November 14, 2013

Q3 2013 - Management Discussion and Analysis

The third quarter of 2013 brought a continuation of gradual improvement of the demand for our semi-finished and finished products as compared to Q2 2012. The production and sales increased both tonnage-wise and value-wise. This was coupled with the positive development of our profitability however, the increase of the margins was not as notable as the one related to sales. Cognor S.A. (Cognor, the Company, the Group) managed to improve operational profits at all levels though the pricing environment remained challenging. Furthermore, for the first time in the last 12 months, we managed to post net profit and that was partially due to the contribution of foreign exchange gains.

The significant improvement of the business as compared to Q2 2012 allowed us to achieve the results similar to the previous quarter which we regard as a positive indicator because of the usual Summer slowdown in the steel industry and the related main annual maintenance works. We carried out those in Q3 2013 which resulted in higher operational costs in August and September.

The increase of our production and sales appears particularly encouraging when confronted with the steel market development in Poland and in the EU. We believe that our outperformance would not have been possible absent of the tool-treatment agreement which we had entered into with a company called Profil earlier in February this year. We intend to continue and potentially tighten the collaboration with that rolling plant, subject to the prospects for the merchant bar market in Poland going forward.

The management of Cognor maintain their positive outlook and continue to expect the slight improvement in the full years' results as compared to 2012. We also hope that the observed recovery in the European economy is likely to form basis for a more significant uplift in the Group's results next year.

I. Reported Statement

1. Income Statement

The Group's revenues increased by PLN 31.7 million and 10.2% and gross profit rose by PLN 6.5 million and 31.7% as compared to Q3 2012. EBIT improved by PLN 2.5 million and 67.5%. EBITDA rose by PLN 1.7 million and 12.3%. EBITDA margin saw some insignificant increase from 4.5% up to 4.6%. The FX had positive effect on our operations with average EUR/PLN and USD/PLN exchange rates increasing in Q3 2013 by 7,8% and 1,7% respectively as compared to Q3 2012.

AVERAGE EXCHANGE RATES	Q3 2013	Q3 2012
PLN		
EUR/PLN	4.25	3.94
% change	7.8%	
USD/PLN	3.21	3.15
% change	1.7%	

EXCHANGE RATES	30-Sep-2013	30-Jun-2013	30-Sep-2012
PLN			
EUR/PLN	4.22	4.33	4.11
% change (Sep13 / Jun13)	-2.6%		
USD/PLN	3.12	3.32	3.18
% change (Sep13 / Jun13)	-5.9%		

The following table outlines average sales prices for semi-finished and finished products manufactured by both of our steel plants. Spreads are calculated by subtracting scrap metal costs from sales prices. Magnitude of those spreads is a major contributor to Cognor's profitability and therefore we perceive them as main market strength indicators, similarly to sales volumes.

Billet spread improved compared to Q3 2012 and remained at identical level as in the previous quarter. The level of billet sales did not differ significantly in either of the quarters therefore we regard those spreads as being comparable and representing accurate condition indicators for the semi-finished product market.

For Ferrostal's production the finished products' spreads in Q3 2013 stayed below those in Q3 2012 and slightly above the level of the previous quarter. Much more negative spread development affected HSJ where the spreads went down in comparison to both Q2 2013 and Q3 2012.

PRICES AND SPREADS	Q3 2013	Q2 2013	Q1 2013	Q4 2012	Q3 2012
(pln/ tonne)					
FERROSTAL					
SCRAP METAL - all purchases	1 045	1 102	1 165	1 136	1 193
BILLETS - sales to external customers	1 961	2 018	2 132	2 009	2 049
BILLET SPREAD	**916**	**916**	**967**	**874**	**856**
FINISHED PRODUCTS - sales to external customers	2 079	2 123	2 222	2 243	2 312
- plain bars	*2 057*	*2 091*	*2 204*	*2 214*	*2 267*
- flat bars	*2 090*	*2 131*	*2 179*	*2 213*	*2 278*
- squares	*2 038*	*2 040*	*2 137*	*2 152*	*2 228*
- other	*2 111*	*2 198*	*2 411*	*2 682*	*3 019*
PRODUCT SPREADS	**1 034**	**1 021**	**1 057**	**1 107**	**1 119**
- plain bars	*1 012*	*989*	*1 039*	*1 078*	*1 074*
- flat bars	*1 045*	*1 029*	*1 014*	*1 077*	*1 084*
- squares	*993*	*938*	*972*	*1 017*	*1 035*
- other	*1 066*	*1 096*	*1 246*	*1 546*	*1 825*

HSJ					
SCRAP METAL - all purchases	1 084	1 099	1 157	1 116	1 176
FINISHED PRODUCTS - sales to external customers	2 840	3 090	3 079	3 224	3 318
- big rounds	*2 730*	*2 965*	*2 922*	*3 012*	*3 133*
- thick sheets	*3 536*	*4 278*	*5 902*	*4 223*	*3 379*
- thin sheets	*12 101*	*11 042*	*11 517*	*10 260*	*10 763*
- other	*13 569*	*24 254*	*18 181*	*28 059*	*29 027*
PRODUCT SPREADS	**1 756**	**1 991**	**1 922**	**2 108**	**2 142**
- big rounds	*1 646*	*1 866*	*1 765*	*1 896*	*1 957*
- thick sheets	*2 452*	*3 179*	*4 745*	*3 107*	*2 203*
- thin sheets	*11 017*	*9 943*	*10 360*	*9 144*	*9 587*
- other	*12 485*	*23 155*	*17 024*	*26 943*	*27 851*

The result of financial activities was negative, primarily due to interest costs. Those were partially offset by positive foreign exchange differences related to the Group's indebtedness at the amount of PLN 14.1 million. They contributed positively to the net result of the period allowing the Company to post net profit in Q3 2013.

INCOME STATEMENT	Q3 2013	Q2 2013	Q3 2012
'000 PLN			
Revenue	343 035	337 687	311 332
Cost of sales	-315 745	-309 084	-290 615
Gross profit	**27 290**	**28 603**	**20 717**
Other income	4 160	1 831	2 536
Distribution expenses	-10 232	-9 225	-5 510
Administrative expenses	-8 193	-8 851	-9 099
Other gains/(losses) - net	-3 506	2 964	136
Other expenses	-3 369	-2 999	-5 108
EBIT	**6 150**	**12 323**	**3 672**
Financial income	129	333	15 370
Financial expenses	-921	-33 945	-15 278
Net financing costs	**-792**	**-33 612**	**92**
Share of profits of associates	-17	-33	0
Excess in the net fair value of acquired assets over cost	0	0	0
Profit before tax	**5 341**	**-21 322**	**3 764**
Income tax expense	-3 834	5 388	-2 393
Profit/loss for the period from discontinued operations	0	0	0
Profit for the period	**1 507**	**-15 934**	**1 371**
Depreciation and amortization	-9 706	-8 868	-10 443
EBITDA	**15 856**	**21 191**	**14 115**

The non-recurring items had some negative effect on EBITDA and a significant positive impact on our net result. The following adjusted EBITDA and net profit figures facilitate an analogous assessment of the Group's results achieved from the ordinary course of business:

DESCRIPTION	Q3 2013	Q2 2013	Q3 2012
'000 PLN			
Reported EBITDA	**15 856**	**22 029**	**14 115**
Non-recurring items including:	-1 717	3 555	639
- costs of sales	*(3)*	*-1*	*(28)*
- other income	*2 625*	*320*	*1 378*
- distribution expenses	*165*	*-77*	*2 645*
- administrative expenses	*0*	*0*	*-400*
- other gains/losses	*-2 589*	*2 053*	*1 600*
- operational FX result	*(1 273)*	*1 836*	*(1 464)*
- other impairments	*(642)*	*-576*	*(3 092)*
Adjusted EBITDA	**17 573**	**18 474**	**13 476**
Reported net result	**1 507**	**-15 934**	**1 371**
Non-recurring items including:	12 699	-15 371	15 245
- EBITDA adjustments	*-1 717*	*3 555*	*639*
- FX result on debt minus the FX result on assets	*14 090*	*-18 251*	*13 528*
- result from discontinued operations	*0*	*0*	*0*
- cancellation of bonds	*0*	*0*	*1481*
- pro-forma income tax adjustment	*326*	*-675*	*-403*
Adjusted net result	**-11 192**	**-563**	**-13 874**

According to the above adjustments, the Q3 2013 adjusted EBITDA stood at PLN 17.6 million and the adjusted net result at PLN (-) 11.2 million - more by PLN 4.1 and 2.7 million accordingly in comparison to the figures for Q3 2012.

The main entities of the Group made the following contribution to the consolidated results for Q3 2013:

	FERR	ZW-WB	HSJ	ZLMET
'000 PLN				
Revenues	177 731	6 941	120 301	124 907
- incl. Internal	*524*	*6 630*	*495*	*83 086*
EBIT	8 107	542	-2 105	-279
EBITDA	11 491	748	1 864	233
Profit for the period	**4 797**	**445**	**-2 822**	**-568**

2. Balance Sheet

The amount of total assets decreased by 1.8% in comparison to Q3 2012 due to the decrease of value of the non-current assets. Those decreases were mostly fueled by a 2.8% decrease in property plant and equipment value. As compared to the end of Q2 2013, the Company's balance sheet saw stabilization of non-current and the decrease of current assets, mainly due to the decrease in cash and cash equivalents at the total amount of PLN 16.5 million.

ASSETS	Q3 2013	Q2 2013	Q3 2012
'000 PLN			
A. TOTAL NON-CURRENT ASSETS	**454 213**	**463 417**	**477 886**
I. Intangible assets	12 755	13 366	14 571
II. Property, plant and equipment	299 382	303 855	325 489
III. Other receivables	42 204	43 331	41 398
IV. Investment property and other investments	6 264	5 769	7 604
V. Prepaid perpetual usufruct of land	18 639	18 744	19 059
VI. Deferred tax assets	74 969	78 352	69 765
B. TOTAL CURRENT ASSETS	**452 598**	**475 449**	**445 139**
I. Inventories	187 452	198 410	182 325
II. Receivables	223 370	217 883	202 039
1. Trade receivables	*218 438*	*212 537*	*198 319*
2. Current income tax receivable	*10*	*86*	*6*
3. Other investment	*4 922*	*5 260*	*3 714*
III. Cash and cash equivalents	31 274	47 792	48 898
IV. Assets classified as held for sale	8 698	9 760	11 877
V. Assets of disposal groups	0	0	0
VI. Other	1 804	1 604	0

Although the Group posted net profit in Q3 2013 the consolidated equity decreased as compared to the end of Q3 2012 due to negative net results recorded in the period of the last twelve months. Net profit of the last quarter was largely driven by the FX gains related to the Group's indebtedness at the amount of PLN 14.1 million. They also contributed to the slight reduction of our net indebtedness. At the end of the quarter the gross debt stood at PLN 544.5 million and the net indebtedness amounted to 513.2 million, less by PLN 24.8 million as compared to Q2 2013 and by PLN 9.5 million in comparison to Q3 2012. The current liabilities increased sharply compared to Q3 2012 in connection with reclassification of the EUR 118.0 million of the Company's senior secured notes (the Notes) from long-term into short-term liabilities.

EQUITY AND LIABILITIES	Q3 2013	Q2 2013	Q3 2012
'000 PLN			
A. EQUITY	**137 767**	**136 274**	**188 486**
I. Issued share capital	132 444	132 444	132 444
II. Reserves and retained earnings	-8 232	-9 362	43 348
III. Minority interest	13 555	13 192	12 694
B. LIABILITIES	**769 044**	**802 592**	**734 539**
I. Non-current liabilities	**20 585**	**20 919**	**504 308**
1. Employee benefits obligation	*6 705*	*6 719*	*6 560*
2. Interest-bearing loans and borrowings	*4 615*	*5 462*	*488 751*
3. Other	*9 265*	*8 738*	*8 997*
II. Current liabilities	748 459	781 673	230 231
1. Interest-bearing loans and borrowings	*536 481*	*571 901*	*69 353*
2. Bank overdraft	*3 400*	*8 484*	*13 534*
3. Trade payables	*205 356*	*196 565*	*143 369*
4. Defferd government grants	*1 036*	*3 221*	*1 768*
5. Other financial liabilities	*0*	*0*	*0*
6. Employee benefits obligation	*1 754*	*1 000*	*1 667*
7. Current income tax payable	*0*	*165*	*5*
8. Provisions for payables	*432*	*337*	*535*
TOTAL EQUITY AND LIABILITIES	**906 811**	**938 866**	**923 025**

3. Cash flow

The Group had a positive operating cash flow in Q3 2013 as a result of: depreciation charges at PLN 8.7 million, profit before tax at PLN 5.3 million and the PLN 0.7 inflow from working capital. Cash from investing activities was negative with expenditures related to acquisitions of property, equipment and other assets standing at PLN (-) 3.4 million. Financing activities contributed negatively due to repayment of financial liabilities at PLN 9.1 million and the interest costs paid at PLN 22.8 million.

CASH FLOW	Q3 2013	Q2 2013	Q3 2012
'000 PLN			
A. OPERATING ACTIVITIES	23 626	25 071	-21 850
B. INVESTING ACTIVITIES	-3 102	12	128
C. FINANCING ACTIVITIES	-31 954	-16 398	-19 701
NET INCREASE IN CASH	**-11 430**	**8 685**	**-41 423**

II. Main Metrics

In light of the reclassification of the Notes maturing in February 2014 as short-term liabilities, the liquidity metrics suffered substantially. Due to deteriorating EBITDA the leverage ratio remains just under 10 times multiple. Rotation metrics record good levels.

MAIN METRICS	Q3 2013	Q2 2013	Q3 2012
Liquidity ratio	0,60	0,61	1,93
Quick ratio	0,35	0,35	1,14
Inventories turnover (days)	53	58	56
Receivables turnover (days)	57	57	57
EBITDA margin	4,6%	6,3%	4,5%
Net profit margin	0,4%	-4,7%	0,4%
Equity	137 767	136 274	188 486
Net Debt	513 222	538 055	522 740
Net debt / LTM EBITDA	9,7	10,5	6,0

III. Future capital structure

The Group's capital structure relies on continued access to external financing and that consists largely of the Notes maturing in February 2014. Recently, Cognor has agreed contractually with 68.9% of the noteholders on a proposal for the refinancing. The Company and its legal and financial advisors continue to progress the documentation of this proposal, with the intention to make a further public announcement and reach agreement with all remaining stakeholders in the near future.

IV. Business development

The Company intends to undertake the mid-term business development plans as discussed in previous reports. We expect that the terms of the currently discussed refinancing transaction will allow Cognor to facilitate realization of the expansionary CAPX projects.

V. Earnings call

The conference call on our Q3 2013 results will be held in English language on Tuesday, November 19, 2013, at 16:00 CET (15:00 London). On that day a presentation discussing operational and financial details will be made available on the Company's website at: www.cognor.eu.

All participants are invited to review the presentation and are kindly requested to register in advance using the following link:
https://eventreg1.conferencing.com/webportal3/reg.html?Acc=803090&Conf=188900