Cap.: US$ 52 m
Reuters code: CERM.WA
Av. daily turnover: US$ 0.09 m
Free float: 75%
12M range: PLN 2.75-3.65

- **2Q10E results.** CNG is to publish its 1H10 financial results on August 31. We believe that the 2Q10 results will be mediocre, with sales almost flat yoy and a decrease at the NP level, however the results' slide should not be as huge as in the previous quarters. Thus, in comparison with the surprisingly poor 4Q09 financials and weak 1Q10, we believe that 2Q10 results should not constitute another disappointment.

- **Weak sales at the quarter's beginning offset by a demand recovery since mid-May.** We forecast CNG's 2Q10 consolidated sales at PLN 46 million, flattish yoy. After poor sales till mid-May, June brought a recovery in demand for ceramic tiles produced by the Company, which helped to offset the weak quarter beginning. Although it is much too early to announce the end of a misery on the domestic construction materials market (absorbing c. 90% of CNGs' top line), the demand slide has lost its speed. This tendency is also visible in July – some producers hope to generate at least flat sales yoy vs. deep slump in previous months. Moreover, it should be remembered that ceramic tiles prices have been declining till 3Q09, which means that in 2H10 the prices should be already more or less comparable yoy. It seems also that the demand at the premium-end of the market has slightly switched from very expensive imported tiles to domestic ones (the sales of CNG's and Cersanit's premium products behaved better in 1H10 than the economy segment). Further, despite previous threats of a massive demand drop in sales to commercial clients (c. 20% of CNG's top line), it has not materialised, at least so far.

- **EBIT under pressure from unutilised capacity and an increase in the costs of raw materials, however yoy results drop should be already lower than in previous months.** With a flattish yoy sales and an increase in the costs of raw materials, profitability should drop, in our view. We forecast the Company's 2Q10 consolidated EBIT margin at 7% vs. 9% in 2Q09 and yoy EBIT drop by 22%. The Company recognised net financial costs of PLN 1.4 million in the base quarter of 2Q09, while we expect a lower value in 2Q10 (at PLN 0.9 million). Thus, we forecast pre-tax profit to drop by 14% yoy in 2Q10. Assuming twice higher yoy effective tax rate (6% in 2Q09), we forecast the Company's 2Q10 consolidated NP at PLN 2 million, down 19% yoy. Although, it is not a marvellous scenario, the results should be decent compared to previous quarters financials.

- **Financial forecast revision.** We have incorporated 1H10E projections into our financial model for the Company. As a result, we have downgraded our ST forecasts for CNG.

We project 2010 sales and NP at PLN 170 million and PLN 8 million, 2% and 13% below our previous forecasts, respectively. It seems that after a massive demand drop till mid-May 2010, the demand slide has slowed down. However, we are more inclined to expect stagnation this year than a sudden demand recovery.

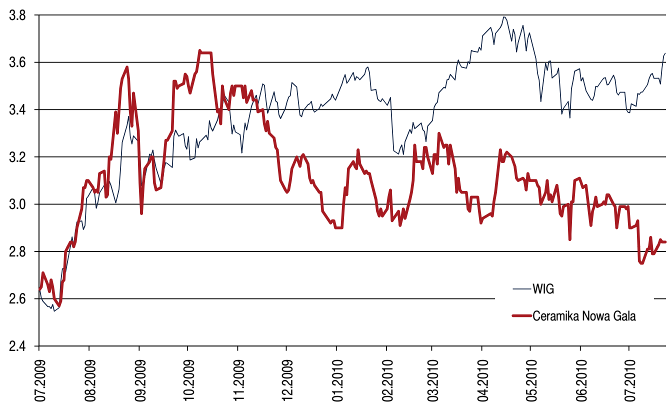
Guide to adjusted profits
No factors necessitating adjustments.

Key data

IFRS consolidated		2009	2010E	2011E	2012E
Sales	*PLN m*	165.5	170.3	188.3	225.6
EBITDA	*PLN m*	25.1	31.2	39.5	45.9
EBIT	*PLN m*	6.7	13.0	21.1	26.4
Net income	*PLN m*	5.2	8.0	13.7	17.3
EPS	*PLN*	0.10	0.15	0.26	0.33
EPS yoy change	*%*	-72	52	72	26
FCFF	*PLN m*	11.2	18.3	15.4	1.6
Net debt	*PLN m*	79.7	71.2	59.0	61.6
P/E	*x*	30.9	20.3	11.8	9.4
P/CE	*x*	6.8	6.2	5.0	4.4
EV/EBITDA	*x*	9.1	7.0	5.2	4.6
EV/EBIT	*x*	34.1	16.9	9.8	7.9
Gross dividend yield	*%*	0.0	0.0	1.5	2.5
Number of shares	*m*	57.0	57.0	57.0	57.0

Source: Company, DM IDMSA estimates

Stock performance



Source: ISI

Upcoming events

1. Release of 1H10 consolidated results: August 31, 2010
2. Release of 3Q10 consolidated results: November 15, 2010

Catalysts

1. Demand for construction materials
2. Foreign sales structure development
3. Entering new markets

Risk factors

1. Lower than expected demand in Poland
2. Interest rate and currency risk
3. Political and operational risk due to planned acquisition abroad
4. Merger with a foreign entity; lower than expected sales effects; difficulties in management

Such a scenario would mean that the worst times might have been already behind the Company. Nevertheless, it should be remembered that CNG faces not only a problem of a demand misery but also a supply growth. After the launch of Cersanit's additional capacity in the Ukraine, supply on the domestic market has increased, creating additional competition for products manufactured by Ceramika Gres, CNG's subsidiary. However, recent CNG's plans to re-position Ceramica Gres products to the higher segment of the market seem to be a good idea for us. Given CNG's scale of operations, we believe that it would be more profitable to concentrate on premium products allowing to generate higher margins, the scale effects in the entry or economy segments will be difficult to achieve. Moreover, although the problem of an overcapacity on the domestic market is very painful, it seems that the premium segment, where imports still exist, is the lowest. It seems that the economy slowdown forces consumers to look for cheaper products of the same quality, which also means that the penetration of Western markets, extremely difficult for Polish ceramic tile producers so far, should be slightly easier. Nevertheless, we remain sceptical regarding CNG's hopes to develop sales in Western countries.

▲ **12M EFV intact.** Although we have made a downward revision to our ST projections, the longer-term forecasts remain almost unaltered. Thus, with valuation horizon forward shift, our EFV assessment for CNG goes up by 6% from PLN 3.2 per share to PLN 3.4 per share.

▲ **Buy + Neutral.** After recent slide of the Company's market share price, double-digit upside potential to our 12M EFV has appeared. Additionally, the pace of yoy decline of the Company's profits should markedly decelerate compared to preceding quarters. Moreover, the pace of a demand drop on the domestic construction materials market has lost its momentum, which should be a good omen for 2H10E results. Thus, we upgrade our LT fundamental recommendation for the Company's shares from Hold to a Buy and our ST market-relative bias to Neutral from Underweight.

Fig. 1 *Ceramika Nowa Gala; 2Q10 and 1H10 results' forecast*

IFRS consolidated PLN m			yoy change			yoy change	Realisation of FY figures in 2Q:		Realisation of FY figures in 1-2Q:	
	2Q10E	2Q09		1-2Q10E	1-2Q09		2010E	2009A	2010E	2009A
Sales	46.3	47.2	-2%	80.9	82.8	-2%	28%	28%	49%	49%
EBITDA	7.6	8.2	-7%	12.1	15.9	-24%	30%	26%	48%	51%
EBITDA margin	*16.5%*	*17.4%*	-	*14.9%*	*19.2%*	-	-	-	-	-
EBIT	3.1	4.0	-22%	3.0	7.0	-57%	47%	31%	45%	54%
EBIT margin	*6.8%*	*8.5%*	-	*3.7%*	*8.4%*	-	-	-	-	-
Pre-tax profit	2.2	2.6	-14%	1.5	5.3	-72%	46%	28%	30%	58%
Pre-tax profit margin	*4.8%*	*5.5%*	-	*1.8%*	*6.4%*	-	-	-	-	-
Net profit	2.0	2.4	-19%	1.6	4.9	-67%	38%	31%	31%	61%
Net profit margin	*4.3%*	*5.2%*	-	*2.0%*	*5.9%*	-	-	-	-	-

Source: Company, DM IDMSA estimates

Fig. 2 *Ceramika Nowa Gala; Changes in IDM's forecasts*

IFRS consolidated	2010E			2011E		
PLN m	current	previous	change	current	previous	change
Sales	170.3	174.4	-2%	188.3	203.1	-7%
EBITDA	31.2	34.8	-10%	39.5	41.6	-5%
EBIT	13.0	15.9	-18%	21.1	22.4	-6%
NP	8.0	9.2	-13%	13.7	14.3	-4%

Source: DM IDMSA estimates

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*	-	*07.01.2010*	14%	-23%	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	↑
-	→	-	*14.12.2009*	-	-	-	3.17	3.20	→
Hold	→	*07.01.2010*	-	*25.07.2010*	-7%	-10%	3.04	3.20	→
-	→	-	*03.02.2010*	-	-	-	3.06	3.20	→
-	→	-	*01.03.2010*	-	-	-	3.13	3.20	→
-	→	-	*29.03.2010*	-	-	-	3.03	3.20	→
-	→	-	*25.04.2010*	-	-	-	3.10	3.20	→
-	→	-	*17.05.2010*	-	-	-	3.08	3.20	→
-	→	-	*14.06.2010*	-	-	-	3.00	3.20	→
-	→	-	*19.07.2010*	-	-	-	2.83	3.20	→
Buy	↑	*25.07.2010*	-	*Not later than 25.07.2011*	-	-	2.84	3.40	↑

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*	-	*07.01.2010*	2.75	-26%
-	→	-	*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	-
-	→	-	*14.12.2009*	-	3.17	-
Neutral	↑	*07.01.2010*	-	*29.03.2010*	3.04	-4%
-	→	-	*03.02.2010*	-	3.06	-
-	→	-	*01.03.2010*	-	3.13	-
Underweight	↓	*29.03.2010*	-	*25.07.2010*	3.03	-6%
-	→	-	*25.04.2010*	-	3.10	-
-	→	-	*17.05.2010*	-	3.08	-
-	→	-	*14.06.2010*	-	3.00	-
-	→	-	*19.07.2010*	-	2.83	-
Neutral	↑	*25.07.2010*	-	*Not later than 25.07.2011*	2.84	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	26	29	12	1	0
Percentage	38%	43%	18%	1%	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	20	31	16	1	0
Percentage	29%	46%	24%	1%	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	1	2	2	1	0
Percentage	17%	33%	33%	17%	0%

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