Dom Maklerski

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Monthly Report: March 2014

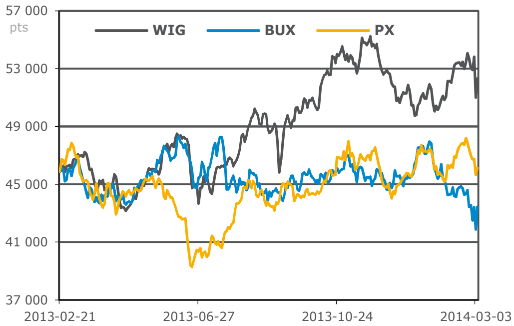
Equity Market, Macroeconomics

Equity market

The outlook for the global economy remains optimistic. The Russia/Ukraine conflict (expected to have a limited impact on Polish GDP), and the slow momentum in emerging market economies, positions Poland as a safe haven for international capital.

WIG	52,216 pts
Average 2013E P/E	20.8
Average 2014E P/E	18.6
Avg. daily trading volume (3M)	PLN 895m

WIG vs. CEE indices



Sector Outlook

Financial Sector

The WIG Banks index climbed 11.9% (in dollars) in February, and it outperformed MSCI EM Financials which gained 3.4% (in dollars). Performing even better than the benchmark were Millennium (+17.0%) and Bank Handlowy (+16.5%). For March, we project good earnings results from PKO BP, and seasonally weaker showings from PZU and Kruk. As for CEE banks, we expect to learn the Hungarian's government plans with respect to foreign-currency mortgages, and we anticipate continuing pressure on banks with exposures to Ukraine and Russia (RBI and OTP)

Gas & Oil

Market forces have shifted in favor of oil refiners who are set for continuing expansion in gasoline cracks combined with a narrowing Brent-WTI spread. The main beneficiary of these trends will be PKN Orlen. The outlook for PGNiG is less rosy after weak Q4 results and a disappointing FY2014 guidance.

Power Utilities

Sentiment to utilities has improved thanks to high prices of carbon allowances and capacity payments. We continue to see the most upside potential in Enea and Tauron.

Media, IT

Our top media pick is Cyfrowy Polsat whose share price has rallied after strong Q4'13 results and reports of decreasing debt. We also see upside potential in ABC Data and Cinema City.

Resources

KGHM remains our top pick in resources as low copper stocks combined with an upcoming seasonal increase in demand are sure to keep prices high in coming months. Coal miners have less good prospects ahead.

Industrials

A weakened ruble is going to weigh on the Q1 2014 earnings of Amica, Fasing, Selena, Rovese, Relpol, Apator, Zamet, SecoWarwick, and Ropczyce. Otherwise, we expect that over 70% of the industrial companies followed by us will report year-on-year growth this quarter. The manufacturing stocks tracked by us are currently trading at 12.6x 2014E P/E and 7.5x EV/EBITDA, showing discounts of 15% to 30% relative to MSCI Industrials Europe and World.

Construction

We would take advantage of the price dips in Erbud and Unibep shares to buy these stocks. The strong performance displayed YTD by Elektrotim and Herkules is grounded in fundamentals and both stocks still have upside potential. ZUE is trading at attractive multiples after a price dip combined with several major contracts acquired in the last few weeks.

Property Developers

Developers underperformed the broad market noticeably in February, but they are poised for a rebound in coming months, supported among others by the decreasing likelihood of interest rate reductions. We see most upside potential in Robyg, LC Corp, Capital Park, and Echo Investment.

Other

We are downgrading Work Service to hold after recent price increases.

Rating Changes

Company	Rating	Change
BZ WBK	Reduce	▼
Ciech	Hold	▼
Energa	Accumulate	▼
Erbud	Buy	▲
Getin Noble Bank	Sell	▼
Handlowy	Hold	▼
Impexmetal	Hold	▼
ING BSK	Hold	▼
Millennium	Sell	▼
PGE	Reduce	▼
Police	Suspended	
Rovese	Reduce	▲
TVN	Accumulate	▼
Work Service	Hold	▼
ZA Puławy	Suspended	

Research Department:

Michał Marczak
+48 22 697 47 38
michal.marczak@mdm.pl

Kamil Kliszcz
+48 22 697 47 06
kamil.kliszcz@mdm.pl

Michał Konarski
+48 22 697 47 37
michal.konarski@mdm.pl

Jakub Szkopek
+48 22 697 47 40
jakub.szkopek@mdm.pl

Paweł Szpigiel
+48 22 697 49 64
pawel.szpigiel@mdm.pl

Piotr Zybała
+48 22 697 47 01
piotr.zybala@mdm.pl

Equity Market

Our baseline scenario for the equity market as outlined in January remains intact. The global economic outlook for the year ahead is quite positive, though the prospects for emerging countries are less rosy, and against this backdrop Poland should be perceived as a safe destination for foreign capital. In fact, our relative attractiveness is already being confirmed by the behavior of the zloty. A new factor shaping the market landscape is the crisis in Ukraine. At the moment, we believe its implications are primarily political rather than economic. According to our economists, the direct (trade with Ukraine) and indirect (trade with Russia) consequences for Poland may be that actual GDP growth will be 0.2-0.4% slower than projected. While it does weigh upon the economic momentum expected in the first half of the year, however, the crisis should not affect the medium- to long-term outlook for Poland which has been boosted recently by stimulus provided by the government, including an addition of PLN 25 billion to the 2014-2020 infrastructure budget. The Polish inflation rate is set to remain low in the months ahead, and this, combined with the still-high deflation risks faced by the Euro Area, and the possible consequences of the Ukraine crisis (i.e. a slight slowdown in Poland), should extend the period during which interest rates are kept low (the current consensus, which we expect to be revised soon, is that a tightening cycle is set to begin toward the end of 2014). In addition to decelerating the whole GDP, the Ukraine crisis will be felt more severely in certain export-driven sectors including by appliance manufacturers and food producers. On a positive note, we think it can trigger fund shifting from Russia to Poland by concerned investors, and propel unwinding of positions in companies with large exposures to Ukraine and Russia, most notably banks like Raiffeisen, Erste, and OTP, which will work well for banks in Poland.

Growth remains the baseline scenario

Despite weak data coming from the US in January (industrial production, retail sales, jobs dragged down by freezing weather) and a lack of recovery in China and other emerging countries, the global economy is firmly on a fast track to recovery. The Global Manufacturing PMI hit its highest level since April 2011 this February at 53.3 points, implying GDP growth at ca. 4% compared to ca. 3% in Q4 2013 (annualized). The fastest growth is expected in developed countries: the United States and Japan (incl. through delayed effects of weaker yen), and the Eurozone. In the emerging world, leading indicators so far are signaling stagnation persisting at least through the first half of the year (China, Brazil, India, pre-crisis Russia, have Manufacturing PMIs around 50 points). CEE is a different story as Poland (with PMI Man up from 55.4 to 55.9pts), Czech Republic (55.5 vs. 56.9 pts), and Hungary (54.3pts) all enjoy strong leading indicators fueled by recovering demand from their main export destinations in the Euro Area as well as from local buyers. Poland's latest PMI reading was the fourth highest in history (higher levels were recorded in mid-2004 and at the end of 2010). The optimism stems among others from increasing production and a rebound in new orders (local as well as foreign) to the second all-time high. The Ukraine crisis will no doubt dampen the leading indicators in the next few months, but it will not sabotage the overall trend.

Key central banks remain extremely accommodative, encouraged among others by low inflation (at 1.7% in January in OECD; France and Spain are on the brink of deflation). If the weak US data are confirmed (around April/ May) to have been caused by weather, the Fed should stick to its QE unwinding plan (scaling stimulus back by $10 billion at each FOMC meeting). The possibility of accelerated tapering, which was never priced in, is now very small. We continue to expect further monetary easing from the European Central Bank in the coming weeks (rate cuts, other special measures). The Bank of Japan as well is expected to increase asset buying by 2015.

Note that most emerging market assets still underperform developed markets, due among others to currency mechanisms. Can this change in the course of 2014? We think yes as more speculative traders adopt a more selective approach to emerging markets and buy underpriced assets. We assume that the economic recovery happening in developed countries will trickle down on to emerging countries. As expectations are low, upside will be easy to come by; for example, Manufacturing PMI Turkey has reached 53.4pts despite raised interest rates. We do not expect complete revisions of economic projections to suggest that emerging markets are recovering at slower rates than developed countries. We do think, however, that in some cases a variety of negative factors are priced in by now. For example the P/E ratio for the last 12 months for MSCI EM is 11.7 compared to 18.0 for MSCI World - such a huge gap has no foundation in economic outlooks.

Ukraine crisis

Until Russia shuts off gas and oil supplies, its conflict with the Ukraine remains political in nature and has little impact on the CEE region, including Poland. Exports to Ukraine accounted for just about 1.5% of our total trade balance in 2013. Russia is a slightly more important partner for us as it accounts for 5% of total trade. So, Polish exports to the east are not huge, as these numbers show, however, they have been increasing steadily over the past two years. The impact that the Russia/Ukraine tensions are expected to have on Polish exporters stem from weakened rubles and hryvnias which make Polish goods much less competitive. Further, the conflict will likely push both countries into a recession in 2014, and this again has implications for demand for Polish goods, especially household appliances, machines, and food. The political aspects of the conflict can also affect Polish companies depending on how much Russia wants to hold the fact that Poland sides with the Ukraine against us. Such political decisions so far have included a ban on Polish meat and other foods. The companies with most exposure to Russia and Ukraine include Amica, Fasing, Selena, Rovese, and Relpol, (ca. 15-20% of total sales), Apator, Zamet, SecoWarwick, and Ropczyce (ca. 10%). mBank economists believe that the Ukraine vs. Russia situation will slow down GDP growth in Poland by ca. 0.2-0.4% this year.

If Russia does shut Europe off from gas and oil, the baseline scenario changes to a recession in the CEE region stemming from reduced business activity combined with lower demand from the Eurozone after the recovery there grinds to a halt (Eurozone trade accounts for more than half of total trade).

Financial support from the international community is the key to Ukraine overcoming the crisis and not declaring bankruptcy which would incur losses for financial institutions. The EUR 11 billion aid offered by the International Monetary Fund can tide the country over for a few months, but it is nowhere near to being enough.

To reiterate, we believe the conflict between Ukraine and Russia can prompt capital reallocations from Russia to

Poland, and propel unwinding of positions in companies with large exposures to Ukraine and Russia, most notably banks like Raiffeisen, Erste, and OTP, which will work well for banks in Poland.

Michał Marczak
tel. +48 22 697 47 38
michal.marczak@mdm.pl

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Previous Ratings for Companies Re-Rated as of the Date of This Monthly Report:

BZ WBK

rating	Hold	Hold	Reduce
rating day	2013-08-06	2014-01-15	2014-03-06
price on rating day	326.50	380.40	422.00
WIG on rating day	48458.44	50605.74	52216.05

Ciech

rating	Buy	Accumulate	Hold
rating day	2013-09-09	2013-11-05	2014-03-06
price on rating day	24.34	30.00	33.10
WIG on rating day	46717.04	53989.37	52216.05

Energa

rating	Buy	Accumulate
rating day	2014-01-23	2014-03-06
price on rating day	16.60	17.20
WIG on rating day	51906.45	52216.05

Erbud

rating	Buy	Accumulate	Buy	Accumulate	Hold
rating day	2013-07-19	2013-08-06	2013-09-09	2013-10-04	2013-11-06
price on rating day	20.40	23.20	20.20	24.55	31.43
WIG on rating day	46221.23	48458.44	46717.04	50982.03	53504.47

	Accumulate	Accumulate	Buy
	2014-01-15	2014-01-21	2014-03-06
	32.76	32.47	28.23
	50605.74	50917.69	52216.05

Getin Noble Bank

rating	Reduce	Sell	Reduce	Sell
rating day	2013-07-01	2013-10-04	2014-01-15	2014-03-06
price on rating day	1.86	2.43	2.84	3.20
WIG on rating day	44747.79	50982.03	50605.74	52216.05

Handlowy

rating	Hold	Sell	Accumulate	Hold
rating day	2013-07-01	2013-10-04	2014-01-15	2014-03-06
price on rating day	93.00	111.05	105.00	110.45
WIG on rating day	44747.79	50982.03	50605.74	52216.05

Impexmetal

rating	Buy	Hold
rating day	2014-01-15	2014-03-06
price on rating day	3.40	3.33
WIG on rating day	50605.74	52216.05

ING BSK

rating	Hold	Buy	Hold
rating day	2013-07-01	2014-01-15	2014-03-06
price on rating day	94.66	109.10	128.50
WIG on rating day	44747.79	50605.74	52216.05

Millennium

rating	Reduce	Sell	Hold	Sell
rating day	2013-07-01	2013-10-04	2014-01-15	2014-03-06
price on rating day	5.21	7.36	7.55	9.28
WIG on rating day	44747.79	50982.03	50605.74	52216.05

PGE

rating	Hold	Hold	Reduce
rating day	2013-06-12	2014-01-15	2014-03-06
price on rating day	17.80	16.55	18.35
WIG on rating day	48324.52	50605.74	52216.05

Police

rating	Suspended
rating day	2014-03-06
price on rating day	19.36
WIG on rating day	52216.05

Rovese

rating	Sell	Sell	Reduce
rating day	2013-08-06	2014-01-15	2014-03-06
price on rating day	2.06	2.05	1.92
WIG on rating day	48458.44	50605.74	52216.05

TVN

rating	Accumulate	Hold	Buy	Accumulate
rating day	2013-06-14	2013-09-09	2013-12-11	2014-03-06
price on rating day	10.89	13.15	15.00	16.00
WIG on rating day	48152.82	46717.04	52692.63	52216.05

Work Service

rating	Buy	Buy	Hold
rating day	2013-10-09	2014-01-15	2014-03-06
price on rating day	11.02	12.45	14.30
WIG on rating day	50137.88	50605.74	52216.05

ZA Puławy

rating	Reduce	Suspended
rating day	2013-10-04	2014-03-06
price on rating day	176.70	147.90
WIG on rating day	50982.03	52216.05

List of abbreviations and ratios contained in the report:
EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
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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ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from –5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
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Michał Marczak
member of the management board
tel. +48 22 697 47 38
michal.marczak@mdm.pl
strategy, resources, metals

Research Department:

Kamil Kliszcz
deputy director
tel. +48 22 697 47 06
kamil.kliszcz@mdm.pl
energy, chemicals, power generation

Michał Konarski
tel. +48 22 697 47 37
michal.konarski@mdm.pl
banks

Jakub Szkopek
tel. +48 22 697 47 40
jakub.szkopek@mdm.pl
industrials

Paweł Szpigiel
tel. +48 22 697 49 64
pawel.szpigiel@mdm.pl
media, IT, telco

Piotr Zybała
tel. +48 22 697 47 01
piotr.zybala@mdm.pl
construction, real-estate development

Sales and Trading:

Piotr Dudziński
director
tel. +48 22 697 48 22
piotr.dudzinski@mdm.pl

Marzena Łempicka-Wilim
deputy director
tel. +48 22 697 48 95
marzena.lempicka@mdm.pl

Traders:

Krzysztof Bodek
tel. +48 22 697 48 89
krzysztof.bodek@mdm.pl

Michał Jakubowski
tel. +48 22 697 47 44
michal.jakubowski@mdm.pl

Tomasz Jakubiec
tel. +48 22 697 47 31
tomasz.jakubiec@mdm.pl

Szymon Kubka, CFA, PRM
tel. +48 22 697 48 16
szymon.kubka@mdm.pl

Anna Łagowska
tel. +48 22 697 48 25
anna.lagowska@mdm.pl

Paweł Majewski
tel. +48 22 697 49 68
pawel.majewski@mdm.pl

Adam Mizera
tel. +48 22 697 48 76
adam.mizera@mdm.pl

Adam Prokop
tel. +48 22 697 47 90
adam.prokop@mdm.pl

Michał Rożmiej
tel. +48 22 697 49 85
michal.rozmiej@mdm.pl

Head of Foreign Institutional Sales:

Matthias Falkiewicz
tel. +48 22 697 48 47
matthias.falkiewicz@mdm.pl

"Private Broker"

Jarosław Banasiak
director, active sales
tel. +48 22 697 48 70
jaroslaw.banasiak@mdm.pl

Dom Maklerski mBanku S.A.
ul. Wspólna 47/49, 00-684 Warszawa
www.mDomMaklerski.pl