



November 14, 2014

Q3 2014 - Management Discussion and Analysis

The third quarter of 2014 was a third consecutive period of improved performance as compared to 2013 however, the positive difference has continued its tendency to shrink. Our gross profit, EBIT and EBITDA improved, also when adjusted for non-recurring items. The events of one-off nature had a particularly significant impact on our net result. The adjusted net result was much better than a year ago however in negative territory for the first time in 2014. Similarly to Q3 2013 the last quarter was a period of general overhauls at all of our plants. This year though the service period was slightly longer since we decided to carry out a larger scope of maintenance works and include realization of expansionary capital expenditures at that time. In our opinion that factor had a larger negative impact on our Q3 2014 figures as compared to Q2 2014 than the deteriorating market sentiment.

After the increase of 5% (yoy) in Q2 the Polish steel output fell by (-)4.3% in Q3 2014. In the EU(28) the steel production saw an increase of just 0.5%. China slowed down to less than 3.9% which resulted in the global crude steel production enlargement of 2.7%.

While the GDP slowdown warnings are being increasingly articulated for Europe and China we remain fairly positive for the rest of 2014 based on the current order book.

I. Reported Statement

1. Income Statement

The Group's revenues increased by PLN 23.9 million and 7.0% primarily due to the 11.5% increase in shipments of combined ferrous scrap metal, steel semi-finished and finished products. Gross profit rose by PLN 7.3 million and 26.9% as compared to Q3 2013, driven by higher sales of billets and finished products. EBIT increased by PLN 1.8 million and EBITDA by PLN 1.4 million. EBITDA margin increased from 4.6% up to 4.7%. The FX had some negative effect on our operations with the average EUR/PLN and USD/PLN declining as compared to Q3 2013 by (-)1.8% and (-)1.9% respectively. Similarly, a negative impact it had on our net financial costs - the FX losses related to the Group's debt stood at PLN (-)1.5 million driven by the weakening zloty against the euro: EUR/PLN quoted at PLN 4.18 as of September 30, 2014 and at PLN 4.16 as of June 30, 2014.

AVERAGE EXCHANGE RATES		Q3 2014	Q3 2013
<i>PLN</i>			
EUR/PLN		4.17	4.25
% change		-1.8%	
USD/PLN		3.15	3.21
% change		-1.9%	

EXCHANGE RATES		30-Sept-2014	30-Jun-2014	30-Sept-2013
<i>PLN</i>				
EUR/PLN		4.18	4.16	4.22
% change		0.4%		
USD/PLN		3.30	3.05	3.12
% change		8.1%		

The improvement of our operations was mostly driven by the increase in production and sales of our semi-finished and finished products. At the same time the spread for the Ferrostal billet sales was decreased by PLN (-)98 per tonne and the finished product's spread by PLN (-)11 per tonne. Those were partially offset by the positive spread development related to HSJ's products at PLN 73 per tonne however, the magnitude of that increase was not sufficient to fully offset the influence of Ferrostal's spread contraction.

PRICES AND SPREADS	Q3 2014	Q2 2014	Q1 2014	Q4 2013	Q3 2013
<i>(pln/ tonne)</i>					
FERROSTAL					
SCRAP METAL - all purchases	966	972	1 052	1 073	1 045
BILLETS - sales to external customers	1 784	1 744	1 995	1 972	1 961
BILLET SPREAD	818	772	942	899	916
FINISHED PRODUCTS - sales to external customers	1 989	2 066	2 158	2 168	2 079
- plain bars	2 051	2 076	2 136	2 153	2 057
- flat bars	2 040	2 070	2 157	2 162	2 090
- squares	2 034	2 056	2 108	2 163	2 038
- rebars	1 846	1 938	2 138		
- angles	2 083	2 120	2 185	2 166	2 079
- other	3 971	3 475	2 370	2 404	2 787
PRODUCT SPREADS	1 023	1 094	1 105	1 095	1 034
- plain bars	1 085	1 104	1 084	1 080	1 012
- flat bars	1 074	1 098	1 105	1 089	1 045
- squares	1 068	1 084	1 056	1 090	993
- rebars	880	966	1 086		
- angles	1 117	1 148	1 133	1 093	1 034
- other	3 005	2 503	1 318	1 331	1 742
HSJ					
SCRAP METAL - all purchases	1 048	1 034	1 060	1 084	1 084
FINISHED PRODUCTS - sales to external customers	2 900	2 950	2 947	2 761	2 840
- big rounds	2 761	2 808	2 838	2 698	2 730
- thick sheets	2 912	6 420	4 723	2 855	3 536
- thin sheets	11 379	11 126	10 732	11 810	12 101
- other	29 635	25 941	24 004	21 878	13 569
PRODUCT SPREADS	1 852	1 916	1 886	1 677	1 756
- big rounds	1 713	1 774	1 778	1 614	1 646
- thick sheets	1 864	5 386	3 663	1 771	2 452
- thin sheets	10 331	10 092	9 672	10 726	11 017
- other	28 587	24 907	17 121	20 794	12 485

In Q2 2014 an incorrect recognition of maintenance costs accrual was entered that resulted in reduction of administrative expenses by PLN 1.7 million while it should have been accounted for as part of costs of sales. In Q3 2014 the error has been rectified hence the increase of administration expenses level over the 2014 quarterly average of PLN 8.9 million.

The increase in our operational profitability was undermined by FX losses related to the Group's indebtedness at PLN 1.5 million.

INCOME STATEMENT	Q3 2014	Q2 2014	Q3 2013
'000 PLN			
Revenue	366 967	367 938	343 035
Cost of sales	-332 330	-331 361	-315 745
Gross profit	34 637	36 577	27 290
Other income	-831	2 551	4 160
Distribution expenses	-11 102	-10 616	-10 232
Administrative expenses	-11 064	-7 189	-8 193
Other gains/(losses) – net	238	659	-3 506
Other expenses	-3 891	-5 375	-3 369
EBIT	7 987	16 607	6 150
Financial income	1 799	0	129
Financial expenses	-15 750	-14 666	-921
Net financing costs	-13 951	-14 666	-792
Share of profits of associates	-16	-14	-17
Gain on bargain purchase	49	3 799	0
Profit before tax	-5 931	5 726	5 341
Income tax expense	1 034	-1 096	-3 834
Profit for the period	-4 897	4 630	1 507
Depreciation and amortization	-9 286	-8 659	-9 706
EBITDA	17 273	25 266	15 856

The non-recurring items had some significant impact on EBITDA and 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 2014	Q2 2014	Q3 2013
'000 PLN			
Reported EBITDA	17 273	25 266	15 856
Non-recurring items including:	-2 917	-589	-3 281
- costs of sales	-19	19	-3
- other income	184	288	1 061
- distribution expenses	-579	55	165
- other gains/losses	66	861	-2 589
- operational FX result	91	-277	-1 273
- other impairments	-2 660	-1 535	-642
Adjusted EBITDA	20 190	25 855	19 137
Reported net result	-4 897	4 630	1 507
Non-recurring items including:	-3 449	4 178	11 448
- EBITDA adjustments	-2 917	-589	-3 281
- FX result on debt	-1 462	870	14 090
- result on debt repurchase	403	0	0
- share of associate result	49	3 785	16
- pro-forma income tax adjustment	478	112	623
Adjusted net result	-1 448	452	-9 941

According to the above, the Q3 2014 adjusted EBITDA stood at PLN 20.2 million and the adjusted net result at PLN (-)1.5 million – both improved as compared to the figures of Q3 2013. We'd like to draw attention though to the following couple of items included in the calculation of the adjusted figures.

On November 4, 2014 we decided to conclude the dispute against Mechel Group (Mechel) related to the agreement dated February 4, 2011 on the sale of shares in Cognor Stahlhandel GmbH (the Agreement) and the payment of the outstanding amount of PLN 7.2 million as per our calculations of the final share price. Bearing in mind the expected length and costs of further arbitration proceedings together with the uncertainty over Mechel's financial position in the future, we decided to agree on the terms under which Cognor accepted the amount of EUR 1.2 million as the final settlement of all of the Mechel's payment obligations arising from the Agreement. While this resulted in a loss of PLN (-)2.3 million we are of the opinion that the dispute required prompt settlement since the associated risks have become too high. The amount of the loss is included as a provision under "other gains/losses" in Q3 2014.

The other item is related to repurchases of our senior secured notes (the Notes). In Q3 2014 we bought back a nominal of EUR 0.5 million and made a gain of PLN 0.4 million. The gain is specified under "result on debt repurchase" in the non-recurring adjustments table above. In Q4 2014 we followed with further repurchases at the nominal amount of EUR 1.5 million. The result of the latter will be accounted for in Q4 2014. Subject to our liquidity position and actual Note's pricing we may continue open market buybacks within the limits of the Note's indenture.

The main entities of the Group made the following contribution to the consolidated results of Q3 2014:

	FERR	ZW-WB	HSJ	ZLMET
'000 PLN				
Revenues	197 040	7 385	108 963	103 844
- incl. Internal	558	7 222	994	60 271
EBIT	18 237	950	11 734	4454
EBITDA	13 373	950	5 610	188
Profit for the period	7 893	682	-12 897	-582

2. Balance Sheet

The amount of total assets increased by 6.9% in comparison to Q3 2013 primarily due to the 14.6% increase in value of current assets. The increase was driven primarily by higher level of inventories – an increase of 32.7%. An opposite trend can be observed in comparison to Q2 2014 where both inventories and receivables decreased resulting in the 6.1% decrease of current assets.

ASSETS	Q3 2014	Q2 2014	Q3 2013
'000 PLN			
A. TOTAL NON-CURRENT ASSETS	450 334	443 970	454 213
I. Intangible assets	11 776	11 762	12 755
II. Property, plant and equipment	294 515	294 874	299 382
III. Other receivables	42 113	41 647	42 204
IV. Investment property and other investments	2 196	2 212	6 264
V. Prepaid perpetual usufruct of land	24 471	24 623	18 639
VI. Deferred tax assets	75 263	68 852	74 969
B. TOTAL CURRENT ASSETS	518 638	552 311	452 598
I. Inventories	248 807	268 707	187 452
II. Receivables	227 228	247 672	223 370
1. Trade receivables	204 494	224 750	218 438
2. Current income tax receivable	47	33	10
3. Other investments	22 687	22 889	4 922
III. Cash and cash equivalents	33 828	27 260	31 274
IV. Prepayments	0	0	1 804
V. Assets classified as held for sale	8 775	8 672	8 698
TOTAL ASSETS	968 972	996 281	906 811

In Q3 2014 the Group reduced its leverage with the gross debt amounting to PLN 485.1 million and the net indebtedness at PLN 451.3 million - less by PLN 62.0 million as compared to Q3 2013 and by PLN 17.3 million in comparison to Q2 2014. The main reason behind was the successful completion of the financial restructuring which resulted in the issuance of convertible notes at the amount of EUR 25.1 million. These are now accounted for as equity and no longer as the Company's indebtedness. Primarily for that reason our equity went up by PLN 85.3 million as compared Q3 2013. The restructuring also resulted in maturity extension of most of the Group's indebtedness. Our Notes mature in 2020 hence the increase in the Company's long-term debt as compared to Q3 2013.

EQUITY AND LIABILITIES	Q3 2014	Q2 2014	Q3 2013
'000 PLN			
A. EQUITY	223 115	228 807	137 767
I. Issued share capital	132 444	132 444	132 444
II. Reserves and retained earnings	65 871	72 110	-8 232
III. Non-controlling interests	24 800	24 253	13 555
B. LIABILITIES	745 857	767 474	769 044
I. Non-current liabilities	461 157	422 266	20 585
1. Employee benefits obligation	9 215	9 230	6 705
2. Interest-bearing loans and borrowings	407 508	407 504	4 615
3. Other	44 434	5 532	9 265
II. Current liabilities	284 700	345 208	748 459
1. Interest-bearing loans and borrowings	72 063	82 099	536 481
2. Bank overdraft	5 510	6 228	3 400
3. Trade payables	199 866	247 791	205 356
4. Deferred government grants	117	117	1 036
5. Employee benefits obligation	2 324	1 760	1 754
6. Current income tax payable	44	0	0
7. Provisions for payables	4 776	7 213	432
TOTAL EQUITY AND LIABILITIES	968 972	996 281	906 811

3. Cash flow

The Group had a positive operating cash flow in Q3 2014 as a result of depreciation charges, working capital development and other less significant elements. Working capital contributed at PLN 17.0 million. Cash flows from investing activities were negative due to capital expenditures at PLN (-)8.7 million. Due to the August coupon payments at the total amount of (-)17.9 million, our financing activities were strong use of cash.

CASH FLOW	Q3 2014	Q2 2014	Q3 2013
'000 PLN			
A. OPERATING ACTIVITIES	37 130	10 135	23 626
B. INVESTING ACTIVITIES	-5 493	-1 035	-3 102
C. FINANCING ACTIVITIES	-24 353	-948	-31 954
NET INCREASE IN CASH	7 284	8 142	-11 430

II. Main Metrics

Liquidity metrics improved very substantially as a result of successful completion of the financial restructuring. Receivable collection saw an improvement; inventory turnover went up. Improving EBITDA and partial conversion of debt into equity helped to reduce our leverage down to 5.0 times multiple.

MAIN METRICS	Q3 2014	Q2 2014	Q3 2013
Liquidity ratio	1.82	1.60	0.60
Quick ratio	0.95	0.82	0.35
Inventories turnover (days)	67	73	53
Receivables turnover (days)	50	55	57
EBITDA margin	4.7%	6.9%	4.6%
Net profit margin	-1.3%	1.3%	0.4%
Equity	223 115	228 807	137 767
Net debt	451 253	468 571	513 222
Net debt / EBITDA	5.0	5.2	9.5

III. Business development

During the overhaul period we managed to carry out two elements of the mid-term capex programme for HSJ: (i) the upgrade of the CCM and (ii) the modernization of the long products rolling mill. We expect those to positively contribute to our product quality resulting in lesser costs associated with defective production and to open more opportunities in the market. The other elements of the expansionary capital expenditures at HSJ are scheduled for 2015. Further capex plans remain subject to evolution of our results in 2015 and subject to progress with reduction of our leverage.

IV. Earnings call

The conference call on our Q3 2014 results will be held in English language on Friday, November 21, 2014 at 16:00 CET (15:00 London). On that day a special presentation will be made available for a download on the Company's website at: www.cognor.eu.

All participants are kindly requested to register in advance using the following link: <https://eventreg1.conferencing.com/webportal3/req.html?Acc=803090&Conf=191499>