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ES-SYSTEM

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Q3 2009 Results

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Current Price: PLN 5.07

ES-System's sales slowed their decline in Q3 2009 to a year-on-year rate of 8.1%, compared to a 16.8% drop in H1 2009. Domestic sales fell 13.3% compared to the same period a year ago, while international sales increased 12.8%. Weaker demand from the construction industry was partly offset with increased sales through wholesale channels. The Q309 EBIT margin shrunk to 11.8% from 12.5% in Q3 2008 because of lower retail sales and higher wholesale sales which generate weaker returns. EBITDA was 7.7% lower than in the same period a year ago, while the EBITDA margin was slightly higher thanks to a 23.1% y/y increase in depreciation charges. In spite of a stagnant market, ES-System has managed to build an order backlog for Q4 2009 that will generate revenues similar to last year's figure. After a dismal first half of 2009, the third-quarter results indicate that the worst is over for the company.

Q1-Q3 results

ES-System's revenues for the first three quarters of 2009 amounted to PLN 109.6m, which was 13.6% less than in the same period a year ago. After a 16.8 y/y drop in H1 2009, in Q309, sales slowed down their decline to 8.1%. The improvement was owed to stronger exports (+12.8% y/y) and a deceleration in the downward trend of domestic sales which decreased 13.3% relative to Q3 2008, compared to a 16.0% drop in H1 2009. Today, ES-Systems Polish and international markets are stabilizing, and halted construction projects are gradually resumed.

Domestic sales

ES-System is noticing a return of confidence among construction companies whose increasing optimism about the future is expected to fuel orders for lighting systems. ES-System managed to mitigate the shortage of orders from Polish construction-industry customers by increasing sales to wholesale customers. Like in past periods, ES-System is under competitive pressure from cheaper producers from China and India as Polish buyers seek cheap lighting solutions.

Exports

ES-System recorded an increase in sales to fifteen of its export markets, and a slump in twenty markets in Q309. Even so, the overall export revenue in the period was 12.8% higher than last year. Further, the volume of orders received in Q309 from international customers surged 40% from Q209, nearing the record level recorded in Q3 2008. The company entered four new markets in the third quarter (Australia, Greece, Ireland, and Uruguay), and currently focuses its marketing efforts on markets with the greatest growth potential (Bulgaria, Ukraine, Lithuania, Austria, Kuwait, Denmark, Croatia, New Zealand).

Q3 2009 results

(PLN m)	2008	1-3Q2008	1-3Q2009	change	3Q2008	3Q2009	change
Revenue	175.4	126.9	109.6	-13.6%	46.1	42.3	-8.1%
Domestic sales	137.2	98.9	84.1	-15.0%	36.8	31.9	-13.3%
as percentage of total sales	*78.2%*	*73.3%*	*80.0%*	-	*78.8%*	*76.7%*	-
Exports	38.2	27.9	25.5	-8.7%	9.3	10.5	12.8%
as percentage of total sales	*21.8%*	*26.7%*	*20.0%*	-	*21.2%*	*23.3%*	-
EBIT	18.0	13.2	8.3	-36.8%	5.8	5.0	-13.3%
EBIT margin	*10.3%*	*10.4%*	*7.6%*	-	*12.5%*	*11.8%*	-
EBITDA	23.0	16.8	12.8	-24.0%	7.1	6.5	-7.7%
EBITDA margin	*13.1%*	*13.2%*	*11.7%*	-	*15.3%*	*15.4%*	-
Net income	14.2	10.4	6.1	-41.2%	4.7	3.8	-19.6%

Source: ES-System, BRE Bank Securities

ES-System's accumulated operating profit for the first three quarters of 2009 amounted to PLN 8.3m after a 36.8% drop from the same period a year ago. The EBIT margin fell from 10.4% generated in the period from January through September 2008 to 7.6% for the same period of 2009. One reason behind the margin contraction was weaker demand (fixed costs), and another reason were increased low-margin sales through wholesale channels. Margins on export sales matched those earned on domestic sales, largely thanks to increased sales of customized solutions with higher added value. In the near term, we expect operating margins to stay below their historical averages. An improvement will be triggered by a turnaround in the construction industry, which generates demand for high-margin tailor-made lighting solutions.

The 3Q09 EBIT margin was much higher than the accumulated margin for the three quarters (11.8% vs. 7.6%), but lower than the figure reported in Q308 (12.5%). This was an effect of high contributions to total revenues of high-margin products developed for the construction industry – if their sales fall, so does the consolidated EBIT margin.

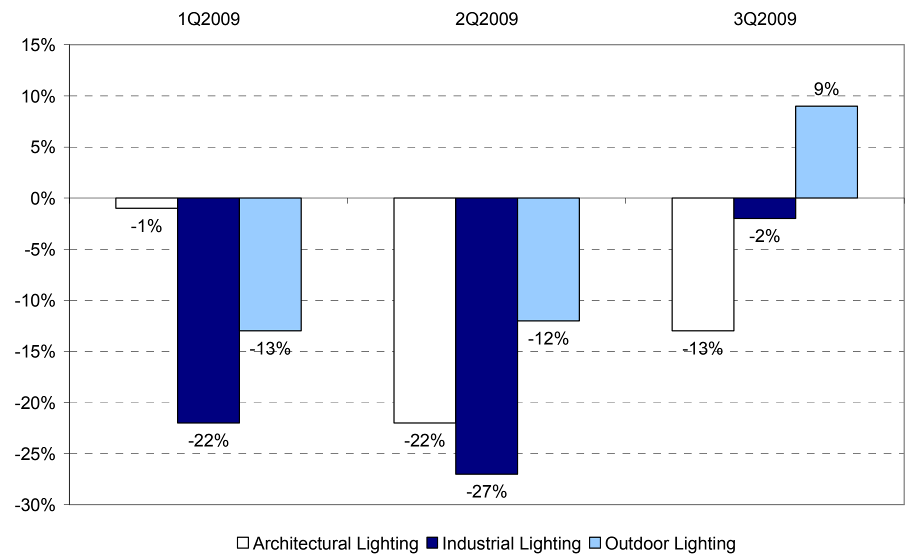
The Q309 EBITDA margin was higher than in Q308 (15.3%) at 15.4%, thanks to a 23.1% y/y increase in depreciation (in 2008, ES-System recorded high capital expenses of PLN 22.3m).

The bottom-line profit for the first three quarters came in at PLN 6.1m after a 41.2% drop below the year-ago figure. The reasons for this decrease included a 36.8% lower EBIT, and a deferred-tax charge of PLN 0.8m stemming from differences between depreciation expenses calculated for book and tax purposes. Finance gains amounted to PLN 0.4m. The bottom-line profit for the third quarter of 2009 figured to PLN 3.8m after a 19.6% decrease vs. Q3 2008.

Business Segments

The three core business segments that are responsible for 86% of ES-Systems sales experienced a rebound in Q3 2009 relative to the first half of the year. The segment of Outdoor Lighting was the most successful, recording a 9% y/y increase in revenue (during the first two quarters, the sales generated by this segment fell by no more than 13%). The segment of Industrial Lighting has been the one most affected by the economic downturn, reporting a 2% y/y decrease in revenues in Q309 (in the first two quarters, the segment's sales dropped by more than 20% as manufacturers postponed lighting and other upgrades). The segment of Architectural Lighting was the least successful, recording a 13% y/y sales shrinkage in Q309. As part of the Architectural Lighting business, ES-System currently focuses on marketing energy-saving lighting solutions that are compliant with the European Union's energy-consumption policies. Such energy-efficient systems will gradually replace old, wasteful lighting technology. A regulation laying down the requirements for tertiary-sector lighting products, aimed at reducing energy usage within the EU by 15%, entered into force on 13 April 2009 across all EU member states.

Q1-Q3 2009 revenue growth by business segment



Source: BRE Bank Securities

Operating Cash Flows

ES-System generated positive operating cash flows in the amount of PLN 15.8m during the period from January through September 2009. The company reduced its receivables turnover days to 86.6 from 93.9 a year ago, and the accounts payable days from 83.8 to 67.0. Inventories increased by PLN 0.5m.

Amid a weak economy, ES-System applies very strict rules when granting trade credit to its partners, and insures its export receivables with the Export Credit Insurance Corporation (KUKE). Further, the company keeps a close watch on payment-due dates and takes measures to effectively collect any outstanding accounts.

CAPEX

Due to slumping demand, ES-System had to reduce its original 2009 CAPEX budget of PLN 10m. The company is not seeking acquisition targets at the moment, but the Management admits that a low debt (20.9%) and high liquidity ratios (current ratio at 3.45; quick ratio at 2.44) create acquisition potential.

In future, ES-System is going to invest in new subsidiary 'ES-System NT,' established to produce cutting-edge electronic components for lighting systems, and to address the renewable energy market. By locating the new operations in the Krakow Special Economic Zone, ES-System can count on tax credits and easier access to credit. The Management is reluctant to speak about the costs of the investment. All we now is that the three land lots earmarked for the production facilities cost PLN 1.9m. The new operations are scheduled for a launch in September 2010.

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List of abbreviations and ratios contained in the report.
EV *– net debt + market value (EV – economic value)*
EBIT *– Earnings Before Interest and Taxes*
EBITDA *– EBIT + Depreciation and Amortisation*
PBA *– Profit on Banking Activity*
P/CE *– price to earnings with amortisation*
MC/S *– market capitalisation to sales*
EBIT/EV *– operating profit to economic value*
P/E *– (Price/Earnings) – price divided by annual net profit per share*
ROE *– (Return on Equity) – annual net profit divided by average equity*
P/BV *– (Price/Book Value) – price divided by book value per share*
Net debt *– credits + debt papers + interest bearing loans – cash and cash equivalents*
EBITDA margin *– EBITDA/Sales*

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