

Friday, December 05, 2014 | periodic report

## Monthly Report: December 2014

### Equity Market, Macroeconomics

#### Equity Market

The Polish stock market is stuck in a sideways trend and the one factor which could cause it to break out is if economic indicators in December continue to deliver positive surprises. Upbeat data could prevent further rate cuts in Poland and stop downward revisions to analysts' expectations as to bank earnings next year.

#### Sector Outlook

##### Financial Sector

We maintain a bearish outlook on the bank sector which is poised in anticipation of further interest rate cuts estimated at 50 basis points. At the same time, sentiment toward CEE banks is set to be lifted after the passing of an FX loan conversion law in Hungary.

##### Gas & Oil

PKN shares have finally responded to the favorable fundamentals observed for nearly half a year, with additional upside provided by falling prices of crude oil, resulting in a rating downgrade to accumulate after the price rally. Our outlook on the gas utility PGNiG remains bearish.

##### Power Utilities

The third-quarter earnings season delivered positive surprises from Enea and Tauron and after the resulting price rally we are downgrading ENA to hold and TPE to accumulate. As for PGE, the recent price decline mandates an upgrade to hold.

##### Telecoms, Media, IT

TVN still shows upside potential after the price increase observed since the beginning of November. On the other hand, the telecom Orange Polska displays downside risk due to high CAPEX offered on LTE frequencies, expected to entail a reduction in next year's dividend payout. We maintain a bearish view on Agora.

##### Resources

Commodity prices last month fell at a speed which surprised most investors. We consider the fundamentals for copper (low inventories, demand/supply balance) to be better than those for oil, and as such we anticipate another price rally on the LME in December driving up the value of KGHM.

##### Industrials

Of the forty-nine companies comprising our industrials price tracker, only 37% reported y/y earnings growth in Q3 2014 – the lowest ratio since Q1 2013, representing deterioration from Q2 2014. Compared to our expectations, 49% of the firms tracked delivered negative surprises in Q3.

##### Construction

Our top picks among smaller construction firms are Elektrotim and Torpol. Elektrobudowa reported good Q3 results which reinforced our positive outlook. We have a neutral rating for Herkules after recent price increases.

##### Property Developers

LC Corp stands out from housing developers and Polnord deserves a mention as well thanks to consistent improvement in the balance-sheet position. Among commercial developers, we see the most upside potential in Capital Park and Echo Investment.

##### Retail

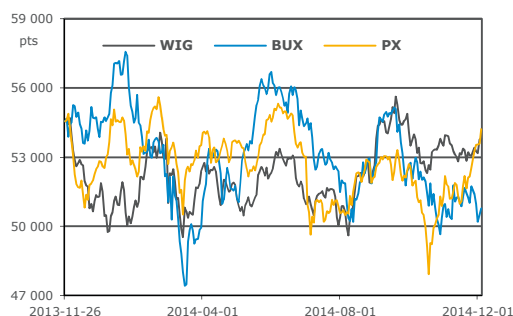
The earnings of the fashion retailer LPP are under continuing downward pressure from the depreciation of RUB and UAH vis-a-vis PLN. Moreover, LPP and the footwear retailer CCC are both affected by increased USDPLN. The FMCG wholesaler Eurocash is experiencing a slowdown driven by persistent price deflation observed in Poland.

##### Other

We see upside potential in Work Service which is poised for strong earnings growth in 2015.

WIG ..... 53,347  
Average 2014E P/E ..... 14.1  
Average 2015E P/E ..... 11.8  
Avg. daily trading volume (3M)... PLN 802m

#### WIG vs. indices in the region



#### Rating changes

Company	Rating	Change
ABC Data	Suspended	
Cyfrowy Polsat	Hold	▼
Enea	Hold	▼
Famur	Buy	▲
Pekao	Reduce	▼
PGE	Hold	▲
PKN Orlen	Accumulate	▼
Tauron	Accumulate	▼

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## Equity Market

The 2015 investment strategies announced by global investment banks make for the optimistic consensus that equity markets next year are set for a continued upswing. Commerzbank strategists concur, predicting rates of return on main world indices up to 10% with the expectation of more volatility spurred by measures taken by local central banks. The bullish trends are poised to last through the end of the first quarter / beginning of the second quarter 2015 when investors will start to wait for a European QE (the ECB is expected to make a decision in March or April). In the US, a recovering economy will continue to support company earnings. Until then, bond yields in Europe will remain low. After the ECB decision, investors will focus on monetary policy normalization in the US, expected to commence in June 2015 at the latest. In our view, the US monetary tightening will proceed at a much faster pace than assumed today (25bp hikes at each Fed meeting), resulting in a quick flattening of the yield curve (with short-end yields rising to 150bps by the end of December 2015, and 270bps on 10Y Treasuries) which will generate losses for debt funds as well as having spillover effects on Eurozone yields. Financial markets are more than likely to have a bad reaction to the US tightening and its impact on economic growth, with the S&P500 expected to stage a 15-20% downward correction over a period of several months. In actuality, however, the hiked rates should not be expected to derail the US economy from its growth track as historically they will still be very low. In Europe, on low prices of crude oil, a weak euro, after ECB measures, economic growth will gain momentum in Germany and peripherals who conduct reforms (Spain – France and Italy will continue to do badly). As for financial markets, they should go back to upside pricing in the final months of next year.

Today, the slump in global commodity prices has split the emerging world into beneficiaries (importers, led by China) and victims (South America, mainly Brazil, and Russia), and this rift is expected persist through the first half of 2015. The Warsaw Stock Exchange is somewhere halfway between the two extremes, but its close ties with the recovering German economy will infuse it with a positive top-down outlook.

In Poland, our original expectations of continuing monetary easing, putting pressure on bank stocks, combined with declining commodity prices (including metals), putting a drag on commodity stocks, have in the last few days been proven overly pessimistic. The anticipation of further rate cuts has been diminished by upbeat economic data (GDP, Manufacturing PMI) and the maintenance of interest rates at unchanged levels in December. As for resources, their prices have plummeted so far down that from this point on they can only go up. The one factor which is keeping expectations of monetary easing in Q1 2015 up is price deflation which, according to our economists, is set to remain in place until mid-2015. If the momentum in positive economic surprises is sustained and investors start to believe that further rate cuts are no longer necessary, however, we can expect a rebound in sentiment toward banks (resulting in discontinuation of the constant downward adjustments to earnings prospects), driving a return of foreign investors to Polish financial sector stocks.

## Polish PMI and GDP buck European trends

Polish Manufacturing PMI unexpectedly rebounded to 53.2pts from 51.2pts last month, driven by improved sentiment as regards current manufacturing activity (55.0 vs. 52.0pts) and domestic as well as foreign new orders (54.6 vs. 51.4pts). As such the Polish PMI is very upbeat in contrast to European indicators where Manufacturing PMI is down to 50.1pts from 50.4pts the month before, with Germany PMI falling to 49.5pts and PMI Italy and France decreasing to 49.0 and 48.4 points, respectively. Even more surprisingly for some investors, Polish GDP in Q3 has been reported to have grown at an annual rate of 3.3% supported strong internal demand and investment which unexpectedly offset stagnant activity in manufacturing and construction.

In spite of the positive economic surprises, the Polish stock market does not seem to be able to break away from its sideways trend due to a conjunction of a number of factors. For one, foreign investors are missing attractive bottom-up investments here that meet their liquidity requirements (i.e. WIG20). Moreover, analysts keep cutting 2015 earnings projections for banks in anticipation of cuts in central bank interest rates, and at the same time Polish banks are overpriced relative to European peers (on premiums left over from the time of the pension reform). Further, with sentiment to the coal sector globally sour, upside catalysts can only be provided by power utilities which, however, are kept down by dividend expectations. Unlike developed market funds, emerging market funds, including EMEA, continue to experience withdrawals. The falling prices of small and midcaps (which given their current liquidity are completely off the radar for international funds) are due to the lack of new capital in domestic funds and the slowdown seen in manufacturing and construction (putting pressure on company earnings). As the WSE continues to trade sideways and while real interest rates on deposits/savings remain at 3%+, it is hard to expect a sudden surge in inflows into Polish investment funds.

Our economists believe that even if data continues to be upbeat in December the Monetary Council in Q1 2015 will resume monetary easing (inflation, rate cuts in CEE and Asia, QE in SE). At the same time, if leading economic indicators paint a positive outlook for the future, and investors start to believe that further rate cuts are no longer necessary, we can expect a rebound in sentiment toward banks (resulting in discontinuation of the constant downward adjustments to earnings prospects), driving a return of foreign investors to Polish financial sector stocks. On the other hand, weak data and strengthened expectations of rate cuts will keep the Polish stock market in a rut (and the Eurozone QE will not be played out with Polish stocks).

## EMEA fund withdrawals

Emerging market funds, especially EMEA and Latin America funds, have been experiencing considerable withdrawals in the last four weeks, with the cash redirected to developed market funds or, within the emerging world, to Asia, most notably China where the Shanghai market index has soared 40% and trading volumes tripled since mid-2014.

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## Macroeconomics

### Retail sales

Retail sales growth accelerated to 2.3% in October from 1.6% in September, in line with expectations. Looking at the detailed breakdown, we can see that the stronger October growth was owed mainly to food sales as auto sales again showed a y/y decline and the acceleration in sales of apparel and footwear was marginal. Appliances and "other" sales as well were a source of disappointment in October which may have something to do with housing trends in the period. Any positive and negative data surprises must be evaluated vis-a-vis seasonal patterns and working day arithmetic. If there are no positives, momentum remains weak and there are no signs that consumption of goods will accelerate soon. The slightly better data coming out after all the usual exclusions are still just noise. Prices deserve a separate comment. On the whole, prices are down 1.4% y/y and excluding food and fuels (the exogenous anchors for relative prices) the deflation reaches 2.2%. The falling prices are the reason why real sales are not plummeting. However, the economic consequences of the deflation for businesses could be dire if consumers continue to postpone spending while real interest rates remain high. At this stage businesses are probably accepting lower margins or cutting costs, but if the price deflation persists they may be forced to cut salaries as well. A sharp, exogenous shock in the form of a depreciating zloty would be the perfect solution at this juncture as it would prop up exports earnings and make more room for price hikes by producers. However, such a policy outcome is impossible to reach without a proper policy change. We think that a rate cut would do the trick. Therefore we continue to bet on a resumption of the easing cycle in Poland, adding to the attractiveness of local bonds.

### Industrial production

Polish industrial production in October showed year-on-year growth of 1.6% after decelerating from 4.2% in September. The seasonally adjusted momentum was similar m/m at 1.5%. Such a result can be interpreted as confirmation that there is no upward momentum in the Polish industry – our favorite measure of a moving average m/m growth hovers around zero. Output in October increased in 20 out of 34 sectors, mostly those most export-oriented. In turn, industries producing coke, petroleum and other energy generated a reduced output due to warm weather, while transport equipment manufacturers took a hit on lower demand from eastern markets. We maintain that at this point the worst is already behind the Polish economy which, however, should not be expected to regain noticeable momentum for a while still. A flat momentum implies that GDP growth should bottom out in Q4 2014 and Q1 2015 when base effects will be the least favorable. Polish manufacturers today have no independent pricing power and as a result they are generating weaker profits, meaning less inclination to invest. At the same time, the manufacturing industry is not experiencing any upward cost pressure. Construction output dropped 1% on annual basis in October (seasonally adjusted: -0.2% y/y and +0.9% m/m), below forecasts that indicated a modest increase. Building activity in Poland remains stagnant and the multitude of infrastructure projects that some expected to be spurred by the November local elections never materialized. For reasons which seem obvious from today's perspective, namely that local investment is typically small scale and spread over time. Summing up, building activity in Poland is set to remain static until EU-funded public investment kick off in March/April 2015.

### Jobs

The average salary increased 3.8% y/y in October, marking an acceleration from the annual growth rate of 3.4% recorded in September. The figure is slightly better than anticipated by analysts but it fits within the overall upward trend which we expect to continue in the coming months (with the possible exception of November and December if media reports about bonus cuts in the coal industry come true). The decent rise in pay and hence in disposable income (supported by low prices of food and fuel) should drive consumer demand going forward even amid a rising savings rate. Employment in October was up 0.8% from last year after adding 7000 jobs, in line with the expectations formed on the basis of the trends observed across the different industries in September combined with the signals sent by PMI and labor demand statistics. Finally, the October employment figures may have received a boost from the launch of a Polish distribution center by Amazon which hired several thousand people. Going forward, we expect employment to continue to rise at the modest but steady pace of up to 1% y/y.

### Inflation

The Polish inflation rate decelerated to a negative 0.6% in October from -0.3% in September, reaching its lowest level in recorded history. The main drivers behind the slowdown were prices of food, down 2% m/m, and services, with fuel prices as well decreasing 1% from September. Overall, October saw falling prices across many CPI categories including healthcare, communications, entertainment, etc. The core annual CPI plummeted to 0.2% from 0.7% in September. The deflation is set to persist in the months ahead given recent data, including fuel prices which did not yet reflect the global crude slump in October and which all told are expected to fall by a further 3-4% in the next few months. The deflation obviously supports the case for further rate cuts by the Monetary Council, though the timing of these cuts is hard to predict at this point.

### Current account balance

Poland's account deficit narrowed to EUR 235m in September thanks to a trade surplus of EUR 614m (vs. a September deficit of EUR 69m) achieved thanks to a rebound in exports (exceeding the July exports by EUR 868m; at the same time imports recovered at a slower rate, topping the July level by EUR 325m). The other C/A components performed in line with expectations in September, with services and primary income showing a seasonal deterioration and the secondary income account displaying an improved balance thanks to higher transfers from the EU. Unfortunately, the central bank's balance of errors and omissions (deficit) remains very high at 165% of the 12-month C/A balance.

### Government deficit

The government deficit amounted to PLN 27.2 billion in October after an increase of PLN 4.8 billion from September, less severe than the usual gap widening seen this time of the year. Consequently, the deficit relative to the amount budgeted earlier this year is only 60%. A detailed look at government finances in October suggests that the annual deficit may reach about PLN 30 billion this year, which would be less than the latest predictions by the Finance Ministry. October was pretty decent in terms of the income generated by the government given the persistent price deflation and a decelerating economic activity. Tax revenues were up 2.2% year on year, with revenues from personal income taxes rising 5.4%, corporate income taxes up 4.9%, and VAT receipts 4.0% higher. All in all, it looks like the annual tax revenues will exceed the budget by about 4% or PLN 10

billion. October expenditures as well contributed to a lower-than-budgeted ytd spend at 80.9% of the target amount vs. 83.3% planned by the government. The savings were facilitated by reduced subsidies paid into the National Social Insurance Fund combined with savings achieved on debt service costs which accounts for just 1.98% of 12M GDP – the lowest level since 2008. Going forward, the costs of national debt service are bound to continue going down thanks to the pension reform and low interest rates. With this in mind, we believe the current projections by the Finance Ministry as to the 2014 annual government deficit are overly pessimistic and we think the year-end gap may be as much as PLN 18 billion lower than budgeted at some

PLN 30 billion. Given the possible rebound in tax revenues which to date have been kept down by deflation, and looking at the structural nature of the savings achieved this year on government spending, we expect the central government deficit to continue correcting the imbalance in the coming years. At the same time, we agree with the government's medium-term budget targets which assumes an eventual waiver of the excess deficit procedure.

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## Current ratings by Dom Maklerski mBanku

Company	Recommendation	Date issued	Price on report date	Target price	Current price	Upside / Downside	P/E		EV/EBITDA	
							2014	2015	2014	2015
<b>Banks</b>										
BZ WBK	Sell	2014-09-08	403.00	344.95	386.00	-10.6%	17.1	15.7		
GETIN NOBLE BANK	Accumulate	2014-12-01	2.23	2.38	2.22	+7.2%	13.1	13.5		
HANDLOWY	Sell	2014-09-08	118.00	103.37	109.00	-5.2%	16.8	14.6		
ING BSK	Hold	2014-10-07	144.00	144.12	150.45	-4.2%	18.9	15.1		
MILLENNIUM	Hold	2014-10-07	8.77	8.46	8.19	+3.3%	15.2	13.3		
PEKAO	Reduce	2014-12-05	186.45	173.34	186.45	-7.0%	18.3	15.9		
PKO BP	Buy	2014-07-14	38.20	43.20	37.62	+14.8%	14.4	11.6		
KOMERCNI BANKA	Sell	2014-10-07	5000.00	4115 CZK	5000.00	-17.7%	15.2	14.3		
ERSTE BANK	Hold	2014-01-15	28.59	29,6 EUR	21.18	+39.8%	11.1	8.3		
RBI	Buy	2014-01-15	26.70	32,1 EUR	15.82	+102.9%	5.4	3.6		
OTP BANK	Hold	2014-01-15	4440.00	4618 HUF	4001.00	+15.4%	7.2	6.1		
<b>Insurance</b>										
PZU	Hold	2013-11-06	468.00	425.00	470.30	-9.6%	14.8	14.7		
<b>Financial services</b>										
KRUK	Buy	2014-06-06	95.49	113.29	117.00	-3.2%	14.1	13.0		
<b>Fuels, chemicals</b>										
CIECH	Hold	2014-09-29	41.35	41.60	46.39	-10.3%	27.2	17.1	7.4	7.0
LOTOS	Hold	2014-03-26	36.31	38.60	26.90	+43.5%	6.0	5.6	5.1	4.6
MOL	Buy	2014-03-07	171.20	211.90	163.50	+29.6%	8.5	6.4	3.9	3.2
PGNIG	Reduce	2014-11-28	5.07	4.60	4.79	-4.0%	11.3	10.3	5.3	5.0
PKN ORLEN	Accumulate	2014-12-05	48.03	49.10	48.03	+2.2%	-	9.0	-	5.9
POLWAX	Buy	2014-11-06	15.05	24.20	16.75	+44.5%	7.8	7.3	7.3	6.5
<b>Power Utilities</b>										
CEZ	Reduce	2014-10-31	90.20	83.60	92.75	-9.9%	11.1	13.2	7.2	7.7
ENEA	Hold	2014-12-05	17.00	17.20	17.00	+1.2%	8.2	9.8	4.8	5.9
ENERGA	Hold	2014-10-31	24.66	23.60	23.99	-1.6%	10.1	10.8	5.8	6.0
PGE	Hold	2014-12-05	20.02	20.10	20.02	+0.4%	9.5	11.4	4.6	5.9
TAURON	Accumulate	2014-12-05	5.27	6.00	5.27	+13.9%	7.9	8.1	4.5	5.1
<b>Telecommunications</b>										
NETIA	Hold	2014-07-07	5.27	5.60	5.69	-1.6%	39.0	42.9	4.6	4.9
ORANGE POLSKA	Reduce	2014-11-05	9.98	8.90	9.30	-4.3%	24.2	27.8	4.1	4.6
<b>Media</b>										
AGORA	Reduce	2014-08-27	8.24	7.60	8.08	-5.9%	202.0	-	4.4	4.2
CYFROWY POLSAT	Hold	2014-12-05	24.14	23.84	24.14	-1.2%	23.9	17.2	10.9	6.3
GLOBAL CITY HOLDINGS	Under Review	2014-05-13	34.30	-	39.41	-	-	-	-	-
TVN	Buy	2014-09-11	14.98	17.50	16.20	+8.0%	16.6	15.4	12.9	12.0
<b>IT</b>										
ASSECO POLAND	Accumulate	2014-07-08	40.75	45.60	53.65	-15.0%	12.8	13.4	7.3	7.3
COMARCH	Suspended	2013-03-11	89.60	-	113.75	-	-	-	-	-
SYGNITY	Suspended	2013-02-05	16.80	-	16.39	-	-	-	-	-
<b>Mining &amp; Metals</b>										
JSW	Hold	2014-01-15	50.73	55.00	19.99	+175.1%	-	-	1.5	1.4
KGHM	Hold	2014-11-05	127.25	139.00	117.40	+18.4%	9.2	8.1	4.8	4.2
LW BOGDANKA	Hold	2014-07-07	116.00	136.90	107.75	+27.1%	12.3	9.9	5.7	4.9
<b>Manufacturers</b>										
ASTARTA	Hold	2014-06-06	47.40	48.60	18.75	+159.2%	6.9	2.5	3.5	3.1
BORYSZEW	Reduce	2014-08-06	5.84	5.20	6.30	-17.5%	15.9	14.0	9.3	8.4
FAMUR	Buy	2014-12-05	3.16	3.80	3.16	+20.3%	14.6	11.8	5.8	4.9
IMPEXMETAL	Buy	2014-08-18	2.31	3.40	2.72	+25.0%	10.1	8.9	7.4	6.5
KERNEL	Hold	2014-07-07	32.15	32.50	29.74	+9.3%	-	4.3	8.5	3.7
KĘTY	Hold	2014-07-01	226.95	226.80	291.00	-22.1%	16.7	15.8	10.2	9.4
KOPEX	Buy	2014-07-07	10.75	14.50	10.84	+33.8%	12.0	9.4	5.5	5.0
ROVESE	Sell	2014-11-26	1.41	1.37	1.41	-2.8%	-	21.0	7.1	6.4
TARCZYŃSKI	Buy	2014-12-03	11.55	14.60	11.85	+23.2%	14.1	9.3	7.2	6.0
VISTAL	Buy	2014-10-15	13.78	16.90	11.19	+51.0%	11.1	6.3	8.3	6.1
<b>Construction</b>										
BUDIMEX	Buy	2014-11-19	132.00	160.60	138.05	+16.3%	19.8	19.6	7.7	8.4
ELEKTROBUDOWA	Buy	2014-05-20	72.50	105.00	76.30	+37.6%	15.1	9.9	6.9	5.6
ERBUD	Buy	2014-03-06	28.23	35.90	24.41	+47.1%	12.0	9.7	4.3	3.5
UNIBEP	Buy	2014-01-21	7.89	10.20	7.98	+27.8%	12.1	9.5	7.8	6.5
<b>Property Developers</b>										
CAPITAL PARK	Buy	2014-10-22	4.59	6.70	4.20	+59.5%	47.0	26.8	37.1	41.8
DOM DEVELOPMENT	Buy	2014-06-23	46.00	57.80	46.20	+25.1%	20.0	15.8	18.1	13.4
ECHO	Buy	2014-10-22	6.25	8.00	6.60	+21.2%	5.4	20.1	7.8	26.7
GTC	Buy	2014-10-22	5.85	7.00	5.95	+17.6%	-	9.0	-	10.3
ROBYG	Buy	2014-06-23	2.35	3.07	2.22	+38.3%	22.7	12.9	15.8	11.9
<b>Other</b>										
WORK SERVICE	Buy	2014-10-07	18.70	22.50	18.50	+21.6%	30.8	18.7	15.2	10.8



## Ratings Issued in the Past Month

Company	Rating	Previous Rating	Target Price	Rating Day
BUDIMEX	Buy	Accumulate	160.60	2014-11-19
GETIN NOBLE BANK	Accumulate	Hold	2.38	2014-12-01
KGHM	Hold	Buy	139.00	2014-11-05
ORANGE POLSKA	Reduce	Sell	8.90	2014-11-05
PEKAO	Hold	Reduce	173.34	2014-11-05
PGNiG	Reduce	Hold	4.60	2014-11-28
POLWAX	Buy	-	24.20	2014-11-06
ROVESE	Sell	Hold	1.37	2014-11-26
TARCZYŃSKI	Buy	Buy	14.60	2014-12-03

## Ratings Changed as of 5 December 2014

Company	Rating	Previous Rating	Target Price	Rating Day
ABC DATA	Suspended	Buy	-	2014-12-05
CYFROWY POLSAT	Hold	Accumulate	23.84	2014-12-05
ENEA	Hold	Accumulate	17.20	2014-12-05
FAMUR	Buy	Hold	3.80	2014-12-05
PEKAO	Reduce	Hold	173.34	2014-12-05
PGE	Hold	Reduce	20.10	2014-12-05
PKN ORLEN	Accumulate	Buy	49.10	2014-12-05
TAURON	Accumulate	Buy	6.00	2014-12-05

## Ratings Statistics

Rating	All		For Issuers Who are Clients of Dom Maklerski mBanku	
	Count	As pct. of total	Count	As pct. of total
Sell	4	7.7%	2	6.7%
Reduce	6	11.5%	5	16.7%
Hold	18	34.6%	10	33.3%
Accumulate	4	7.7%	3	10.0%
Buy	21	40.4%	11	36.7%



## Banks

### October loan and deposit statistics for MFI sector

Loans by monetary financial institutions extended in October remained steady month on month (-0.1%) but on a year-on-year basis they expanded by 6%. Relative to September, retail lending increased by 0.3%, driven mainly by an 0.6% rise in mortgage sales, while corporate lending contracted by 0.7%. The year-on-year growth in overall lending in October was led by corporate loans (+6.3%) as well as retail loans (+5.7%), in particular consumer facilities loans which soared 6.6%. Deposits in monetary financial institutions increased 0.7% m/m and 8.3% y/y in October, led by respective increases of 0.8% and 8.2% in retail savings and 0.5% and 8.5% in corporate savings. The ratio of loans to deposits decreased to 102.9% in October from 103.8% in September. The ytd lending statistics are consistent with our 6.4% growth projection for 2014. In 2015, we anticipate an acceleration to 8.9%.

### Q3 mortgage sales

According to a report by Amron-Sarfin, Polish banks extended 43,653 mortgage loans in Q3 2014 with a total value of PLN 9.232 billion, marking drops of 3.6% q/q and 3.1% y/y. Year-to-date mortgage sales increased by 3.6% compared to 9M 2013, and adjusted for subsidized lending the loan amount extended in the period showed year-on-year growth of 10.9%. Margins on the Q3 mortgages averaged 1.81%, up from 1.76% in Q2 and 1.60% in Q4 2013. but in September the average margin logged a month-on-month decline of 2bps for the first time since February 2013. 47% of the total mortgage facilities extended in Q3 had an LTV ratio over 80%, with 40% granted at LTV between 50% and 80%. As for financing periods, the most popular home loans (62% of total) were those granted for 25-35 years. We find the third-quarter mortgage data slightly disappointing even if we allow for seasonal trends. Our 2014 annual mortgage lending projection for Polish banks assumes 5.3% growth followed by an acceleration to 11.6% in 2015 driven by record-low interest rates and a low market penetration rate.

### October loan and deposit interest rates

The average interest rate charged in October on new consumer lending fell to 11.0% from 12.5% in September, with the interest rate on mortgage loans down from 5.2% to 4.8% and the interest rate on corporate loans rising from 4.1% to 4.2%. As for deposits, the average interest rate offered on retail savings in the period fell to 2.5% from 2.8% and the average rate offered on corporate savings dropped from 2.4% to 2.0%. The falling bank rates followed reductions in central bank interest rates. That said, the average interest rate offered on deposits was 53bps over the WIBOR (3M) rate vs. 42bps in September and 15bps in August, reflecting increasing competition between Polish banks.

### Polish bank loan quality in October

The NPL ratio in the bank sector remained virtually unchanged in October from the September level of 7.4%. led by improvement from 6.94% to 6.77% in the retail NPL ratio as the ratio relative to corporate loans increased from 8.08% to 8.26% driven mainly by large corporate accounts where NPL increased from 8.39% to 8.62% (the SME NPL ratio was stable at 12.25%). The ratio of non-performing mortgage loans deteriorated slightly from 3.19% to 3.26% and other retail NPL improved from 13.9% to 13.2%.

### Bank sector earnings in October

The aggregate monthly net income of the Polish bank sector amounted to PLN 1,324 million in October, marking a decline of 1.8% from September and an increase of 10.1% from October 2013. The month-on-month contraction was led by a 15% drop in net interest income driven by cuts in central bank interest rates. A 14.1% fall in interest expenses was not enough to offset a 12.9% slump in interest income. The net interest margin over average assets (adjusted for the number of days per month) shrunk to 1.81% from 2.23% the month before. Fee income as well showed respective m/m and y/y shrinkage of 7.9% and 19.2%. Provisioning remained steady relative to the previous month and October 2013 (+1.7% m/m, +1.4% y/y), with cost of risk flat at 100bps. Total costs fell 24.4% in October thanks to a 17.2% m/m reduction in administrative expenses. In the year through October, the net profit of the bank sector was up 10.3% from the same period in 2013 at PLN 14.4 billion, driven by an 11.2% increase in net interest income which offset a 3.8% decline in fee income and a 6.3% rise in provisioning.

### KNF issues mortgage guidance for SKOKs

The KNF has issued mortgage lending guidance for the credit and savings union franchise SKOK pegging LtV at 95% through September 2016 followed by 90% until September 2017 and 85% max starting in October 2017. This compares to LTV requirements for banks with a 90% cap set to be introduced in January 2015 followed by 85-90% from January 2016. The new rules give Polish banks a reasonable basis to acquire SKOK branches.

### Polish banks face deposit insurance contribution hikes

Poland's deposit insurance agency BFG has set the new mandatory 2015 annual contributions for banks at 0.189% of risk-weighted assets and established the prudential fee at 0.05% of RWA, marking an increase from the respective fees of 0.1% and 0.037% of RWA paid this year, with the total annual burden next year increasing from 0.137% to 0.239% RWA. The BFG contribution hike comes as a surprise to us. As far as its impact on the operating costs of the banks in our coverage, we estimate the extra charges at PLN 205m for PKO BP (equivalent to 5.1% of the expected 2015 net profit), PLN 115.8m for Pekao (3.8% of 2015E net profit), PLN 103.6m for BZ WBK (4.3% of 2015E net profit), PLN 49.1m for ING BSK (3.8% of 2015E net profit), PLN 39.4m for Millennium (5.3% of 2015E net profit), PLN 30.7m for Bank Handlowy (3.2% of 2015E net profit), and PLN 49.5m for Getin Noble Bank (7.7% of 2015 net profit).

### Interchange fees set for 2015 cut

Poland is set to reduced interchange fees to 0.3% starting next year in the wake of similar reductions made across the EU. The falling interchange fees add to the raised BFG contributions and interest rate cuts in painting a bleaker 2015 outlook for Polish banks.

### KNF issues dividend guidance for banks and insurers

New guidance by Poland's financial regulator KNF allows banks with material exposure to non-financial deposits to distribute 100% of annual net earnings as dividends subject to a Tier-1 ratio above 12%, CAR over 15.5%, and a BION (Polish equivalent of SREP) score in the 1-2 range. Banks with material exposure to non-financial deposits and CAR between 12.5% and 15.5% can pay out up to 50% of annual net earnings as dividends, and all other banks can make

distributions up to 100% provided their Tier-1 ratios are above 9%, CARs are above 12.5%, and the BION scores are between 1 and 2. As for insurance companies, in order to be able to make 100% payouts, they have to report capital requirement coverage ratios of 160% for life insurers and 200% for non-life insurers and a ratio of assets to technical reserves at 110% minimum, before as well as after any such payout. Of system-critical banks, Pekao can make 100% distributions and PKO BP can pay out up to 50% of annual net profits as dividends under the new guidance. As for the other banks in our coverage, all of them except including Getin Noble Bank have the capacity to pay dividends out of 2014 profits, with 100% payout ratios expected of Pekao and Handlowy and projected ratios of 60% at ING BSK, 50% at PKO BP, Millennium, and BZ WBK, and 0% at GNB and Alior Bank.

### **Fitch affirms ratings for Pekao, ING, BZ WBK, and Handlowy**

Fitch has affirmed the support and IDR ratings for PKO BP, Pekao and its mortgage arm Pekao Bank Hipoteczny, ING, BZ WBK, and Handlowy reflecting the view that these banks can with high probability receive support from their owners if necessary. Fitch notes that the IDR ratings of Handlowy, ING and BZ WBK are largely dependent on the ratings of their owners.

### **Hungarian government submits FX loan conversion bill**

The Hungarian FX loan conversion bill specifies that the conversion will apply to home loans extended since 1 May 2004, and sets the exchange rates at CHF/HUF 256.47 and EUR/HUF 308.97. The conversion date is set at 1 February 2015. The interest on the converted loans will be linked to the 3-month BUBOR, and the interest premium must be identical to the premium on the original loans (e.g. in case of CHF the original interest rate minus the CHF Libor) but not lower than 1%. Interest margins are capped at 4.5% for home loans and 65% for mortgage-backed loans. The banks cannot charge any extra fees for the conversion. Fidesz official Antal Rogan estimates that the payments on the converted loans will be 25-30% lower than today, and he predicts that over 90% of the affected borrowers will sign up for the conversion. Combined with the compensation offered to borrowers for unilateral changes by banks in loan contracts, Mr. Rogan estimates that the home loan conversion FX rate is equivalent to CHF/HUF 190.

### **FM Bank PBP**

#### **Regulator sets new deadline for FM Bank sale**

Poland's financial regulator KNF set a 30 April 2015 deadline for the private equity fund Abris to sell its 99.6% stake in FM Bank PBP after the fund has failed to comply with certain guidelines. This is the second time the KNF has set an FM Bank divestment deadline for Abris - the first deadline, later revoked, was July 2014. Newspapers list OTP Bank among others as a prospective buyer for FM Bank.

#### **Abris to sell FM Bank by end 2014**

According to an Abris Capital Partners partner the firm wants to sell FM Bank PBP by the end of the year.

### **Alior**

#### **Alior eyes loan expansion and stable NIM**

Alior Bank is hoping to increase sales of new loans by PLN 350-380m per month in the coming months. Further, the Bank wants to maintain NIM at 4.7% in Q4 2014

#### **Alior to raise capital, increase provisioning in Q4**

Alior shareholders approved a share issue aimed at raising financing to acquire Meritum Bank. Further, Alior may raise rise reserves by PLN 10m in Q4 following an asset quality review conducted by the regulator.

### **Bank BPH**

#### **First prospective buyers emerge for Bank BPH**

According to press reports the prospective buyers interested in Bank BPH which is being put up for sale by GE Money as part of its withdrawal from emerging Europe include Intesa, Credit Mutuel and Societe Generale.

### **Sberbank**

#### **Sberbank posts provisioning surge in Q3**

At RUB 71.3 billion, the Q3 2014 net profit of Sberbank fell 26.9% from Q2 and 24.6% from Q3 2013, and it came in line with the consensus estimate (as provided by Sberbank) of RUB 70.1 billion. The contraction in profits witnessed in the period was due to a 41.6% q/q surge in provisioning. At the same time, however, Sberbank successfully grew loan volumes by an impressive 28.2% from last year and 7% relative to the quarter before. We expect the third-quarter results to spur downward revisions to analysts' expectations for FY2014 which peg the Bank's annual net profit at RUB 342 billion (the annualized annual bottom line is an estimated RUB 323bn).

Net interest income rose 2.0% q/q and 17.4% y/y to RUB 255.2bn in Q3, and it fell 1.6% short of market consensus. Net interest margin (over average assets) shrunk by 11bps to 5.10%. Compared to the second quarter, a 3.7% increase in interest income more than offset the strong, 5.9% rise in interest expenses, especially those incurred on interbank deposits.

Loans increased by 7.0% q/q and 28.2% y/y, with retail lending soaring 7.3% q/q and 30.3% y/y, led by 13.0% q/q expansion in consumer loans. Deposits were up 4.8% q/q and 17.3% y/y in Q3 2014. As a result, the loans/deposits ratio increased to 114.0% in Q3 from 112.0% in Q2.

Fee income increased 7.6% q/q and 23.2% y/y to RUB 69.6bn, exceeding market expectations of RUB 68.1bn. The growth relative to the second quarter was driven by a 36.4% surge in document fees, a 6.7% increase in fees from settlements with individuals, and a 4.8% rise in card fees, offsetting a 6.8% decline in overall settlement fees.

Loan-loss reserves amounted to RUB 104.5bn in Q3 after a q/q surge of 41.6% and a y/y boost of 137.0%, slightly exceeding market expectations at RUB 106.9bn. The increased provisioning reflected the slowdown in Russia and the recognition of higher risk reserves against big Russian exposures and unfavorable currency trends, combined with higher reserves against Ukrainian exposures. Cost of risk (to average gross loans) increased from 202bps in Q2 to 272bps in Q3 2014. The NPL ratio worsened slightly to 3.5% from 3.4% in the quarter before, and the coverage ratio rose to 146% from 141%. The biggest increase in the non-performing loan ratio was recorded in mortgages (up from 1.8% in Q2 to 2.1% in Q3) and in credit cards (up from 3.6% to 4.2%).

BZ WBK		Sell									
Analyst: Michał Konarski		Current price:		PLN 386				Last rating:		2014-09-08	
		Target price:		PLN 344.95							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Net interest income	3 346.4	4 682.5	39.9%	3 896.4	-16.8%	4 504.6	15.6%	Number of shares (m)		98.9	
Net interest margin	5.6%	3.9%		3.4%		3.6%		MC (current price, PLN/m)		38 186.6	
Total income	4 136.3	6 089.8	47.2%	6 455.0	6.0%	7 002.3	8.5%	Free float		30.0%	
Operating income*	2 194.5	2 670.9	21.7%	3 526.8	32.0%	4 015.8	13.9%				
Pre-tax income	1 704.0	1 969.4	15.6%	2 754.0	39.8%	3 192.0	15.9%				
Net income	1 367.6	1 611.5	17.8%	2 136.8	32.6%	2 431.1	13.8%				
ROE	16.8%	11.9%		14.8%		15.6%		Price change: 1M		2.9%	
P/E	20.6	22.4		17.9		15.7		Price change: 6M		-0.5%	
P/BV	3.2	2.6		2.6		2.3		Price change: 12M		-1.3%	
DPS	8.0	7.6		10.7		11.4		Low (52 weeks)		345.0	
Dyield (%)	2.1	2.0		2.8		3.0		High (52 weeks)		422.0	

\* before provisions

**We maintain a sell rating for BZ WBK whose shares gained 2.6% in November as the WIG-Banks index climbed 1.0%. We expect BZ WBK will experience growth this year driven by one-time gains such as the divestment of the asset management unit and the Aviva insurance operations. At the same time, the addition of SCB has made the Bank more sensitive to interest rate reductions which may put downward pressure on future quarterly profits. BZW deserves to be valued at a premium relative to the Polish banking sector in our view given its above-average ROE, but at the current level the premium is too high.**

### Fitch affirms BZW ratings

Fitch maintained BZ WBK's long-term IDR and Viable rating at 'BBB+' and 'bbb,' respectively, with the IDR outlook maintained at stable. The ratings reflect the high probability of aid by the owner, Santander Bank, if need be. Fitch says BZ WBK's Viable rating can be raised by a notch to 'bbb+' if the Bank's financial standing remains stable after the inclusion of other banks into the BZ WBK Group.

Getin Noble Bank		Accumulate									
Analyst: Michał Konarski		Current price:		PLN 2.22				Last rating:		2014-12-01	
		Target price:		PLN 2.38							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Net interest income	1 348.6	1 297.8	-3.8%	1 465.2	12.9%	1 470.0	0.3%	Number of shares (m)		2 650.1	
Net interest margin	2.4%	2.1%		2.2%		2.1%		MC (current price, PLN/m)		5 883.3	
Total income	2 190.8	1 886.0	-13.9%	1 983.0	5.1%	2 006.6	1.2%	Free float		49.8%	
Operating income*	1 356.9	1 007.3	-25.8%	1 060.3	5.3%	1 047.3	-1.2%				
Pre-tax income	409.1	388.0	-5.2%	358.7	-7.5%	448.3	25.0%				
Net income	333.2	399.7	20.0%	447.7	12.0%	435.3	-2.8%				
ROE	7.9%	8.8%		9.0%		8.0%		Price change: 1M		-10.5%	
P/E	17.7	14.7		13.1		13.5		Price change: 6M		-30.6%	
P/BV	1.4	1.2		1.1		1.0		Price change: 12M		-21.3%	
DPS	0.0	0.0		0.0		0.0		Low (52 weeks)		2.1	
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks)		3.7	

\* before provisions

**We have an accumulate rating for Getin Noble Bank with the 9-month price target at PLN 2.38/share. GNB shares have plummeted 39% from their 2014 high on concerns over a possible capital raise combined with a deteriorating earnings outlook in the coming years. In our view, the risk of negative future earnings surprises is low and we expect the Bank to report strong growth in 2016. At the same time, we maintain that GNB deserves to be valued at a higher discount than any other peer given its low ROE and solvency ratios.**

### Q3 profit affected by one-time charges

At PLN 79.7m, the Q3 2014 net profit of Getin Noble Bank showed a 41.3% drop from the second quarter and a 5.3% decrease from Q3 2013, and it missed market expectations by 36.9% and fell short of our PLN 135.8m forecast due to the recognition of an AQR allowance. If we factor out the one-time charges, we can see strong NIM growth and continued reductions in operating costs in Q3.

**Total income** increased 3.0% q/q and 14.6% y/y in Q3, and it came in line with market expectations. Net interest income showed q/q growth of 4.1% while fee income logged a decline of 0.8%.

**Net interest income** amounted to PLN 379.6m in Q4/14, up 11.5% q/q and 5.5% y/y driven by 0.8% q/q growth in interest income offset by a 1.5% increase in interest expenses. The quarterly net interest margin (over average assets) expanded by 9bps to 2.24%.

**Loans** contracted 1.0% q/q and 1.2% y/y in Q3, led by a 2.9% q/q drop in corporate lending and an 0.7% q/q decline in retail lending with mortgage volumes down 0.5%, auto loans decreasing 2.0%, and consumer loans falling 1.1%.

**Deposits** in Q3 showed a decreases of 1.9% from the previous quarter and an 0.6% expansion from Q3 2013. The ratio of term deposits to overall deposits declined from

84.8% in Q2 to 84.6% in Q3 while at the same time the loans/deposits ratio showed a small rise from 89.8% to 91.1%.

**The quality of assets** remained stable in Q3 with the NPL ratio at 13.7%. The coverage ratio as well remained flat q/q at 59% but it fell considerably relative to the 65% posted in Q3 2013. Higher NPL ratios recorded in corporate lending (9.6% vs. 8.7% in Q2), auto loans (26% vs. 25.2% in Q2) and mortgage loans (10.8% vs. 10.6% in Q2) were offset by a reduction from 31.5% to 28.9% in consumer loans.

**Provisioning** was raised by 70.2% compared to Q3 2013 and 37.1% relative to Q2 2014 to PLN 224.0m, well ahead of the market estimate of PLN 163m. The higher charges were related primarily to the asset quality review conducted in the third quarter, with PLN 21.7m recognized before the AQR and a further PLN 22.3m booked after the AQR (making for a total charge of PLN 44.0m). As for loan-loss reserves, they increased by PLN 60.8m q/q in mortgages and by PLN 11.1m in corporate, but at the same time they were reduced by PLN 1.1m in auto loans and by PLN 10.4m in consumer lending. Cost of risk (to average gross loans) increased from 124 bps in Q2'14 to 170bps in Q3'14 or to 137bps after adjustment for the one-time charges.

**The Tier 1 ratio** amounted to 8.9% in Q3, and CAR was 12.5%. Getin added net profit to equity after H1 2014 in October, and as a result the two solvency ratios are expected to increase to 9.5% and 13.1%, respectively.

### GNB eyes higher reserves, margin pressure

Getin expects loan-loss reserves to remain steady at the Q2 level of ca. PLN 160m in the quarters ahead though in Q4 2014 the Bank is planning to sell a large NPL portfolio. Further, Getin expects downward pressure on net interest income in Q4 2014.

Handlowy		Sell						
Analyst: Michał Konarski		Current price:		PLN 109		Last rating:		2014-09-08
		Target price:		PLN 103.37				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Net interest income	1 488.3	1 242.2	-16.5%	1 178.6	-5.1%	1 279.6	8.6%	Number of shares (m)
Net interest margin	3.5%	2.8%		2.5%		2.6%		130.7
Total income	2 780.0	2 540.9	-8.6%	2 368.7	-6.8%	2 492.7	5.2%	MC (current price, PLNm)
Operating income*	1 297.1	1 182.2	-8.9%	1 072.8	-9.3%	1 242.6	15.8%	14 241.9
Pre-tax income	1 239.0	1 218.1	-1.7%	1 045.4	-14.2%	1 199.9	14.8%	Free float
Net income	970.1	972.7	0.3%	847.3	-12.9%	972.5	14.8%	25.0%
ROE	14.0%	15.3%		11.7%		13.4%		Price change: 1M
P/E	14.7	14.6		16.8		14.6		-4.0%
P/BV	1.9	1.9		2.0		1.9		Price change: 6M
DPS	2.8	5.8		7.2		6.5		-10.1%
Dyield (%)	2.5	5.3		6.6		5.9		Price change: 12M
								-5.5%
								Low (52 weeks)
								98.1
								High (52 weeks)
								127.2

\* before provisions

**We maintain a sell rating for Handlowy with the target price at PLN 103.37/share. BHW shares took a 9% hit in October followed by a 5.3% slide in November on reduced interest rates, underperforming the WIG-Banks benchmark which retreated by respective monthly margins of 2.8% and 6.2%. Handlowy has the most sensitivity in the sector to interest rate cuts, moreover, it is expected to post a 9.4% drop in annual net profit this year. It deserves premium valuation given its above-average dividend potential supported by a high Tier-1 ratio, combined with the sector's lowest ratio of loans to deposits, but the current premium is too high in our view.**

### Q3 conference highlights

**Operating costs** decreased 2.9% y/y in Q3 2014 to PLN 303.8m, a level which Handlowy considers satisfying.

Relative to Q2, costs fell 7.5% thanks to a reversal of a PLN 4-5m vacation reserve. Handlowy expects to see the full effects of restructuring in 2015 (PLN 80-100m annual savings) though at the same time it is planning to raise its marketing and infrastructure budget.

**Cost of risk** in Q3 was supported by a PLN 7.8m reserve reversal. Despite intensified sales of consumer loans, marketed primarily (70%) to new customers, cost of risk is not likely to increase thanks to consistently prudent lending requirements.

**NIM** will come under pressure in the quarters ahead due to falling interest rates, but the declines will be partly offset by growing loan sales.

We expect a slowdown in Handlowy's earnings in Q4 and through 2015 stemming from its high sensitivity to interest rate reductions. What is more, 2015 may not be as good for bond trading profits.

ING BSK								Hold	
Analyst: Michał Konarski		Current price:		PLN 150.45		Last rating:		2014-10-07	
		Target price:		PLN 144.12					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Net interest income	2 048.9	2 042.6	-0.3%	2 269.0	11.1%	2 545.9	12.2%	Number of shares (m)	130.1
Net interest margin	2.8%	2.5%		2.5%		2.6%		MC (current price, PLNm)	19 573.5
Total income	3 209.4	3 245.1	1.1%	3 430.0	5.7%	3 806.2	11.0%	Free float	25.0%
Operating income*	1 343.2	1 417.0	5.5%	1 564.0	10.4%	1 896.3	21.3%		
Pre-tax income	1 016.1	1 192.9	17.4%	1 226.4	2.8%	1 543.3	25.8%		
Net income	832.3	961.5	15.5%	1 035.3	7.7%	1 296.2	25.2%		
ROE	11.4%	11.5%		11.8%		13.9%		Price change: 1M	6.3%
P/E	23.5	20.4		18.9		15.1		Price change: 6M	13.0%
P/BV	2.4	2.3		2.2		2.0		Price change: 12M	28.3%
DPS	0.0	0.0		4.4		4.8		Low (52 weeks)	106.9
Dyield (%)	0.0	0.0		2.9		3.2		High (52 weeks)	150.5

\* before provisions

**We maintain a neutral investment rating for ING BSK whose shares gained 26.8% in the year through November, outperforming the WIG-banks index which increased 23.5%, reflecting better-than-expected earnings. Looking at the composition of its balance sheet, we believe the Bank is shielded against interest rate cuts, moreover, its low ratio of loans to deposits is a source of competitive advantage. Finally, one of the highest solvency ratios in the Polish bank sector mandates premium valuation for ING.**

### Q3 conference highlights

**Provisioning** totaled PLN 65.2m in Q3, with PLN 52.0m charge-offs made against corporate loans and PLN 13.2m booked against retail loans. Intense sales of consumer loans

may drive quarterly retail loan loss reserves up by some PLN 15-20m.

**Operating costs** were down 1.9% q/q at PLN 489.5m despite the recognition of a PLN 7m litigation allowance.

**Card fees** fell by 50% or PLN 26bn relative to Q2 in the wake of reduced interchange fees, with the 2014 annual card fee income expected to show a y/y drop by PLN 45m.

The annualized net profit for 9M 2014 indicates that the Bank is well on track on achieving the consensus expectation of PLN 1,084m net profit. Further, ING will benefit from reduced interest rates in 2015 thanks to a low ratio of loans to deposits (84%) which leaves room for fast-paced lending expansion and the building of a securities portfolio which will contribute to interest income.



Millennium		Hold									
Analyst: Michał Konarski		Current price:		PLN 8.19				Last rating:		2014-10-07	
		Target price:		PLN 8.46							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Net interest income	1 161.2	1 270.8	9.4%	1 411.6	11.1%	1 534.9	8.7%	Number of shares (m)		1 213.1	
Net interest margin	2.2%	2.3%		2.4%		2.4%		MC (current price, PLNm)		9 935.4	
Total income	2 008.2	2 006.4	-0.1%	2 272.8	13.3%	2 413.4	6.2%	Free float		34.5%	
Operating income*	832.0	916.8	10.2%	1 087.1	18.6%	1 196.9	10.1%				
Pre-tax income	593.8	680.6	14.6%	820.5	20.5%	921.9	12.4%				
Net income	472.2	535.8	13.5%	654.2	22.1%	744.6	13.8%				
ROE	10.0%	10.5%		11.8%		12.5%		Price change: 1M		1.1%	
P/E	21.0	18.5		15.2		13.3		Price change: 6M		-4.7%	
P/BV	2.1	1.9		1.7		1.6		Price change: 12M		11.4%	
DPS	0.0	0.0		0.2		0.3		Low (52 weeks)		7.0	
Dyield (%)	0.0	0.0		2.7		3.3		High (52 weeks)		9.6	

\* before provisions

**We maintain a neutral rating for Millennium whose shares in November depreciated by 7.8%, more than the 8.7% drop posted by the WIG-Banks benchmark. The underperformance was led by concerns over a possible divestment by the main owner Millennium BCP combined with high profit sensitivity to the raised mandatory contributions to the Bank Guarantee Fund. At the same time, Millennium generates strong quarterly earnings results thanks to low sensitivity to interest rate cuts. Going forward, the Bank's solvency ratios will be greatly improved after the planned adoption of the advanced internal rating-based approach.**

### BCP considers partial divestment

Millennium's owner Millennium BCP is reportedly considering reducing its interests in the Polish unit without losing the controlling stake. A sale of a minority stake by an international owner of a Polish bank with over-50% holdings would hardly be a surprise, although in this case Millennium BCP has stated before that it does not need to sell MIL shares as its capital needs for the year are fully met.



Pekao Reduce								
Analyst: Michał Konarski			Current price: PLN 186.45		Last rating: 2014-12-05			
			Target price: PLN 173.34					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Net interest income	4 862.0	4 505.6	-7.3%	4 575.6	1.6%	5 033.7	10.0%	Number of shares (m) 262.5
Net interest margin	3.3%	2.9%		2.8%		2.9%		MC (current price, PLNm) 48 937.5
Total income	7 790.2	7 407.9	-4.9%	7 354.0	-0.7%	7 933.1	7.9%	Free float 49.9%
Operating income*	4 248.7	4 055.3	-4.6%	3 851.4	-5.0%	4 401.6	14.3%	
Pre-tax income	3 619.4	3 433.2	-5.1%	3 301.3	-3.8%	3 804.7	15.2%	
Net income	2 906.0	2 767.8	-4.8%	2 675.8	-3.3%	3 084.2	15.3%	
ROE	13.1%	11.9%		11.5%		13.1%		Price change: 1M 2.9%
P/E	16.8	17.7		18.3		15.9		Price change: 6M -1.7%
P/BV	2.1	2.1		2.1		2.1		Price change: 12M 1.8%
DPS	5.4	8.4		10.0		10.2		Low (52 weeks) 166.0
Dyield (%)	2.9	4.5		5.3		5.5		High (52 weeks) 199.8

\* before provisions

**We are downgrading PEO from hold to reduce after a 5.0% price increase in November logged while the WIG-Banks index gained only 1.0%. Pekao shares are trading at a huge, 19% premium to the sector on 12-month forward P/E, compared to a historical 5-year premium of 9%. We believe Pekao should be valued at a premium to the sector given its high dividend-paying potential backed by the sector's highest solvency ratio, but at the current level the premium is too high in our view.**

#### Pekao posts upside Q3 surprise on low reserves

At PLN 704.4m, the Q3 2014 net profit of Pekao showed a 11.6% decrease from the second quarter and a 17.9% drop from Q3 2012, but it beat the PLN 676.1m consensus estimate by 2.2%, and exceeded our PLN 678.1m forecast thanks to lower provisioning and higher gains realized on available-for-sale securities (PLN 95m vs. PLN 35m in Q2). On the other hand, we were disappointed by the 12bp q/q shrinkage in the quarterly NIM. After generating a net profit of PLN 2,023m in the nine months through September 2014, Pekao is on track to achieving the full-year target of PLN 2,715m. Pekao reported 12bp contraction to 2.83% in

the quarterly net interest margin, reflected in an 0.5% q/q decrease in net interest income. With loans up 0.8% q/q and deposits down 4.9%, the loans/deposits ratio increased to 91.9% from 95.6% in Q2'14. Third-quarter fee income was down 4.0% q/q and 5.8% y/y. Operating costs decreased by 0.5% each relative to Q3'13 and Q2'14 led by an 0.8% decline in payroll costs and a 0.5% decline in non-payroll costs. Loan-loss reserves decreased more than anticipated in Q3 at 5.9% q/q and 21% y/y and as a result, cost of risk fell from 50bps to 46bps. The NPL ratio in Q3 improved again from 7.0% in Q2 to 6.9% in Q3.

#### Pekao eyes NIM contraction in Q4

Due to central bank rate reductions Pekao expects its Q4 interest income to fall by PLN 70-80m resulting in 20-30bp contraction in the net interest margin. On a positive note, the NIM downside should be mitigated by a large portfolio of AFS securities.

#### Pekao gets green light to buy a SKOK

Pekao received permission to acquire SKOK im. Mikołaja Kopernika.

PKO BP		Buy									
Analyst: Michał Konarski		Current price:		PLN 37.62				Last rating:		2014-07-14	
		Target price:		PLN 43.2							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Net interest income	8 089.3	6 722.0	-16.9%	7 456.4	10.9%	8 437.8	13.2%	Number of shares (m)		1 250.0	
Net interest margin	4.2%	3.4%		3.3%		3.3%		MC (current price, PLNm)		47 025.0	
Total income	12 007.4	10 706.9	-10.8%	11 614.8	8.5%	12 788.3	10.1%	Free float		68.6%	
Operating income*	6 939.1	6 047.4	-12.9%	5 878.6	-2.8%	7 130.6	21.3%				
Pre-tax income	4 613.9	3 959.9	-14.2%	4 036.6	1.9%	4 999.3	23.8%				
Net income	3 738.6	3 233.8	-13.5%	3 266.0	1.0%	4 045.3	23.9%				
ROE	15.9%	13.0%		12.4%		14.1%		Price change: 1M		0.0%	
P/E	12.6	14.5		14.4		11.6		Price change: 6M		-6.5%	
P/BV	1.9	1.9		1.7		1.6		Price change: 12M		-5.2%	
DPS	1.3	1.8		0.8		1.3		Low (52 weeks)		35.6	
Dyield (%)	3.4	4.8		2.0		3.5		High (52 weeks)		44.2	

\* before provisions

**We stand by our buy rating for PKO BP whose shares fell 4.7% in the year through November, much more than the WIG-Banks index which in the same period retreated 2.7%. We attribute the dampened sentiment to an expected sale of a 6% stake by the Polish State Treasury combined with expectations of monetary easing in Poland. In our view, even assuming Poland is in for a new monetary policy easing cycle, the high discount at which PKO is valued relative to peers is undeserved. What is more, the merger with Nordea should help mitigate the impact on 2015 of negative factors such as lower interest rates, raised BFG contributions, and cut interchange fees.**

### PKO beats expectations on lower provisioning

At PLN 873.4m, the Q3 2014 net profit of PKO BP showed 2.1% growth from Q2 and a 16.1% surge from Q3 2013, and it slightly exceeded the PLN 853.9m consensus estimate as well as our PLN 853.5m estimate. The upside surprise was owed to lower-than-expected provisioning which offset a weaker-than-expected total income. PKO BP delivered 78% of our 2014 annual net profit estimate and 76% of the consensus estimate in 9M 2014. Total income showed a q/q decline of 0.6% in Q3, net interest income expanded 2.0% (in line with expectations), and fee income fell 7.3% on reduced interchange fees. The net interest margin contracted by 2bps to 3.25%. PKO's loan and deposit portfolios remained steady in Q3 relative to the quarter before, and the loans/deposits ratio was flat at 104%. Operating expenses were steady as well compared to the previous quarter, and they ended slightly lower than predicted by analysts. PKO reduced loan-loss reserves by 14.8% in Q3, much more than anticipated by the market. Cost of risk (to average loans) decreased to 102bps in Q3 from 131bps in Q2.

### Q3 earnings conference highlights

PKO's Management said during the Q3 earnings conference that they expected a decrease by 30bps in net interest margin in Q4 2014, putting downside to the Bank's shares. Another key takeaway that we have after the meeting are that the Bank will recognize the highest quarterly post-merger integration costs against the profit for Q4 at PLN 57m. We expect these announcements to be followed by downward revisions to analysts' earnings expectations in 2014 and 2015. For our part, given the deeper-than-anticipated cuts in market interest rates, we do not think PKO is capable of delivering its promise of steady 2014 net profit at PLN 3.2bn.

### NIM

In Q3 2014, PKO's net interest margin (over average interest-earning assets) remained at the steady level of 3.6%, but in Q4 further cuts in interest rates, especially the lending rate, is expected to drive the quarterly NIM down by 30bps. Moreover, the lowered market rates will continue to affect profits in Q1 2015. Today, the market is fraught with uncertainty as to the magnitude of the next interest-rate reduction by the central bank. PKO's expectation is of one final cut by 25bps. The Bank intends to cushion the blow dealt by the monetary easing by intensifying lending to consumers and homebuyers who today are paying record-high loan margins (upwards of 2%). Corporate lending offers lower margins.

### Integration of Nordea

PKO BP has revised its assumptions as to synergies and integration costs arising on the acquisition of Nordea. In Q3 2014, the integration costs were low at just PLN 15m, and with the annual costs projected at PLN 85m this implied Q4 costs of PLN 57m. Cost synergies are estimated at PLN 6m this year. In 2015, the integration costs are expected to total PLN 115m, and the synergies are projected at PLN 105m. By 2016-2017, the Bank will no longer incur costs while recognizing estimated annual synergies of respective PLN 174m and PLN 200m. Talled up, the total costs of Nordea's integration into PKO's organization have risen from the original estimate of PLN 305m to PLN 325m, driven by accelerated integration processes (resulting in zero costs as soon as in 2016). At the same time, the expected synergies increased from PLN 176m to PLN 200m (or from PLN 223.5m to PLN 278m including revenue synergies).

### Cost of risk

Cost of risk (to average loans) amounted to 102bps in Q3 vs. 131bps in Q2 2014. PKO sees potential for CoR reductions in the corporate business. The Bank sold non-performing consumer loans worth less than PLN 100m in the third quarter, marking a decline from the usual quarterly average expected to return to PLN 150-200m in Q4. The impact of such sales on P&L is marginal.

### Loans and deposits

PKO BP feels comfortable with a loans/deposits ratio of 104%. In Q3 the ratio was 87%. The Bank is not planning any major marketing campaigns to sell more deposits, but it wants to maintain its market share in retail loan sales at 25-27%.

### Net profit

PKO says maintenance of annual net profit at the 2014 level next year will be a challenge.

**Komercni Banka**
**Sell**

Analyst: Michał Konarski	Current price:		CZK 5000					Last rating:	2014-10-07
	Target price:		CZK 4115						
(CZK m)	2012	2013	change	2014E	change	2015E	change	Key metrics (CZK m)	
Net interest income	21 947.0	21 207.0	-3.4%	21 633.7	2.0%	23 125.2	6.9%	Number of shares (m)	37.8
Net interest margin	2.8%	2.7%		2.6%		2.7%		MC (current price, PLNm)	188 855.9
Total income	32 689.0	30 894.0	-5.5%	31 264.9	1.2%	32 931.0	5.3%	Free float	39.6%
Operating income*	19 178.0	17 746.0	-7.5%	18 117.6	2.1%	19 641.9	8.4%		
Pre-tax income	16 939.0	16 940.0	0.0%	15 731.0	-7.1%	16 576.2	5.4%		
Net income	13 953.0	12 528.0	-10.2%	12 405.2	-1.0%	13 239.9	6.7%		
ROE	15.8%	12.7%		12.3%		12.8%		Price change: 1M	6.6%
P/E	13.5	15.1		15.2		14.3		Price change: 6M	8.9%
P/BV	1.9	1.9		1.9		1.8		Price change: 12M	15.2%
DPS	160.0	230.0		215.0		215.0		Low (52 weeks)	4 200.0
Dyield (%)	3.2	4.6		4.3		4.3		High (52 weeks)	5 179.0

\* before provisions

**We maintain a sell rating for Komercni Banka. KOMB share price (in US dollars) surged 6.7% in the past month, far outperforming MSCI EME Financials which fell 2.2%. Today, KOMB is trading on a par with the WIG-Banks index on 12M forward P/E, but based on the five-year historical average it is valued at a 13% discount which we consider more deserved given the slow pace at which the Bank grows its earnings relative to the Polish peers and the uninspired 2015 earnings guidance presented after the Q3 earnings season.**

### Komercni posts low reserves in Q3

At CZK 3,268m, the Q3 2014 net profit of Komercni Banka showed a 1.1% decline from the second quarter and an 0.6% rise from Q3 2013, and it beat the CZK 3,069m consensus estimate by 6.5%, and exceeded our CZK 3,113m forecast on lower-than-expected loan-loss reserves. Komercni Banka achieved 78% of annual the market consensus (Bloomberg) and our estimate as to the full-year net profit.

**Net interest income** increased 1.1% q/q and 1.9% y/y in Q3 2014 to CZK 5,395m, slightly exceeding market expectations. At the same time, the quarterly net interest margin (over average assets) shrunk by 3bps to 2.41% under pressure from rising deposit prices as interest rates remain low.

**Loans** increased 0.6% q/q and 4.0% y/y in Q3'14, driven by retail lending (+1.3% q/q) as corporate lending remained flat. Deposits logged a q/q increase of 3.4% led by 3.6% higher corporate savings and 2.1% higher retail savings. The ratio of loans to deposits declined from 72% in Q2 to 70% in Q3 2014.

**Fee income** in Q3 fell by 3.7% to CZK 1,647m relative to the quarter before due to lower fees earned on loans (-6.3%), cross-sales (-6.0%) and other services

(-9.1%). **Operating costs** increased by 1.7% q/q to CZK 3,254m, in line with market expectations, driven by 3.2% higher payroll costs. The costs/income ratio remained at the steady quarterly level of 42.2% in Q3.

**Loan-loss reserves** were raised by 16.4% q/q but in spite of this they were 19.7% lower than in Q3 2013 at CZK 305m, well below the consensus estimate of CZK 389m. Komercni increased provisioning against non-performing corporate loans from CZK 40m to CZK 88m in Q3, but at the same time it reduced provisioning against retail NPLs from CZK 230m to CZK 212m. Cost of risk increased to 25bps in Q3 from 22bps in Q2 2014. The quality of assets remained stable, with the share of LUSR exposure (bad debt) at 5.5% and the reserves/NPL rising to 67.9% from 66.7% in Q2.

### Key takeaways from Q3 earnings call

**2014 earnings outlook:** Komercni expects a 2% decline in revenue and a 1% decrease in operating costs. Q3 trading income was above average compared to previous quarters. Cost of risk is set to remain stable throughout the year.

**2015 earnings outlook:** Revenue is expected to remain steady on flat interest income, 2% lower fee income, and higher trading income. NIM in 2015 will contract on low market interest rates. Operating costs will be flat.

**Dividend:** The dividend policy has been revised to reflect a raised annual payout ratio from up to 70% to a range of 70% to 100% after an increase in the Tier-1 ratio to 17.1%, above the 15-16% target. The 2015 outlook painted by Komercni's Management is rather lackluster compared to consensus forecasts which predict at 4% increase in net income. In our view, even the achievement of a flat income may be a challenge if cost of risk normalizes. With that being said, the market had a positive reaction to the raised dividends.

Erste Bank		Hold						
Analyst: Michał Konarski		Current price:		EUR 21.18		Last rating:		
		Target price:		EUR 29.6		2014-01-15		
(EUR m)	2012	2013	change	2014E	change	2015E	change	Key metrics (EUR m)
Net interest income	5 235.3	4 858.1	-7.2%	4 917.8	1.2%	5 141.1	4.5%	Number of shares (m)
Net interest margin	2.5%	2.3%		2.3%		2.3%		MC (current price, PLNm)
Total income	7 229.5	6 961.3	-3.7%	7 051.4	1.3%	7 349.4	4.2%	Free float
Operating income*	2 781.2	2 139.3	-23.1%	2 768.2	29.4%	3 077.7	11.2%	
Pre-tax income	801.2	374.3	-53.3%	1 374.5	267.2%	1 736.4	26.3%	
Net income	342.4	195.8	-42.8%	818.4	318.0%	1 100.7	34.5%	
ROE	3.2%	1.7%		6.7%		8.4%		Price change: 1M
P/E	24.4	46.5		11.1		8.3		Price change: 6M
P/BV	0.8	0.8		0.7		0.7		Price change: 12M
DPS	0.0	0.4		0.2		0.5		Low (52 weeks)
Dyield (%)	0.0	1.9		0.8		2.4		High (52 weeks)

\* before provisions

**We maintain a neutral rating for Erste Bank. EBS share price (in dollars) plunged 22.5% in the year through November, reflecting weak sentiment stemming from the losses on forced NPL sales in Romania and the Hungarian borrower compensation measures. Erste believes it can return to generating profits in 2015, but this pursuit may be undermined by the FX loan conversion push planned in Hungary.**

**RBI**
**Buy**

Analyst: Michał Konarski	Current price:		EUR 15.82					Last rating:	2014-01-15
	Target price:		EUR 32.1						
(EUR m)	2012	2013	change	2014E	change	2015E	change	Key metrics (EUR m)	
Net interest income	3 472.2	3 728.9	7.4%	3 785.1	1.5%	3 960.7	4.6%	Number of shares (m)	194.9
Net interest margin	2.5%	2.8%		2.8%		2.9%		MC (current price, PLNm)	3 084.1
Total income	5 304.3	5 477.3	3.3%	5 523.8	0.8%	5 851.1	5.9%	Free float	21.5%
Operating income*	2 040.4	1 990.3	-2.5%	2 196.2	10.3%	2 561.2	16.6%		
Pre-tax income	1 031.6	834.7	-19.1%	1 134.3	35.9%	1 525.2	34.5%		
Net income	752.0	602.9	-19.8%	566.1	-6.1%	850.8	50.3%		
ROE	10.1%	8.0%		7.3%		10.2%		Price change: 1M	-5.0%
P/E	4.1	5.1		5.4		3.6		Price change: 6M	-37.7%
P/BV	0.4	0.4		0.4		0.4		Price change: 12M	-34.9%
DPS	1.1	1.2		0.4		0.9		Low (52 weeks)	15.0
Dyield (%)	6.6	7.4		2.3		5.5		High (52 weeks)	31.3

\* before provisions

**We maintain a buy rating for RBI whose stock (in US dollars) plummeted 32.2% in the year through November as sentiment waned in the wake of the Ukraine-Russia conflict necessitating higher provisioning, combined with the losses taken as a consequence of the Hungarian borrower compensation laws. In 9M 2014, pre-tax profit generated in Russia accounted for 73% of the consolidated total for the period. It is worth noting that RBI paid off the remaining portion of participation capital this year despite annual losses projected at EUR 500m, potentially indicating a relatively strong capital position.**

### RBI posts lower-than-expected loss in Q3

At EUR 118.9m, the Q3 2014 net loss (before participation capital) reported by Raiffeisen Bank International (RBI) was lower than the EUR 137m anticipated by the market (as quoted by RBI). The upside surprise was owed mainly to higher-than-expected net interest income and fee income combined with lower provisioning. At the same time, the Bank has raised its full-year provisioning estimate for 2014 from EUR 1.5-1.7 billion to EUR 1.8 billion. It is worth noting that RBI repaid EUR 0.7bn in participation capital in September, with the Q3 results additionally weighed down by a EUR 205m charge related to the Hungarian government's borrower compensation plan. Despite the lower-than-expected loss, looking at the raised provisioning guidance, the profit shrinkage observed in Russia, and the high charge-offs booked in the corporate segment, we expect negative market reactions today to the Q3 report.

**Total income** in Q3 2014 showed respective quarter-on-quarter and year-on-year declines of 1.5% and 1.0%, marking less severe q/q contraction than the 2.7% drop expected by analysts achieved thanks to a 3.8% increase in fee income. The net interest margin (over average assets) decreased by 19bps to 2.90% in Q3 despite 2.1% expansion in loan volumes. Net interest income logged a q/q fall of 3.6% and remained flat relative to Q3 2013, led by lower income on derivatives. Fee income improved on higher FX fees and bullion and precious metals fees.

**Operating costs** in Q3 2014 decreased by 4.5% y/y to EUR 776.5m, a level lower than the EUR 784m consensus. Compared to the quarter before, payroll costs showed a q/q drop of 3% and administrative costs declined 1%.

**Loan-loss reserves** increased dramatically in Q3, showing q/q growth of 79.7% and y/y growth of 55.8% at EUR 515.0m, slightly less than the EUR 525m consensus. By operating segment, the strongest increases in provisioning were seen in other CIS (+53.8% q/q) and in corporate banking (where reserves surged from EUR 11m in Q2 to EUR 236m in Q3), driven by RBI's increasing exposure to the

Asian commodity market. At the same time, the NPL edged up slightly from 10.7% to 11.1% and the coverage ratio remained flat at 65.4% in Q3. By segment, NPL ratios improved in CEE (from 11.7% in Q2 to 11.5% in Q3) and SEE (from 14.5% to 14.2%), and worsened in Ukraine (from 36% to 39.8%) and in corporate banking (from 6.2% to 8.6%).

**A breakdown by division** shows weak Q3 performance in CEE (reporting a quarterly loss of EUR 139m led by Hungary), Russia (-21.3% q/q), and other CIS (posting a net loss of EUR 83.7m vs. a net profit of EUR 2.4m in Q2). On the other hand, net profit in SEE showed a strong, 37% increase from Q2. The downturn in CEE was caused by the EUR 205m charges recognized in Hungary (up from EUR 67m in Q2) in the wake of the borrower compensation scheme. The total Hungary-related charges booked to date have far exceeded RBI's original estimate of EUR 140m. and next year the Bank is still poised to lose about EUR 20m of Hungarian interest income after the February FX-to-forint conversion of home equity loans.

**RBI's Russia division** posted a 21.3% q/q drop in net profit in Q2 as an 11.2% increase in net interest income and a 2.2% decline in operating costs were offset by a loss of EUR 36m incurred on trading activity. The Russian NPL ratio increased to 5.6% in Q3 from 5.5% in Q2 while the coverage ratio decreased from 75.5% to 74.4%. **RBI Ukraine** booked a net loss of EUR 105m in Q3, marking considerable deterioration from the EUR 10m loss reported in Q2 driven by a 11.4% q/q drop in net interest income combined with a 57% surge in operating costs driven by higher intangible assets and a 56.2% upturn in reserves. The NPL ratio increased to 39.8% from 36.0%, and at the same time the coverage ratio rose to 81% from 79%.

RBI has slightly adjusted its FY2014 **guidance**. The Bank expects steady lending this year, with loan-loss reserves reaching EUR 1.8 billion (raised from an earlier estimate of EUR 1.5-1.7bn). Further, it hopes to reduce operating costs by 2016 compared to the costs incurred in 2012, and it anticipated net profit growth in the mid-triple digits in 2015.

### RBI anticipates 2015 provisioning boost in Russia

Raiffeisen Bank International expects next year's risk provisioning at its Russian units to be slightly higher than the annualized charges of EUR 47m booked in Q3 2014. Assuming stable reserves in Russia in the next five quarters, this implies a 16% increase in loan-loss reserves in 2015 resulting in a higher NPL ratio. For the Polish operations, Raiffeisen expects profits to ease slightly on the recently reduced lending rate and raised BFG contributions. The Russia provisioning boost should not come as a surprise to the market given the political and economic climate.

OTP BANK		Hold					
Analyst: Michał Konarski		Current price:		HUF 4001		Last rating:	
		Target price:		HUF 4618		2014-01-15	
(HUF bn)	2012	2013	change	2014E	change	2015E	change
Net interest income	647.8	653.1	0.8%	671.5	2.8%	710.1	5.7%
Net interest margin	6.4%	6.5%		6.5%		6.7%	
Total income	1 488.6	1 538.7	3.4%	1 518.1	-1.3%	1 654.1	9.0%
Operating income*	445.9	447.7	0.4%	466.4	4.2%	499.4	7.1%
Pre-tax income	192.2	184.9	-3.8%	237.9	28.6%	266.3	11.9%
Net income	121.7	145.8	19.8%	140.5	-3.6%	164.1	16.8%
ROE	8.3%	9.5%		8.8%		9.7%	
P/E	8.3	6.9		7.2		6.1	
P/BV	0.7	0.6		0.6		0.6	
DPS	101.7	145.9		145.0		152.2	
Dyield (%)	2.5	3.6		3.6		3.8	
						Key metrics (PLN bn)	
						Number of shares (m)	251.7
						MC (current price, PLNm)	1 007.0
						Free float	100.0%
						Price change: 1M	1.5%
						Price change: 6M	-13.6%
						Price change: 12M	-6.0%
						Low (52 weeks)	3 555.0
						High (52 weeks)	4 875.0

\* before provisions

**We remain neutral on OTP. The Bank's shares (in dollars) fell 15.7% in the year through November, reflecting the charges expected to be incurred in the wake of the Hungarian legislation aimed at compensating borrowers for unilateral loan changes and unfair exchange rate pricing, including the planned conversion of FX loans to forints bound to put a dent in OTP's interest income in the coming years. For these reasons, we consider the discount at which OTP is valued relative to the sector justified.**

### OTP posts better-than-expected Q3 results

At HUF 34.10bn the Q3 2014 net profit of OTP Bank (before minority interests) showed 214% growth from Q3 2013 and it beat the average market estimate of HUF 28.7bn as well as our estimate of HUF 26bn thanks to a reversal of allowances for borrower payouts totaling HUF 7.73bn. At the same time, the Bank set aside an allowance of HUF 6.84bn for its Ukrainian operations.

Net interest income in Q3 20w4 remained flat relative to Q2 but compared to Q3 2013 it fell 4.3%. By geographic market, interest income grew 7% q/q in Romania, 1% in Russia, 2.4% in Bulgaria, and 7% in Serbia, while falling 10.6% in Ukraine. Fee as well was flat q/q and 4.5% lower y/y, and it fell slightly short of the consensus estimate of HUF 41.7bn. Loan-loss reserves not counting the new Ukraine charges increased 2.8% q/q but decreased 1.4% y/y. By region, provisioning was up 19% in Ukraine, 8% in Russia, and 15% in Romania, and down 23% in Bulgaria, 32% in Serbia, and 33% in Hungary. The NPL ratio increased to 21.8% in Q3 from 21.86 in Q2 2014 and 20.6% in Q3 2013. The ratio of reserves to NPL edged up to 84.8% from 84.1% in the

previous quarter. The Core Tier 1 rose to 14.5% in Q3 2014 from 14.2% in Q2 2014.

A regional profit breakdown shows quarter-on-quarter growth in Hungary (+8.7%), Bulgaria (+15.5%), Montenegro (which turned a Q2 net loss of HUF 0.02bn to a net profit of HUF 0.67bn), and Serbia (with HUF 0.04bn net profit vs. Q2 net loss of HUF 0.11bn). At the same time, Russia and Ukraine both posted respective net losses of HUF 5.72bn and HUF 10.86bn. The NPL ratio improved in Hungary (falling to 18.4% from 19.4% in Q2), almost completely making up for the increased NPL ratios reported in Russia (a rise from 23.1% to 25.2%) and Ukraine (up from 41.8% to 44.2%).

### Q3 conference highlights

**The Hungarian government's FX loan conversion program** will affect only mortgage loans. The exchange rates are expected to be EUR/HUF 309.0 and CHF/HUF 256.5, implying that the one-time losses incurred by the banks will not be too painful. The amount of the interest rate margin that Hungarian banks will be required to use in the future under the so-called "fair lending" bill is still unknown. OTP's Q3 loss in **Ukraine** amounted to HUF 37bn excluding charges related to Crimea and Eastern Ukraine. The annual loss is estimated at HUF 50bn.

**Russian** operations are expected to continue generating losses in Q4 2014 though the ruble's weakness relative to the HUF means the standalone loss will be lower than taken on a consolidated basis. The Russian business is undergoing restructuring and its future profitability is expected to be lower than in the past. The Ukraine and Russia losses are the main disappointments taken away from the Q3 conference.



## Insurance

PZU		Hold							
Analyst: Michał Konarski		Current price:		PLN 470.3				Last rating: 2013-11-06	
		Target price:		PLN 425					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Gross written premium:	16 243.1	16 480.0	0.0	17 712.4	0.1	18 438.4	0.0	Number of shares (m)	86.4
non-life insurance	8 789.2	8 274.0	-0.1	9 056.2	0.1	9 471.8	0.0	MC (current price, PLN/m)	40 611.5
life insurance	7 454.0	7 745.0	0.0	7 745.0	0.0	8 656.2	0.1	Free float	64.8%
Technical profit	19 916.4	18 726.2	-6.0%	20 052.8	7.1%	20 911.0	4.3%		
Pre-tax income	4 038.7	4 159.9	3.0%	3 428.2	-17.6%	3 457.9	0.9%		
Net income	3 255.2	3 295.0	1.2%	2 745.6	-16.7%	2 769.5	0.9%		
ROE	24.1%	25.1%		22.1%		21.8%		Price change: 1M	-3.6%
P/E	12.5	12.3		14.8		14.7		Price change: 6M	4.3%
P/BV	2.9	3.4		3.2		3.2		Price change: 12M	3.6%
DPS	22.4	29.7		58.6		31.8		Low (52 weeks)	409.0
Dyield (%)	4.8	6.3		12.5		6.8		High (52 weeks)	511.0

**We maintain a neutral rating on PZU whose shares fell 5% in November after rising 4.9% in October. Thanks to low bond yields, we expect sentiment to the insurer to remain robust through the third quarter as investors anticipate a strong investment income. In addition, the strategy update scheduled for a December release is designed to make PZU less dependent on the volatile investment income through greater focus on core income growth and development of healthcare services.**

### PZU posts in-line Q3 results

At PLN 843.5m, the Q3 2014 net profit of PZU showed a 12.1% drop from the second quarter and a 22.6% drop from Q3 2013, and it fell came in line with the PLN 847.0m consensus forecast and our PLN 830.0m estimate as higher claims were offset by strong investment income. Gross written premiums were consistent with market expectations. PZU achieved a whopping 81% of the PLN 3,155m annual consensus in the nine months through September, and we expect upward revisions to the analysts' expectations.

PZU saw 2.8% q/q contraction and a 1.6% y/y rise in gross written premiums in Q3 2014. Under the new segmentation of financial results, in 9M 2014, Poland Non-Life GWP amounted to PLN 6,155m (-1.3% y/y), and Poland Life GWP came in at PLN 5,846m (+0.2% y/y). Q3 net claims at PLN 2,994m were 8.7% higher than in Q2 and 8.8% higher than in Q3 last year, and they exceeded the PLN 2,852m consensus. Operating expenses decreased 8.9% year on year and they remained steady compared to Q2. Investment income totaled PLN 805m in Q3 (-2.1% q/q, -9.7% y/y), well over the market forecast of PLN 774.5m.

### PZU to expand in AM and private healthcare

PZU under a new growth strategy intends to focus on growing the asset management business and in investment in private healthcare services expected to provide opportunities to upsell insurance. Hospital acquisitions are not part of the plan. Last but not least, PZU wants to make sure that its recurring administrative costs do not grow faster than premiums. PZU's CEO had already talked in previous interviews about the planned investment portfolio remodeling and investment in healthcare.



## Financial Services

Kruk Buy								
Analyst: Michał Konarski		Current price: PLN 117		Target price: PLN 113.29		Last rating:		2014-06-06
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Income	343.0	405.6	18.3%	513.8	26.7%	579.7	12.8%	Number of shares (m) 17.0
Debt purchases	303.0	355.7	17.4%	465.7	30.9%	529.7	13.7%	MC (current price, PLN/m) 1 984.2
Collection	32.9	39.9	21.4%	36.4	-8.8%	36.9	1.3%	Free float 87.0%
Indirect margin	194.1	222.9	14.8%	286.0	28.3%	318.0	11.2%	
Pre-tax income	85.1	98.5	15.7%	144.9	47.1%	162.6	12.2%	
Net income	81.2	97.8	20.4%	140.6	43.8%	152.8	8.7%	
ROE	29.2%	26.7%		28.9%		24.1%		Price change: 1M 5.3%
P/E	24.4	20.3		14.1		13.0		Price change: 6M 22.5%
P/BV	6.2	4.8		3.6		2.8		Price change: 12M 32.4%
DPS	0.0	0.0		0.0		0.0		Low (52 weeks) 77.2
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks) 119.0

**We maintain a buy rating for Kruk which continues its reign over the Polish and Romanian debt management markets and whose future growth prospects are confirmed by the recent foray into home loan management and plans to enter Germany. We expect Kruk to grow net earnings in the next three years at a much faster pace than its competition as well as faster than Polish banks. What is more, the financial results reported for 9M 2014 could prompt upward revisions to analysts' expectations for the year.**

#### Kruk posts weaker-than-expected Q3

At PLN 29.5m, the Q3 2013 net profit of Kruk showed 56.7% shrinkage from the second quarter and an 11.6% drop from Q3 2013, and it fell short of PLN 18m consensus and our PLN 30m forecast. Adjusted for an PLN 18.7m gain from the sale in Q2 of a debt portfolio the q/q drop amounts to 37%. Adjusted revenue in Q3 disappointed by falling 27.7% q/q

and 16.9% y/y, led mainly by the segment of purchased debt (-30.0% q/q, -18.4% y/y). Revenue from debt collection as well showed a q/q drop of 7.9%. Direct and indirect costs edged up just 1.1% q/q. The Q3 bottom line was affected by a revaluation loss of PLN 13.2m on purchased debt portfolios (vs. a gain of PLN 12.4m recognized in Q2). Kruk spent PLN 42m on debt portfolios in Q3, adding to 9M 2014 expenditures of PLN 355m. The nominal value of the portfolios purchased in Q3 was PLN 519m. Despite the weak Q3, Kruk is on track to beating the annual consensus estimate at PLN 137m after generating a net profit of PLN 126m in the first nine months.

#### Kruk buys mortgage debt

Kruk purchased a PLN 443m mortgage portfolio in November, the second this year after a first-quarter purchase of a PLN 710m portfolio for PLN 230m.

## Gas & Oil, Chemicals

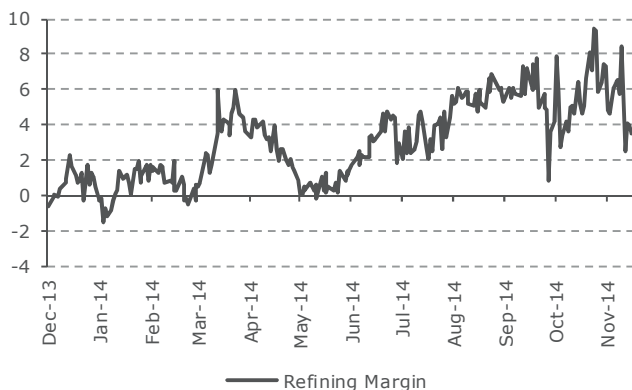
### Refining margins widen again in November

Refining margins increased from under \$5 to \$6.4/Bbl in November as crude oil prices plummeted and demand strengthened, especially in South America which helped to relieve the oversupply in the Atlantic Basin. Hovering around the top end of the five-year range, margins this year are not following the usual seasonal patterns. The Urals-Brent pricing spread after dropping below \$1/Bbl toward the end of October remained low throughout November due to reduced supply of Russian oil via Baltic ports, but at the beginning of December it rebounded to \$1.2/Bbl. In petrochemicals, margins on olefins and polyolefins remained high throughout October and November as manufacturers stopped inventory draws. When it comes to biodiesel costs, the crude price slump has put a squeeze on the biofuel margins of refiners, though the decline stopped at the average level seen in the first half of the year. Polish margins on retail fuel improved by about 8 groszy a liter in November compared to Q3 thanks to high sales volumes combined with lower sales prices.

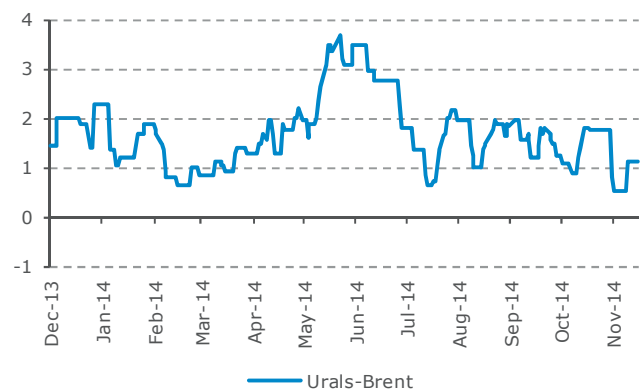
### US crude inventory builds, OPEC keeps production target unchanged

The US crude oil inventory increased by 2.8mmbbl (0.7%) in November on rising local production (+1.2% m/m) not offset by seasonally higher refinery usage. With refinery CUR up at 90.9% vs. 87.8% in October, the gasoline inventory as well increased by 4.6mmbbl (+2.3% m/m), though it still remains 2% below the five-year average thanks to a 2.7% m/m surge in demand. Distillate stocks in November posted 6.5mmbbl (5%) draws driven by high domestic demand (+10% m/m) and higher exports. The main development affecting the oil market in November was the OPEC's decision to keep production targets unchanged, resulting in a persistent oversupply going forward. In our view, production cutbacks on the part of producers with higher profitability thresholds (alternative energy, deep sea drilling) will progress at a slow rate, especially since the falling crude prices are dealing a harder blow on the profitability of new projects than they are on existing drilling.

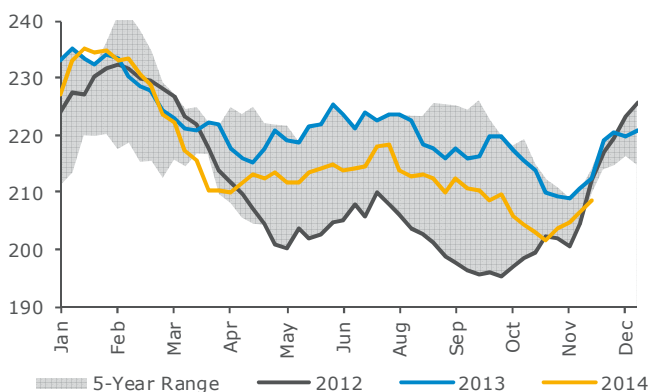
Refining Margin (USD/Bbl)



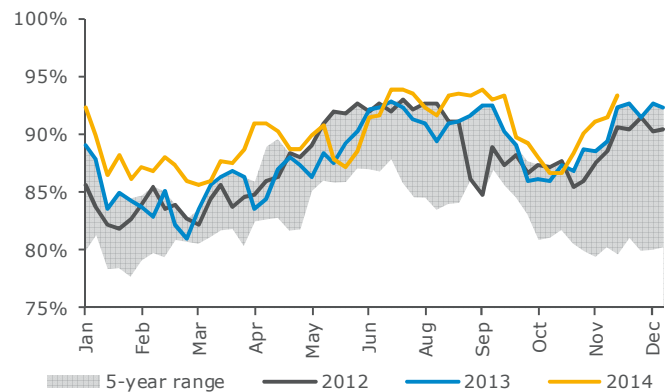
Urals-Brent Price Spread (USD/Bbl)



US Gasoline Inventory



US Refinery Capacity Utilization



Source: Bloomberg, Reuters, Dom Maklerski mBanku

Ciech		Hold						
Analyst: Kamil Kliszcz		Current price:		PLN 46.39		Last rating		2014-09-29
		Target price:		PLN 41.6				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	4 378.0	3 501.0	-20.0%	3 137.7	-10.4%	3 090.0	-1.5%	Number of shares (m) 52.7
EBITDA	38.5	356.3	826.6%	497.0	39.5%	534.8	7.6%	MC (current price, PLNm) 2 444.7
EBITDA margin	0.9%	10.2%		15.8%		17.3%		EV (current price, PLNm) 3 696.7
EBIT	-198.2	139.7		296.6	112.3%	324.1	9.2%	Free float
Net profit	-430.6	49.4		90.0	81.9%	142.7	58.6%	
P/E		49.4		27.2		17.1		Price change: 1M 9.8%
P/CE		9.2		8.4		6.9		Price change: 6M 46.0%
P/BV	2.8	2.7		2.6		2.3		Price change: 12M 51.7%
EV/EBITDA	95.1	10.2		7.4		7.0		Low (52 weeks) 29.9
Dyield (%)	0.0	0.0		2.4		0.0		High (52 weeks) 46.4

**Ciech shares gained 10% in November on strong Q3 results and an ambitious five-year growth strategy which in our view did not contain any premise that would prompt upward revisions to the earnings estimates for this year or next. Ciech is set for hikes in the costs of gas in Q4 following an upturn in German market prices, moreover, the high industry expectations observed in H1 2014 of potential for hikes in next year's prices of soda ash have cooled by now. Further, the strong results generated this year on sales of pesticides are not likely to make noticeable contributions to the consolidated EBITDA yet in the periods ahead. Finally, Ciech's cash flow performance in the coming quarters is set to deteriorate following payment of overdue dividends, a silent partner buyout, and an increase in CAPEX. We maintain a hold rating for CIE for now while noting that any further price increases in the weeks ahead should be taken as an opportunity to take profits.**

#### Ciech announces updated strategy

Ciech's updated growth strategy for 2014-2019 assumes revenue growth in the Soda Division, a doubling of the market share in Polish pesticides, and increasing EBITDA and equity value. Ciech puts the average annual revenue target at PLN 3.8bn (vs. our estimate of PLN 3.25bn and expected 2014 revenue of PLN 3.1bn), and pegs adjusted EBITDA at PLN 660m (vs. PLN 550m expected by us and PLN 497m anticipated this year), with margin at 17%. Other strategic goals include average annual dividend yield of 3% and net debt/EBITDA below 1.90 by 2019 (vs. our 1.6x projection for the year). Summing up, Ciech has set quite ambitious

objectives for itself, including the doubling of pesticide sales in Poland, and we assume its earnings targets factor in the upside in prices of soda ash. We would take the new strategy with a grain of salt looking at the increasingly high earnings projections made for the harder-to-predict latter years of the forecast period.

#### Q3 EBIT tops expectations

Ciech's reported Q4 2014 EBIT exceeded came 11% ahead of our forecast and the core EBIT beat expectations by an even wider margin after adjustment for PLN 20m other operating losses including a ca. PLN 10m litigation allowance and a PLN 6m property impairment loss. On the other hand, the German unit posted a one-time gas bonus of ca. EUR 3m. Adjusted for this bonus, the Soda Division exceeded expectations in Q3 with EBIT about PLN 8m higher than anticipated owed to lower costs (as predicted, revenue was affected by plant downtime which resulted in lower output). In the Organic Division, core EBIT also came PLN 8m ahead of expectations thanks to higher sales of pesticides (owed to the launch of a new agent into the sales mix). The losses incurred in Q3 2014 on financing activity were PLN 10m higher than anticipated at PLN 38m due to higher FX losses combined loan-interest write-off. Combined with a higher-than-expected effective tax rate (30%), this caused the bottom-line profit to miss our forecast. Ciech generated operating cash flow of PLN 55m in Q3 2014 and after PLN 63m CAPEX and interest payments net debt at 30 September was PLN 37m higher than at 30 June at PLN 1.1bn. Summing up, the Q3 results were an upside surprise which, however, did not affect our full-year EBITDA forecast.

Lotos		Hold						
Analyst: Kamil Kliszc		Current price:		PLN 26.9		Last rating		2014-03-26
		Target price:		PLN 38.6				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	33 111.0	28 597.3	-13.6%	31 273.0	9.4%	31 682.2	1.3%	Number of shares (m)
EBITDA	979.2	802.6	-18.0%	1 846.0	130.0%	1 919.2	4.0%	MC (current price, PLNm)
EBITDA margin	3.0%	2.8%		5.9%		6.1%		EV (current price, PLNm)
EBIT	312.8	146.5	-53.2%	1 152.8	686.9%	1 204.9	4.5%	Free float
Net profit	927.8	39.4	-95.8%	582.6	1378.2%	623.7	7.0%	
P/E	3.8	88.6		6.0		5.6		Price change: 1M
P/CE	2.2	5.0		2.7		2.6		Price change: 6M
P/BV	0.4	0.4		0.4		0.3		Price change: 12M
EV/EBITDA	10.0	11.5		5.1		4.6		Low (52 weeks)
Dyid (%)	0.0	0.0		0.0		3.3		High (52 weeks)

Lotos shares took a nosedive following a share issue and weak Q3 results even as refining market fundamentals remained strong. At the same time, falling crude prices have lowered the value of the Company's E&P assets and the NPV of the B8 project. Given the dilution expected to occur in the wake of the planned share issue (55 million shares expected to raise PLN 1 billion), Lotos's 2015E EV/EBITDA does not look very attractive even after the price decline, and we continue to view rival PKN Orlen as the best pick in the oil sector right now. We are working on an update to our valuation of Lotos and in the mean time we maintain a hold rating for the stock.

### Lotos issues shares

Lotos issued 55 million shares at 18.1 apiece in November, raising PLN 995m in fresh cash. Existing shareholders had from 20 to 28 November to exercise pre-emption rights. Lotos promised to present a growth strategy through 2020 in mid-2015 specifying raised 2P and production targets (at 100mboe/d in 2020 vs. 24mboe/d planned by the end of 2015). 2015-2016 CAPEX is projected at PLN 2bn on average per year. Lotos has no plans to pay dividends in the foreseeable future.

MOL		Buy										
Analyst: Kamil Kliszcz		Current price:		PLN 163.5				Last rating		2014-03-07		
		Target price:		PLN 211.9								
(HUF bn)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	5 521.3	5 401.1	-2.2%	5 723.0	6.0%	5 995.5	4.8%	Number of shares (m)		104.5		
EBITDA	524.9	520.4	-0.9%	568.2	9.2%	679.2	19.5%	MC (current price, PLNm)		17 088.9		
EBITDA margin	9.5%	9.6%		9.9%		11.3%		EV (current price, PLNm)		30 059.9		
EBIT	205.3	-18.7		236.8		300.0	26.7%	Free float		31.3%		
Net profit	151.5	27.1	-82.1%	149.0	449.9%	195.7	31.4%					
P/E	8.3	46.6		8.5		6.4		Price change: 1M		2.8%		
P/CE	2.7	2.2		2.6		2.2		Price change: 6M		-6.1%		
P/BV	0.7	0.7		0.7		0.7		Price change: 12M		-18.9%		
EV/EBITDA	4.9	4.1		3.9		3.2		Low (52 weeks)		149.0		
Dyid (%)	2.9	3.1		3.1		4.8		High (52 weeks)		206.8		

The negative effects that falling crude prices are having on sentiment around oil producers in case of MOL should be partly offset by persistently favorable macro conditions. Going forward, we also expect good news pertaining to Kurdistan production and a reversal of the negative volume trends in Hungary and Croatia. Moreover, as MOL slowly works out the issues over INA with the Croatian government, it has been able to take measures aimed at divestment of the Croatian unit, with positive effects on sentiment. We are working on an update to our valuation and earnings forecasts for MOL to reflect the changed market conditions.

### MOL beats out analysts' expectations in Q3

MOL's adjusted LIFO-based EBITDA came in at HUF 163.9bn in Q3 2014, well ahead of our HUF 133bn estimate and a HUF 136bn consensus estimate. The main driver behind the upside surprise was Downstream where LIFO-based EBITDA including petrochemicals totaled HUF 80.8bn vs. HUF 67bn projected by us (the petrochemicals EBITDA itself exceeded expectations by some HUF 3bn). LIFO charges including FX effects were HUF -13.1bn vs. HUF -14.7bn anticipated. It seems that MOL took full advantage of the favorable macro conditions observed in the third quarter. The quarterly results were not influenced by any major one-offs. In Upstream, adjusted EBITDA amounted to HUF 66.2bn (we expected HUF 63bn) while production was more or less in line with expectations. The reported EBITDA was boosted by a HUF 6.4bn charge reversals. MOL expects crude oil production to increase by 10% next year to 105-110 kboe/d (our projection is 109 kboe/d), and it anticipates adjustments to the reserves found in Kurdistan and Kazakhstan. In Gas Midstream, EBITDA in Q3 2014 missed our HUF 14.3bn estimate at HUF 11.9bn due to unfavorable adjustments to tariff prices. MOL's consolidated EBITDA for the quarter was supported slightly lower SG&A expenses and intercompany elimination gains. After higher-than-expected financing losses (HUF 35bn vs HUF 8bn), driven mainly by FX effects, and a higher-than-expected tax levied on strong profits in Hungary, net profit came in at HUF 28.5bn. MOL generated operating cash flow of HUF 141bn and incurred CAPEX of HUF 95bn in Q3.

### CFO on INA and crude prices

CFO Jozsef Simola said MOL had no intention of shelving the project in Kurdistan even as prices of crude continue to fall. The Hungarian refiner may take advantage of the low prices to acquire new E&P projects. As a refiner, MOL actually benefits from low prices of crude inputs. Mr. Simola believes in a favorable resolution of the negotiations with the Croatian government regarding INA, but if a compromise proves impossible MOL will sell its interests in the Croatian utility (according to rumors the Company may have already been approached by Klesch, a multinational organization whose business includes oil refining, chemicals, and steel commodities. The mere mention of a potential INA divestment can provide upside to MOL's performance today.

### MOL, MVM bid on Slovenske Elektrarne

MOL jointly with the Hungarian state-owned utility MVM submitted a bid on a 66% stake in the Slovak utility Slovenske Elektrarne. The bid confirms the speculation about MOL's interest in Slovenske Elektrarne. We expect that MOL's role in the partnership is that of financing provider, and this is hardly desirable though on the upside we believe the Hungarians' chances of winning the bid are slim.

### MOL demands dividend from INA

MOL submitted a motion with the Management Board of its Croatian unit INA requesting a General Meeting to vote on a special distribution to shareholders out of HRK 2bn (EUR 260m) retained earnings. The push for dividends looks to us like yet another bargaining tactic in MOL's negotiations with the Croatian government. MOL has a 49.08% stake in INA and the Croatian government holds 44.84%, which means the dividend motion will not necessarily be dismissed. A Croatian government official said yesterday that such a special distribution would weaken INA's investment capacity. With net debt at 30 September at HRK 4bn, the net debt/EBITDA ratio of 1.3x would double to 2.6x after the payout requested by MOL. INA has credit facilities available to make such a distribution.

PGNiG		Reduce										
Analyst: Kamil Kliszcz		Current price:		PLN 4.79				Last rating		2014-11-28		
		Target price:		PLN 4.6								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	28 730.0	32 120.0	11.8%	31 566.5	-1.7%	31 686.3	0.4%	Number of shares (m)		5 900.0		
EBITDA	4 609.0	5 612.0	21.8%	6 008.4	7.1%	6 356.2	5.8%	MC (current price, PLNm)		28 261.0		
EBITDA margin	16.0%	17.5%		19.0%		20.1%		EV (current price, PLNm)		31 968.7		
EBIT	2 540.0	3 149.0	24.0%	3 458.7	9.8%	3 811.3	10.2%	Free float		27.6%		
Net profit	2 242.0	1 918.0	-14.5%	2 492.0	29.9%	2 753.7	10.5%					
P/E	12.6	14.7		11.3		10.3		Price change: 1M		-3.0%		
P/CE	6.6	6.5		5.6		5.3		Price change: 6M		-5.0%		
P/BV	1.0	1.0		0.9		0.9		Price change: 12M		-15.2%		
EV/EBITDA	7.9	5.9		5.3		5.0		Low (52 weeks)		4.2		
Dyield (%)	0.0	2.7		3.1		4.0		High (52 weeks)		5.8		

Compared to European energy producers whose E&P operations have a major share in EBITDA, PGNiG's performance year to date has been surprisingly strong, ignoring the downturn in oil prices observed for the last few months. We do not see a good reason for such outperformance and we consider completely false the belief which has been gaining traction lately among traders that PGNiG is naturally hedged against crude price movements through its trade business. In fact, we expect that the Company's sensitivity to energy prices will become apparent as soon as in Q4, providing an argument for further adjustments to the trading multiples to reflect the mounting business risks, converging closer and closer to multiples typical of upstream companies. Some upside to PGN shares may be triggered before the end of the year by the publication of an updated growth strategy, though when it comes to dividends we would not expect major changes relative to the existing policy. We maintain a negative rating for PGN despite the recent price decline to reflect the fact that, assuming our 2015 projection for average Brent price at \$85/Bbl comes true, we will have to make downward revisions to the financial forecasts for the year.

### Distribution beats expectations in Q3 despite volume contraction

The Q3 2014 results of PGNiG came in line with consensus expectations and well ahead of our estimates thanks to the strong performance of Distribution where EBIT came in at PLN 156m rather than showing an operating loss of PLN 65m as assumed by us. Note that the discrepancy stems from a postponement to Q4 of the recognition of bonus allowances (estimated at PLN 60m) combined with a positive effect of system balancing to the tune of PLN 58m. We had assumed that a 10% drop in distribution volumes after a warm September the system balancing effects would be negative and transmission costs would be inflated by the formula used in settlements with Gaz-System based on average historical

usage. With October and November temperatures still high for this time of the year, the balancing effects in Q4 may be a source of downside surprise. Analyzed by operating segment, the Q3 2014 Upstream EBIT amounted to PLN 717m, coming in line with our PLN 716m estimate despite the lack this time of dry well charges which we had projected at PLN 50m. Trade & Storage EBIT came in at PLN 86m vs. PLN 125m anticipated. PGNiG reversed a PLN 141m inventory charge recognized earlier in Q3 (we had assumed higher reversals at PLN 170m) but this was offset by PLN 200m hedging losses. The Heat segment generated a lower-than-expected EBIT loss in Q3 (PLN 47m vs. PLN 60m) thanks among others to lower D&A. PGNiG incurred financing costs of PLN 120m in Q3 (less than our PLN 145m forecast). Operating cash flow for the period totaled PLN 721m, and after PLN 660m CAPEX and dividends net debt at 30 September showed an increase to PLN 3.4bn.

### Gazprom agrees to pay for disrupted gas supplies

PGNiG confirmed that it had received a compensation from Gazprom for reduced deliveries of natural gas experienced in recent weeks. The Polish gas utility also wants to renegotiate the terms of the Yamal gas contract. PGNiG will recognize what we expect to be small Gazprom compensation in Q4. As for price negotiations with the Russian supplier, they are not likely to generate a satisfying outcome, and they will most likely end up in an arbitration court.

### PGNiG launches power plant project

PGNiG's subsidiary PGNiG Termika is set to announce a call for bids by the end of November to build a gas-and-steam power plant in its power station in Żerań with 420-490 MWe power capacity and 250 MWt heat capacity. The utility is hoping to sign the contract with the builder by mid-2016. Given the timing, it looks like the Żerań plant will be brought on line in 2019 at the earliest rather than in 2018 as we had assumed.

PKN Orlen		Accumulate										
Analyst: Kamil Kliszcz		Current price:		PLN 48.03				Last rating		2014-12-05		
		Target price:		PLN 49.1								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	120 101.6	113 853.0	-5.2%	108 734.3	-4.5%	115 410.0	6.1%	Number of shares (m)		427.7		
EBITDA	4 284.5	2 503.0	-41.6%	-1 185.0		5 084.3		MC (current price, PLNm)		20 542.9		
EBITDA margin	3.6%	2.2%		-1.1%		4.4%		EV (current price, PLNm)		30 546.9		
EBIT	2 024.4	333.0	-83.6%	-3 269.3		3 144.8		Free float		72.5%		
Net profit	2 344.8	176.0	-92.5%	-3 462.5		2 290.6						
P/E	8.8	116.7				9.0		Price change: 1M		13.3%		
P/CE	4.5	8.8				4.9		Price change: 6M		11.9%		
P/BV	0.8	0.8		0.9		0.9		Price change: 12M		5.7%		
EV/EBITDA	6.8	11.7				5.9		Low (52 weeks)		36.9		
Dyild (%)	0.0	3.1		3.0		3.5		High (52 weeks)		48.0		

**PKN shares in November finally responded to the favorable market fundamentals observed for the last few months and to strong 3Q results. Since then, refining margins have widened even more on falling prices of crude oil which make for lower input costs and higher crack spreads on heavy products that are not indexed to oil prices (asphalts, base oils). Moreover, the Orlen fuel stations have been generating higher sales volumes and margins. In Petrochemicals, cheaper naphtha has reinforced PKN's competitive edge relative to ethane-based installations. All told, PKN is more than likely to deliver a positive earnings surprise in the fourth quarter, including in terms of cash flow which determines the size of next year's dividend. We are downgrading PKN to accumulate to reflect the recent price increase, but our next research update will most likely include upward forecast revisions.**

### **Supervisory Board approves power plant project**

PKN Orlen's Supervisory Board approved the construction of a 600 MWe power plant in Płock. The cost of the plant, which is scheduled for a launch at the end of 2017, is estimated at PLN 1.65bn. As well as electrical power, the plant will also supply industrial steam to the Płock refinery. The power plant project is accounted for in our financial forecasts for PKN.

### **PKN implements new work schedule at Płock refinery**

PKN Orlen is preparing to implement a new work schedule at the refinery in Płock to reduce shift overlaps and help streamline the workforce. PKN has identified 184 excess FTEs at the refinery and under the new shift system it expects to reduce the headcount by 600 people resulting in annual savings of PLN 20m to PLN 60m.



Polwax		Buy						
Analyst: Kamil Kliszcz		Current price:		PLN 16.75		Last rating		2014-11-06
		Target price:		PLN 24.2				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	260.5	241.1	-7.4%	252.9	4.9%	257.2	1.7%	Number of shares (m)
EBITDA	30.2	27.5	-8.8%	30.0	8.9%	32.7	9.0%	MC (current price, PLNm)
EBITDA margin	11.6%	11.4%		11.9%		12.7%		EV (current price, PLNm)
EBIT	27.2	24.9	-8.7%	27.3	10.0%	29.9	9.4%	Free float
Net profit	19.4	20.0	2.9%	21.5	7.6%	23.6	9.7%	
P/E	8.6	8.4		7.8		7.3		Price change: 1M
P/CE	7.5	7.4		6.9		6.5		Price change: 6M
P/BV	4.5	3.2		2.6		2.2		Price change: 12M
EV/EBITDA	7.3	8.4		7.3		6.5		Low (52 weeks)
Dyield (%)	0.0	2.4		6.0		6.3		High (52 weeks)

**Polwax is one of the two leading producers of paraffin waxes in Poland with a market share in the European market estimated at 5%. Polwax products are used primarily in the candle business (80% of total sales), but the sales mix also includes specialized waxes and industrial paraffins. Polwax's Management have been working on reducing costs and increasing the profitability of the sales mix including through a very capable R&D team which works closely together with customers as well as external academic institutions in developing the best products. Polwax's earnings are characterized by stability (facilitated by a mature candle market, secure deliveries of raw materials, and long-term relationships with customers) and low sensitivity to economic fluctuations (thanks to stable prices of materials and products) which shape the dividend policy. We maintain a buy rating for PWX which is highly likely to exceed our earnings forecasts this year.**

### Polwax posts excellent 3Q results

Polwax generated core EBITDA of PLN 11.2m in Q3 2014, marking y/y growth of 38%, on revenue of PLN 80m (+18%

y/y). We attribute the strong growth relative to Q3 2013 to higher exports of industrial waxes and anti-corrosion agents with export volumes soaring 37% and export revenue up 50% or PLN 4.5m. Polwax is aiming to increase the share of high-margin products in total sales. The gross profit margin in Q3 showed y/y expansion from 19.2% to 20% despite PLN 7.1m higher sales to the Biedronka discount chain at below-average margins. Polwax incurred financing losses of PLN 0.3m in Q3 after a PLN 0.6m gain on FX operations. After a 23% effective tax rate the net quarterly profit showed an increase of 39% relative to Q3 2013. Operating cash flow was negative in Q3 at PLN -13m vs. PLN -9.8m a year ago rising on higher receivables. After CAPEX of PLN 0.4m net debt as of 30 September was PLN 51.7m vs. PLN 52.4m in Q3 2013. With PLN 4.1m spent year to date, the 2014 full-year CAPEX will probably be over PLN 1m lower than we originally assumed. With the help of factoring, working capital in 2014 will show improvement relative to 2013. Polwax achieved 75% of our annual net profit estimate in 9M 2014 and given seasonal patterns it is well on track to exceeding expectations this year.

## Power Utilities

### Polish electricity usage dips in October

Electricity usage in Poland was 0.05% lower in October 2014 than in the same month in 2013 due to higher temperatures. At the same time, the monthly power output was down 4.5%, led again by an 0.6 TWh increase in cross-border imports. Production by lignite-fired power plants logged the strongest, 8% drop from October 2013 due to scheduled and unplanned downtime. Hard coal-fired plants reduced production by 4% while gas-fired plants generated a higher output supported by the resumption of subsidies. Wind farms posted a 19% drop in power output relative to October 2013 due to worse wind conditions, while hydroelectric dams generated an output similar to the year-ago level resulting from slower capacity additions. Total installed wind capacity at 30 September was 3.65 GW, which compares to an end-of-year projection by the Polish TSO of 4 GW vs. 3.37 GW in December 2013.

### Government opposes introduction of price caps on household electricity

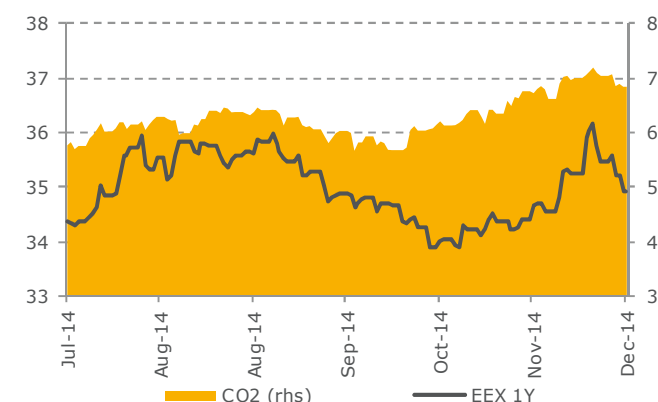
The Polish Economy Ministry rejected a proposal by the energy regulator URE to introduce price caps on electricity sold to household customers as a way of boosting competition. The rejection does not affect utilities in our view as it is hard to imagine that such a price cap could be much higher than the current tariff price. What will affect utility earnings next year is the new price tariff which is pending approval by the URE. In the current political climate, we

expect further tightening of the household tariff in 2015 led by higher wholesale prices and the requirement to redeem red and yellow certificates.

### 2015 electricity price outlook

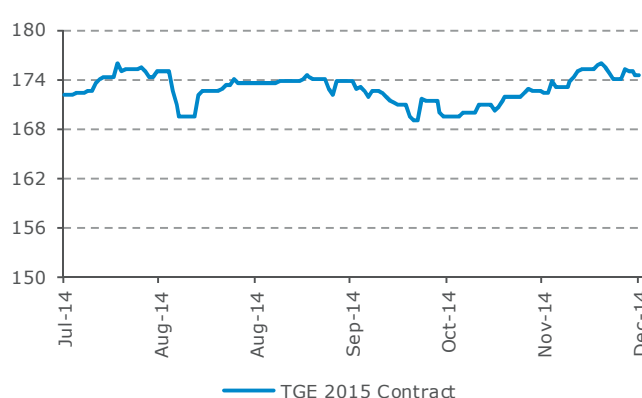
German electricity prices in November rebounded from their local lows, at times reaching EUR 36/MWh, driven by reports about possible coal-fired capacity closures led by a need to achieve reduced emissions targets. Though later denied, these reports triggered a rally on the prices of natural gas and electricity, with additional support provided by favorable trends in emission allowances reflecting changes in the schedule for the introduction of a market stabilization reserve. In Poland, one-year forward TGE contracts ended November at PLN 175/MWh, remaining PLN 26/MWh on average higher than the German contracts. The ytd TGE trading volume is 102 TWh (vs. 94 TWh in Y+1 contracts), and the average weighted price is PLN 167.6/MWh. As for the spot market, fueled by continuing tension, the base-peak premium remained high in November (at PLN 58/MWh qtd vs. PLN 38 in Q3 and PLN 22 in Q4 2013), as a result of reduced availability of capacity in the wake of unplanned shutdowns. Finally, prices of green certificates closed at PLN 160/MWh in November vs. PLN 172/MWh the month before, falling on uncertainty about new renewable energy regulations and the possible delay in the stalling of supply of certificates of origin.

### Electricity (EUR/MWh) v. Carbon Allowances (EUR/t)



Source: Bloomberg, Dom Maklerski mBanku

### Poland 2015 Electricity Contracts (PLN/MWh)



CEZ										Reduce	
Analyst: Kamil Kliszcz			Current price:		PLN 92.75			Last rating		2014-10-31	
			Target price:		PLN 83.6						
(CZK m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	215 095.0	217 273.0	1.0%	204 272.8	-6.0%	210 528.1	3.1%	Number of shares (m)		538.0	
EBITDA	84 779.0	73 699.0	-13.1%	71 283.1	-3.3%	65 492.2	-8.1%	MC (current price, PLNm)		49 898.6	
EBITDA margin	39.4%	33.9%		34.9%		31.1%		EV (current price, PLNm)		77 214.2	
EBIT	57 083.0	45 755.0	-19.8%	43 236.6	-5.5%	36 951.4	-14.5%	Free float		29.5%	
Net profit	41 429.0	35 885.0	-13.4%	29 889.7	-16.7%	25 153.7	-15.8%				
P/E	8.0	9.2		11.1		13.2		Price change: 1M		1.8%	
P/CE	4.8	5.2		5.7		6.2		Price change: 6M		4.1%	
P/BV	1.3	1.3		1.2		1.2		Price change: 12M		13.9%	
EV/EBITDA	6.0	6.9		7.2		7.7		Low (52 weeks)		74.5	
Dyield (%)	7.3	6.5		6.5		5.4		High (52 weeks)		100.6	

**CEZ's performance in November was boosted by an upturn in the prices of carbon emissions and German power, and the resulting gain of 4% while Polish peers PGE and Energa saw their shares fall brought the Czech stock's ytd performance in line with the WIG-Energy benchmark. Going forward, however, sentiment to the stock is set to weaken as carbon prices have taken a downward shift led by an unmoved deadline for the implementation of a market stabilization reserve in the EU. What is more, we must note that CEZ compares unfavorably with its Polish peers when it comes to the earnings and dividend outlook for the coming years. What is more, investors seem to be completely ignoring the Czech utility's nuclear power ambitions and M&A plans. As coal prices remain low, we do not see any fundamental drivers for vertically integrated energy producers. We stand by our negative rating for CEZ.**

### Q3 results depressed by one-offs

CEZ posted disappointing profits in Q3 as a result of huge asset impairment losses totaling CZK 3.2bn. Even adjusted for these losses, however, the quarterly EBIT was still CZK 1.9bn short of our estimate. In the Generation segment, adjusted EBIT came in at CZK 2.3bn vs. CZK 4.8bn anticipated on lower volumes (-1.1 TWh y/y) and losses on forward power contracts and emission allowances. Adjusted Distribution EBIT was in line at CZK 4bn. In Mining, EBIT exceeded our estimate by CZK 0.3bn. CEZ incurred losses of

CZK 1.8bn on financing activity in Q3 (we expected CZK 1.2bn) on higher FX losses posted by Turkish subsidiaries. Operating cash flow was positive at CZK 22bn but after dividends net debt increased slightly to CZK 161bn at 30 September. CEZ has raised its 2014 annual EBITDA guidance from CZK 70.5bn to CZK 72bn to reflect an over-CZK 2bn settlement with Albania expected to come in in Q4 (note that the guidance is based on asset impairment equivalent to D&A). Moreover, the Company is planning a cost-cutting program expected to reduce the negative impact of the downturn in power prices expected in 2015-2016. The resulting 2015 savings are estimated at CZK 4.6bn.

### CEZ bids on Slovenske Elektrarne

CEZ submitted a preliminary bid on a 66% stake in Slovenske Elektrarne. As a reminder, Slovenske Elektrarne is a subsidiary of Enel with 5 GW total capacity including 1.9 GW of nuclear power, 1.4 GW of coal-fired power, and 1.6 GW of hydroelectric power. In 2013, it generated EBITDA of EUR 710m and net profit of EUR 356m, implying that its value is roughly in the ballpark of EUR 3.0-3.5bn (with the worth of the 66% stake at EUR 2.0-2.3bn). A closer look at the Slovak utility reveals a high level of reserves for nuclear plant closures and neutralization and an ongoing expansion of the nuclear plant in Mochovce (expenditures incurred to date vs. budget and timing risks). CEZ's bid on SE is in line with expectations.

Enea		Hold										
Analyst: Kamil Kliszcz		Current price:		PLN 17				Last rating		2014-12-05		
		Target price:		PLN 17.2								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	10 091.4	9 150.5	-9.3%	9 404.3	2.8%	9 611.5	2.2%	Number of shares (m)		441.4		
EBITDA	1 574.6	1 658.8	5.3%	1 846.1	11.3%	1 772.5	-4.0%	MC (current price, PLNm)		7 504.5		
EBITDA margin	15.6%	18.1%		19.6%		18.4%		EV (current price, PLNm)		8 864.8		
EBIT	824.9	897.0	8.7%	1 184.7	32.1%	1 075.8	-9.2%	Free float		48.5%		
Net profit	699.7	715.4	2.2%	909.7	27.2%	762.0	-16.2%					
P/E	10.7	10.5		8.2		9.8		Price change: 1M		5.1%		
P/CE	5.2	5.1		4.8		5.1		Price change: 6M		5.6%		
P/BV	0.7	0.7		0.6		0.6		Price change: 12M		7.6%		
EV/EBITDA	3.9	3.9		4.8		5.9		Low (52 weeks)		12.5		
Dyield (%)	2.8	2.1		3.4		3.0		High (52 weeks)		18.1		

**After a strong third quarter boosted by noticeable effects of cost restructuring, Enea shares outperformed the WIG-Energy index in November, prompting a rating downgrade to hold after the resulting price increase. We do not see any upside in ENA stock in the coming month as more marked results of the ongoing cost streamlining will take several months to materialize in full and given that the low coal prices and the expected improvement in generation margins are already priced into our 2015 earnings forecast for the Company. At the same time, any big wind farm acquisitions can create downside risk as the uncertainty as to future renewable energy subsidies in Poland persists. What we think investors should not worry about, in turn, is that Enea will be forced to get involved in bailing out the ailing coal industry.**

### Enea delivers upside surprise in Q3

Enea's financial results for Q3 2014 exceeded our expectations and consensus estimates without any help from one-time events. Relative to our forecast, EBIT came in

PLN 40m ahead despite PLN 10m higher D&A expenses. By operating segment, Distribution posted an upside surprise with EBIT at PLN 180m vs. PLN 166m anticipated thanks to lower payroll costs combined with higher distribution volumes. Generation EBIT as well far exceeded our PLN 28m forecast at PLN 44m despite PLN 7m higher D&A on higher power output combined with tighter cost control and a PLN 10m one-time gain provided by wind farms. In turn, Trade EBIT fell short of our PLN 15m estimate at just PLN 5m, due probably to increased costs of customer acquisition (as the quarterly sales volume was 0.4 TWh higher than assumed). General expenses (+PLN 9m) looked better as well shaped by the ongoing savings program. After in-line financing activity and a low effective tax rate of 16%, Enea's Q3 2014 net profit beat our estimate by an impressive 26%. Enea generated operating cash flow of PLN 323m in Q3 but after CAPEX of PLN 536m, dividends, and a PLN 260m heat utility acquisition, net debt as of 30 September amounted to PLN 401m.

## Energa

Hold

Analyst: Kamil Kliszcz		Current price:		PLN 23.99				Last rating	2014-10-31
		Target price:		PLN 23.6					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	11 176.8	11 429.2	2.3%	10 234.5	-10.5%	10 648.2	4.0%	Number of shares (m)	414.1
EBITDA	1 629.2	1 965.5	20.6%	2 307.9	17.4%	2 357.7	2.2%	MC (current price, PLNm)	9 933.5
EBITDA margin	14.6%	17.2%		22.6%		22.1%		EV (current price, PLNm)	13 336.9
EBIT	906.0	1 194.8	31.9%	1 461.0	22.3%	1 447.8	-0.9%	Free float	50.0%
Net profit	457.0	764.0	67.2%	982.5	28.6%	918.1	-6.6%		
P/E	21.7	13.0		10.1		10.8		Price change: 1M	-3.2%
P/CE	8.4	6.5		5.4		5.4		Price change: 6M	20.0%
P/BV	1.3	1.2		1.2		1.1		Price change: 12M	41.1%
EV/EBITDA	7.0	6.5		5.8		6.0		Low (52 weeks)	15.8
Dyield (%)	6.6	5.0		4.2		5.0		High (52 weeks)	25.1

**Slightly weaker-than-expected Q3 results may have been a trigger for profit taking by investors in November (YTD +60%). At the current level, ENG valuation does not reflect any of the risk exposure faced by the Company, neither regulatory risk (possible WACC reduction, mark-to-market adjustments in distribution) nor political risk (energy industry consolidation mulled by the Polish government, resumed investment in conventional power-generating capacity, divestment of shares by the government). At the same time, investors are quite happy to immediately reward the Company for any piece of information or speculation that could potentially create some upside (such as its highly unlikely privatization). One factor that could bring Energa's share price down in the near future is the increase in US Treasury yields which could dampen sentiment to dividend-paying stocks. On the other hand, low bond yields seen in Poland pose downside risk to the 2016 profits of the distribution business (the application of 2.5% yield to the distribution tariff would imply a drop in WACC by 1.5ppt driving the expected EBIT down by as much as PLN 170m). For now, we stand by our neutral rating for ENG.**

### Energa misses mark with core Q3 results

Energa generated Q3 2014 EBIT in line with our expectations and market estimates, but the nominal figure was boosted by PLN 33m gains on other operating activity including PLN 20m severance pay allowance reversals. The core EBIT is about 10% lower than anticipated. The Q3 performance of the different operating segments was more or less as we had assumed, with Distribution achieving EBIT of PLN 198m (we forecast PLN 202m), and EBIT in Generation coming in at PLN 114m (vs. PLN 119m) with the hard coal- and biomass-

fueled Ostrołęka power station generating higher revenue than the hydropower plants. In the "Other" segment, the EBIT loss was PLN 10m higher than anticipated. Energa incurred lower-than-expected financing costs in Q3, but this was offset by a higher effective tax rate (23%) which caused the quarterly bottom line to miss our estimate by a very narrow margin. After a weak H1, Energa improved operating cash flow in Q3 at PLN 540m. After PLN 300m CAPEX, this facilitated a reduction in debt from PLN 3.4bn to PLN 3.2bn.

### Energa announces updated CAPEX plan

Energa is planning to spend PLN 18.2bn on capital investment between 2014 and 2022 (the earlier 2013-2021 budget was PLN 19.7bn but it included PLN 1bn wind farm acquisitions). Of the total, the core CAPEX has been set at PLN 11.8bn (raised from PLN 15.9bn), and PLN 6.4bn (vs. PLN 3.8bn earlier) 4bn has been allocated to contingent investment dependent on the regulatory environment. The core CAPEX allocates PLN 9.8bn to distribution (we anticipated PLN 12.2bn), PLN 1.1bn to conventional power generation (we had a similar projection) and PLN 0.6bn to sales and other areas (we assumed PLN 0.3bn). Further, PLN 0.4bn has been earmarked for ongoing renewable energy projects, which is less than our PLN 3.4bn assumption based on the goals outlined in the IPO prospectus, but the difference stems from the fact that Energa includes new wind farm projects (as well as acquisitions and R&D) in the PLN 6.4bn contingent budget. All in all, the assumptions as to Energa's CAPEX that underlie our valuation model are consistent with the revised budget (PLN 16.9bn vs. PLN 18.2bn). Our cumulative EBITDA forecast for Energa for the years 2014-2022 is PLN 23.4bn.

PGE		Hold							
Analyst: Kamil Kliszcz		Current price:		PLN 20.02				Last rating	2014-12-05
		Target price:		PLN 20.1					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	30 481.1	30 144.9	-1.1%	27 589.5	-8.5%	27 975.9	1.4%	Number of shares (m)	1 869.8
EBITDA	7 310.1	8 017.8	9.7%	8 017.3	0.0%	7 326.0	-8.6%	MC (current price, PLNm)	37 433.1
EBITDA margin	24.0%	26.6%		29.1%		26.2%		EV (current price, PLNm)	37 070.5
EBIT	4 377.8	5 060.4	15.6%	4 986.8	-1.5%	4 264.5	-14.5%	Free float	38.1%
Net profit	3 616.3	4 118.5	13.9%	3 945.4	-4.2%	3 270.4	-17.1%		
P/E	10.4	9.1		9.5		11.4		Price change: 1M	-7.9%
P/CE	5.7	5.3		5.4		5.9		Price change: 6M	-4.5%
P/BV	0.9	0.9		0.8		0.8		Price change: 12M	15.3%
EV/EBITDA	4.8	4.3		4.6		5.9		Low (52 weeks)	15.7
Dyiel (%)	9.1	4.3		5.5		5.3		High (52 weeks)	22.5

PGE shares plummeted over 8% in November, falling in line with the WIG-Energy benchmark, prompting a rating upgrade on our part. The weak performance last month was most likely a consequence of a weak third quarter (marked by low nominal profits depressed by one-offs) combined with a warning about a planned increase in 2014 year-end actuarial reserves which may result in lower dividends next year. Adding to the worsened sentiment was the speculation about PGE's possible involvement in bailing out the coal industry through coal mine acquisitions for PLN 2-3bn or a joint venture with Poland's largest miner Kompania Węglowa which would be taken as destruction of any value for shareholders and which would mean zero dividends for several years. The zero dividend scenario is not priced in yet as the market continues to expect a 5% dyield but the effect of rising electricity prices on next year's earnings is fully accounted for in the analysts' consensus. On a final note, we want to mention again that what could trigger an upturn in PGE's value as a power producer incurring fixed costs is a rebound in coal prices, not likely to take place for at least one more year.

### Q3 profit depressed by one-offs

PGE's Q3 2014 net profit was negatively affected by PLN 386m impairment of the bonds of Autostrada Wielkopolska (AW) held by the Company combined with high financing losses (PLN 433m; we expected a gain of PLN 15m) driven by a PLN 25m loss on mark-to-market adjustments to interest rate swaps and PLN 19m FX losses. The core profits came close to expectations though they did receive support from higher-than-expected PPA compensation (PLN 192m vs. PLN 120m). By segment, Generation EBIT at PLN 489m fell short of our PLN 526m forecast despite higher volumes and PPA compensation, dragged down probably by a PLN 36m loss on other operating activity and higher costs. Distribution EBIT at PLN 344m beat our PLN 318m estimate despite higher D&A and thanks to higher volumes, and Retail EBIT showed a lower-than-anticipated operating loss (PLN -55m vs. PLN -81m). In turn, Renewables EBIT missed our PLN 37m mark at PLN 28m, as did Wholesale EBIT at PLN 97m vs PLN 113m. As mentioned, the consolidated net profit was weighed down by one-time financing losses. On a positive note, PGE generated strong operating cash flow in Q3 at PLN 2.8 billion. After PLN 1.6bn CAPEX (with 9M CAPEX at PLN 4.6bn vs. PLN 6bn annual budget) and dividends, the net cash position at 30 Sep. decreased to PLN 1.6bn.



Tauron		Accumulate										
Analyst: Kamil Kliszcz		Current price:		PLN 5.27				Last rating		2014-12-05		
		Target price:		PLN 6								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	24 753.0	19 131.1	-22.7%	18 018.6	-5.8%	18 749.6	4.1%	Number of shares (m)		1 752.5		
EBITDA	3 851.6	3 661.5	-4.9%	3 597.6	-1.7%	3 790.6	5.4%	MC (current price, PLNm)		9 235.9		
EBITDA margin	15.6%	19.1%		20.0%		20.2%		EV (current price, PLNm)		16 125.6		
EBIT	2 165.1	1 934.1	-10.7%	1 798.1	-7.0%	1 842.0	2.4%	Free float		54.5%		
Net profit	1 476.4	1 308.3	-11.4%	1 173.4	-10.3%	1 138.9	-2.9%					
P/E	6.3	7.1		7.9		8.1		Price change: 1M		0.4%		
P/CE	2.9	3.0		3.1		3.0		Price change: 6M		-2.6%		
P/BV	0.6	0.5		0.5		0.5		Price change: 12M		8.9%		
EV/EBITDA	3.7	4.1		4.5		5.1		Low (52 weeks)		4.0		
Dyld (%)	5.9	3.8		3.6		3.2		High (52 weeks)		5.6		

**Tauron has been consistently delivering upside earnings surprises for many quarters now, prompting upward revisions to consensus expectations but finding no reflection whatsoever in the share price which year to date continues to underperform peers. The main reason for this is Tauron's less attractive dividend policy, but our expectation is that dividend yields as investor bait are set to be soon replaced with earnings prospects, especially in light of the planned introduction of capacity reward mechanisms which may completely change the outlook on the business of power generation. Further, a planned sale of wind farms is set to free up cash and improve the valuation multiples. We are downgrading TPE from buy to accumulate to reflect the recent price rally.**

### Core Q3 EBIT slightly tops expectations

Tauron beat expectations with the financial results for Q3 2014 though the upside surprise was largely owed to one-time operating gains of PLN 40m. The adjusted EBIT is still about 4% higher than anticipated. By segment, Mining EBIT showed an operating profit of PLN 29m vs. an operating loss of PLN 6.2m expected by us owing to slightly higher volumes and an improved sales mix combined with lower costs. In Generation, the actual EBIT loss at PLN 43m was lower than our PLN 68.9m forecast thanks mainly to higher volumes, with operating reserve income at PLN 62m. Distribution EBIT came in line at PLN 370m though it probably reflected a major portion of the one-time gains. Renewables EBIT exceeded our PLN 19m forecast at PLN 25m, and Trade EBIT as well was higher at PLN 105m vs PLN 97m. In turn, EBIT in the Heat segment showed an operating loss of PLN 21m vs. zero profit expected by us (this was due to the recognition of a PLN 22m carbon allowance to cover a shortage incurred within the segment). Financing activity in Q3 produced in-line results for Tauron. Tauron generated operating cash flow of PLN 943m in Q3 2014 and after PLN 731m CAPEX (9M CAPEX was PLN 2.5bn vs. PLN 4.3bn annual budget) and PLN 324m dividend its net debt as of 30 September increased slightly to PLN 6.26bn (the debt/EBITDA ratio remained steady at 1.7x).

### Suppliers livid over Tauron unit bankruptcy

Tauron filed a bankruptcy petition in October pertaining to its wholly-owned subsidiary Polska Energia - Pierwsza Kompania Handlowa Sp. z o.o (PKH) following the receipt of claims for future payments exceeding PKH's assets. The claimants are wind farms which several years ago signed contracts with PKH for long-term supplies of power and green certificates at fixed prices. According to reports, the owners of these wind farms are accusing Tauron that by making PKH bankrupt it wants to evade having to meet the contractual obligations at prices higher than the current market prices. Tauron responded by saying it is not responsible for PKH's obligations and that it considers the threats of multi-billion claims (some sources put them at PLN 2bn) against PKH and the Polish government a pressure tactic. PKH generated revenue of ca. PLN 100m in 2013. According to our estimates, Tauron stands to lose PLN 20-30m annually if PKH were to deliver on the commitments made to the wind farms (which means that its bankruptcy would indeed pay off). The multi-billion claims mentioned by the papers are probably a sum of the balance of the future revenues provided for in the 15-year contracts. Seeing as PKH is a limited-liability company, we do not see how the creditors can quash the bankruptcy filing.

### CEO on 2014 outlook

CEO Lubera said in an interview that Tauron was not planning acquisitions of existing coal mines as it is building its own mines. Further, Tauron expects to finalize the divestment of wind farms within two months and it views the new climate policy which involves free emission allowances and capacity payments as conducive to growth in coal-fired power generation. Finally, as capital investment reaches its peak, Tauron may offer lower dividends next year than are provided for in the regular dividend policy. Tauron paid out 25% of the consolidated FY2013 net profit this year and the same payout ratio is factored into our projections for FY2015.



## Telecommunications

Netia		Hold									
Analyst: Paweł Szpigel		Current price:		PLN 5.69				Last rating		2014-07-07	
		Target price:		PLN 5.6							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	2 121.4	1 876.0	-11.6%	1 720.0	-8.3%	1 623.4	-5.6%	Number of shares (m)		347.9	
EBITDA	461.5	532.8	15.4%	483.4	-9.3%	436.1	-9.8%	MC (current price, PLNm)		1 979.6	
EBITDA margin	21.8%	28.4%		28.1%		26.9%		EV (current price, PLNm)		2 201.5	
EBIT	-21.0	92.8		80.0	-13.7%	70.9	-11.5%	Free float			
Net profit	-87.7	46.3		50.7	9.6%	46.1	-9.1%				
P/E		42.8		39.0		42.9		Price change: 1M		2.3%	
P/CE	5.5	4.1		4.4		4.8		Price change: 6M		10.9%	
P/BV	0.9	0.9		0.9		1.0		Price change: 12M		7.8%	
EV/EBITDA	5.6	4.3		4.6		4.9		Low (52 weeks)		4.6	
Dyld (%)	0.0	0.0		7.4		7.5		High (52 weeks)		6.0	

**Netia reported weak results for Q3 2014 but a PLN 145m settlement with Orange Polska has added PLN 0.42 to the value of its shares. Back in 2011, Orange Polska was also slapped with a fine of EUR 127.5m by the European Commission over wholesale margin squeeze practices which, if annulled, will boost its share price by up to PLN 0.61 apiece. We maintain a neutral view on Netia which has recently unveiled a long-awaited strategy through 2020 dedicating more resources to the B2C and B2B segments. At the same time, however, the strategy proposes a network split into B2B and B2C, specifically a separation of the B2C access infrastructure and the SLA arrangements with B2B networks. The same assumptions used in our July SoTP valuation put Netia's value at PLN 6.50. Other strategic objectives set for the next five years include ICT growth (data centers, cloud services, selective acquisitions) and capitalization on the potential lying in wholesale services. In B2C, Netia will focus on maximizing the value of its own network without making major upgrades.**

#### PKP receives preliminary bids on TK Telekom

Poland's railway operator PKP has received preliminary offers on its telecom unit TK Telekom. PKP has not revealed any details on who is in the running, but among the rumored suitors are Netia and Hawe.

#### Netia settles claims with Orange Polska

Under the settlement agreement signed in November, Netia and Orange have waived all claims against each other including any monetary claims which may have arisen under contractual arrangements or otherwise, and any disputes taken to court which the Parties agreed to withdraw. Orange paid the PLN 145.0m settlement to Netia immediately upon execution of the agreement. At the same time, Orange agreed under certain conditions to pay an additional compensation to Netia if the EUR 127.5m fine imposed by the European Commission (decision COMP/39.525) is reduced below EUR 112.0m or annulled partly or in whole. The extra compensation is set at 45% of the difference between EUR 112m and the actual amount of the fine or at EUR 50.4m if the fine is annulled in its entirety. Orange recognized an allowance for the full amount of the Netia settlement in its financial statements as of 30 September 2014, and it charged the burden against the profits for earlier periods. As a result, its future EBITDA results will not be affected at all by the payout. Orange had described its dispute with Netia in the notes to the 2012 and 2013 annual reports as "proceedings by the European Commission related

to broadband access." and it set aside reserves for the full amount of the Commission fine in previous periods. The cash lost to the Netia settlement is equivalent to just 3.7% of OPL's adjusted EBITDA for the last four quarters, and it does not undermine the Telecom's balance-sheet stability or affect the earnings outlook for 2014 as the guidance for the year accounts for all the claims and fines.

#### Netia secures PLN 300m financing

Netia took out a three-year PLN 300m loan with mBank and Bank BGŻ to repay existing facilities with BGŻ, BNP Paribas, mBank, Raiffeisen Bank Polska, and Raiffeisen Bank International AG. The loan is payable in six equal semi-annual installments, the last falling due on 3 November 2017.

#### Q3 2014 results

At PLN 413.4m, the Q3 2014 revenue of Netia came in line with our expectations. As predicted, direct on-network voice ARPU contracted slightly by 3.3% from Q2 while WLR ARPU remained stable. The number of leased lines amounted to 729.2k as the on-network customer base erosion progressed at a slightly faster pace than anticipated. Broadband revenue came in at PLN 170.1m in Q3 (we expected PLN 172m), with ARPU remaining stable at the quarter-before level despite intense competition. The EBITDA for Q3 2014 came in at a disappointing PLN 109.5m (we expected PLN 121.9m) after an increase from PLN 3.8m in Q2 to PLN 8.77m in marketing expenses combined with high restructuring costs (at PLN 6.9m vs. PLN 2.1m forecast) and slightly lower-than-anticipated cost savings. The resulting decrease was offset only to a small extent by a PLN 2.5m sale of overdue receivables. Financing costs incurred in Q3 were also higher than predicted due to losses on fair value adjustments to open contracts. All told, Netia's Q3 2014 bottom line showed a net loss of PLN 4.4m instead of the PLN 9.2m net profit anticipated by us. On a positive note, Netia generated solid cash flow of PLN 144.2m in Q3 2014 achieved by shortening the cash conversion cycle. Moreover, third-quarter CAPEX was lower than last year (PLN 50.0m vs. PLN 57.4m). Netia has reaffirmed its dividend policy and maintained the guidance for FY2014 at PLN 505m EBITDA, PLN 215m CALEX, and PLN 290m adjusted CFO. In other news, Netia finally unveiled the long awaited strategy through 2020 which dedicates more resources to B2C and B2B customers. Netia is planning to split its network split into B2B and B2C, specifically by separating the B2C access infrastructure and making SLA arrangements with B2B networks. The same assumptions used in our July SoTP valuation put Netia's value at PLN 6.50. Other strategic objectives set for the next five years include ICT growth (data centers, cloud services,

selective acquisitions) and capitalization on the potential lying in wholesale services. In B2C, Netia will focus on maximizing the value of its own network without making major upgrades.

#### **Management on post-Q3 outlook**

Netia is in the process of reevaluating its infrastructure and streamlining plans and this will result in restructuring charges which, however, will be offset by the PLN 145m

settlement with Orange. Part of the settlement may be used to reduce debt and hence financing costs. Netia is set to finish network upgrades by the end of 2014 and its plan going forward is to increase sales within its own on-network customer base. The sales goals are two services per average B2C customer and 9–10 services per average B2B customer. As for streamlining, the eighty employees who have agreed to leave with a severance package represent a major portion of the entire downsizing plan.

Orange Polska		Reduce									
Analyst: Paweł Szpigel		Current price:		PLN 9.3				Last rating		2014-11-05	
		Target price:		PLN 8.9							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	14 141.0	12 923.0	-8.6%	12 143.7	-6.0%	11 830.6	-2.6%	Number of shares (m)		1 312.0	
EBITDA	4 841.0	3 895.0	-19.5%	4 004.8	2.8%	3 627.0	-9.4%	MC (current price, PLNm)		12 201.6	
EBITDA margin	34.2%	30.1%		33.0%		30.7%		EV (current price, PLNm)		16 330.4	
EBIT	1 574.0	788.0	-49.9%	951.8	20.8%	778.1	-18.2%	Free float			
Net profit	855.0	296.0	-65.4%	503.8	70.2%	438.7	-12.9%				
P/E	14.3	41.2		24.2		27.8		Price change: 1M		-6.2%	
P/CE	3.0	3.6		3.4		3.7		Price change: 6M		-12.0%	
P/BV	0.9	1.0		1.0		1.0		Price change: 12M		-8.4%	
EV/EBITDA	3.6	4.3		4.1		4.6		Low (52 weeks)		9.1	
Dyield (%)	16.1	5.4		2.7		5.4		High (52 weeks)		11.9	

We maintain a bearish outlook on Orange Polska's business prospects going forward, shaped by continuing price pressure on the market for mobile services combined with intensified competition in broadband coming from cable operators and Netia and increasing costs of interconnection driven by mass customer defections to rival calling plans. In a fiercely competitive environment, we project a 6.8% EBITDA drop to PLN 3,627m in 2015 accompanied by an increase in expenditures on 800 MHz frequencies and fiber-optic infrastructure, all of which may result in a 50% cut to PLN 0.25 in next year's DPS. Orange faces an unexpected new contender in the LTE frequency auction in NetNet, a company owned by the son of a business partner of Zygmunt Solorz-Żak, the principal shareholder of Cyfrowy Polsat which given its strong stake in winning the auction may drive up the price of the 2x5MHz frequency band (the other bidders are P4, Emitel, and T-Mobile).

#### Netia settles claims with Orange Polska

Under the settlement agreement signed in November, Netia and Orange have waived all claims against each other including any monetary claims which may have arisen under contractual arrangements or otherwise, and any disputes taken to court which the Parties agreed to withdraw. Orange paid the PLN 145.0m settlement to Netia immediately upon execution of the agreement. At the same time, Orange agreed under certain conditions to pay an additional compensation to Netia if the EUR 127.5m fine imposed by the European Commission (decision COMP/39.525) is reduced below EUR 112.0m or annulled partly or in whole.

The extra compensation is set at 45% of the difference between EUR 112m and the actual amount of the fine or at EUR 50.4m if the fine is annulled in its entirety. Orange recognized an allowance for the full amount of the Netia settlement in its financial statements as of 30 September 2014, and it charged the burden against the profits for earlier periods. As a result, its future EBITDA results will not be affected at all by the payout. Orange had described its dispute with Netia in the notes to the 2012 and 2013 annual reports as "proceedings by the European Commission related to broadband access" and it set aside reserves for the full amount of the Commission fine in previous periods. The cash lost to the Netia settlement is equivalent to just 3.7% of OPL's adjusted EBITDA for the last four quarters, and it does not undermine the Telecom's balance-sheet stability or affect the earnings outlook for 2014 as the guidance for the year accounts for all the claims and fines.

#### Six telecoms apply for LTE frequencies

Six telecommunications firms applied to take part in the 800 MHz and 2600 MHz frequency auction. They are: Orange Polska, P4, Hubb Investments, T-Mobile Polska, Polkomtel, and NetNet. NetNet is a surprise applicant. It is reportedly owned by the son of a business partner of the noted businessman Zygmunt Solorz-Żak.

#### Inea migrates customers to Play

Local telecom/TV/Broadband provider operating in the wielkopolskie region has switched mobile voice and Internet service providers for over 24 thousand customers from Orange to Play.

## Media

Agora										Reduce	
Analyst: Paweł Szpigel		Current price:		PLN 8.08				Last rating:		2014-08-27	
		Target price:		PLN 7.6							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	1 138.6	1 073.9	-5.7%	1 104.4	2.8%	1 157.2	4.8%	Number of shares (m)		50.9	
EBITDA	80.7	103.5	28.2%	96.5	-6.8%	99.4	3.0%	MC (current price, PLNm)		411.6	
EBITDA margin	7.1%	9.6%		8.7%		8.6%		EV (current price, PLNm)		420.3	
EBIT	-13.1	7.4		3.6	-51.9%	2.6	-26.1%	Free float		81.4%	
Net profit	-9.0	1.2		2.0	72.9%	-0.2					
P/E		349.1		202.0				Price change: 1M		1.0%	
P/CE	4.9	4.2		4.3		4.3		Price change: 6M		-15.8%	
P/BV	0.3	0.3		0.3		0.3		Price change: 12M		-22.9%	
EV/EBITDA	5.4	4.6		4.4		4.2		Low (52 weeks)		7.7	
Dyield (%)	12.4	0.0		0.0		0.0		High (52 weeks)		11.4	

**Agora's financial results for Q3 2014 came ahead of our expectations thanks to lower-than-anticipated marketing costs and small savings achieved in the segments of Radio, Cinemas, and Outdoor. Despite surprisingly positive data for overall third-quarter adspend, with press advertising falling at a 12% lower rate than in Q3 2013, the ad revenue generated by Agora's flagship newspaper *Gazeta Wyborcza* showed a y/y drop of 21.1%, with per-copy revenue falling even more relative to the previous quarter. Subscriptions for *Wyborcza's* online edition amounted to 21.2 thousand at 31 September, which means they will most likely not reach the 40,000 target set for the end of the year. Finally, operating cash flow at Agora was weak in Q3. Agora is venturing into television and this is the right move ensuring positive exposure to TV advertising budgets which, however, is not going to generate results for many more quarters. With paid circulation of *Wyborcza* in the ten months through October down 13.0% from the same period last year, our outlook for Agora remains bearish.**

### Q3 2014 results

At PLN 243.9m, the Q3 2014 revenue of Agora came in line with our expectations after a y/y rise of 1.7%. By segment, Outdoor and Cinema slightly exceeded our revenue estimates while Internet and Newspaper sales missed the mark. Costs surprised on the upside in Q3 at PLN 253.7m vs. PLN 256.9m anticipated thanks to lower costs of advertising and utilities incurred by the cinema chain Helios combined with lower systems maintenance and advertising costs incurred in Outdoor and reduced marketing costs in the Radio segment. The quarterly EBITDA came in at PLN 14.0m, showing an increase of PLN 2.7m from Q3 2013 and coming PLN 4.8m ahead of our estimate. A net financing gain of PLN 2.2m was offset by weak performance of the film

channel Stopklatka and higher tax, resulting in a net loss of PLN 10.2m. Cash flow from operations amounted to PLN 5.1m in Q3 vs. PLN 12.2m a year ago (with 9M CFO at PLN 42.4m in 2014 vs. PLN 76.7m in 2013), decreasing on changes in working capital and other downward adjustments totaling PLN 3.7m (we are hoping to learn more during the earnings call). Agora reported having a net cash position of PLN 87.4m as of 30 September 2014, including PLN 40.8m cash and PLN 46.6m short-term investment. In addition, the outdoor advertising unit AMS had PLN 47.0m receivable from deposits placed against bank guarantees needed under a contract for the construction of bus and tram stop shelters in Warsaw (disclosed as noncurrent accounts receivable). Net debt as of 30 September stood at PLN 114.5m (including Helios's debt of PLN 96.9m).

### Agora secures broadcasting license for new channel

Agora obtained a broadcasting license for a new channel planned by its subsidiary TV Zone and it may apply for more TV licenses in the future. We like the Publisher's expansion in TV resulting in increasing exposure to advertising expenses which will not necessarily start contributing noticeably to profits in the coming quarters.

### Newspaper circulation in October

Paid distribution of Agora's flagship newspaper *Gazeta Wyborcza* amounted to 189.6 thousand copies in October, marking a drop of 8.8% from the same month last year. At the same time, paid distribution of the *DGP* daily fell 8.2% to 56.1 thousand copies, and daily sales of the *Rzeczpospolita* broadsheet dropped 19% to 58.5 thousand. The tabloid *Fakt* remains the sales leader among Polish newspapers with October circulation at 323.2k copies per day. Sales of rival *Super Express* increased 2.9% to 160.2k copies.

Cyfrowy Polsat		Hold										
Analyst: Paweł Szpigel		Current price:		PLN 24.14				Last rating		2014-12-05		
		Target price:		PLN 23.84								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	2 778.2	2 910.8	4.8%	6 163.3	111.7%	9 501.4	54.2%	Number of shares (m)		639.5		
EBITDA	1 032.3	1 046.3	1.4%	2 363.7	125.9%	3 866.3	63.6%	MC (current price, PLNm)		15 438.6		
EBITDA margin	37.2%	35.9%		38.4%		40.7%		EV (current price, PLNm)		25 816.8		
EBIT	789.2	789.9	0.1%	1 265.9	60.3%	2 031.1	60.4%	Free float		48.5%		
Net profit	598.3	525.4	-12.2%	646.6	23.1%	896.1	38.6%					
P/E	14.1	16.0		23.9		17.2		Price change: 1M		-7.6%		
P/CE	10.0	10.8		8.9		5.7		Price change: 6M		9.2%		
P/BV	3.4	2.8		2.1		1.9		Price change: 12M		25.0%		
EV/EBITDA	10.1	9.6		10.9		6.3		Low (52 weeks)		18.7		
Dyield (%)	0.0	0.0		1.1		0.0		High (52 weeks)		27.8		

**Cyfrowy Polsat's share price has soared 29% since our January research update, prompting a rating downgrade from accumulate to hold. We see downside potential in CPS going forward resulting from the resignation of one of its executives combined with relatively weak financial results for Q3. Moreover in Q4 2014, the pay TV provider is set to incur higher costs on aggressive marketing of the SmartDom triple-play service, growing use of smartphones, and the widespread of mobile video content. The huge price discounts offered by Cyfrowy additionally raises the risk of a decreasing value of the customer base.**

#### Six telecoms apply for LTE frequencies

Six telecommunications firms applied to take part in the 800 MHz and 2600 MHz frequency auction. They are: Orange Polska, P4, Hubb Investments, T-Mobile Polska, Polkomtel, and NetNet. NetNet is a surprise applicant. It is reportedly owned by the son of a business partner of the noted businessman Zygmunt Solorz-Żak.

#### Cyfrowy posts in-line Q3 EBITDA, weak CFO

While nominally close to expectations, the Q3 2014 EBITDA of Cyfrowy Polsat had a surprising composition. Revenue amounted to PLN 2,425m (we expected PLN 2,325m) driven by sales synergies achieved on the SmartDom service bundles (with RGUs increasing to 16.4 million, the contract customer base stable at 6.2 million, ARPU per customer up to PLN 86.5, and RGU per customer at 1.98x) combined with good ad sales (with market share at 26.3% vs. 24.1% in Q3'13). At the same time, Cyfrowy reported rising costs in Q3 driven by intensified SmartDOM customer acquisition, broadcasting rights to the FIVB championship, and higher

costs of data transmissions. Costs ex. D&A amounted to PLN 1,510m in Q3 vs. PLN 1,406m. The quarterly EBITDA came in at PLN 910m. After net financing costs of PLN 385m (vs. PLN 356m expected), the bottom-line profit came out lower than anticipated. Cyfrowy generated relatively weak CFO of PLN 672m in Q3 reflecting negative changes in working capital (PLN 58.4m outflow after a change in receivables plus PLN 102.1m outflows due to other changes).

#### TV viewership in November

The lading commercial broadcasters had a lackluster November in terms of viewership figures. The Polsat network posted an 0.42ppt gain in its target audience share (prime-time 16-49 year-olds) to 24.38%, thanks to the relatively recently acquired channels TV4 and TV6 (posing y/y gain of 0.37ppt) and stable channel audiences. TVN's performance was slightly worse with target network viewership up 0.47ppt owing to a strong, 0.95ppt increase in themed channel audiences as the main channel audience shrunk by 0.48ppt. The public channels TVP1 and TVP2 had a weak month in November, losing 0.6ppt and 2.3pt, respectively, of their viewership.

#### Cyfrowy negotiates data prices

Cyfrowy Polsat has commenced price negotiations with its wholesale LTE and HSPA+ network access provider Midas. The Company is hoping the new rates, expected to enter into force in 2015, will be applied retroactively to data capacity ordered this year whose wholesale data costs have surged considerably this year on soaring data usage (22.7 million gigabytes delivered by Midas in Q3 vs. 8.1 million in the same period last year), affecting profit margins.

TVN Buy												
Analyst: Paweł Szpigel		Current price:		PLN 16.2				Last rating		2014-09-11		
		Target price:		PLN 17.5								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	1 584.3	1 554.6	-1.9%	1 609.1	3.5%	1 681.4	4.5%	Number of shares (m)		344.7		
EBITDA	456.0	372.4	-18.3%	584.1	56.9%	610.6	4.5%	MC (current price, PLNm)		5 584.5		
EBITDA margin	28.8%	24.0%		36.3%		36.3%		EV (current price, PLNm)		7 506.3		
EBIT	374.3	297.2	-20.6%	517.1	74.0%	541.7	4.8%	Free float		46.2%		
Net profit	485.9	-197.8		336.9		363.7	8.0%					
P/E	11.5			16.6		15.4		Price change: 1M		7.3%		
P/CE	9.8			13.8		12.9		Price change: 6M		-1.8%		
P/BV	4.1	5.9		5.2		4.8		Price change: 12M		10.1%		
EV/EBITDA	16.4	20.8		12.9		12.0		Low (52 weeks)		13.3		
Dyield (%)	0.6	3.9		0.0		0.0		High (52 weeks)		17.0		

**TVN released a 2014-2016 earnings guidance which is consistent with our expectations pegging adjusted EBITDA (including dividends from nC+ and Onet as per the definition of adjusted EBITDA provided by the Company) at PLN 505,2m in 2014, PLN 601m in 2015, and PLN 620.6m in 2016. The annual CAPEX guidance is slightly higher than our assumptions at respective PLN 48m, PLN 54m, and PLN 59m. Our dividend / buyback expectations are PLN 276m each in 2014 and 2015. To us, the biggest surprise when it comes to the new guidance is the fact that has been released at all after years of TVN just issuing rough adspend projections from time to time or, more recently, projections of "advertising-related revenue." We suspect that this sudden need to share signals TVN's divestment by its controlling shareholders (ITI and Canal+). We maintain a positive outlook on TVN.**

### Q3 2014 results

TVN generated in-line overall revenue of PLN 328.5m in Q3 2014 but a breakdown shows that advertising revenue was lower than our PLN 222.2m estimate at PLN 216.5m after 5.2% y/y growth, and sponsorship revenue rose 5.6% to PLN 31.3m vs. PLN 32.3m expected. At this pace, the revenue momentum seems slow to us during a period of growing adspend and a new fall programming lineup. Costs in Q3 amounted to PLN 260.2m, exceeding our PLN 255.7m forecast on higher payroll, license amortization charges, and COGS. Reported EBITDA amounted to PLN 90.2m after PLN 2.7m costs incurred on other operating activity and PLN 6.1m equity in profits of associates (lower than our PLN 10.5m forecast). Net financing costs including FX differences amounted to PLN 57.9m vs. PLN 55.7m expected. Net profit at PLN 15.3m fell far short of our estimate. At 30 September, TVN's DTH platform nC+ had 2.15 million subscribers (-3% y/y), and it generated monthly ARPU of PLN 68.0 (+4% y/y) with total quarterly revenue at PLN 1,606m (-5% y/y) and EBITDA at ca. PLN 280m (+45% y/y). Under a EUR 60m Senior Notes 7.875% redemption program, TVN repurchased notes with a nominal value of EUR 33m in the first half of the year and in November it has launched the second installment set at 7.5 million shares at PLN 20 apiece to meet the total budget capped at PLN 150m. We have to point out the worrying changes that occurred in TVN's working capital in Q3 during which PLN 76.7m outflow was recognized as a result of reduction in other current payables and accruals.

### Management on post-Q3 outlook

TVN is set to become the subject of due diligence audits by prospective investors of whom there are reportedly 12. The operating plans for the future including the launch of two new channels, TVN Fabuła dedicated to airing mostly TV

series and TVN Sportive offering fitness and lifestyle advice programming rather than showing the usual sporting events. TVN has an upbeat outlook for Q4 and it stands by its 2014 revenue growth projection in the mid-single digits.

### TVN targeted by Liberty Global?

According to unconfirmed reports, Liberty Global International, the owner of the cable provider UPC Poland, may be interested in making a bid on TVN. In September, Liberty jointly with Discovery Communications acquired All3Media, a global provider of TV content with the key European markets in Germany and the UK.

### TV viewership in November

The lading commercial broadcasters had a lackluster November in terms of viewership figures. The Polsat network posted an 0.42ppt gain in its target audience share (prime-time 16-49 year-olds) to 24.38%, thanks to the relatively recently acquired channels TV4 and TV6 (posing y/y gain of 0.37ppt) and stable channel audiences. TVN's performance was slightly worse with target network viewership up 0.47ppt owing to a strong, 0.95ppt increase in themed channel audiences as the main channel audience shrunk by 0.48ppt. The public channels TVP1 and TVP2 had a weak month in November, losing 0.6ppt and 2.3pt, respectively, of their viewership.

### TVN partners with T-Mobile

TVN and T-Mobile Polska are creating a new T-Mobile Zone service called 'Player' designed to be a subscription-based VoD service offering polish and international feature films and TV shows as well as, importantly, live streaming of TVN shows. The service will be offered to all retail subscribers of T-Mobile.

### TVN unveils outlook through 2016

Based on economic projections for Poland and the earnings results achieved in the nine months through September 2014, TVN's expectations for the two three years assume GDP growth at an annual rate of 3.0-3.5% and stable low-to-mid single digit growth in television advertising expenses, combined with high single-digit growth in online advertising. With this in mind, TVN expects to report revenue growth in the low single digits in 2014 followed by an acceleration to the mid-to-high single digits (5-9%) in 2015-2016. Accordingly, including what are expected to be increasing dividends from associates, TVN estimates its 2014 annual consolidated adjusted EBITDA at ca. PLN 520m, increasing to PLN 590m in 2015 and PLN 630m in 2016. As for investing and financing activity, the guidance makes the following assumptions:

- TVN will conduct a proportional share buyback in 2015 for PLN 225-250m, and pay out 50% of the year's net



- profit as dividends to shareholders in 2016;
- CAPEX is set in the ballpark of PLN 60m in 2014, PLN 70m in 2015, and PLN 60m in 2016 assuming a continuously low effective tax rate;
- Any operating cash flow remaining in 2015-2016 after CAPEX, taxes, interest expenses, and shareholder distributions will be allocated toward the reduction of debt;
- TVN is not planning any new debt issues at this point except if an opportunity arises to refinance existing debt thanks to favorable market conditions or a change of controlling ownership in TVN;
- The EUR/PLN exchange rates assumed for forecasting purposes are consistent with current market expectations.



**IT**

ABC Data		Suspended									
Analyst: Paweł Szpigel		Current price:		PLN 3.5				Last rating		2014-12-05	
		Target price:		PLN -							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	3 693.1	4 822.5	30.6%	5 816.0	20.6%	6 240.3	7.3%	Number of shares (m)		125.2	
EBITDA	58.8	79.6	35.3%	96.7	21.6%	105.0	8.6%	MC (current price, PLNm)		438.3	
EBITDA margin	1.6%	1.6%		1.7%		1.7%		EV (current price, PLNm)		626.5	
EBIT	55.6	77.2	38.9%	93.3	20.9%	101.5	8.8%	Free float		25.8%	
Net profit	31.1	59.2	90.5%	67.8	14.5%	74.0	9.2%				
P/E	14.1	7.4		6.5		5.9		Price change: 1M		-8.6%	
P/CE	12.8	7.1		6.2		5.6		Price change: 6M		-11.4%	
P/BV	1.5	1.4		1.2		1.1		Price change: 12M		-14.4%	
EV/EBITDA	9.5	7.1		6.5		5.9		Low (52 weeks)		3.5	
Dyield (%)	4.6	6.8		10.3		7.7		High (52 weeks)		4.5	

**We are suspending coverage of ABC Data due to low trading volumes. The Company has downgraded its 2014 EBITDA guidance to PLN 74.8m from PLN 92.1m, implying an 8% y/y increase in fourth-quarter EBITDA to PLN 31.6m. New CEO Ilona Weiss promises continuation of generous dividend payments by ABC Data in the future, appeasing the concerns raised by the announcement of a planned debt issue. ABC Data intends to spend the bond proceeds on diversifying financing sources by replacing part of bank loans with bonds so as to prevent an increase in net debt**

**Q3 2014 results**

ABC Data reported weaker-than-expected Q3 results with sales at PLN 1,375m vs. PLN 1.4bn forecast by us. A revenue breakdown reveals a higher share of sales outside of the EU (12.1% vs. 8.1% in Q3 2013) taking the place of sales to the EU. The gross profit margin amounted to 4.79% in Q3 vs. 4.35% anticipated. Selling expenses were higher than our PLN 33.1m forecast at PLN 45.9m due to PLN 10.0, receivables write-offs. Adjusted for this one-off, the Q3 EBIT figures to PLN 17.5m, i.e. 9% less than our PLN 19.2m estimate, due to a PLN 1.3m q/q increase in general expenses and PLN 1.5m other net financing costs. Financing costs were in line, but the effective tax rate was high at 54.7%. Cash flow from operations amounted to PLN 30.8m in Q3 vs. PLN 20.9m in the same period last year. The cash conversion cycle was shortened by 3.5 days in Q3. Payables did not yet show the promised benefits of reverse factoring.

Asseco Poland		Accumulate										
Analyst: Paweł Szpigiel		Current price:		PLN 53.65				Last rating:		2014-07-08		
		Target price:		PLN 45.6								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	5 529.1	5 898.1	6.7%	6 060.2	2.7%	6 120.5	1.0%	Number of shares (m)		83.0		
EBITDA	888.9	875.0	-1.6%	885.3	1.2%	873.9	-1.3%	MC (current price, PLNm)		4 453.0		
EBITDA margin	16.1%	14.8%		14.6%		14.3%		EV (current price, PLNm)		6 450.9		
EBIT	649.9	610.5	-6.1%	624.1	2.2%	615.9	-1.3%	Free float		65.4%		
Net profit	370.1	393.9	6.4%	348.8	-11.4%	332.7	-4.6%					
P/E	12.0	11.3		12.8		13.4		Price change: 1M		7.9%		
P/CE	7.3	6.8		7.3		7.5		Price change: 6M		26.5%		
P/BV	0.6	0.6		0.6		0.6		Price change: 12M		8.0%		
EV/EBITDA	6.9	7.5		7.3		7.3		Low (52 weeks)		39.3		
Dyield (%)	3.8	4.5		4.8		5.2		High (52 weeks)		54.0		

**Asseco Poland shared a very buoyant outlook with analysts during the third-quarter earnings conference, promising a strong fourth quarter for the Russian unit R-Style and noticeable effects of the modified approach to servicing the contract acquired from Poland's social security authority ZUS. With the free cash flow generated in 9M 2014 35% higher than in the same period last year, we believe Asseco is set to raise dividends next year (we assume DPS at PLN 2.81), to the delight of investors. We maintain a positive outlook on ACP and we are working on an updated valuation of the Company.**

### Q3 2014 results

The Q3 2014 revenue of Asseco Poland exceeded our forecast by 4.3% at PLN 1,486m thanks mainly to the Israel unit Matrix. EBIT topped our estimate by 8.7% at PLN 163.9m, driven primarily by the Polish business (where EBIT came in at PLN 81.4m vs. PLN 73.0m expected), specifically the parent company which on a standalone basis saw a 3.5% y/y decline in revenue but which grew gross profit by 7.2% to PLN 96.4m with the gross margin at 31.4% vs. 28.3% in Q3 2013. The standalone quarterly SG&A expenses were PLN 3.4m lower than in Q3 2013 at PLN 30.5m after all this EBIT came in at PLN 65.9m vs.

PLN 56.0m in 3Q'13. Going back to consolidated results, Israeli operations had a strong third quarter, with Sapiens International posting 15.7% y/y growth in 9M 2014 EBIT. Eastern Europe surprised on the upside with EBIT at PLN 5.6m vs. PLN 1.5m expected, driven probably by new contracts generated by R-Style combined with the consolidation of the June acquisition, Asseco Kazakhstan LPP. Asseco generated CFO of PLN 93.2m in Q3 2014 vs. PLN 54.9m in Q3 2013 thanks to reduced cash outflows to working capital. We did not like the news about the purchase of Magic Software bonds for PLN 28.7m (\$9.3m) in Q3 after an earlier purchase of PLN 107.9m-worth of corporate paper of Sapiens Software.

### Asseco signs PLN 10m contracts

Asseco Poland signed two systems modification contracts worth a combined PLN 10m with the social security agency ZUS under the framework service agreement

### Public IT spending to tighten in 2015

Asseco Poland executive Przemysław Borzestowski predicts that 2015 may be a tough year for IT companies with large exposure to public sector contracts, though the impact on Asseco will be minor. A rebound in government orders is expected in 2016 after the deployment of EU funding.

## Resources

JSW		Hold										
Analyst: Michał Marczak		Current price:		PLN 19.99				Last rating		2014-01-15		
		Target price:		PLN 55								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	8 821.0	7 632.2	-13.5%	6 815.5	-10.7%	7 435.5	9.1%	Number of shares (m)		117.4		
EBITDA	2 374.8	1 382.1	-41.8%	798.8	-42.2%	1 005.3	25.9%	MC (current price, PLNm)		2 347.1		
EBITDA margin	26.9%	18.1%		11.7%		13.5%		EV (current price, PLNm)		1 189.9		
EBIT	1 308.2	201.9	-84.6%	-430.7		-117.9	-72.6%	Free float		44.8%		
Net profit	985.1	77.3	-92.2%	-415.3		-165.5	-60.2%					
P/E	2.4	30.4						Price change: 1M		-24.6%		
P/CE	1.1	1.9		2.9		2.5		Price change: 6M		-56.9%		
P/BV	0.3	0.3		0.3		0.3		Price change: 12M		-67.9%		
EV/EBITDA	0.1	0.6		1.5		1.4		Low (52 weeks)		20.0		
Dyld (%)	26.9	12.6		0.0		0.0		High (52 weeks)		62.3		

**JSW's Management Board decided to put on hold the planned eurobond issue which was supposed to refinance the debt incurred to acquire the Knurów-Szczygłowiec mine ('KS,' PLN 1.2bn). Coking coal remains firmly at or around \$119-120/t, but in the base-case economic scenario the price should not go down any more. Against this backdrop, JSW's main focus going forward is on reducing CAPEX below PLN 1.4bn and cutting payroll costs by the target amount of PLN 350m, and this is a realistic goal which, however, can only be achieved by handling the demands of the local unions (looking at the experiences of other mines like KW and KHW, we may expect widespread protests and marches by miners from the whole of the Upper Silesian coal basin). The Polish coal industry cannot be turned around without the involvement of the government. A structural redefinition of the ample employee benefits enjoyed by most Polish miners could help permanently reduce payroll costs (currently accounting for over 50% of the total costs of a mine), and in case of JSW once coal prices rebound the prospective lower costs make it an attractive investment for the long term. In the near term, however, the Miner faces a turbulent restructuring period with an unknown outcome, and it is set to continue reporting weak quarterly earnings. With this in mind, we would hold off buying JSW until spot coal prices start to recover or until its workers explicitly agree to the proposed restructuring plan.**

### JSW posts disappointing Q3 inflated by creative accounting

JSW reported quarter-on-quarter growth of 12.8% to PLN 1.65bn in Q3 2014 revenue, with EBITDA showing a profit of PLN 375m (vs. a loss of PLN 14.3m in Q2) and the bottom line a net profit of PLN 38.8m (vs. Q2 net loss of PLN 253m), but this improvement was owed solely to two unexpected one-time events. First, the Company recognized a gain of PLN 297.4m on a bargain acquisition of the assets of the Knurów Szczygłowiec (KS) mine, calculated by deducting the price (PLN 1.49bn) from the net value of these assets (PLN 2,312.2m total including PLN 2,276m expert appraisal, PLN 36.2m inventory, and PLN 524.8m payables. For

accounting purposes, the gain should have been adjusted for PLN 45m contract tax. The net addition to EBITDA provided by the settlement of the acquisition was PLN 252m, with the bargain gain considered a non-cash event and the tax diminishing the cash position. This shows that the KS acquisition was actually no bargain at all, especially considering JSW's current market cap of PLN 2.5bn vs. the acquisition price of PLN 1.5bn.

Moving on, JSW generated weak coal sales in Q3 2014. The Company has consolidated the revenues of KS, whose annual production capacity is 3.8 million tons, since 1 August. Adjusted for 90% capacity utilization and only two quarters of consolidation in Q3, KS should have added about 570kt to the quarterly coal output consisting 50/50 of thermal coal and semi-soft coking coal. The total Q3 2014 production volume of JSW was reported at 3.94mmt compared to the usual quarterly volume of 3.5mmt produced before the KS acquisition. This means that JSW continued to encounter problems at its mines in Q3, though less severe than in the dismal Q2 when output fell to 2.5mmt. If Q4 output is similar to Q3, this will mean the Company is again able to meet the expectations of investors. On lower-than-expected but improving output, the Q3 sales volume was extremely disappointing at just 2.35mmt compared to an average 2.2-2.4mmt before the KS acquisition. Consequently, the coal inventory at 30 September increased to 1.2mmt (with ca. 120kt added by KS) from 604kt at 30 June. As for Q3 sales prices, they were consistent with expectations with coking coal averaging PLN 394/t, down 3.3% from Q2, on a changed sales mix with a higher share of the cheaper semi-soft coking coal coming from KS. The average price of thermal coal was PLN 233.5/t (+1.1% q/q). As for the coke segment, JSW delivered our expectations in Q3 with steady quarterly output of 954kt and sales 1% higher than in Q2 at 995kt. The average sales price of coke was 1.8% lower than in the previous quarter at PLN 650/t. Finally, JSW's net debt as of 30 September was PLN 397m, and in November the Company was due to make the final PLN 300m payment for KS which in the end was halted. This makes for net debt of PLN 730m plus cash burnt on operations in Q4. In 2015, if coal prices do not rebound from this year's lows, JSW is due for a restructuring exercise if it wants to maintain healthy liquidity.

KGHM		Hold										
Analyst: Michał Marczak		Current price:		PLN 117.4				Last rating		2014-11-05		
		Target price:		PLN 139								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	26 705.0	24 110.0	-9.7%	21 593.3	-10.4%	23 496.2	8.8%	Number of shares (m)		200.0		
EBITDA	8 199.0	5 952.0	-27.4%	5 637.2	-5.3%	6 245.9	10.8%	MC (current price, PLNm)		23 480.0		
EBITDA margin	30.7%	24.7%		26.1%		26.6%		EV (current price, PLNm)		26 796.3		
EBIT	6 475.0	4 372.0	-32.5%	3 730.1	-14.7%	4 194.0	12.4%	Free float		68.2%		
Net profit	4 753.0	3 033.0	-36.2%	2 548.9	-16.0%	2 913.9	14.3%					
P/E	4.9	7.7		9.2		8.1		Price change: 1M		-5.7%		
P/CE	3.6	5.1		5.3		4.7		Price change: 6M		-3.4%		
P/BV	1.1	1.0		1.0		0.9		Price change: 12M		4.1%		
EV/EBITDA	2.9	4.3		4.8		4.2		Low (52 weeks)		99.9		
Dyield (%)	24.1	8.3		4.3		4.3		High (52 weeks)		138.0		

The copper market is poised to enter a slower sales season lasting from December until early spring, and as production grows this will result in inventory rebuilding on world exchanges. For the last four weeks, the global inventory has remained low at around 280 thousand tons (2.5 weeks of global consumption). The announcement of a yet another possible fiscal stimulus package to the tune of US \$16 billion, and interest rate cuts in Poland, did not drive up the prices of metal commodities. As prices of silver, gold, and molybdenum fall, KGHM's unit costs are set to rise, driving up the operating leverage (and putting at risk further investment) if industrial metals continue on the upward trend. On the upside, a weakening zloty can partly offset the negative trends; historically, KGH shares have shown closer correlation with dollar prices of copper rather than with zloty prices, thanks probably to foreign investors. We expect a rebound in prices of industrial metals in the near term after weeks of declines, resulting in improved sentiment to mining stocks.

### KGHM posts in-line third quarter

KGHM generated standalone revenue of PLN 4.11 billion in Q4 2014 with EBITDA at PLN 1,163m and net profit at PLN 629m and posted respective consolidated results at PLN 5.19bn, PLN 1,473m, and PLN 679m. The standalone copper output amounted to 146kt, including 102kt primary, with the quarterly silver production at 297 tons. At the same time, copper sales totaled 138kt, slightly less than our 142kt forecast, and silver sales came in line at 296 tons. The pre-precious metals credit unit cost of production averaged PLN 16,922 in Q3 2014, marking a decrease of 3.7% from Q3 2013 achieved despite lower prices of silver driven by 11% higher output and lower taxes paid by some mines on cheaper copper. KGHM recognized hedging gains of PLN 115m in Q3, of which PLN 120m was added to revenue and PLN 5m was deducted from EBIT. The hedging transactions settled in the period accounted for 16% of realized copper sales, with FX hedges affecting 24% of revenues. KGHM opened its first hedging position for copper

sales in a long time in Q3 (the hedged volume is relatively small at 11kt from August 2014 to June 2015), as well as entering into a large \$810m FX hedge.

Moving on, KGHM International as well did not deliver any upside surprises in Q3 with revenue amounting to PLN 657m (-7.4% y/y), EBITDA coming at PLN 216m (-17.5% y/y), and net profit at PLN 37m (-15.9% y/y). The quarterly production of the KGHM International mines amounted to 22kt of copper (+4% y/y) and 17.1kt of previous metals, marking a 20% drop from last year. A major factor responsible for the y/y revenue and profit declines (accounting for PLN 57m of the drop at topline level) were cutbacks in service outsourcing to DCM Mining. The C1 unit cost was reduced to \$2.25/lb from \$2.41/lb despite the improvement that took place at the key Robinson mine, and it remains high compared to the Polish C1 cost of \$1.77/lb. KGHM has not released the third-quarter operational data for the Sierra Gorda mine yet.

### KGHM finds new copper fields in Poland

A four-year exploration process by LGHM of the "Gaworzyce-Radwanice" (GR) concession area (99 square kilometers adjacent to the western border of the existing "Polkowice-Sieroszowice" mine) revealed that the area holds 216 million tons of mineral resources with average grading of 1.89% Cu (approximately 4.1 million tons of copper) and 35g/t Ag (ca. 7.5kt of silver). The next step is an application to mine the concession. The Gaworzyce-Radwanice concession to date has been part of KGHM's back-up reserves earmarked for mining in the future. Its size as reported yesterday is larger than earlier estimates of 63mmt of ore and 1.9mmt of copper, making it a material asset relative to the miner's operations in Poland. For comparison, the mineral resources in other concessions are 340mmt in "Lubin" and 290mmt in "Głogów Głęboki," with the total Polish resources estimated at 1.5 billion tons. In the first stage, KGHM will use the resources available in the neighboring working mine to aid copper extraction from the GR area. Note that GR is a long-term project which will extend KGHM's Polish mine life rather than adding to the local production volumes as existing copper deposits run out.

LW Bogdanka		Hold										
Analyst: Michał Marczak		Current price:		PLN 107.75				Last rating		2014-07-07		
		Target price:		PLN 136.9								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	1 835.8	1 899.8	3.5%	2 017.0	6.2%	2 268.4	12.5%	Number of shares (m)		34.0		
EBITDA	658.1	754.9	14.7%	743.2	-1.5%	857.9	15.4%	MC (current price, PLNm)		3 664.9		
EBITDA margin	35.8%	39.7%		36.8%		37.8%		EV (current price, PLNm)		4 268.9		
EBIT	357.3	424.8	18.9%	381.9	-10.1%	470.3	23.1%	Free float		100.0%		
Net profit	289.7	329.7	13.8%	297.1	-9.9%	369.7	24.4%					
P/E	12.6	11.1		12.3		9.9		Price change: 1M		-5.2%		
P/CE	6.2	5.6		5.6		4.8		Price change: 6M		-9.8%		
P/BV	1.6	1.5		1.4		1.3		Price change: 12M		-20.6%		
EV/EBITDA	6.1	5.4		5.7		4.9		Low (52 weeks)		106.6		
Dyid (%)	4.7	5.4		4.9		6.1		High (52 weeks)		138.0		

The global coal market remains stagnant with prices of thermal coal trading flat for a few weeks straight. Amid falling prices of crude oil on the one hand and the zloty's depreciation versus the dollar on the other hand, this makes for a passable outlook for Polish coal miners. The Polish coal industry is facing another attempt at cost restructuring which is bound to end with worker strikes at the major mines, and the resulting pressures could spill over to LW Bogdanka even though it is quite far removed from the hotbed of the conflict. The warm temperatures observed so far in the fourth quarter are not doing much to help unload piled-up coal, and a high inventory offers little hope for a price rebound next year (in October the stockpiles declined slightly by 0.2mmt to 8.7mmt). Regardless, we anticipate improvement in LW Bogdanka's profits in the months ahead thanks to increased production. We remain neutral on LWB.

#### Bogdanka posts in-line third quarter

The Q3 2014 financial results of LW Bogdanka came in line with our forecasts with revenue up 10% to PLN 545m, EBITDA totaling PLN 198m, and net profit coming in at PLN 79.4m (compared to our respective projections of PLN 523m revenue, PLN 195m EBITDA, and PLN 81m net profit). The PLN 20m higher-than-expected topline was achieved on stronger sales volumes (at 2.49mmt, +9.7% y/y, vs. out 2.38mmt estimate). As a result, with the quarterly coal output at 2.38mmt, Bogdanka managed to considerably reduce stockpiles to just 52.3kt as of 30 September - a level equivalent to just two days of sales and potentially dangerous from the point of view of shipment logistics. Bogdanka generated average per-ton revenue at PLN 109 in Q3 2014 (marking a y/y drop of 8.3% to a level

exactly matching our forecast), and incurred average per-ton cash costs of PLN 136. Further, the higher-than-expected revenue did not entail higher profits which were weighed down by unexpected PLN 6m losses on other operating activity (most likely related to the stock option plan).

#### KW workers axe CEO Taras

After 209 days in office, the CEO of Poland's largest coal miner Kompania Węglowa Mirosław Taras was dismissed on Friday by the Supervisory Board. The reason cited for the dismissal was a lack of dialog with the workers. From what we can glean from press reports covering the relationship between KW's Management and its workers, the unions are refusing to budge on proposed extra pay cuts aimed at helping to get the Company out of its disastrous financial state. The turnaround measures proposed by the Management Board under Mr. Taras's leadership relied heavily on pay reductions (payroll accounts for over 50% of total costs) through modifications to the collective bargaining agreement as well as on production streamlining through loss-making mine closures and increasing output at the top-performing mines. We agree that measures like these are the key to turning KW around. Meanwhile, the fiasco of the Taras mission suggests more leniency towards worker demands on the part of the Polish government which seems to have softened its tough stance. After a failed eurobond issue, the government has to look for other sources of financing for KW, giving rise again to speculation about the coal industry's integration with the power industry. Worse still, the dismissal of Mr. Taras sends a message to other mine workers (e.g. JSW employees) that persistence over the retention of extra pay regardless of the fact that it can bring the employer to ruin pays off.



## Industrials

### Polish manufacturing growth

%	Oct'13	Nov'13	Dec'13	Jan'14	Feb'14	Mar'14	Apr'14	May'14	Jun'14	Jul'14	Aug'14	Sep'14	Oct'14
Y/Y	+4.4%	+2.9%	+6.6%	+4.1%	+5.3%	+5.4%	+5.4%	+4.4%	+1.7%	+2.3%	-1.9%	+4.2%	+1.6%

Source: GUS

#### October manufacturing data, investing ideas for December

Poland's industrial production in October 2014 expanded at an annual rate of 1.6%. Annual growth rates in the preceding months amounted to 4.2% in September, -1.9% in August, 2.3% in July, 1.7% in June, 4.4% in May, 5.4% in April and March, 5.3% in February, 4.1% in January, 6.6% in December 2013, 2.9% in November, and 4.4% in October 2013. Output expanded in 20 sectors relative to October 2013, and six fewer sectors than in September 2014 reported month-on-month growth.

Eurozone PMI remains above the 50pt threshold at 50.1 points in December. Manufacturing PMI Germany is 49.5pts vs. 51.4pts in November and 49.9pts in October and PMI Poland rebounded over the 50pt in November (51.2pts) and December (53.2pts) after falling to 49.4pts in August, 49pts in September, and 49.5pts in October. The European indicators have retreated closer to the 50pt mark in the last six months after posting stronger momentum in late 2013, led probably by the tense relations with Russia and the crisis in Ukraine. The resulting drop in exports to both Russia and Ukraine dampened investors' sentiment to European manufacturers, and adding to the slump were the international sanctions imposed on Russia to which it responded banning imports of certain goods from the West.

Of the 49 companies tracked by us, only 37% reported year-on-year earnings growth in Q3 2014 - the lowest ratio since Q1 2013 (32%), marking considerable deterioration from Q2 2014 (51%). The ratio of companies experiencing year-on-year contraction in profits was the highest since Q2 2013 at 41% driven by unfavorable base effects (in Q3 2013 as many as 50% of the tracked companies posted y/y growth followed by 57% in Q4) combined with weaker Manufacturing PMI data)

Contrary to expectations, companies with large exposure to Russia did not experience falling exports in Q3, as evidenced by Amica whose Russian sales increased at a single-digit rate in Q3 despite the ruble's depreciation vs. the zloty, Fasing, Mercor and Relpol whose Russian revenues decreased at a slower rate than implied by the weakened ruble, Selena, posting increasing exports to the East, and Zetkama for which Q3 in Russia was business as usual. To our surprise, the group of exporters which did log sales shrinkage in Q3 were companies selling to the EU. Examples include Boryszew with flat y/y sales of auto parts and negative operating margin, Ergis (experiencing a sales slump in September in an increasingly competitive market), Forte (reporting revenue slowdown from the double-digit growth seen in the first half of the year), and Selena (whose EU sales fell in Q3).

The companies that delivered upside surprises in Q3 2014 included lighting manufacturers ES-System and Lena Lighting, meat producers Tarczyński and ZM Kania (benefitting from low prices of raw meat), mining equipment manufacturers Fasing, Famur, and Kopex (all reporting a solid quarter amid a local demand slump), and the appliance maker Amica (benefitting from the bankruptcy of a rival), the electronic waste recycler Elemental (reporting growth through acquisitions combined with higher margins

generated on non-ferrous metal scrap), the metals processor Impexmetal (experiencing growth in all areas involving non-ferrous metals), the tractor maker Ursus (delivering a major order to an Ethiopian customer), the hydraulic pump manufacturer Hydrotor (reporting revenue as well as operating profit growth), and the building chemicals distributor Selena (achieving strong margins boosted by cost control measures).

On the other end of the spectrum is Boryszew (experiencing low margins on auto parts and increasing debt), Izostal (affected by delays in government orders), Ergis (experiencing increased competition and falling sales in September), Forte (reporting a decelerating revenue momentum), Libet (which did not manage to capitalize on increased infrastructure demand ahead of the November local elections), PKM Duda (facing still competition in Poland and downward margin pressure), PGO (reporting falling sales and margins), Ropczyce (posting a slowdown caused by lower sales to Ukraine), Pozbud, and Zamet Industry (generating lower margins on offshore structures and posting year-on-year earnings slowdown).

Compared to our expectations, the Q3 2014 no-surprise ratio at 31% was similar to the quarter-before ratio of 24%, while the negative surprise ratio increased from 47% to 49% - the highest level since statistics started to be kept in 2013.

Our Industrials price tracker has fallen 23% year to date while at the same time MSCI Industrials Europe declined 0.8% and MSCI Industrials World posted a gain of 0.2%. The price correction resulting in the narrowing of the discount to MSCI World and Europe is a reflection of the weak third-quarter earnings season.

The industrial stocks in our tracking portfolio are trading at median 13.7x 2014E and 11.1x 2015E P/E and 7.2x 2014E and 6.5x 2015E EV/EBITDA, implying discounts in the range of 17-30% relative to MSCI Industrials Europe and World.

On price-to-book, Polish industrials are valued at 1.0x 2014E and 2015E P/B, i.e. 54-61% lower than their global peers. The ratio of P/(BV-goodwill) (tangible P/B) for Polish stocks is estimated at 1.1x in 2014 and 1.0x in 2015.

Our top industrial sector picks are the moment are Cognor (a high-beta play on a rebound in infrastructure spending at 3.3x 2015E P/E and 5.8x EV/EBITDA), Feerum (benefitting from automated production and a rebound in orders expected in 2015), Fasing (the cheapest manufacturer of mining equipment at 6.5x 2014E P/E and 3.0x EV/EBITDA), Impexmetal (experiencing increasing margins on aluminum sheet), Mercor (trading at cheap levels after a record dividend payout), Lena Lighting (reporting growing earnings this year and expected to offer 6-7% dividend yield in 2015), Kopex (exposure to high-margin international markets), Orzeł Biały (experiencing increasing margins on recycled battery lead), Relpol (set for 2014 profit rebound), Tarczyński (poised for 2015 rebound after plant upgrades), Vistal (poised to benefit from increased infrastructure spend and strong demand from the offshore industry, and Zetkama (expected to revise upwards its earnings guidance).

## Recommended Portfolio Allocations

Company	Weight	Price (PLN)	P/E			EV/EBITDA			DY			P/(BV-goodwill)			2014E Net Debt/EBITDA
			'13	'14	'15	'13	'14	'15	'13	'14	'15	'13	'14	'15	
AC Auto Gaz	MW	29.20	10.2	11.0	10.9	6.8	7.1	7.0	7.2%	7.9%	7.3%	2.9	2.8	2.7	-0.3
Berling	MW	5.59	9.0	10.6	9.0	5.5	6.6	5.3	3.8%	5.4%	3.3%	1.3	1.2	1.1	-1.8
Libet	MW	2.61	21.3	13.7	9.5	5.9	4.9	4.3	0.0%	1.9%	2.2%	0.6	0.6	0.6	2.0
Bumech	MW	1.95	63.8	29.5	-	3.0	3.0	3.8	0.0%	0.0%	0.0%	0.3	0.3	0.3	2.4
Patentus	MW	1.25	6.2	18.8	72.9	6.7	7.4	8.1	0.0%	0.0%	0.0%	0.4	0.4	0.4	4.1
Fasing	OW	19.00	7.3	6.5	5.6	3.3	3.0	2.8	3.4%	3.7%	2.3%	0.5	0.5	0.5	0.9
Orzeł Biały	OW	6.55	-	15.2	6.5	-	7.4	4.2	3.4%	0.0%	2.3%	0.5	0.5	0.4	1.0
PGO	UW	5.20	23.1	29.0	29.1	13.7	14.7	13.6	0.0%	0.0%	1.0%	2.7	2.3	2.0	0.5
Selena FM	MW	14.19	15.8	8.0	8.2	5.4	4.5	5.0	2.7%	2.0%	2.5%	0.8	0.8	0.7	1.0
Zamet Industry	UW	3.60	11.6	11.5	11.1	9.2	7.4	6.8	8.9%	0.0%	3.1%	3.5	2.7	2.3	-0.1
ES System	MW	2.35	22.9	12.1	12.7	8.1	6.0	6.0	2.1%	2.1%	2.1%	0.7	0.6	0.6	-2.0
Forte	MW	49.40	20.3	14.3	12.9	13.1	10.0	9.3	1.9%	3.0%	3.5%	3.1	2.7	2.4	0.0
Zetkama	OW	66.69	12.9	10.5	10.8	8.7	6.9	6.9	0.0%	0.0%	2.8%	2.1	1.8	1.6	-0.3
Apator	MW	36.45	18.7	15.9	14.6	11.7	11.1	9.8	3.8%	3.0%	2.5%	4.9	4.4	3.7	0.0
Mercor	OW	7.10	9.6	10.0	9.8	1.4	6.9	6.8	0.0%	130.4%	0.0%	0.5	1.2	1.2	2.6
Pozbud	OW	4.40	10.1	12.7	10.0	6.8	9.2	7.1	2.0%	2.4%	2.4%	1.0	1.0	0.9	1.5
Ferro	MW	9.80	9.5	7.7	7.9	7.6	7.1	7.0	2.4%	10.2%	2.6%	2.7	2.5	2.0	1.9
Relpol	OW	6.68	13.0	11.3	8.6	6.1	5.2	4.3	5.5%	3.7%	4.0%	0.9	0.9	0.8	0.1
Seco Warwick	MW	21.50	14.9	39.6	15.4	8.2	17.7	8.7	0.0%	3.3%	1.3%	1.2	1.3	1.2	0.7
Ergis Eurofilms	MW	4.00	13.9	9.6	8.6	5.8	5.4	5.1	0.5%	2.5%	3.1%	1.2	1.1	1.0	2.2
ZM Ropczyce	MW	17.00	6.1	10.3	10.7	5.6	7.2	6.8	2.0%	3.8%	3.4%	0.4	0.4	0.4	3.9
Amica	MW	111.00	9.7	12.2	9.6	7.5	6.9	6.8	4.1%	3.2%	2.1%	2.2	2.0	2.0	1.0
ACE	MW	10.68	28.2	22.3	13.5	6.4	6.3	5.2	2.7%	9.2%	1.6%	1.4	1.6	1.5	0.9
Izostal	MW	5.35	13.3	37.7	14.4	9.7	19.8	9.0	3.4%	2.2%	0.8%	1.1	1.1	1.0	2.4
BSC Drukarnia	MW	25.90	14.3	13.1	12.3	7.6	6.7	5.9	1.9%	1.9%	1.9%	1.5	1.3	1.2	-0.9
Radpol	MW	8.30	13.9	13.9	11.3	9.0	8.1	7.0	2.4%	3.4%	2.2%	2.4	2.2	1.9	1.3
Hydrotor	MW	33.19	11.3	10.2	11.2	6.4	5.1	5.3	6.0%	6.0%	3.9%	1.0	1.0	1.0	-0.3
Duda	UW	7.29	8.8	12.4	10.5	5.6	6.2	6.3	0.0%	0.0%	0.0%	0.7	0.7	0.7	2.6
ZM Kania	MW	2.71	22.2	15.7	12.3	15.6	10.5	9.2	0.0%	0.0%	0.0%	2.3	2.1	1.8	2.9
Cognor	OW	1.40	-	11.3	3.9	9.9	6.4	5.8	0.0%	0.0%	0.0%	0.8	0.8	0.6	5.4
Kruszwica	MW	58.79	12.7	17.4	17.7	8.1	10.9	10.4	0.2%	4.0%	4.3%	2.1	2.0	2.0	1.4
Feerum	OW	15.45	12.2	20.8	8.9	8.4	12.6	6.1	0.0%	0.0%	1.7%	1.6	1.5	1.3	1.1
LZMO	MW	1.85	2.5	98.1	14.7	-	98.1	5.8	0.0%	0.0%	0.0%	1.0	1.0	0.9	6.9
Ceramika NG	MW	1.25	-	18.8	55.4	7.9	6.4	6.5	0.0%	5.3%	1.1%	0.4	0.4	0.4	2.4
Oponeo	MW	10.52	42.4	34.3	20.8	11.0	10.3	8.7	0.3%	0.7%	1.0%	2.6	2.4	2.2	-2.4
Elemental Holding	MW	3.19	20.2	14.3	12.7	19.1	12.8	10.4	0.0%	0.0%	0.0%	3.3	1.9	1.6	1.8
Koelner	MW	6.96	24.2	36.9	12.6	7.9	8.1	6.2	1.2%	4.7%	4.7%	0.7	0.7	0.7	3.9
Grajewo	MW	30.50	9.9	13.9	13.1	10.5	7.8	6.8	0.0%	0.0%	0.0%	2.8	2.3	2.0	0.4
Alchemia	UW	5.02	-	41.9	26.2	23.6	15.5	12.6	0.0%	0.0%	0.0%	1.9	1.8	1.7	1.3
Astarta	MW	75.00	7.7	6.1	2.2	7.4	3.3	2.9	0.1%	0.0%	2.5%	0.4	0.4	0.3	2.1
Boryszew	UW	6.30	100.4	15.9	14.0	13.7	9.3	8.4	0.0%	0.0%	0.0%	2.5	3.3	3.3	2.5
Impexmetal	OW	2.72	7.5	10.1	8.9	8.3	7.4	6.5	0.0%	0.0%	4.0%	0.6	0.6	0.5	2.5
Famur	OW	3.16	7.3	14.6	11.8	3.6	5.8	4.9	0.0%	26.6%	0.0%	1.6	2.2	1.9	0.3
Kernel	MW	8.75	6.3	-	4.2	4.7	8.4	3.7	0.0%	0.0%	2.9%	0.6	0.6	0.5	4.0
Kęty	MW	291.00	17.6	16.7	15.8	12.9	10.2	9.4	2.1%	3.4%	3.6%	2.4	2.3	2.2	0.8
Kopex	OW	10.84	11.9	12.0	9.4	5.1	5.5	5.0	0.5%	1.7%	1.7%	0.6	0.6	0.6	1.7
Rovese	UW	1.41	-	-	21.0	8.6	7.1	6.4	0.0%	0.0%	0.0%	0.8	1.0	0.9	2.5
Tarczyński	OW	11.85	14.4	14.1	9.3	7.1	7.2	6.0	0.9%	0.0%	0.0%	1.2	1.1	1.0	3.7
Vistal Gdynia	OW	11.19	7.8	11.1	6.3	8.2	8.3	6.1	0.0%	0.0%	0.0%	1.1	1.0	0.8	4.1

Source: Dom Maklerski mBanku; UW = Underweight, MW = Market Weight, OW = Overweight



Astarta		Hold										
Analyst: Jakub Szkopek		Current price:		PLN 18.75				Last rating		2014-06-06		
		Target price:		PLN 48.6								
(UAH m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	3 701.6	4 008.9	8.3%	4 956.3	23.6%	4 972.3	0.3%	Number of shares (m)		25.0		
EBITDA	880.3	670.4	-23.8%	1 549.5	131.1%	1 473.4	-4.9%	MC (current price, PLNm)		468.8		
EBITDA margin	23.8%	16.7%		31.3%		29.6%		EV (current price, PLNm)		1 184.6		
EBIT	616.9	376.6	-39.0%	1 236.8	228.4%	1 164.9	-5.8%	Free float		32.0%		
Net profit	467.4	244.0	-47.8%	309.7	26.9%	867.4	180.1%					
P/E	4.6	8.8		6.9		2.5		Price change: 1M		-27.9%		
P/CE	2.9	4.0		3.4		1.8		Price change: 6M		-60.4%		
P/BV	0.6	0.5		0.4		0.4		Price change: 12M		-71.5%		
EV/EBITDA	5.4	7.8		3.5		3.1		Low (52 weeks)		14.5		
Dyield (%)	0.0	0.1		0.0		2.2		High (52 weeks)		68.0		

**Ukrainian plants produced 1.2 million tons of sugar in 2013, a quantity 46% lower than produced in 2012 and well below annual consumption. The estimated sugar inventory at the beginning of 2014 was 1.9mmt, much closer to the volume of local demand excluding Crimea. Astarta reported weak financial results in Q3 2014 due to high SG&A expenses and higher-than-expected losses on value adjustments to biological assets. As sugar beet harvesting comes to an end, given the recent drop in the share price, AST may be set for a rebound in the coming weeks. We stand by our hold rating for AST.**

### 2014 3Q results

At UAH 1522.8m, the Q3 2014 revenue of Astarta came 15.0% ahead of expectations and showed year-on-year growth of 48.3%. In sugar, revenue was 3% higher than anticipated despite 7.7% lower-than-average sales prices and thanks to 8.9% higher volumes. Sales of soybean oil exceeded our expectations by 58.5%, and sales of grains beat our estimate by 29.6% (on 45.1% higher volume and 10.7% lower sales prices). Milk sales came in line with expectations. The Q3 gross profit adjusted for biological asset adjustments came in at UAH 338.6m, showing y/y growth of 39.8% but falling 18.1% short of our forecast. The asset valuation effects amounted to UAH -210.2m vs.

UAH -68.2m expected. SG&A expenses were very high in Q3, exceeding our forecast by 59.4% and other operating expenses as well proved 40% higher than anticipated. All told, the Q3 EBITDA missed our estimate by 90% and EBIT showed an operating loss. After FX charges and interest expenses of UAH 302m (we expected UAH 388.8m), the Q3 2014 net loss came in at UAH 370.3m vs. our forecast of UAH -171.0m.

Astarta generated operating cash flow of UAH 9894 in Q3 2014 vs. UAH 48.1m in Q3 2013. Net debt at 30 September was UAH 3.5bn, marking an increase of UAH 360m from 30 June driven by the UAH's depreciation vs. EUR and USD. The net debt/12M EBITDA ratio was 3.2x.

Astarta achieved 81% of our FY2014 annual revenue forecast, 98% of expected EBITDA, and 100% of our net profit estimate in the nine months through September.

### Sugar prices in Ukraine

Ukrainian sugar prices have taken a downward shift as the beet harvesting season gets underway, falling from an all-time high of UAH 9200/t to UAH 7000/t since September. Our forecast of the 2014 price average is UAH 7222/t.

Boryszew		Reduce									
Analyst: Jakub Szkopek		Current price:		PLN 6.3				Last rating		2014-08-06	
		Target price:		PLN 5.2							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	4 881.2	4 838.3	-0.9%	5 101.7	5.4%	5 337.4	4.6%	Number of shares (m)		220.0	
EBITDA	243.9	206.4	-15.4%	294.3	42.6%	312.5	6.2%	MC (current price, PLNm)		1 386.0	
EBITDA margin	5.0%	4.3%		5.8%		5.9%		EV (current price, PLNm)		2 723.1	
EBIT	134.3	97.1	-27.7%	171.8	76.9%	189.2	10.2%	Free float		42.9%	
Net profit	39.3	13.8	-64.9%	87.2	532.2%	99.0	13.4%				
P/E	36.2	100.4		15.9		14.0		Price change: 1M		-1.6%	
P/CE	9.5	11.3		6.6		6.2		Price change: 6M		22.3%	
P/BV	3.3	2.2		2.8		2.7		Price change: 12M		14.5%	
EV/EBITDA	11.0	13.7		9.3		8.4		Low (52 weeks)		4.1	
Dyld (%)	0.0	0.0		0.0		0.0		High (52 weeks)		7.0	

**Boryszew offered new shares in a private placement to Alchemia (15.0 million shares acquired for PLN 82.5m) and the principal shareholder Mr. Roman Karkosik (5.0 million shares for PLN 27.5m). To ensure sufficient cash for payment, Boryszew's subsidiary Impexmetal had acquired 16.5 million shares in Alchemia for approximately PLN 87m from the two investors in the course of the prior seven months. This means that the actual proceeds from the July issue will be small at just a little over PLN 20m. Moreover, the strengthened ownership ties between members of the Boryszew Group are likely to dampen investors' sentiment (on concerns about further ALC share purchases in the future at unfavorable prices). After the capital raise, BRS shares are currently trading at premiums of 17% and 56% to peer 2014-2015E P/E and EV/EBITDA multiples. Boryszew reported weak financial performance in Q3 2014 and we were especially disappointed with the huge debt and the falling profits of the Automotive segment. On an adjusted basis, Boryszew achieved 75.1% of our annual revenue estimate, 67.8% of expected EBITDA, and 40.9% of the net profit estimate in 9M 2014. We stand by our reduce rating for BRS.**

### 2014 3Q results

At PLN 1,295.7m, the Q3 2014 revenue of Boryszew came in line with expectations after 3.7% y/y growth. By segment, the quarterly sales of Impexmetal were in line and other holding company activities generated PLN 5.0m higher-than-expected revenue while sales of automotive parts fell 8.2% short of expectations after flat growth from Q3 2013. Finally, sales of chemicals showed an 11.4% drop from last year resulting from a unit divestment.

As for segmental EBIT results, Impexmetal posted an operating profit of PLN 82.3m in Q3 while the Automotive segment incurred an operating loss of PLN 5.0m even after PLN 10.2m one-time gains from other operating activity. Holding activity EBIT showed a higher-than-expected operating loss of PLN 6.4m vs. PLN 3.0m. Boryszew

generated a one-time gain of PLN 41.1m on other operating activity in Q3 2014 including a PLN 28.6m divestment gain and charge reversals. Adjusted for the one-offs, the quarterly EBITDA figure is 9.0% lower than our estimate and EBIT falls 22.4% short of the mark, with the bottom line showing a net quarterly loss.

Boryszew generated negative cash flow of PLN -27.4m in Q3 2014 vs. PLN +91.6m recorded in Q3 2013. Net debt at 30 September was at a record high of PLN 897.2m (3.5x 12m EBITDA or 4.2x EBITDA adjusted for one-offs) and this is all the more worrying that the Company has recently decided to resume the share buyback program and buy out the minority interests in Hutmen.

Summing up, we have a negative view of Boryszew's financial performance especially the huge debt and the falling profits of the Automotive segment. On an adjusted basis, Boryszew achieved 75.1% of our annual revenue estimate, 67.8% of expected EBITDA, and 40.9% of the net profit estimate in 9M 2014.

### Management on post-Q3 outlook

Boryszew is planning to spend about PLN 150m on capital projects in 2015, about the same as in 2014, with the investment focused on the automotive and aluminum business. Part of the CAPEX is allocated to the construction of a factory in Mexico. Sales of auto parts could be PLN 200m higher in 2015 than in 2014 according to CEO Szeliga. In addition, Boryszew is looking into M&A opportunities that could offer synergies. The expenditure on the Mexico project is projected at PLN 40m over three years. Boryszew's profits at the moment are being weighed down by the factory in Russia which is experiencing low demand combined with political risk and a weak ruble, and which may not recover next year CEO Szeliga stand by his promise that the second half of 2014 has been much better for Boryszew than the first half. Our financial forecasts for Boryszew assume 2015 CAPEX at PLN 80m, half of the PLN 150m suggested by the CEO.

Famur		Buy										
Analyst: Jakub Szkopek		Current price:		PLN 3.16				Last rating		2014-12-05		
		Target price:		PLN 3.8								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	1 471.5	1 176.4	-20.1%	839.1	-28.7%	924.6	10.2%	Number of shares (m)		481.5		
EBITDA	455.6	384.7	-15.6%	274.2	-28.7%	300.7	9.6%	MC (current price, PLNm)		1 521.5		
EBITDA margin	31.0%	32.7%		32.7%		32.5%		EV (current price, PLNm)		1 591.5		
EBIT	348.9	224.6	-35.6%	132.6	-41.0%	166.4	25.5%	Free float		16.8%		
Net profit	271.1	207.6	-23.4%	104.1	-49.9%	128.9	23.8%					
P/E	5.6	7.3		14.6		11.8		Price change: 1M		-4.2%		
P/CE	4.0	4.1		6.2		5.8		Price change: 6M		-32.8%		
P/BV	1.7	1.3		1.8		1.6		Price change: 12M		-39.9%		
EV/EBITDA	3.4	3.6		5.8		4.9		Low (52 weeks)		2.9		
Dyild (%)	0.0	0.0		26.6		0.0		High (52 weeks)		5.5		

**Huge exposure in Q1-Q3 to the local market (at 80-90% of total sales) where orders for mining equipment are few and far between means Famur's revenues this year are set for contraction. At the same time, contracts acquired from customers in Russia (OAO SUEK-Kuzbass, Arcelor Mittal) and Turkey (Hattat Enerji Ve Madec Tic), with a total value of PLN 465m, will cushion the revenue slowdown. From a low 2014 base, we believe Famur is set to report rising profits throughout 2015. The financial results for Q3 2014 fell short of our estimates but matched consensus expectations. We are upgrading Famur from hold to buy.**

### Famur meets consensus expectations in Q3

At PLN 137.4m, the Q3 2014 revenue of Famur missed our forecast by 13.6% and fell 6.5% short of the consensus estimate. By segment, revenues fell short of our expectations across the board, and compared to Q2 2014 sales of transportation systems fell 27.3%, sales of gallery systems were down 5.5%, while sales of longwall systems increased 14.3%. The consolidated quarterly gross profit fell 17.2% short of our estimate at PLN 47.2m (+5.0% q/q). By segment, gross margins exceeded forecasts in gallery systems (67.8% vs. 60.0%) and transportation systems (32.2% vs. 19.0%) but missed the mark (at 16.7% vs. 30.0% expected) in longwall systems. Q3 EBITDA was 8.2% lower than our estimate but it came 4.6% ahead of consensus after a PLN 1.0m boost from one-time gains. At PLN 24.1m, the Q3 2014 bottom-line loss logged by Famur was lower than anticipated thanks to negative tax of PLN -0.9m.

Famur generated operating cash flow of PLN 71.0m in Q3 2014 vs. PLN 97.7m in Q3 2013. Net debt as of 30 September 2014 was PLN 17.5m.

Famur achieved 54% of our FY2014 annual revenue forecast, 69% of expected EBITDA, and 68% of our net profit estimate in the nine months through September 2014. The Company is scheduled to start work on several contracts abroad in Q4, suggesting a better quarter for the longwall systems business.

### Famur secures order from Russia

Famur signed a contract for delivery of a EUR 25.85m longwall system to Russia's OAO SUEK-Kuzbass. The deadline is in Q1 2015.

### Famur buys PLN 69m controlling stake in Famak

Famur paid PLN 69.1m for a controlling stake in Famak, producer of loading and overhead cranes. Famur's intention is to reinforce Famak's market position through further development and eventually build a new company called "Famur Fugo Famak" integrating the surface mining and loading business after the acquisition in August of a controlling stake in the mining equipment producer Fugo by TDJ.

### Famur secures orders from Opole power station

Famur and consortium partner Famak acquired a contract to deliver two turnkey stoking and deslagging systems to the Opole power station for a fee of PLN 139.75m. The deadlines are in November 2018 and in March 2019. The contract boosted Famak's order backlog to PLN 300m.

Impexmetal		Buy						
Analyst: Jakub Szkopek		Current price:		PLN 2.72		Last rating		
		Target price:		PLN 3.4		2014-08-18		
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	2 596.3	2 728.7	5.1%	2 764.1	1.3%	2 920.0	5.6%	Number of shares (m)
EBITDA	137.0	125.0	-8.8%	133.5	6.8%	147.1	10.2%	MC (current price, PLNm)
EBITDA margin	5.3%	4.6%		4.8%		5.0%		EV (current price, PLNm)
EBIT	79.1	72.8	-8.0%	77.3	6.1%	89.8	16.2%	Free float
Net profit	56.5	72.7	28.8%	53.8	-26.0%	61.0	13.4%	
P/E	9.6	7.5		10.1		8.9		Price change: 1M
P/CE	4.8	4.4		4.9		4.6		Price change: 6M
P/BV	0.6	0.6		0.5		0.5		Price change: 12M
EV/EBITDA	6.9	8.3		7.4		6.5		Low (52 weeks)
Dyield (%)	0.0	0.0		0.0		4.0		High (52 weeks)

**Despite an over-75% surge year to date in the premiums charged for physical delivery of aluminum, Impexmetal managed to grow per-ton EBITDA by 21% in Q3 2014 to the highest quarterly level since Q3 2011. The Company has been able to pass the increasing costs of raw aluminum inputs onto end customers, moreover, it has increased the share of high-margin thin sheet metal in the sales mix. 2014 third-quarter results came well ahead of expectations across all business lines and as a result Impexmetal achieved 77% of our FY2014 annual revenue forecast, 93% of expected EBITDA, and 120% of our net profit estimate in the nine months through September 2014, necessitating upward revisions to our current forecasts. We stand by our positive investment rating for Impexmetal.**

### 2014 3Q results

At PLN 751.3m, the Q3 2014 revenue of Impexmetal came 1% ahead of our forecast and showed year-on-year growth of 2.1%. By segment, revenue in zinc & lead was 36.8% higher than anticipated on 9.5% higher volumes, while revenue from aluminum product sales missed our mark by 4.2% on 2.6% higher volumes and revenue in copper fell 34.7% short of expectations despite 16.3% higher sales volume (we would attribute this to a less favorable sales mix or a change in the accounting approach). EBITDA beat our

estimate by 51.8% at PLN 56.4m, marking 36.4% expansion from last year. Compared to our expectations, EBIT came 25.9% higher in aluminum, 51.4% higher in copper, 274.8% higher in zinc & lead, and 109.0% in bearings, after posting all-out year-on-year growth. Other operating activity in Q3 generated a small loss of PLN 2.9m. Net profit at PLN 32.3m topped our estimate by 86.5% after soaring 79.3% year on year.

Operating cash flow amounted to PLN -12.2m in Q3 2014 vs. PLN +48.6m reported in Q3 2013. Net debt was PLN 410.4m at 30 September vs. PLN 344.4m at 30 June, rising on Alchemia share purchases and the negative cash flow from operations.

Impexmetal achieved 77% of our FY2014 annual revenue forecast, 93% of expected EBITDA, and 120% of our net profit estimate in the nine months through September 2014.

### Aluminum prices and input costs

Premiums charged by primary aluminum suppliers took a downward turn in March 2013 after sharp increases observed from H2 2012 through February 2013, hitting a year-to-date low of USD 240/t in October 2014. As of today, however, the premiums are back at high levels again at \$495/t after a ytd increase of 76%.

Kernel		Hold									
Analyst: Jakub Szkopek		Current price:		PLN 29.74				Last rating		2014-07-07	
		Target price:		PLN 32.5							
(USD m)	2011/12	12/13	change	13/14F	change	14/15F	change	Key metrics			
Revenue	2 157.4	2 796.8	29.6%	2 421.3	-13.4%	2 190.8	-9.5%	Number of shares (m)		79.7	
EBITDA	322.0	290.7	-9.7%	161.0	-44.6%	352.2	118.8%	MC (current price, PLNm)		2 369.8	
EBITDA margin	14.9%	10.4%		6.6%		16.1%		EV (current price, PLNm)		3 070.9	
EBIT	256.5	200.9	-21.7%	67.7	-66.3%	252.5	272.9%	Free float		61.8%	
Net profit	206.7	111.3	-46.2%	-39.9		165.7					
P/E	3.4	6.3				4.3		Price change: 1M		17.7%	
P/CE	2.6	3.5		13.2		2.7		Price change: 6M		-3.6%	
P/BV	0.6	0.5		0.5		0.5		Price change: 12M		-25.7%	
EV/EBITDA	2.9	3.1		5.7		2.5		Low (52 weeks)		22.0	
Dyield (%)	0.0	0.0		0.0		2.8		High (52 weeks)		42.0	

The Ukrainian inventory of sunflower seeds was 85% higher at the beginning of April than at the same time last year, and this is expected to drive production and sales of sunflower oil in 2014. Kernel is also benefitting from increasing seed crushing margins (+14% y/y in Q2'14) facilitated by the 2013 bumper sunflower harvest. As for the crops and trade segments, their profitability is poised to expand in Q4 2014 after the Ukrainian government resumes payment of VAT refunds to exporters. Moreover, thanks to increased fertilization, Kernel expects to achieve higher yields on its cropland in the 2013/2014 season, and since it exports 90% of its output abroad a weak hryvnia is set to help reduce its local costs and improve margins. Kernel's Q3 2014 results beat expectations and showed year-on-year growth and the results for the second quarter of 2015 ending on 31 December continue to be supported by favorable base effects. We maintain a neutral rating for Kernel.

### 2014 3Q results

At USD 579.2m, the Q1 FY2015 (calendar Q3 2014) revenue of Kernel exceeded our forecast by 27.7% after a year-on-year surge of 40.3%. By segment, relative to our forecasts, sales of bulk sunflower oil were 16.1% higher on higher prices (possibly achieved through higher sales of sunflower meal) and sales of grain were 27.7% higher also on higher prices. The FY2015 first-quarter EBITDA came in at \$80.5m, topping our estimate by 80.8% and far exceeding the year-

ago result of \$3.0m. Compared to our expectations, EBITDA in the bulk oil segment came 21.1% ahead, with per-ton EBITDA at \$88.8 (vs. \$3.6 in Q1 FY2014 and \$75 anticipated by us) reaching its highest level in two years. In the grain segment, EBITDA beat our estimate by an impressive 84.6%, with per-ton EBITDA at \$14.5 vs. \$7.8 anticipated. Farming operations generated EBITDA of \$10.7m vs. \$2.0m expected and a year-ago EBITDA loss of \$6.4m, with the improvement driven by much better crop yields. Value adjustments to biological assets resulted in a charge of \$1.6m against the quarterly operating profit, lower than the \$9.4m loss incurred in Q1 FY2014. Kernel incurred higher-than-expected FX losses of \$17.2m (vs. \$13.7m in USD) in Q1 on a weakened hryvnia and VAT currency conversion. All told, Kernel's FY2015 first-quarter bottom line showed a net profit of \$23.4m, beating our expectations of a \$5.6m loss.

Unusually for Kernel, the Q1 operating cash flow was positive at \$46.0m (vs. \$-35.9m in Q1'14) thanks to earlier seed stockpiling and higher sales of vegetable oil and grains. Net debt as of 30 September was down to \$647.7m from \$677.8m at 30 June and it was equivalent to 2.2x 12M EBITDA (2.6x excluding the effects of other operating activity).

Kernel's profits in the second quarter of 2015 ending on 31 December continue to be supported by favorable base effects combined with low-cost seed stockpiles and high sales of grains.

Kęty		Hold										
Analyst: Jakub Szkopek		Current price:		PLN 291				Last rating		2014-07-01		
		Target price:		PLN 226.8								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	1 568.1	1 593.8	1.6%	1 773.5	11.3%	1 886.3	6.4%	Number of shares (m)		9.4		
EBITDA	224.2	225.9	0.7%	292.0	29.3%	309.6	6.0%	MC (current price, PLNm)		2 729.8		
EBITDA margin	14.3%	14.2%		16.5%		16.4%		EV (current price, PLNm)		2 965.5		
EBIT	142.1	144.9	2.0%	208.3	43.8%	224.0	7.5%	Free float		48.0%		
Net profit	117.0	153.5	31.1%	163.3	6.4%	172.3	5.5%					
P/E	22.9	17.6		16.7		15.8		Price change: 1M		4.6%		
P/CE	13.5	11.5		11.1		10.6		Price change: 6M		34.2%		
P/BV	2.6	2.4		2.3		2.2		Price change: 12M		32.3%		
EV/EBITDA	13.0	12.9		10.2		9.4		Low (52 weeks)		190.0		
Dyid (%)	1.7	2.1		3.4		3.6		High (52 weeks)		297.6		

**Kęty's financial results for Q3 2014 came in line with guidance and our expectations. As predicted, the Company has kept the annual guidance intact after Q3. For Q4 2014, we anticipate double-digit growth in EBITDA and EBIT, but net profit is likely to show year-on-year contraction from a high year-ago base. A strengthening dollar could negatively affect Kęty's share price in the short term as it drives up the costs of aluminum inputs and thus reduces margins on aluminum products. We are reiterating a hold rating for KTY.**

### Kęty to build packing film factory

Kęty's new growth plan for the flexible packaging business includes the construction of a new facility to produce plastic film and engraved cylinders for roto packaging print. The costs are estimated at PLN 150m, and the expected launch date for the factor is Q1 2017. The new production facilities are part of a broader growth strategy for the years 2015-2020 which Kęty is set to unveil in the first quarter of 2015.

### Aluminum prices and input costs

Premiums charged by primary aluminum suppliers took a downward turn in March 2013 after sharp increases observed from H2 2012 through February 2013, hitting a year-to-date low of USD 240/t in October 2013. As of today, however, the premiums are back at high levels again at \$495/t after a ytd increase of 76%.

Kopex		Buy						
Analyst: Jakub Szkopek		Current price:		PLN 10.84		Last rating		2014-07-07
		Target price:		PLN 14.5				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	2 022.2	1 395.1	-31.0%	1 413.4	1.3%	1 497.0	5.9%	Number of shares (m)
EBITDA	234.3	235.6	0.5%	216.9	-8.0%	232.2	7.1%	MC (current price, PLNm)
EBITDA margin	11.6%	16.9%		15.3%		15.5%		EV (current price, PLNm)
EBIT	109.6	91.2	-16.7%	97.7	7.1%	120.2	23.1%	Free float
Net profit	54.7	67.6	23.5%	67.2	-0.5%	85.8	27.6%	
P/E	14.7	11.9		12.0		9.4		Price change: 1M
P/CE	4.5	3.8		4.3		4.1		Price change: 6M
P/BV	0.3	0.3		0.3		0.3		Price change: 12M
EV/EBITDA	6.6	5.1		5.5		5.0		Low (52 weeks)
Yield (%)	0.0	0.5		1.7		1.7		High (52 weeks)

**Famur withdrew from the acquisition of Kopex which means there is a higher probability that soon its owner TDJ will sell between 4.7 and 7.4 million of Kopex shares through the stock market. In the mean time, KPX stock remains under pressure, but once the TDJ interests hit the market we would take this as an opportunity to increase positions in Kopex. Kopex delivered an upside surprise for the third time this year with the financial results for Q3 2014, and it achieved 71% of our FY2014 annual revenue forecast, 105% of expected EBITDA, and 126% of our net profit estimate in the nine months through September 2014, necessitating upward revisions to the current forecasts. We stand by our buy rating for KPX.**

### 2014 3Q results

At PLN 322.4m, the Q3 2014 revenue of Kopex missed our forecast by 6.6% and fell 1.6% short of the consensus estimate. The core segments of mining services, underground mining equipment, and electrical and electronic equipment all missed expectations when it came to the quarterly sales while sales of coal beat our forecast by 39.7% and other sales came 213.6% higher. On lower-than-expected sales, the Q3 2014 gross profit exceeded our forecast by 8.4% after a 1.0% y/y decline. As for gross margins, they amounted to 25.0% in mining services (vs. 19.0% expected and 16.0% in Q3 2013), 24.4% in underground mining equipment (vs. 17.0% expected and 18.3% in Q3'13), and 32.6% in electrical and electronic equipment (vs. 35.0% expected and 27.9% in Q3'13). Kopex incurred surprisingly low SG&A expenses in Q3 2014 which

proved 13.1% lower than our forecast after a y/y drop of 23.1%. Other operating activity generated a one-time loss of PLN 4.0m in Q3. EBITDA exceeded our estimate and consensus by nearly 14% and it showed slight expansion from a high year-ago base despite the one-time loss on other operating activity. After all this, Q3 net profit at PLN 26.3m beat our estimate by 36.1%.

Kopex generated operating cash flow of PLN 52.2m in Q3 2014 (66.8% of Q3 EBITDA), and its net debt as of 30 September was PLN 417.1m (1.4x 12M EBITDA) after increasing by PLN 18.2m from 30 June and it achieved 71% of our FY2014 annual revenue forecast, 105% of expected EBITDA, and 126% of our net profit estimate in the nine months through September 2014, necessitating upward revisions to the current forecasts.

### Management on post-Q3 outlook

Kopex confirmed during the Q3 earnings conference that the improvement reported for the last several quarters has been owed to cost cuts and streamlining. Going forward, the Company faces weak demand from Polish coal mines and as a remedy it is looking for business opportunities among foreign mines producing resources other than coal. Kopex's order backlog at 30 September 2014 was 4% lower than at the same time last year at PLN 1.396 billion, with the core business backlog totaling PLN 1.376bn. In a bit of good news, Kopex's Argentinian customer resumed payments recently (the work left to be delivered under the contract by 30 June 2015 is worth about PLN 140m).



Rovese								Sell	
Analyst: Jakub Szkopek		Current price:		PLN 1.41		Last rating		2014-11-26	
		Target price:		PLN 1.37					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	1 669.0	1 870.5	12.1%	1 770.2	-5.4%	1 835.3	3.7%	Number of shares (m)	811.4
EBITDA	162.3	213.9	31.8%	247.2	15.6%	259.0	4.7%	MC (current price, PLNm)	1 144.1
EBITDA margin	9.7%	11.4%		14.0%		14.1%		EV (current price, PLNm)	1 759.3
EBIT	18.2	37.4	105.0%	77.7	107.9%	92.5	19.1%	Free float	28.4%
Net profit	-62.8	-64.4	2.6%	-168.3	161.4%	54.5			
P/E						21.0		Price change: 1M	-4.7%
P/CE	14.1	10.2		887.9		5.2		Price change: 6M	6.8%
P/BV	0.5	0.6		0.7		0.7		Price change: 12M	-38.7%
EV/EBITDA	8.3	8.6		7.1		6.4		Low (52 weeks)	1.2
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks)	2.3

In the last five years, Rovese raised a whopping PLN 917.2m through three equity offerings while generating only PLN 46.7m free cash flow. In the same period, the cumulative EBITDA dropped 16.5% (despite plant acquisitions completed in 2013) and the EBITDA margin shrunk by 6.6ppts. In the five years since we cover Rovese, the Company's quarterly earnings results exceeded our expectations only once, in Q2 2011. Otherwise, fourteen out of the nineteen quarterly resorts were a source of disappointment. At the current market cap, Rovese's price-to-book ratio not including acquisition gains amounts to 0.97x. In our view, the only factor which could justify a valuation of Rovese above the current market cap (PLN 1.1bn) is its replacement value estimated at PLN 4.1bn. Unfortunately, in the current market, characterized by oversupply and weakening demand, the development of new tile capacity to add to the already existing overcapacity is not a viable option for any business. Our 9-month price target for RSE is 3.6% higher than the price offered in the upcoming tender offer by the businessman Michał Sołowow, presenting a good opportunity to exit a troubled investment.

### 2014 3Q results

At PLN 532.2m, the Q3 2014 revenue of Rovese exceeded our estimate by 7.3% after y/y growth of 5.3%. By segment, sales of ceramic tiles were 7.9% higher than anticipated after 7.7% growth from Q3 2013, sales of sanitaryware rose 0.9% from last year, and sales of other ceramics grew 3.9%. The gross profit margin remained weak In Q3 at 31.8% (vs. 32.5% expected by us and 31.7% posted in Q3'13) and the gross profit showed y/y contraction of 4.9%. SG&A expenses proved 28% higher than anticipated even after a year-on-year reduction of 9.8%. Other operating activity generated a

small loss of PLN 0.4m. Q3 2014 EBITDA at PLN 78.6m came in line with our forecast but fell 4.5% short of market expectations but after lower-than-anticipated D&A (at PLN 39.4m vs. PLN 43.5m consensus) EBIT exceeded all expectations. Rovese recognized FX gains on loan value adjustments of PLN 2.2m in Q3 2014 vs. FX losses of PLN 3.2m expected by us and as a result the quarterly pre-tax profit was 22.9% higher than we had assumed. After a low effective tax rate of 8.1%, the quarterly net profit beat our forecast by 40.1%.

Rovese generated operating cash flow of PLN 76.5m in Q3 2014 vs. PLN 86.9m in Q3 2013. Net debt as of 30 September 2014 was PLN 720.9m (3.2x 12M EBITDA).

### Rovese targeted in acquisition bid

A tender offer for 339.2 million Rovese shares representing 41.8% of all shares outstanding was announced in November by the businessman Michał Sołowow and his subsidiary FTF Galleon, offering to pay PLN 1.42 per share (PLN 478m total). The bid is designed to run in three stages, the first starting on 3 and ending on 8 December, the second lasting from 9 to 15 December, and the third lasting from 16 December to 8 January 2015. The goal is to acquire a 100% voting stake in Rovese and delist it from the Warsaw Stock Exchange. Today, Mr. Sołowow directly and indirectly holds a 65.99% stake in Rovese (the indirect holdings are via FTF Galleon with 51.91% and Calgeron Investment Limited (a subsidiary of Synthos) with 7.8%).

### Prices of building materials in October

The building materials wholesaler PSB saw a 4% increase in sales in October compared to the same month a year ago, with year-to-date sales for the first ten months up 13% year on year. At the same time, prices of ceramic tiles and bathroom and kitchen fittings declined by 0.2% m/m.

Tarczyński										Buy									
Analyst: Jakub Szkopek				Current price:		PLN 11.85								Last rating		2014-12-03			
				Target price:		PLN 14.6													
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics											
Revenue	386.7	448.3	15.9%	484.8	8.2%	540.5	11.5%	Number of shares (m)						11.3					
EBITDA	33.2	32.9	-1.0%	39.2	19.1%	42.4	8.1%	MC (current price, PLNm)						134.5					
EBITDA margin	8.6%	7.3%		8.1%		7.8%		EV (current price, PLNm)						280.9					
EBIT	21.2	17.3	-18.4%	19.1	10.4%	23.3	22.0%	Free float						44.2%					
Net profit	10.8	9.3	-13.8%	9.5	2.5%	14.4	51.2%												
P/E	7.0	14.4		14.1		9.3		Price change: 1M						20.2%					
P/CE	3.3	5.4		4.5		4.0		Price change: 6M						1.3%					
P/BV	1.2	1.2		1.1		1.0		Price change: 12M						-17.7%					
EV/EBITDA	5.0	7.1		7.2		6.0		Low (52 weeks)						9.3					
Dyid (%)	6.0	0.9		0.0		0.0		High (52 weeks)						15.2					

**Tarczyński is expected to grow sales volumes by 12% in 2015 driven by the launch of the new processing plant, the entry into the new markets of Czech Republic and Slovakia under the Lidl label, and growing deli meat sales in the UK. What is more, the Company has renewed its partnership with the meat distributor Bruno Tassi which before the 2013 IPO accounted for over 10% of total sales. The outlook for Q4 2014 and Q1 2015 is buoyed by falling prices of raw pig meat which today are 10.5% lower than the average for the last eleven months. We believe the new processing plant will not drive up Tarczyński's D&A expenses which in 2015 are expected to drop by PLN 1m to PLN 19m through extended depreciation periods (compared to local rivals, to date, the depreciation rate at TAR has been 13% higher than at PKM Duda and 90% higher than at ZM Kania). As a result, we project that 2015 EBIT and net profit will show respective growth of 22% and 50% and we maintain a buy rating for TAR.**

### 2014 3Q results

At PLN 127.2m, the Q3 2014 revenue of Tarczyński was 9.1% lower than our forecast after year-on-year growth of 5.3%. On lower prices and stockpile draws, the quarterly gross profit increased to PLN 25.4m. D&A expenses were higher than our PLN 5.1m projection at PLN 5.2m. Selling expenses came PLN 1.8m lower than our estimate at PLN 14.8m (thanks to lower marketing costs) and general expenses came in at PLN 3.9m vs. PLN 4.6m anticipated.

Other operating activity in Q3 generated a small gain of PLN 0.4m EBITDA exceeded forecasts by 27.3% after soaring PLN 72.4m from Q3 2013. The EBITDA margin reached its highest level since Q4 2012 at 9.6%. After in-line financing activity, net profit for Q3 2014 beat our expectations by 54.8% after a y/y surge of 87.4%.

Tarczyński achieved 72% of our FY2014 annual revenue forecast, 82.3% of expected EBITDA, and 100% of our net profit estimate, in the nine months through September 2014. Accordingly, we have revised our annual revenue forecast downward by 3.5% to PLN 490-500m while raising the EBITDA estimate by 15% to PLN 41-42m and upgrading the net profit estimate by PLN 40.9m to PLN 11-11.2m.

Tarczyński generated operating cash flow of PLN 30.7m in Q3 2014 vs. PLN 11.1m in Q3 2013. After factoring payments of PLN 18.6m, net debt at 30 September was PLN 137.0m vs. PLN 134.3m at 30 June 2014.

As prices of fresh pig meat remain low, Tarczyński's earnings outlook for Q4 2014 is buoyant as well.

### Price trends in pig meat

Prices of pig carcass as quoted by Germany's ZMP took an upward turn in June, reaching EUR 1.78 per kilogram, but in the last few months they plummeted to EUR 1.40/kg – the lowest level since February. The year-to-date price average is EUR 1.60/kg.

**Vistal**
**Buy**

Analyst: Jakub Szkopek	Current price:		PLN 11.19					Last rating	2014-10-15
	Target price:		PLN 16.9						
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	230.2	283.4	23.1%	290.3	2.4%	355.2	22.3%	Number of shares (m)	14.2
EBITDA	10.8	34.2	216.1%	37.7	10.1%	49.4	30.9%	MC (current price, PLNm)	159.0
EBITDA margin	4.7%	12.1%		13.0%		13.9%		EV (current price, PLNm)	314.3
EBIT	0.0	23.5		22.2	-5.5%	33.7	51.7%	Free float	29.6%
Net profit	1.1	20.4	1789.3%	14.3	-29.8%	25.2	76.4%		
P/E	103.7	7.8		11.1		6.3		Price change: 1M	-16.9%
P/CE	9.4	5.1		5.3		3.9		Price change: 6M	-27.8%
P/BV	1.4	1.1		1.0		0.8		Price change: 12M	-6.8%
EV/EBITDA	19.9	8.2		8.3		6.1		Low (52 weeks)	11.2
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks)	17.9

According to our calculations, at least five bridge projects with a total value of PLN 283m are set to commence in Poland in the second half of 2014. This will be followed by expenditures on new bridge infrastructure to the tune of PLN 427.5m minimum in 2015, and PLN 1,114m in 2016, comprising 33 bridges of which fifteen at a cost exceeding PLN 50m. In Vistal's other key operating segment of offshore drilling solutions demand is on an upward momentum as international customers gain awareness about the high quality of Polish products (in case of Vistal the quality is guaranteed by a new state-of-the-art production facility which is the largest in the Baltic Sea area) and seek cheaper workforce (Polish welders earn about three times less than their counterparts in Norway and half of the rates paid in Germany, the Netherlands, and Denmark). For example, Kvaerner, member of the Norwegian oil and gas industry provider Aker Solutions, names Polish firms among its core infrastructure suppliers. With this in mind, we are projecting an over-20% increase in Vistal's revenue in 2015 combined with EBITDA growth of 30%. In Q3 2014, Vistal delivered core financial results in line with our forecasts and ahead of consensus. We stand by our buy rating for VST.

**Vistal wins PLN 67m bridge contract**

Vistal was selected to build a river bridge in Malbork based on a bid of PLN 67.3m.

**2014 3Q results**

At PLN 76.4m, the Q3 2014 revenue of Vistal exceeded expectations by about 4%. with Infrastructure revenue 38.7% higher than anticipated and Marine&Offshore revenue falling 54.6% short. The quarterly gross profit came in at PLN 14.6m (we expected PLN 15.0m). By segment, the gross margin in Infrastructure was lower than anticipated at 18.6% vs. 25.0%, and the gross margin in Marine&Offshore topped our 16.5% estimate at 35.1%. SG&A expenses came in line with expectations, and other operating activity produced a gain of PLN 0.2m. As a result, the quarterly operating profit at PLN 6.8m exceeded our estimate slightly by 1.1% while beating consensus by a whopping 25.1%. After a high effective tax rate of 60%, the bottom-line profit fell far short of expectations; at the statutory tax rate, the quarterly net profit is 10.4% lower than our estimate but 25% higher than the consensus estimate.

Vistal generated operating cash flow of PLN 9.8m in Q3 2014 vs. PLN 12.0m in Q3 2013. Net debt stood at PLN 195.3m at 30 September 2014 after a q/q CAPEX of PLN 18.6m.

Vistal achieved 78% of our FY2014 annual revenue forecast, 74% of expected EBITDA, and 66% of our net profit estimate in the nine months through September 2014. In Q3 2014, Vistal delivered core financial results in line with our forecasts and ahead of consensus.

**Management on post-Q3 outlook**

Vistal's confirmed order backlog as of 30 September was PLN 217m, with orders pending confirmation estimated at PLN 161m and pending bids for new orders totaling PLN 407m. According to CEO Matyka, the Company will spend about PLN 3.1m still by the end of 2014 on capital investment.

The Q3 backlog of 217m compares to earlier end-of-quarter figures of PLN 210m in Q2, PLN 216m in Q1, and PLN 276m in Q4 2013. The value of pending orders (PLN 378m) compares to PLN 325m in Q2, PLN 402m in Q1, and PLN 334m in Q4 2013. Total confirmed and pending orders amounted to PLN 785m in Q3 vs. PLN 674m in Q2, PLN 654m in Q1, and PLN 686m in Q4 2013.

**Vistal secures order for offshore infrastructure**

Vistal signed a PLN 24.6m (net) contract for the delivery of a hull for a specialized wind farm service vessel. The contract is equivalent to 7% of our 2015 revenue projection and 15% of the expected revenue of the marine & offshore segment.

**Vistal gains vital partner in Budimex**

Vistal reported having acquired orders totaling PLN 17.1m, equivalent to over 10% of equity, from the construction firm Budimex in the last twelve months. The largest of the orders is a PLN 9.2m steel structure delivered for the purposes of a bypass road. The PLN 17.1m Budimex orders acquired in the last 12 months represent 5% of our 2015 revenue forecast for Vistal. Vistal acts as consortium partner for Budimex and Warbud in a number of infrastructure contract bids as a way of increasing its chances of securing subcontracting work.

## Construction

### Recommended portfolio allocations for tracked construction stocks

Company	Weight	Price (PLN)	MCap	Net Debt	EV	Revenue		Net Profit		EBITDA		P/E		EV/EBITDA	
						2014	2015	2014	2015	2014	2015	2014	2015	2014	2015
Elektrotim	OW	9.95	99	-13	87	208	239	4	9	9	15	24.2	10.6	9.2	5.8
Herkules	MW	2.93	127	98	225	112	123	8	11	31	38	16.7	11.5	7.2	5.6
Ulma	UW	68.99	363	-6	357	201	221	-6	8	65	82	-	43.7	5.3	3.7
Torpol	OW	10.00	230	-96	134	802	1 115	21	27	43	53	11.0	8.4	5.2	4.7
Trakcja	MW	1.09	448	170	618	2 134	1 926	39	36	87	84	11.6	12.4	7.3	7.1
ZUE	MW	6.72	155	-23	132	634	570	6	12	17	23	27.7	13.0	8.5	5.9

Source: Companies, Dom Maklerski mBanku; UW = Underweight, MW = Market Weight, OW = Overweight

We are downgrading Herkules from overweight to marketweight after the strong price increases logged in November and year to date. At the same time, we have raised our 2015 financial forecasts for the Company after Q3 2014 while lowering our projections for Ulma and ZUE without changing their portfolio weights. As for Elektrotim, we issued a rating update on 12 November with the portfolio weight upgraded from marketweight to overweight.

Elektrotim reported disappointing financial results for the first nine months of 2014 but in Q4 it is set for a rebound in revenues as well as profits. Moreover, the Company signed several material contracts in November which boosted its order backlog to a record PLN 264m, suggesting record revenues in 2015 as well as, hopefully, higher margins. We believe Elektrotim's earnings results next year will return to the levels seen in 2007-2009. On our forecasts, ELT is currently trading at 10.6x 2015E P/E and 5.8x EV/EBITDA. Last but not least, we expect the Company to pay DPS of at least PLN 0.60 next year, offering the sector's highest dividend yield at 6.1%. We maintain an overweight rating for Elektrotim.

Our updated financial forecasts for Herkules include slight upward revisions to the expectations for 2014 (with EBITDA raised 8% to PLN 30.8m and net profit upgraded by 2% to PLN 7.6m) and stronger revisions to the forecasts for 2015 with expected EBITDA raised by 32% to PLN 38.2m and net profit upgraded by 34% to PLN 11.1m. The upgrades were led by improving market conditions which have boosted the Company's order backlog to the highest level in years combined with the acquisition of a 64% stake in Viatron, supplier of rental cranes to wind farm builders, expected to add PLN 1.5m to the annual net profits. Herkules is set to decide on next year's dividend by the end of the first quarter 2015, and given its high debt we would not expect a big payout. HRS shares have gained 12% in the past month on the positive developments, and year to date they have increased by about 30%, outperforming all other construction stocks. The stock is currently trading at 11.5x 2015E P/E and 5.6x EV/EBITDA, close to the market average, but its high debt has prompted a downgrade in the portfolio weighting to marketweight even despite the raised earnings forecasts.

Torpol reported strong y/y growth in Q3 2014 and it left the annual earnings guidance intact. On our forecasts, Torpol is trading at 11.0x 2014E P/E and 5.2x EV/EBITDA – the best ratios in the sector (the guidance implies slightly higher multiples). Next year, we expect Torpol to experience revenue growth of ca. 40% to over PLN 1,100m with net profit coming in at ca. PLN 27m. Note that these projections are based

just on the existing order backlog. As for margins, we expect the 2015 gross margin to amount to 5.3% (9M 2014 margin was over 7%). On our FY2015E estimates, Torpol is valued at 8.4x P/E and 4.7x EV/EBITDA, and even after a surge of 24% since the July IPO it remains a top pick in the construction sector. We stand by our positive portfolio weighting for Torpol.

Trakcja is planning expansion in Scandinavia which is sure to generate strong revenue growth but not in several more years. We maintain that Trakcja will report strong financial results in 2014 but in 2015 and 2016 it is set for a slowdown due to protracted procedures for railroad contract awards. We maintain a marketweight rating for Trakcja.

Weaker-than-expected Q3 results prompted another downgrade to our annual forecasts for Ulma which in the first nine months incurred a net loss of PLN 8.2m. The area where Ulma has been hurt the most by contract delays is road infrastructure which in 2010-2012 was the main source of revenue. With road expenditure not likely to show a noticeable revival until 2016, Ulma is set for two more years of slow earnings growth. Despite strong cash flows (EV/EBITDA~4-5x), the Company has been reducing debt at a less-than-impressive rate and by 2016 it may be forced to spend more on replacement projects. We maintain an underweight rating for ULM.

ZUE explained its weak Q3 showing with a more conservative accounting approach applied to long-term contracts which prompted downward revisions to our earnings expectations for 2014. ZUE is trading at less attractive multiples than its peer Torpol. We remain neutral on ZUE.

## Construction

### Government to spend EUR 2.5bn on power generation

The Polish government allocated over EUR 2.5bn of the 2014-2020 EU funding to the construction of new power generation and transmission capacity, gas pipelines, and emission reductions. Of the power engineering firms listed on the WSE, the biggest beneficiary of the resulting order opportunities will include Elektrobudowa and Erbud through the heat distribution engineering unit Engorem.

## Elektrotim

### Elektrotim posts another weak quarter in Q3

Elektrotim's financial results for Q3 2014 again were a source of disappointment with revenue failing to reflect the usual seasonal H2 acceleration at a meager PLN 45.2m (-29%



y/y). The gross margin looked much better at 10.1%, marking a small contraction from Q3 2013. Margins expanded in the segments of installation and automation, but they shrunk in the segment of networks. The quarterly results do not seem to include any one-time events. After a small y/y rise in SG&A and small gains generated on financing activity and other operating activity, net profit in Q3 2014 came in at PLN 0.2m vs. PLN 2.4m in Q3 last year. Elektrotim reported having net cash of PLN 12.7m at 30 September. The improvement in margins relative to the two previous quarters is a positive development even if the Q3 margin was far from its best. Elektrotim signed a number of new contracts in the course of the past month, and its order backlog is at a record level, offering hope for profit improvement in Q4 and 2015. We maintain a neutral view on ELT.

#### **Elektrotim inks road maintenance contract**

Elektrotim and consortium leader Zaberda signed a road maintenance contract with the national road authority GDDKiA effective through April 2015. The preliminary fee is set at PLN 11.1m. The contract follows a similar but larger one (PLN 71.3m) signed in October. Assuming that Elektrotim has a 50% stake in the consortium, the order represents less than 3% of annual revenues.

#### **Elektrotim inks PLN 5.3m contract**

Elektrotim and consortium partner Odeon S.C. submitted the lowest bid (PLN 5.3m) on a contract for Christmas lights for the city of Wrocław in the seasons 2014/2015, 2015/2016, and 2016/2017. The contract accounts for just upwards of 2% of Elektrotim's annual revenue.

#### **Elektrotim inks PLN 16m contract**

Elektrotim has been hired to build a firefighter training ground for a net fee of PLN 16.3m. The deadline is 31 October 2015. The contract accounts for nearly 7% of our 2015 revenue estimate for Elektrotim.

#### **Subsidiary wins army contract**

A consortium involving Elektrotim's subsidiary Zeus S.A. submitted the winning bid (PLN 41.1m) on a contract to build an electronic fence around an army complex in Gdynia. Zeus's stake in the consortium has not been revealed, but given that its order backlog in October was ca. PLN 17m the contract can give a big boost to its and Elektrotim's earnings. Note also that the Gdynia fence marks another army contract for Zeus lately.

### **Herkules**

#### **Herkules reports Q3 results**

Herkules reported good financial results for Q3 2014 with revenue 20% higher than in Q3 last year at PLN 31.8m, EBITDA rising 29% to PLN 9.2m, and net profit growth at PLN 2.9% totaling 44%. The profits did not receive support from any one-time gains, other operating activity produced a small gain of PLN 0.2m, but financing costs surged 20% y/y to PLN 1.3m driven by higher debt incurred on new cranes; net debt as of 30 September was PLN 98m vs. PLN 79.5m at the same time last year. By operating segment, the bulk of the gross profit for Q3 and 9M 2014 was owed to Cranes, marking a shift from last year when most of the profits were generated by other segments. Summing up, as predicted, Q3 2014 was much better for Herkules than Q3 2013. Going forward, we hope that Herkules will continue to improve the profitability of crane rental as well as of the other segments, especially the oversized cargo business which in 9M'14 incurred a net loss of PLN 1.4m and the ferroconcrete segment which in the same period posted a loss of PLN 0.3m.

#### **CEO paints optimistic outlook for 2015**

CEO Zólcik affirmed the 15% sales growth and 100% net profit growth targets for 2014. Revenues in 2015 are to be driven mostly by orders from the power industry including wind farms. Herkules reports a high rental rate for its construction equipment and in the crane segment its growth in the future can be secured only through acquisitions. Herkules wants to pay dividends in 2015.

#### **Viatron fills up 2015 backlog**

Herkules's wind turbine installation unit Viatron has secured orders for 100% of its capacity in 2015 with 72 turbines compared to 43 installed this year. The reason why wind power producers decided to hire suppliers and vendors for next year this early is a drive to capitalize on green energy subsidies for projects scheduled to start supplying to the national grid by the end of 2015.

#### **Herkules buys PLN 11m crane**

Herkules purchased a self-propelling crane from Liebherr-Werk-Ehingen GmbH with maximum capacity of 500t for PLN 11.1m (9EUR 2.6m). The delivery is scheduled for March 2015. The crane will add to the rental equipment fleet of Viatron.

#### **Herkules recognizes crane subsidy**

Herkules recognized part of a government subsidy granted toward the purchase of a rental crane in November with PLN 3.3m booked in its own accounts and PLN 2.87m paid to mLeasing as payment on the loan taken out to buy the crane. Through 27 November 2014, Herkules received subsidies in a total amount of PLN 12.6m. The balance still remaining is PLN 0.28m.

### **Torpol**

#### **Torpol posts in-line Q3**

Torpol had a very good third quarter with sales soaring 55% y/y to PLN 183.9m. The gross margin showed y/y contraction of 0.5ppt to 6.8% but it was still nominally strong and higher than anticipated. After low SG&A expenses of PLN 4.3m and inline results of financing activity and other operating activity, the Q3 EBIT came in at PLN 8.5m (+103% y/y) and net profit was 6.7m (+168% y/y). Torpol achieved 55% of our PLN 20.8m FY2014 annual net profit forecast in 9M 2014 with PLN 11.5m but we believe it can catch up in the seasonally strongest fourth quarter. Torpol's own reiterated annual guidance is PLN 801m revenue and PLN 24.9m net profit. Torpol reported having a net cash position of PLN 96m at 30 September 2014 after raising PLN 59m through a share issue.

#### **Management on H2 outlook**

Railroad builder Torpol accumulated an order backlog of about PLN 2 billion as of 30 September, with the majority of the contracts scheduled for completion in 2014 and 2015. The Company expects to grow revenue in 2015, though at a slower rate than achieved this year, and in subsequent years it anticipates stabilization in revenues as well as profit margins. (the Management does not rule out the release of an official FY2015 guidance). Torpol's cash needs are set to increase next year as it delivers orders to customers, and so investors should not expect a dividend payout at least until 2017. Torpol wants to expand the capacity of its Norwegian operations by investing about NOK 100 million.

#### **Torpol inks PLN 78m contract**

Oslo kommune v/Bymiljøetaten and Torpol signed a contract for resurfacing of street and tram infrastructure in Oslo for a net fee of NOK 157.7m (ca. PLN 78.2m). The deadline is in

June 2017. Torpol had reported having won the contract, which is equivalent to about 10% of this year's revenue, back in September. The contract accounts for about 10% of our 2014 revenue estimate for the Company, and it is probably its largest Norwegian assignment to date.

### **Torpol sings annex to Rail Baltica contract**

Torpol signed amendments to its consortium agreement with Intercor regarding the Rail Baltica project resulting in Intercor's fees being reduced by ca. PLN 15.3m.

## **Trakcja**

### **2014 Q3 results**

Trakcja reported very good financial results for Q3 2014, with revenues and margins expanding relative to Q3 2013 and net profit coming in at PLN 23.8m. As of 30 September, the Company's net debt decreased to PLN 169m, and the net debt/EBITDA ratio remained at a safe 2.0x. Trakcja achieved 85% of our FY2014 annual net profit forecast in the nine months through September, implying a very likely upside surprise in the full-year earnings. Going forward, however, the outlook for Trakcja slows down in line with a shrinking order backlog (in Q3 2014 the Company signed only one major contract worth PLN 21m). As a result, Trakcja is poised for a weak earnings year in 2016 or even longer if the railroad infrastructure orders to be financed under the new EU budget are delayed. We maintain a marketweight rating for TRK despite the Q3 upside surprise. Trakcja generated revenue of PLN 459.9m in Q3 2014, marking year-on-year growth of 34% but falling about 10% short of the consensus estimate. On the upside the gross profit margin exceeded expectations at 10.6% vs. 9.7% posted in Q3 2013. A 16% y/y increase to PLN 16.8m in Q3 SG&A expenses did not overshadow the otherwise good performance. An increase from PLN 3.4m in Q3'13 to PLN 4.7m in Q3'14 was also posted in net financing costs. All told, Trakcja's third-quarter net profit beat consensus by 10% at PLN 23.8m after a surge of 62% from Q3 2013.

### **CEO on 2014 outlook**

Trakcja wants its road building business to generate revenues in the hundreds of millions of zlotys per year in a few years' time, including through orders from Scandinavia and Belarus. Trakcja's business is to be based on four pillars: railroad construction, Baltic States and Scandinavia, power engineering, and roads. A Trakcja company has recently acquired its first road contract from Sweden worth PLN 15m. Margins achievable in Scandinavia are higher than in Poland. As for railroads, EU-funded government spending so far remains low at a projected PLN 7bn in 2014, expected to increase to PLN 9bn in 2015 followed by a slowdown in 2016-2017 and a rebound to PLN 10bn annually between 2018 and 2022. Trakcja has accumulated a backlog of confirmed contracts totaling PLN 2bn with more contracts still pending. After calling bonds, the Company would like to pay dividends in 2016.

### **TRK shares set for reverse split**

Trakcja is scheduled for a swap of 411,196,384 shares with a par value of PLN 0.10 each for 51,399,548 shares with a par value of PLN 0.80 each on 12 December based on reference metrics as on 5 December.

## **Ulma**

### **Ulma misses expectations in Q3**

Ulma reported a weak third quarter with revenue falling 19% y/y to PLN 47.1m led mainly by the domestic construction business, partly offset by higher export revenue, mainly from Kazakhstan. The gross margin as well showed y/y shrinkage to 12.8% from 16.9%. Quarterly SG&A remained stable, other operating activity produced a small gain of PLN 0.3m, and financing activity generated a neutral result vs. costs of PLN 0.9m reported in Q3 2013 thanks to reduced debt. Ulma reported having net cash of PLN 6m as of 30 September 2014 vs. net debt of PLN 36m booked at 30 September last year. CFO amounted to PLN 15.5m in Q3 2014 after a y/y drop of 45%. CAPEX was lower than last year but higher than in the two previous quarters (CFI=PLN -11.5m).

### **Management on post-Q3 outlook**

Ulma blames its dismal financial performance this year on external factors such as delays in infrastructure contract awards on the part of the government. At the same time, the Company says the situation is getting better from quarter to quarter owing largely to internal restructuring efforts and downsizing. Ulma's CAPEX in 2014 and 2015 will be mostly on fleet maintenance rather than on purchases of new rental equipment. The Company's desired business model rests on the three pillars of engineering, industrial construction, and other non-residential construction. The housing market is experiencing a price war according to the CEO.

## **ZUE**

### **ZUE sees improvement in Q3**

ZUE generated 28% revenue growth to PLN 176.6 l and gross margin expansion to 4.5% from 3.1% in Q3 2014 and neutral effects of other operating activity and financing activity, the Q3 2014 net profit amounted to PLN 2.1m vs. PLN 0.3m a year ago. ZUE's net profit for 9M 2014 shows a 69% y/y drop at PLN 2.2m, implying a need for downward revisions. On a positive note, ZUE reported having net cash of PLN 23m as of 30 September 2014 vs. net debt of PLN 17m booked at 30 September last year.

### **Management on H2 outlook**

ZUE is set for a record year in 2014 in terms of revenue while profits may be slightly weaker due to a modified approach to contract accounting which necessitates the recognition of higher reserves as a way of reconciling cash flow with P&L. ZUE has an order backlog of ca. PLN 860m and it is hoping to finalize a contract in Africa soon. ZUE is not planning to market its services in Russia or any of the neighboring countries due to political instability and it also has no intention of expanding into Scandinavia. ZUE has been approached by prospective partners to help build the second leg of the Warsaw metro. As for acquisitions, the Company is not planning any in the next year or two.

## Budimex

Buy

Analyst: Piotr Zybala		Current price:		PLN 138.05				Last rating	2014-11-19
		Target price:		PLN 160.6					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	6 077.7	4 749.5	-21.9%	4 992.4	5.1%	4 970.1	-0.4%	Number of shares (m)	25.5
EBITDA	233.1	362.2	55.4%	251.3	-30.6%	235.2	-6.4%	MC (current price, PLNm)	3 524.4
EBITDA margin	3.8%	7.6%		5.0%		4.7%		EV (current price, PLNm)	1 939.7
EBIT	182.4	333.3	82.7%	228.3	-31.5%	213.0	-6.7%	Free float	30.9%
Net profit	186.0	300.5	61.6%	178.0	-40.8%	179.4	0.8%		
P/E	19.0	11.7		19.8		19.6		Price change: 1M	2.3%
P/CE	14.9	10.7		17.5		17.5		Price change: 6M	4.6%
P/BV	8.1	5.6		7.0		7.0		Price change: 12M	3.8%
EV/EBITDA	9.9	5.4		7.7		8.4		Low (52 weeks)	111.2
Dyield (%)	7.9	3.2		8.6		5.1		High (52 weeks)	148.2

**Budimex has acquired road orders totaling PLN 3.6 billion since the beginning of the year, making 2014 the best year in history for the infrastructure business. Given that Poland's road authority GDDKiA has to date awarded only 17% of the contracts expected to go out to bidders under the new 2014-2020 National Road Infrastructure Plan, and considering that Budimex is the only builder in Poland to have submitted bids for all the tenders held to date, we see potential for even more growth in the quarters ahead. As for earnings, Budimex has surprised on the upside with the revenues and margins generated in the first nine months of 2014, prompting an upward revision of 11% to PLN 178m to our net profit projection for the year. At the same time, to reflect slower-than-anticipated contract awards by the GDDKiA, we have had to lower our 2015 earnings estimate by 14% to PLN 179m. For 2016, however, we anticipate a rebound to PLN 277m driven by road contracts and housing. We maintain a buy rating for BDX.**

### Budimex wins power engineering bid

Budimex and consortium partners, the Austrian firm Andritz Energy & Environment, submitted the lowest bid (PLN 62.9m) on the delivery of a flue gas denitrogenation plant to the EC Siekierki heat and power plant in Warsaw. The budget of the owner, PGNiG Termika, was PLN 68m.

### Budimex breaks ground on new residential development in Warsaw

Budimex's real-estate arm Budimex Nieruchomości has started construction of a new residential complex in Warsaw called "Zielony Marysin" scheduled for completion in Q2 2016. The complex is designed for 138 flats most of which are eligible for loan subsidies. This is Budimex's fourth residential project in Warsaw. According to our calculations, Budimex Nieruchomości has in progress 640 flats scheduled for completion in 2015 and about 1700 flats slated for 2016. This means that in 2015 the Company may see a profit slowdown followed by a rebound the following year.

### Budimex inks PLN 238m contract

Budimex as 95% consortium leader jointly with Ferrovial Agroman signed a contract for the construction of a stretch of the S7 expressway for a net fee of PLN 237.6m. The deadline is 20 months from execution excluding the period from 15 December to 15 March. Budimex announced having won the bid back in September.

### Budimex close to landing PLN 1.1bn order

After the rejection of a grossly underpriced bid by Salini and an in-compliant bid by Astaldi, Budimex, which submitted the third-lowest bid (PLN 1.071m), has come close to getting a contract for the construction of a bypass around Ostróda. The bypass budget is PLN 1,179m.

### Budimex inks PLN 84m contract

Budimex and 5% consortium partner Ferrovial Agroman signed a PLN 83.6m contract for the construction of a bypass road around Międzyrzecz. The deadline is in 22 months excluding the winter months from 15 December to 15 March. Budimex announced having won the bid back in September.

### Budimex inks PLN 239m contract

Budimex signed a PLN 238.5m (net) contract for the construction of a bypass road around the town of Jarocin. The deadline is in 24 months excluding the period from 15 December to 15 March. Budimex reported having won the contract in October.

### Budimex inks PLN 190m contract

Budimex was hired by Landprop Services I Sp. z o.o. to build stage three of Business Garden Wrocław for a fee of EUR 45.3m. The deadline is in September 2016. The contract accounts for about 4% of Budimex's annual revenues.

### Budimex inks PLN 40m contract

Budimex signed a PLN 39.7m contract for army barracks infrastructure accounting for less than 1% of its annual revenues.

### Budimex wins PLN 115m bid

Budimex submitted the lowest bid (PLN 115.4m) on a bypass road around Bełchatów. If won, the contract would account for about 2.3% of Budimex's annual revenues.

### Budimex inks PLN 387m contract

Budimex as 95% consortium leader signed a contract for the construction of a stretch of the S5 expressway for a net fee of PLN 387.3m. The deadline is in 22 months excluding the winter months from 15 December to 15 March. Budimex is set to receive a 5% advance on the contract. Budimex reported having won the contract in October.

### Budimex wins expressway bid

Budimex and consortium partner Ferrovial Agroman submitted the lowest bid (PLN 638.7m) on a 22.6-kilometer stretch of the S3 expressway. The consortium outbid five other firms with Dragados making the highest offer of PLN 837m. The project budget was PLN 747m. The contract accounts for about 13% of annual revenues.



Elektrobudowa		Buy						
Analyst: Piotr Zybala		Current price:		PLN 76.3		Last rating		2014-05-20
		Target price:		PLN 105				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	1 018.0	905.6	-11.0%	1 212.3	33.9%	1 329.6	9.7%	Number of shares (m)
EBITDA	34.6	38.7	11.8%	52.5	35.6%	66.1	26.0%	MC (current price, PLNm)
EBITDA margin	3.4%	4.3%		4.3%		5.0%		EV (current price, PLNm)
EBIT	22.5	24.6	9.5%	39.4	60.3%	52.6	33.5%	Free float
Net profit	22.9	17.2	-24.8%	24.1	39.8%	36.6	51.9%	
P/E	15.8	21.0		15.1		9.9		Price change: 1M
P/CE	10.3	11.6		9.7		7.2		Price change: 6M
P/BV	1.1	1.1		1.1		1.0		Price change: 12M
EV/EBITDA	9.5	7.5		6.9		5.6		Low (52 weeks)
Yield (%)	5.2	2.6		2.6		3.3		High (52 weeks)

**Elektrobudowa's excellent Q3 showing included a positive surprise in margins but on the other hand it showed a further increase to over PLN 280m in contract receivables which may or may not be a sign that the Company is experiencing issues with its orders. Elektrobudowa did commence the delivery of several major long-term power engineering orders this year and it warned investors itself that these contracts were capital-intensive and would result in worsened operating cash flow although so far these projects are all right on schedule. We maintain a buy rating for ELB.**

#### Elektrobudowa inks PLN 27m contract

Elektrobudowa and consortium leader MEGA S.A. signed a contract with PGE Energia Odnawialna for design and construction of a 76MW wind farm. The fee is PLN 66.4m, of which PLN 26.9m attributable to Elektrobudowa. Elektrobudowa reported having won the contract in October. It accounts for a little over 2% of annual revenues.

#### Elektrobudowa posts strong margins in Q3

Elektrobudowa reported a strong third quarter with year-on-year growth achieved both at topline and at bottom-line

level. EBIT exceeded the consensus estimate by a whopping 52%, and net profit beat expectations by 61%. The Company stands by its full-year profit guidance. The operating cash flow achieved in Q3 was less impressive. Despite further increases in accounts receivable under long-term construction contracts, however, Elektrobudowa's cash position remains safe at PLN 1m at 30 September. Elektrobudowa saw 25% revenue expansion to PLN 314.5m in Q3 2014, and it experienced margin growth across all operating segments, resulting in a y/y doubling to 5.6% from 2.6% of the consolidated EBIT margin. The strongest growth was achieved in power engineering, with industrial engineering considerably improving its performance with an EBIT loss of just PLN 2m - much lower than in the six preceding quarters. After in-line financing activity, the Q3 2014 net profit came in at PLN 14.2m after soaring 205% year on year.

#### Elektrobudowa secures credit extension

Bank Handlowy agreed to extend the terms of a PLN 52.8m revolving facility for contract guarantees and of an overdraft facility until 12 November 2015.

Erbud Buy									
Analyst: Piotr Zybala		Current price: PLN 24.41						Last rating	2014-03-06
		Target price: PLN 35.9							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	1 384.5	1 225.1	-11.5%	1 329.0	8.5%	1 399.0	5.3%	Number of shares (m)	12.7
EBITDA	36.9	40.1	8.5%	47.3	17.9%	55.1	16.6%	MC (current price, PLNm)	309.5
EBITDA margin	2.7%	3.3%		3.6%		3.9%		EV (current price, PLNm)	202.2
EBIT	29.4	32.4	10.2%	39.3	21.4%	47.2	19.9%	Free float	
Net profit	17.2	17.5	1.6%	25.8	47.2%	31.7	23.2%		
P/E	18.0	17.7		12.0		9.7		Price change: 1M	-4.6%
P/CE	12.5	12.3		9.2		7.8		Price change: 6M	-3.5%
P/BV	1.3	1.2		1.1		1.0		Price change: 12M	-32.1%
EV/EBITDA	6.0	7.1		4.3		3.5		Low (52 weeks)	22.4
Yield (%)	0.0	0.0		1.1		4.2		High (52 weeks)	37.0

**Erbud generated disappointingly weak margins in Q3 even given the high year-ago comparable base. At the same time, we are happy with the large backlog accumulated by the Company. Weather permitting, we expect Q4 2014 revenue to be as high as in Q3. Despite 50% y/y growth relative to the same period last year, Erbud's net profit for 9M 2014 is equivalent to only 60% of our annual forecast. We are working on updated earnings projections for Erbud but our rating for its shares remains a buy.**

#### **Erbud sees higher revenue, lower margins in Q3**

Erbud reported y/y sales growth of a whopping 43% in Q3 2014 led by improvement across all the operating segments except for exports. On such strong revenue, the quarterly margins were a source of disappointment, especially in domestic building construction where the gross margin was just 3.5% vs. 5.5% in Q3'13. Despite the tighter margins, the gross profit was only 12% lower in Q3 than in the same period in 2013. After a small y/y rise in SG&A and gains provided by other operating activity, the Q3 EBIT came in at PLN 9.6m (-23% y/y) and net profit was 7.0m (-9% y/y).

Erbud reported having net debt of PLN 59m at 30 September vs. net cash of PLN 2m posted at the same time last year, incurred on furthering expansion in power engineering and building construction. The order backlog at 30 Sep was PLN 1526m (-1.6% y/y) and in October Erbud signed further new business of PLN 326m. Summing up, we are somewhat disappointed by the weak Q3 margins even if they were compared to an exceptionally high year-ago base. At the same time, we are happy with the large backlog. Weather permitting, Q4 2014 sales could be equally strong as in Q3. Despite 50% y/y growth relative to the same period last year. Erbud's net profit for 9M 2014 is equivalent to only 60% of our annual forecast. In October alone, the Company acquired new orders worth PLN 326m.

#### **CEO on dividends**

Asked about whether Erbud would pay dividends from 2014 earnings, CEO Grzeszczak responded by pointing out the Company's huge cash needs next year stemming from a large order backlog.

Unibep		Buy										
Analyst: Piotr Zybala		Current price:		PLN 7.98				Last rating		2014-01-21		
		Target price:		PLN 10.2								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	837.8	920.5	9.9%	1 147.2	24.6%	1 232.8	7.5%	Number of shares (m)		34.2		
EBITDA	25.8	34.0	32.0%	39.6	16.4%	47.1	19.0%	MC (current price, PLNm)		272.8		
EBITDA margin	3.1%	3.7%		3.4%		3.8%		EV (current price, PLNm)		309.1		
EBIT	20.2	28.1	39.0%	34.0	21.0%	41.4	21.9%	Free float		27.8%		
Net profit	16.7	13.6	-18.4%	22.5	65.2%	28.6	27.3%					
P/E	16.3	20.1		12.1		9.5		Price change: 1M		0.3%		
P/CE	12.2	14.0		9.7		8.0		Price change: 6M		11.6%		
P/BV	1.6	1.5		1.4		1.2		Price change: 12M		-9.4%		
EV/EBITDA	14.3	7.5		7.8		6.5		Low (52 weeks)		6.9		
Dyield (%)	1.5	1.5		1.6		3.3		High (52 weeks)		9.1		

Unibep's financial performance to date has been shaped by the same trends as Erbud's, with strong revenue growth accompanied by meager growth in margins. Overall, however, the 2014 full-year outlook for profits is better than in 2013, thanks especially to the fourth quarter when y/y growth should be strong relative to a low year-ago base. Unibep commenced construction of a residential complex in Warsaw in November and it purchased land zoned for housing in Poznań, with positive implications for 2016 results. We are working on updated earnings projections for Unibep and despite some downside potential we maintain a buy rating on the stock.

### Q3 2014 results

We have a neutral view on Unibep's financial performance in Q3 with slightly lower-than-expected revenue accompanied by a slightly higher net profit. The gross margin in the building construction segment fell to 4.0% from 6.7% in Q3 2013 due to a lack of high-margin orders from abroad but the tighter profitability was partly offset by other segments. After an 18% y/y surge in SG&A expenses and higher-than-expected losses on other operating activity, EBIT fell short of our PLN 7.5m forecast at PLN 4.8m. Unibep recognized unusually high gains (PLN 2.1m vs. PLN -0.8m in Q3'13) on financing activity in Q3 2014 owing to the closures of forward positions which had probably hedged foreign operations. At the same time, the unwinding may have affected the

quarterly EBIT. At PLN 5.2m, the Q3 2014 net profit beat expectations after y/y growth of 15%. After generating strong Q3 operating cash flow, Unibep reported having net cash of PLN 16m as of 30 September 2014 vs. net debt of PLN 41m booked at 30 September last year.

### Unibep inks PLN 18m contract

Unibep signed an PLN 18m (net) roadworks contract with a deadline in July 2015 representing about 1.5% of annual revenues.

### Unibep starts new residential project

Unibep and its residential arm Unidevelopment signed an agreement for the construction of a residential complex in Warsaw called "Osiedle 360 Stopni" consisting of two multi-family buildings housing 118 flats with a combined floor space of ca. 7000 sqm. The deadline is in Q1 2016. Unibep's fee as general contractor is PLN 27.8m net. The development is factored into our financial forecasts for Unibep.

### Unibep buys land in Poznań

A subsidiary of Unidevelopment (member of Unibep) signed a conditional agreement to purchase a land property in Poznań zoned for the next stages of the "Wilda" residential complex in the city designed for 340 flats. The price is PLN 14.3m. The agreement is conditioned upon the City of Poznań's right of first refusal.

## Property Developers

### Recommended portfolio allocations for tracked real-estate stocks

Company	Rating	Price (PLN)	MCap	Net Debt	EV	Revenue		Net Profit		EBITDA		P/E		P/B	
						2014	2015	2014	2015	2014	2015	2014	2015	2014	2015
BBi Dev.	OW	1.25	131	230	361	33	74	-8	14	262	276	-	9.6	0.50	0.47
PA Nova	OW	15.57	156	224	380	173	176	19	19	295	310	8.2	8.0	0.53	0.50
JWC	MW	2.56	242	511	753	313	314	5	8	643	651	50.9	31.2	0.38	0.37
Polnord	OW	7.06	230	433	663	183	327	-13	9	1358	1366	-	26.2	0.17	0.17
LC Corp	OW	1.62	725	700	1425	323	360	21	51	1206	1256	34.9	14.3	0.60	0.58
Ronson	MW	1.56	425	144	568	161	306	-5	31	460	491	-	13.9	0.92	0.87

Source: Companies, Dom Maklerski mBanku; UW = Underweight, MW = Market Weight, OW = Overweight

We are keeping the portfolio weights assigned to the tracked real-estate stocks unchanged this month. Note that the shares of LC Corp have plunged 12% for unknown reasons which, however, definitely have nothing to do with market fundamentals or the strong financial standing.

BBi Development saw its stock price fall in October through the first half of November, led probably by the stalled sale of the Plac Unii shopping center which, once finalized, should release cash for new developments and lift investors' sentiment. BBi reported weak but in-line financial results for Q3. We see upside potential in the stock and so we stand by our positive portfolio weighting.

P.A. Nova traded sideways through the whole of November after in-line Q3 results and on current results it is trading at cheap multiples. The Developer has been expanding in local markets for retail real estate and although these small markets are can be tough it has achieved very high tenancy rates in all these establishments. In 2015, we assume PA Nova will complete four retail projects with 42k sqm floor space, and we expect that the net profit for the year will increase to PLN 19.3m from PLN 19m in 2014. At the same time, we believe PA Nova is capable of topping our financial projections for 2014 and 2015 and in 2016 it is poised for a sharp upturn in profits. We stand by our positive portfolio weighting for NVA.

JWC displayed the weakest performance of all the companies analyzed in November on weak Q3 results depressed by project delays which will continue to weigh on profits in the next few quarters. A relatively low price-to-book ratio at 0.39x is one of few reasons why we would consider an investment in JWC, and so we stand by a neutral portfolio rating for the stock.

The Q3 2014 results of Polnord proved that the Company has high-margin projects in its portfolio and reflected positive effects of restructuring. In Q4, the Company promises further decrease in debt and higher quarterly sales. PND shares are poised for an upturn after Mr. Ryszard Krauze announces whether or not he wants to sell his shares. We stand by our positive portfolio weighting for Polnord.

LC Corp generated a low, 14% gross margin on the residential business in Q3 due to a high share in closings of two low-margin developments expected to decrease in Q4, with the quarterly gross margin rebounding to 20%. As for the number of closings expected this quarter, we believe it may reach 350-400 units, with pre-sales as well showing strong growth relative to the previous quarters, adding to annual sales projected at 1,090 units. We are set for

downward revisions to our financial forecasts for LC Corp currently inflated by the wrong assumption of a strong depreciation in the EUR/PLN exchange rate which influences valuation gains. We maintain an overweight rating for LCC.

We stand by our 2014 PLN 4.5m net loss estimate for Ronson, backed by the Company's own guidance. In 2015, we expect 856 closings at gross margin of 21.6%, with net profit at a positive PLN 30.5m (P/E~14x). Where our forecasts veer away from Ronson's are the lower-than-expected sales expected in 2014 and 2015. The projected sales of just 700 flats in 2014 mean that Q4 will be the worst quarter of the year for Ronson with sales at just 135 units, and the 800-850 homes that the Company expects to sell in 2015 is much fewer than our 1022-unit forecast. Our conclusion is that Ronson's future sales projections are deliberately overcautious, and we maintain that the Developer is capable of selling close to 1000 homes next year provided it speeds up the building schedule. Ronson's 2015 and 2016 completion schedule gives credence to our respective net earnings projections for those years at PLN 30.5m and PLN 41.4m. We remain neutral on RON.

## Commercial Developers

### Knight Frank office market outlook

Polish developers are scheduled to finish 536k sqm of new office space in 2015 of which 240k sqm in Warsaw according to a new study by Knight Frank. In 2016, the supply is projected at a further 341k sqm of which 290k sqm in Warsaw. The estimate for 2014 is 280k sqm, the same as in 2013. Asking rental rates in Warsaw and smaller cities have stabilized in the last three months, and vacancy rates in Q3 remained steady as well.

## Residential Developers

### Mortgage sales fall in Q3

The value of home loans extended in Q3 2014 fell by 3.61% q/q to PLN 9.23bn, representing 43,653 facilities (-4.1% q/q). According to estimates by AMRON, the 2014 annual value of mortgage lending will total PLN 38bn. Home prices remained steady in Q3 2014. The share of non-performing loans in total mortgages in the period amounted remained at a steady quarterly level of 3.19%.

## BBi Development

### BBi posts weak third quarter

BBi Development reported weak financial results for Q3 2014 due to a lack of income from the Plac Unii mall which in past quarters helped to offset administrative expenses. Further, BBi has no finished residential units available for sale at the

moment. Consequently, EBIT in Q3 2014 showed an operating loss of PLN 2.9m and the bottom line was a net loss of PLN 4.9m. We are disappointed by the fact that BBI has not sold Plac Unii yet as this means it has no cash to commence new developments in the near future.

### **BBI hires Erbud**

BBI Development hired Erbud to build stage two (4,171 square meters of floor space) of the "Małe Błonia" residential complex in Szczecin for a fee of PLN 10.6m net. The deadline is in 420 days.

### **J.W. Construction**

#### **Q3 saved by valuation gains**

JWC generated very weak financial results in Q3 2014 with revenue falling 50% y/y to a meager PLN 38.3m on a shrunken housing inventory (ytd topline shrinkage amounted to 40%) and the gross margin narrowing to 16.5% from 24.1% last year (including gross margin drop to 20.5% from 28.3% in the core development segment). SG&A expenses continued to fall in Q3, showing a y/y drop of 12% at PLN 8.7m and financing costs decreased by as much at PLN 7.3m thanks to a reduced WIBOR rate combined with a debt reduction to PLN 511m at 30 Sep. 2014 from PLN 694m at 30 Sep. 2013 after a share issue in the course of the quarter. Operating cash flow amounted to PLN 12.6m in Q3 2014 vs. PLN 34.2m in Q3 2013. The low core results generated in Q3 were offset by a valuation gain of PLN 10.9m on the commercial property portfolio which drove the quarterly EBIT up to PLN 8.1m and resulted in a bottom-line profit of PLN 2.1m.

### **LC Corp**

#### **LC Corp generates weak margins in Q3**

LC Corp had a good third quarter except for the gross margin on residential development which fell to 14.0% from previous quarterly levels upwards of 20%. Our guess is that this was due to an above-average profitability of one or more of the Company's developments. The profits on commercial were very good. In Q4, we expect higher sales on more listings resulting in higher profits. Going back to Q3, it witnessed revenue of PLN 60.6m (+87% y/y). The gross margin in the commercial segment was steady at 71%. Adjusted for revaluation effects, the Q3 operating profits showed a y/y surge of 192% at PLN 19.9m driven by more closings (113 vs. 88 in Q3'13) and an expanded rental space. LC Corp reduced SG&A expenses by 11% to a very low PLN 5.3m in Q3. Revaluation of commercial properties produced a gain of PLN 2.7m vs. PLN 3.2m in Q3'13. After financing losses of PLN 8.0m (vs. a PLN 9.4m gain post-din Q3 2013) incurred on FX loan valuation, net profit showed a 26% y/y drop to PLN 11.6m LC Corp pre-sold 257 homes in Q3 2014 (+1% y/y, -3% q/q) and at the same time its AFS inventory expanded to 1567 homes (+60% q/q, +37% y/y).

#### **LCC obtains permits for three developments**

LC Corp obtained usage permits for three residential developments in November, two in Wrocław and one in Warsaw.

### **P.A. Nova**

#### **NVA posts in-line Q3 results**

P.A. Nova saw considerable earnings improvement in Q3 2014 with sales revenue relative to Q3 2013 up 35% at PLN 50.2m and gross margin widened to 15.3% from 13.2% without the help of any one-time gains. Other financing activity produced a gain of PLN 0.6m. Net debt as of 30 September was 2% higher than at the same time last year at

PLN 224m. Summing up, NVA had a very strong third quarter and it achieved 77-78% our full-year EBITDA and net profit forecasts in 9M 2014. The recent sale of a retail park not factored into our forecasts will boost Q4 profits. NVA is trading at 8.3x 2014E P/E and 0.52x P/B. It is set for flat growth in 2015 followed by a rebound in 2016 after completion of a shopping mall. We stand by our positive portfolio weighting for NVA.

#### **NVA on post-Q3 outlook**

PA Nova is planning to finish five retail developments with a combined rental space of 49,000 sqm by the end of 2015. The largest project is a shopping mall in Jaworzno worth PLN 191.5m with a rental area of 31.5k sqm (and a tenancy rate so far of 30%), scheduled to open in Q4 2015.

### **Polnord**

#### **Polnord posts solid Q3**

Polnord had another solid quarter in Q3 2014 driven by 216 home closings including 190 in own developments and 26 in joint-venture developments accounted for under the equity method. Revenue amounted to PLN 75.7m and gross profit came in at PLN 17.7m (with gross margin at 23.3%), fully covering SG&A expenses (PLN 6.5m) and net financing costs (PLN 7.1m). Polnord's pre-sales have averaged 300 units per quarter and going forward this means the Company can continue generating sales surplus over costs. The net profit for Q3 2014 amounted to PLN 3m, adding to 9M 2014 net profit of PLN 7.0m. Polnord generated strong operating cash flow of PLN 61m and investing cash flow of PLN 28m in 9M 2014. Its net debt as of 30 September 2014 was PLN 433m, PLN 90m less than in September 2013.

#### **Polnord lists 143 homes**

Polnord has listed for sale 143 flats in the fifth and last building comprising the "Śródmieście Wilanów" development scheduled for completion in 2017.

#### **CEO on 2014 outlook**

Polnord's CEO expects net debt to go down below PLN 400m by the end of the year depending on whether the Company finalizes the sale of its HQ. Polnord is also negotiating the sale of four land lots and it is working on changing its financing structure (by replacing part of outstanding bonds with bank loans). The CEO's sales projection for 2014 is 1,250 flats, with closings at ca. 900. As well as sales, Polnord is negotiating the purchase of residential land in Warsaw and Gdynia, and it is looking for less capital-intensive joint venture opportunities. Once debt is reduced below PLN 300m Polnord will start paying regular dividends.

### **Ronson**

#### **2014 Q3 results**

As predicted, Ronson generated very weak financial results in Q3 2014 with the bottom line showing a net loss of PLN 3.9m. The reason behind such weak performance were closings made in low-margin residential developments. Ronson's accumulated net profit for the nine months through September came in at PLN 0.3m. Our full-year estimate for the Company is a net loss of PLN 4.5m and given the flats scheduled for delivery in Q4 we think the Developer will incur a loss in the last quarter as well, though maybe not as large as we had assumed in June. Ronson closed 96 homes in its cheapest developments in Q3 2014, achieving average revenue per unit of PLN 307,000 vs. PLN 424,000 in Q3 2013. On the fewer and cheaper closings, the Company saw its quarterly revenue fall 48% to PLN 29.5m. The gross profit margin was very narrow in Q3 at just 6.3% due to small price reductions and low-margin closings. Selling and

marketing expenses amounted to PLN 6.1m after an uptick from Q3 2013. Ronson incurred a PLN 0.7m loss on other operating activity and an PLN 0.8m loss on financing activity in Q3 2014, but otherwise it did not experience any major one-offs. Net debt at 30 September 2014 was 13% higher than at the same time last year at PLN 143m driven by a land purchase in Warsaw completed in the first half of the year.

#### **Management on 2014-2015 outlook**

Ronson is set to post a loss in 2014 after a weak fourth quarter when the net loss will be even higher than in Q3 when it amounted to PLN 3.9m. Ronson has about 50 closings scheduled for Q4 in low-margin residential developments, adding to full-year closings of nearly 500. In 2015, the Developer will finish construction of about 1000 new flats of which half is already sold on an off-plan basis. 2016 is set to be even better in terms of pre-sales and closings. As for gross margin, it should rebound above 20% in 2015 and 2016.



Capital Park		Buy									
Analyst: Piotr Zybala		Current price:		PLN 4.2				Last rating		2014-10-22	
		Target price:		PLN 6.7							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	41.5	38.8	-6.3%	44.6	14.8%	73.6	65.2%	Number of shares (m)		105.3	
EBITDA	-87.9	40.8		31.8	-22.2%	35.1	10.6%	MC (current price, PLNm)		442.5	
EBITDA margin	-212.0%	105.1%		71.2%		47.7%		EV (current price, PLNm)		1 178.7	
EBIT	-88.0	40.4		31.4	-22.4%	34.8	10.7%	Free float			
Net profit	-114.9	25.6		9.4	-63.2%	16.5	75.2%				
P/E		17.2		47.0		26.8		Price change: 1M		-7.3%	
P/CE		17.0		45.3		26.3		Price change: 6M		-13.8%	
P/BV	0.4	0.5		0.4		0.4		Price change: 12M		-35.4%	
EV/EBITDA		24.0		37.1		41.8		Low (52 weeks)		3.6	
Dyld (%)	0.0	0.0		0.0		0.0		High (52 weeks)		5.7	

**Capital Park's core financial results for Q3 2014 showed strong improvement from last year even though the bottom line was a net loss. The Company is planning to acquire properties in the future which it can turn and sell quickly at a profit - a prospect which is not accounted for in our forecasts. CAP should finalize the creation of a new FIZ AN real-estate fund within the coming year. We maintain a buy rating for CAP.**

### Capital Park sees growth in Q3

Capital Park generated 37% y/y growth in rental revenue (at PLN 14.1m) and 9% expansion to PLN 9.9m in NOI in Q3 2014, outperforming our expectations. The improvement was led probably by the Eurocentrum building completed in the period and its increasing tenancy rate. Revenue from other sources (incl. property management and sales) amounted to PLN 1.1m in Q3 2014 vs. PLN 0.5m in Q3 2013. SG&A expenses increased 11% to PLN 4.1m. EBIT before property and stock option revaluation effects came in at PLN 7.0m after falling 20% from Q3 2013 (9M 2014 EBIT was PLN 18.1m, +51% y/y). CAP incurred a loss of PLN 0.2m on revaluation of investment properties in Q3 vs. our expected gain of PLN 3m, moreover, it booked a valuation loss of PLN 1.7m on the Management Incentive Scheme (vs. PLN 0.6m in Q3 2013). Adjusted for the valuation effects, Q3 EBIT amounted to PLN 5.1m vs. an operating loss of PLN 15.2m posted in Q3 2013 (incurred on the zloty's appreciation vs. the euro). CAP reported a further increase to PLN 3.3m in net interest expenses in Q3 (stemming from recognition of the loan taken out to refinance Eurocentrum). Depressed by valuation effects, the Q3 2014 bottom line was a net loss of PLN 1.90m vs. a profit of PLN 1.1m expected by us. Capital Park generated operating cash flow of PLN 13.1m in 9M 2014 vs. PLN 2.6m in 9M 2013. It is worth noting the capital expenditures on investment properties which totaled PLN 242m ytd, making Capital Park the second most active developer on the WSE after Echo Investment.

### Capital Park buys real estate

Capital Park purchased a 3000sqm property in Toruń constituting part a retail park for PLN 17m in Q3 2014 with a view to rebranding it into a Vis a Vis location. Earlier, in H1 2014, the Developer had purchased two small properties in Warsaw for a combined PLN 8-9m, and it has two preliminary purchase contracts signed for two more properties in the Capital City worth over PLN 20m each. Further, Capital Park is close to finalizing a joint venture agreement pertaining to redevelopment and expansion of two commercial properties

in the Tricity and Poznań at respective estimated costs of PLN 10+ million and over PLN 50m. Capital Park announced back in May that it was planning to spend about PLN 200m on property acquisition this year, including PLN 50-60m from internal cash resources. The actual investment will probably be slightly smaller, but still the Developer shows consistency in delivering its strategic objectives (buying and refurbishing properties which are then transferred to the Real Estate Income Assets FIZ AN fund sold to individual investors through investment certificates). We believe the Company may sell the first batch of the FIZ AN certificates in the second half of 2015. The prospective profits are not factored into our financial forecasts for Capital Park as they are still too remote to quantify.

### Q3 rental statistics

Capital Park reported that the tenancy rate in the first Eurocentrum office building in Warsaw increased from 58% to 63% in the course of Q3 2014 while at the same time the tenancy rates in the Royal Wilanów building remained at 80% for offices and 83% for commercial spaces. The equity for the construction of the second Eurocentrum building, started in September, is estimated at PLN 40m. Capital Park is planning to start construction of its biggest project, Art Norblin, next June, but it is already looking for an agent to help acquire tenants. We stand by our assumptions as to Capital Park's key projects. We expect the Capital Park to fall about PLN 60m short of the cash needed to put down against bank financing for Art Norblin. To fill the gap, the Company may draw on the PLN 113m cash position or use part of the proceeds of the upcoming PLN 100m bond issue aimed primarily at refinancing existing debt or sell some of its smaller properties.

### CAP has bond prospectus approved by KNF

The Financial Supervisory Authority KNF approved Capital Park's PLN 100m bond issue prospectus. Capital Park has PLN 100m bonds currently outstanding since 2012 issued to finance the Eurocentrum development and other projects, maturing in July 2015.

### Capital Park to issue PLN 65m bonds

Capital Park is set to issue the first PLN 65m tranche in December under a PLN 100m bond program. The bonds will carry a variable rate of interest based on WIBOR 3M + 4.3% payable on a quarterly basis. The mature in 3 years. Subscriptions can be made between 5 and 19 December 2014. Capital Park intends to use the proceeds to call existing A bonds with a nominal value of PLN 65m.

**Dom Development Buy**

Analyst: Piotr Zybala	Current price:		PLN 46.2					Last rating	2014-06-23
	Target price:		PLN 57.8						
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	851.4	676.4	-20.6%	747.6	10.5%	828.1	10.8%	Number of shares (m)	24.8
EBITDA	116.5	76.5	-34.4%	74.1	-3.1%	95.8	29.3%	MC (current price, PLNm)	1 144.4
EBITDA margin	13.7%	11.3%		9.9%		11.6%		EV (current price, PLNm)	1 339.3
EBIT	113.5	73.3	-35.4%	71.3	-2.8%	93.0	30.5%	Free float	26.6%
Net profit	91.2	54.4	-40.3%	57.1	4.9%	72.3	26.6%		
P/E	12.5	21.0		20.0		15.8		Price change: 1M	1.8%
P/CE	12.1	19.9		19.1		15.2		Price change: 6M	-6.3%
P/BV	1.3	1.3		1.3		1.3		Price change: 12M	-12.8%
EV/EBITDA	10.0	16.5		18.1		13.4		Low (52 weeks)	38.6
Dyield (%)	3.2	8.0		4.8		5.0		High (52 weeks)	59.0

November was a slow month at Dom Development with the main story being that the Company commenced construction of the next stage of the Wilno residential complex in Warsaw. After some volatility, DOM shares ended the month at a flat level. DOM is poised for its best quarter of the year in Q4 driven by high sales driven by new listings combined with favorable market conditions. We maintain a buy rating for DOM.

**DOM offers for sale 251 flats in Warsaw**

Dom Development has offered for sale 251 flats in six buildings comprising stage two of the Wilno residential complex in Warsaw. The flats are sized between 31 and m2 square meters and their prices range from PLN 6020 to 6880 per square meter. They are scheduled for completion in May 2016.

Echo Investment		Buy						
Analyst: Piotr Zybala		Current price:		PLN 6.6		Last rating		2014-10-22
		Target price:		PLN 8				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	583.6	528.7	-9.4%	565.1	6.9%	610.9	8.1%	Number of shares (m)
EBITDA	194.9	498.0	155.5%	692.3	39.0%	215.2	-68.9%	MC (current price, PLNm)
EBITDA margin	33.4%	94.2%		122.5%		35.2%		EV (current price, PLNm)
EBIT	189.2	493.8	160.9%	687.0	39.1%	209.9	-69.4%	Free float
Net profit	373.3	309.1	-17.2%	505.2	63.5%	135.8	-73.1%	
P/E	7.3	8.8		5.4		20.1		Price change: 1M
P/CE	7.2	8.7		5.3		19.3		Price change: 6M
P/BV	1.1	1.0		0.8		0.8		Price change: 12M
EV/EBITDA	26.3	10.1		7.8		26.7		Low (52 weeks)
Yield (%)	0.0	0.0		0.0		0.0		High (52 weeks)

**Michał Sołowow failed to sell his 45% stake in Echo to Starwood, and the prospective share float may discourage some investors from buying ECH shares. The divestment does not change much from a business point of view except for possible delays in property sales. In November, Echo commenced a new office project in Wrocław and the next stage of a high-margin residential project in Warsaw. More importantly, the Developer found the first tenant for about 20% of the space in the Q22 office building and secured financing for construction. We maintain a buy rating for ECH.**

#### 2014 Q3 results

Echo achieved a strong gross margin of 41% on residential sales in Q3 2014, while the profitability of rental spaces came in line with expectations. After higher-than-expected SG&A expenses and a loss incurred on other operating activity, the quarterly EBIT figure only matched expectations. At the same time, net profit beat estimates thanks to falling financing costs. Revenue in Q3 2014 amounted to PLN 149m after a 6% year-on-year increase driven by the residential segment including sales of high-margin flats in the Nowy Mokotów development which has proven to be much more lucrative than we had originally thought. The commercial segment performed consistently with expectations in Q3, achieving 2% q/q gross profit expansion on slightly lower sales combined with a 9% drop relative to an inflated Q3 2013 base. Valuation gains on the commercial property portfolio amounted to PLN 5m in Q3 2014 vs. PLN 3.8m expected by us. SG&A expenses in Q3 2014 showed a surprising 18% surge to PLN 24.5m, and other operating activity this time produced a loss of PLN 0.3m. On the upside, financing costs at PLN 29.7m were 6% lower than in Q3 last year. After all this, net profit came 28% ahead of our forecast and 3% ahead of consensus at PLN 30.1m. Operating cash flow adjusted for working capital changes at PLN 61.2m was 18% lower than in Q3 2013.

#### Echo secures first tenant for Q22

Deloitte rented 11,000sqm of office space in Echo's Q22 development in downtown Warsaw. The move-in is scheduled for Q2 2016.

#### Echo commences new residential building

Echo commenced construction of the second stage of the "Nowy Mokotów" 206-unit residential complex in Warsaw where flats are priced between PLN 7 and 11 thousand zlotys per square meter. The whole complex will consist of four buildings with 800 flats.

#### Echo spends PLN 2.55m on bond issues

The total cost of the PLN 200m bond program comprising four issues amounted to PLN 2.55m.

#### Echo commences office building in Wrocław

Echo has commenced construction of the Nobilis Business House office building in Wrocław with 16k sqm of class-A office space.

#### Echo secures loan for Q22

Echo obtained a EUR 116m loan from BZ WBK and PKO BP which it will use to finance the construction of the Q22 office building.

#### Echo divestment by Sołowow falls through

According to unconfirmed reports the US firm Starwood Capital Group withdrew from the acquisition of a 46% stake in Echo Investment from the owner Michał Sołowow due to the price. Mr. Sołowow reportedly wants to use the proceeds from the Echo divestment to buy shares in Synthos and finance a PLN 480m share buyback at another of his companies, Rovese.

GTC										Buy									
Analyst: Piotr Zybala				Current price:		PLN 5.95								Last rating		2014-10-22			
				Target price:		PLN 7													
(EUR m)	2012	2013	change	2014E	change	2015E	change	Key metrics											
Revenue	147.6	131.1	-11.2%	125.1	-4.6%	129.1	3.2%	Number of shares (m)						351.3					
EBITDA	-50.8	-121.0	138.1%	-73.4	-39.3%	121.9		MC (current price, PLNm)						502.7					
EBITDA margin	-34.4%	-92.2%		-58.7%		94.4%		EV (current price, PLNm)						1 406.2					
EBIT	-51.3	-121.4	136.8%	-73.9	-39.2%	121.4		Free float						58.8%					
Net profit	-96.0	-146.8	52.9%	-117.3	-20.1%	55.9													
P/E						2.2		Price change: 1M						1.0%					
P/CE						2.1		Price change: 6M						-25.6%					
P/BV	0.1	0.2		0.2		0.2		Price change: 12M						-28.7%					
EV/EBITDA						16.1		Low (52 weeks)						5.4					
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks)						8.4					

**GTC shares have been climbing for the second month in a row. The Developer again reported commercial property valuation losses in Q3, though this time the loss was small at EUR 0.9m, and otherwise the quarterly results and cash flows came out well. We maintain a buy rating on GTC based on the future profits from the two malls it is planning to build in Warsaw and despite the EUR 120m valuation losses which may still be incurred on investment properties in the Balkans.**

### 2014 Q3 results

GTC reported slightly better-than-expected Q3 2014 results with the quarterly bottom line showing a net profit of EUR 5.1m for the first time this year. The factors that contributed to this included only a small loss (EUR 0.9m) incurred on property value adjustments, combined with reduced administrative expenses and financing costs. Adjusted EBIT came in at EUR 19.2m - the best result in

twelve quarters. Operating cash flow as well was strong in Q3 at EUR 20.3m, up 29% y/y. GTC generated rental revenue of EUR 27.1m (-1% y/y) and gross profit of EUR 20.3m (-1% y/y), in Q3 2014. Revenue from home sales remained at the steady quarterly level of EUR 3.6m, with the gross margin at 5.8%. SG&A expenses showed a y/y reduction of an impressive 29% at EUR 1.8m and even after adjustment for stock option plan valuation they continue to display a 10% decrease at EUR 3.1m. The losses incurred on fair value adjustments to the commercial property portfolio were small at just EUR 0.9m in Q3. Adjusted for revaluation effects, EBIT came in at EUR 19.2m (+12% y/y). After financing losses of EUR 9.1m (-12% y/y), net profit attributable to the shareholders of the parent company came in at EUR 5.1m in Q3 2014 vs. a net loss of EUR 1.0m posted in Q3 2013. Operating cash flow showed a strong, 29% y/y surge to EUR 20.3m in Q3 and it remained 10% higher than the year-ago CFO even after adjustment for working-capital changes.

Robyg									
Buy									
Analyst: Piotr Zybala		Current price:		PLN 2.22				Last rating	
		Target price:		PLN 3.07				2014-06-23	
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	402.9	485.9	20.6%	369.0	-24.1%	363.1	-1.6%	Number of shares (m)	262.1
EBITDA	56.3	57.8	2.7%	51.7	-10.6%	66.5	28.5%	MC (current price, PLNm)	581.8
EBITDA margin	14.0%	11.9%		14.0%		18.3%		EV (current price, PLNm)	817.4
EBIT	55.1	56.7	3.0%	50.4	-11.1%	65.7	30.3%	Free float	16.5%
Net profit	20.0	26.1	30.3%	25.6	-1.7%	45.1	75.8%		
P/E	28.6	22.2		22.7		12.9		Price change: 1M	-0.9%
P/CE	26.9	21.3		21.6		12.7		Price change: 6M	-7.9%
P/BV	1.4	1.4		1.4		1.3		Price change: 12M	0.9%
EV/EBITDA	15.3	13.6		15.8		11.9		Low (52 weeks)	2.1
Dyld (%)	5.4	3.6		3.6		4.5		High (52 weeks)	2.7

**Robyg's financial results for Q43 2014 were predictably weak but the bottom line should bounce back to Q1 and Q2 levels in the fourth quarter. We stand by our FY2014 full-year net profit forecast of PLN 25.6m for Robyg, and our 2015 bottom-line projection assumes an increase to PLN 45m. We have a buy rating for ROB.**

#### Robyg posts in-line core results

Robyg's Q3 earnings results were influenced by one-time events, mostly accounted for in our estimates for the quarter, so the adjusted results came in line with expectations. Robyg recognized unusually few home closings in Q3 (106). However, the consolidated revenue at PLN 43.6m proved 21% higher than our forecast and 11% higher than consensus, owing probably to underestimated home sales prices or other revenues. The gross margin in Q3 2014 amounted to 20.2%, beating our 16.7% estimate and marking the highest quarterly result this year. SG&A expenses were high at PLN 9.8m after a 19% y/y increase. Joint venture projects generated a loss of PLN 0.2m in Q3 2014 vs. a gain of PLN 0.5m anticipated by us. Thanks to a PLN 11.1m valuation gain on an office building, after a PLN 4m litigation charge, EBIT came in at PLN 5.5m and net profit attributable to the shareholders of the parent company beat the PLN 0.5m market estimate at PLN 1.9m. Robyg generated negative operating cash flow of PLN -28m in Q3 2014 (vs. PLN +53m in Q3 2013) after investment in land properties and work in progress.

#### Robyg buys land in Gdańsk

Robyg purchased a 1.99-hectare land property in Gdańsk without a zoning plan in place under a preliminary agreement set to be finalized by 5 June 2015 subject to certain conditions. Robyg estimates the building capacity at 500 flats and ca. 2000sqm of commercial spaces. The cost per square meter is ca. PLN 500, suggesting a gross margin of about 25%. The property purchase is factored into our financial forecasts for Robyg.

#### Robyg gets OK to form joint venture

Robyg obtained permission from the anti-monopoly authority UOKiK to form a joint venture with NCRE II Investments Limited to build a residential development in Warsaw.

#### Robyg calls bonds

Robyg decided to call PLN 10m E bonds and PLN 10m F bonds on 20 December.

#### Robyg lists 460 flats

Robyg is about to list 318 flats in the Park Wola Residence and 135 flats in the Young City complex in Warsaw. Construction of Park Wola Residence is scheduled to commence in Q4 2014 and end in Q1 2016 while Young City is set to start in Q1 2015 and end in Q2 2016. By expanding in Warsaw, Robyg is hoping to achieve sales of 2-2.5 thousand homes per year. The timing of the two projects is consistent with our forecasts.

## Retail

### Warm weather weighs on October sales

The footwear retailer CCC generated consolidated sales of PLN 249m in October marking an increase of 10.2% from the same month last year. Cumulative sales for the ten months through October totaled PLN 1,579m, up 22.9% y/y. If we look closer at CCC's sales results, we can see that they were weighed down by warm weather and a lack of rainfall. Assuming the retailer's shopping area expanded by 18.8% relative to October 2013, the average sales per square meter of retail space show a y/y drop of 7% at roughly PLN 886. Further, weather was the reason why like-for-like sales fell 5.1% y/y in October. Note also that the overall 10.2% revenue growth reported in October was well below the 22.9% growth seen at the beginning of the year. At the same time, with the monthly gross margin estimated to be high at 58%, after PLN 68m SG&A costs, the net profit for October may have amounted to PLN 62m. Added to the net profit generated in the nine preceding months, this makes for a ten-month total of PLN 172m, offering confidence that CCC will deliver its PLN 200m annual target.

### CCC posts excellent Q3 results

On in-line revenue (PLN 473m up 14% y/y), CCC posted a 31.6% higher-than-expected operating profit in Q3 2014 which at PLN 52.2m showed year-on-year growth of a whopping 56.5m; net profit as beat expectations as well by 37.4% at PLN 40m, marking 59.1% growth from Q3 last year. The main earnings driver in the third quarter was a strong gross margin which widened by 7.1ppts y/y to 54.9% fueled by strong August sales (+57.7% y/y). SG&A expenses increased by 25% led by fast-paced international expansion. CCC did not recognize any major one-time events in Q3. The quarterly ratio of costs to operating profit remained steady at PLN 4m. Financing costs increased to PLN 6.1m from PLN 5.1m in the quarter before. The net debt/EBITDA ratio after an increase to 1.7x in Q3 was lower than the 2.0x cap. CCC expanded its sales area by 18.8% y/y to 276,000 sqm in Q3 2014, and since this growth was faster than revenue growth the Company's average revenue per sqm fell by 5.6% and LFL sales were negative.

**Q4 set for slowdown.** Despite relatively weak footwear sales recorded in the usually strong October CCC's CFO says the Company is not planning any aggressive price reductions in November or December. The fall/winter collection remains in stores for the next four months, and it is expected to generate relatively high margins. This is the reason behind the negative cash flow seen in Q3 (PLN -12m). On the unlikely event that any shoes of this year's collection are not sold, they will be added to the 2015 fall/winter collection. In our opinion this will result in high margins and proportionally lower sales in Q4 2014. The storage of unsold shoes until the next winter season may not be a good idea giving changing fashions. CCC maintains the revenue guidance at PLN 2bn and the net profit guidance at PLN 200m.

**Strong Q3 sales:** CCC believes the strong footwear sales reported in July and August were owed to favorable weather combined with customer appreciation for the summer collection and an increasing share of middle-class customers in the customer base. The high gross margin generated in the period was owed to an extended period of sales at full prices.

**International expansion:** CCC's operations in Austria, Germany, and Turkey, generated a combined gross loss on sales of about PLN 18m. Austria is expected to break even in 2015. Next CCC is planning to open 5-7 stores in Bulgaria as well as seeking business opportunities in Serbia, Lithuania, and Estonia, and possibly even in Russia and Ukraine. The Company will reveal updated expansion plans after Q2 2015.

### November sales slow while margins remain strong

CCC generated sales of PLN 203m in November, marking y/y growth of 12.5%, with ytd sales up 21.5% from last year. LFL revenue expansion was experienced only in Poland (+1.6% y/y) as sales in the Czech Republic, Hungary, and Slovakia showed respective contraction of 9.9%, 30.7%, and 9.7%, led probably by unseasonably warm weather in the first half of the month. Assuming a retail area expansion of 23% in November relative to the same month in 2013, the monthly sales per square meter were 7% lower, suggesting that CCC may not reach its annual sales target of PLN 2 billion (unless December sales soar 36% y/y, marking the fastest expansion in five years). On slower sales, CCC maintain margins at relatively high levels in November (we estimate the gross margin at 53%) thanks to a lack of special offers, and after PLN 68m SG&A costs the monthly net profit may have amounted to PLN 32m. According to our estimates, CCC generated a combined net profit of PLN 94m in October and November, adding to a ytd figure of PLN 204m, ahead of the Company's full-year guidance of PLN 200m but below the market estimate of PLN 209m EBIT (Bloomberg).

## LPP

### LPP reports strong October sales figures

LPP's October sales showed a 20% y/y surge to PLN 463m. The fashion retailer's sales for the year through October totaled PLN 3,823m, up 18% from the same period last year. LPP estimates the monthly gross margin at 62%, similar to the figure generated in October 2013. The October sales growth was 2.2ppts faster than the ytd growth reported by LPP. Assuming LPP's shopping area in October was 23% larger than last year, the October sales per square meter were down 8% y/y to PLN 665 (a result better than the average ytd monthly fall of 11%). Further, LPP's monthly gross margin remained steady at the year-ago level despite a higher USDPLN exchange rate (the Company recognizes COGS as incurred in US dollars).

### LPP posts weak Q3

LPP reported weak third-quarter results with revenue at PLN 1,234m (+11% y/y), EBIT at PLN 134.4m (-20% y/y), 6% below consensus, and net profit down 26% to PLN 81.7m, falling 23% short of market expectations. The slower Q3 sales were caused by weaker sales in Russia and Ukraine underpinned by weakened local currencies. The gross margin was 0.8ppt lower due to lower sales in September combined with an unfavorable USDPLN exchange rate (LPP recognizes COGS in dollars). SG&A per square meter continued to follow a downward trend in Q3, falling 9% y/y to PLN 275. LPP did not recognize any major one-time events in Q3. The results of other operating activity were consistent with the averages posted in previous quarters, but on weaker revenue and gross margin the third-quarter EBIT showed a year-on-year shrinkage of 20%. After financing costs of PLN 39.6m incurred on unfavorable FX effects (despite the reclassification of debt to equity in Q2), the quarterly net profit shrunk 26% y/y to PLN 81.7m. LPP expanded its sales area by 33% y/y to 678 sqm in Q3 2014, but sales per square meters fell 16%, and LFL sales were down 6.7% relative to Q3 2013. Finally, weak September sales kept the inventory high, and this reflected on the quarterly operating cash flow.

**2015 expansion plans:** LPP expects to add 152,000 sqm net to its total sales area in 2015 (not including planned closures) vs. 131k sqm added this year. Of the total only 18k



sqm will be opened in Russia and Ukraine based on existing rental contracts (a more accurate projection for R&U will be offered after Q4), and 73k sqm will be added in the EU of which 27k sqm (about 10 stores) in Germany, half along high streets and half in shopping malls.

**Gross margin set for y/y contraction in Q4:** LPP was left with a high inventory at the end of September after slow September sales growth (3%), and after just-decent sales in October this may force the Company to offer large discounts on the winter collections in December and January. An additional factor which may affect the gross margin in Q4 is the increased USDPLN exchange rate.

#### **November sales lag**

LPP generated sales of PLN 381m in November (+9% y/y) with ytd sales up 17% from last year at PLN 4,208m. The monthly gross margin at 57% showed y/y contraction by 2ppts. The slow revenue growth reported in November was caused mainly by the depreciation of the ruble and the hryvnia as Russia and Ukraine accounted for 24.4% of the total revenue for Q1-Q3'14. In turn, the gross margin contraction was led by the dollar's appreciation versus the zloty. According to our calculations, monthly EBIT amounted to PLN 28m in November, adding to two-month EBIT for October/November of PLN 118m. Ytd EBIT through November is estimated at PLN 479m, which would be PLN 197m less than the annual market consensus of PLN 676m (Bloomberg). Even though December is set to be seasonally strong (accounting for an average of 12.3% of annual sales in the last six years), we believe LPP will fall short of market expectations with the 2014 EBIT.

### **Eurocash**

#### **Eurocash to acquire supermarket chain**

Eurocash is waiting for permission from the anti-monopoly authority UOKiK to acquire a 50% stake in Rogala, owner of a chain of 47 grocery supermarkets called "Delikatesy Centrum" present in three voivodeships in Poland. In 2013, Rogala generated sales of nearly PLN 285m. After the 50 acquisition, Eurocash will have the right to appoint one Management Board member but strategic decisions will remain in the hands of the Rogala family. Moreover, the revenues generated by Delikatesy Centrum account for just about 1.7% of Eurocash's annual revenues.

#### **Eurocash posts in-line Q3**

Eurocash reported Q3 2014 results in line with market expectations. However, it is worth noting that the FMCG distributor's supermarket franchise 'Delikatesy Centrum' saw a 4% y/y and 1% ytd contraction in LFL sales. Compared to Q3 2013, the consolidated Q4 revenue showed 6% growth to PLN 4,508m, EBITA declined 2% to PLN 113m, EBIT was down 6% to PLN 80m (in line with consensus), and net profit dropped 22% to PLN 57.5m (5% short of consensus). By segment, Eurocash generated year-on-year sales growth of 4.4% in Cash&Carry (1% LFL growth in Q3'14), 13% in alcohol distribution (owed mainly to excise hikes), 9.8% in Delikatesy Centrum (with 108 supermarkets added relative to Q3 2013, +13% y/y), and 7.1% in cigarettes and impulse purchases. On higher promotion expenses and continuing costs incurred on the integration of Tradis, selling expenses in Q3 2014 were 13% higher than in Q3 2013, and they outpaced revenue by 7ppts. Consequently, the EBITDA margin fell by 0.21ppt to 2.5%. After higher financing costs and effective tax rate (at 16% vs. 2% in Q3 2013), Eurocash's net profit for Q3 2014 showed a year-on-year drop of 22% at PLN 57.5m. Eurocash generated OCF of PLN 106m in Q3 vs. PLN 90m in the same quarter last year. YTD CFO totaled PLN 195m vs. PLN 400.5m in 9M 2013, falling on huge working-capital needs experienced in Q1.

#### **Eurocash on 2015 outlook**

Eurocash is planning to open 60 "Delikatesy Centrum (DC)" stores in Q4 2014 (after 62 openings in 9M'14) followed by 150 in 2015 combined with -10 Cash&Carry (C&C) locations. The CEO does not see signs of a recovery in distribution and so he anticipates continuing contraction in LFL sales at DC locations. To counteract the unfavorable market conditions, Eurocash will focus on improving the cost efficiency of the DC stores and continue buying out franchise DC locations. The streamlining measures are expected to generate savings to the tune of PLN 50m in 2015. As for acquisitions, there are more M&A opportunities available but the asking prices are unacceptable for Eurocash.

#### **Eurocash to open stores at PKN Orlen fuel stations**

PKN Orlen entered into an agreement with Eurocash whereby the latter to open small "Delikatesy Centrum" convenience supermarkets at the former's fuel stations. The project is in very early stages at the moment and it will evolve over the next year. In November, PKN Orlen also launched a similar partnership with Tesco. We must note that past attempts at similar joint ventures (e.g. Carrefour with BP and Shell) have always failed.

#### **Eurocash finalizes deal with Kolporter**

Eurocash and Kolporter finalized the investment agreement signed in December 2013 with the latter acquiring a 25% stake + 1 shares in the former's impulse FMCG distributor KDWT in exchange for a 100% stake in the newly formed company Service FMCG distributing tobacco, beverages, and other FMCG. Further, Eurocash obtained permission from the anti-monopoly office UOKiK to buy 11 of Kolporter's tobacco wholesale locations. The deal with Kolporter is expected to boost Eurocash's tobacco and impulse sales by PLN 2 billion to over PLN 5 billion, and drive overall sales by 10% in 2015. Service FMCG generates EBITDA margins of ca. 1% vs. 2% achieved by Eurocash.

#### **Eurocash acquires minority stake in Frisco.pl**

Eurocash through a minority buyout and a capital injection acquired a 44% stake in the online FMCG retailer Frisco.pl for an undisclosed price. The price of transaction has not been revealed yet. The Company has an option to buy more shares in Frisco in two years' time at the earliest. Frisco currently operates only in Warsaw but with assistance from Eurocash is expects to expand into other cities. In 2013, it generated a profit of PLN 30m without yet breaking even. By acquiring Frisco.pl, Eurocash has ventured into a new fast-growing market (with the annual growth estimated at 30-40% and the total value put at PLN 400-500m). Frisco.pl is Eurocash's smallest acquisition this year which is not going to have a significant impact on this year's revenues. On a positive note, the Company has gained a foothold in online retail.

#### **Eurocash acquires Inmedio**

Eurocash has finalized the acquisition of a 51% stake in Inmedio, a chain of 410 newsagents' located mainly in shopping centers. Inmedio generated sales upwards of PLN 500m in 2013 (equivalent to 3% of the year's sales of Eurocash). Management of the chain is left with the former owner HDS Polska.

## AmRest

### AmRest reports strong Q3

AmRest's strong financial results for Q3 2014 reflected the positive trends observed in the two previous quarters. The quarterly revenue after a 10% y/y increase came in line with market expectations while EBIT at PLN 50m showed y/y growth of 63% and exceeded the consensus estimate by 15%. EBITDA at LN 100m was 28% higher than in Q3 2013 and 6% higher than consensus, and net profit tripled relative to Q3 last year at PLN 31,6m. Such strong growth was owed primarily like-for-like sales expansion observed across all divisions combined with new restaurant openings at an annual rate of 10% and improved cost effectiveness due to rent negotiations and reduced upward pressure on costs. As a result, the Q3 2014 EBIT and EBITDA margins improved by ca. 2ppts. EAT is currently trading at 20.5x 2015E P/E and 7.14x EV/EBITDA.

**Revenues expand y/y.** AmRest saw 9% y/y growth in Q3 2014 sales led by stronger LFL sales across all operating segments, most notably Poland (+9.7% y/y, contributing 40% to the revenue growth), followed by other CEE (+13.3% y/y, 25% revenue share), and new markets (+37.5%, 18.3% contribution). The segment of new markets segment is comprised of La Tagiatella restaurants in Germany, France, and the USA and the Blue Frog restaurant chain in China which has been the main driver of the segment's momentum, achieving double-digit growth in LFL sales. In Russia, AmRest was able to grow sales by nearly 13% (and deliver double-digit LFL sales) despite the devaluation of the ruble.

**Improving cost control.** Through tighter cost control, AmRest saw its EBITDA margin expand by 1.8ppts in Q3 2014 relative to the same period last year. EBITDA increased at the fastest rate in Poland, the Czech Republic, and other CEE, showing respective pace of 26%, 6.4%, and 3.4%. In new markets, the quarterly EBITDA loss narrowed to 4.4m thanks to the good performance of the Blue Frog restaurants and closures of loss-making La Tagiatella International locations. When it comes to segmental EBITDA margins, the Q3 growth leader was other CEE, reporting y/y expansion by 6.9ppts to 9.3%, while the highest nominal margin of the quarter (21.5%, down 0.6ppt y/y) was achieved in Spain.

### McDonald's reopens Russian locations as clampdown eases

McDonald's on Wednesday reopened its central Moscow location near Pushkin Square after months of health and safety investigations launched against the fast food chain's Russian restaurants in retaliation for international sanctions. The return of McDonald's Russia is good news for AmRest which operates 85 KFC locations and 10 Pizza Hut restaurants in Russia generating PLN 104m revenue (14% of total) and PLN 10m EBITDA in Q3 2014. The Russian locations achieve higher sales than AmRest's restaurants in other countries.

## Jeronimo Martins

### JM eyes EUR 11 billion revenue in 2017

Jeronimo Martins Poland, the owner of the "Biedronka" chain of discount supermarkets, is planning to open at least 300 new Biedronka locations in 2015-2017 at a cost of EUR 700-800m (ca. 40% of the total CAPEX projected under the new three-year strategy). The Polish revenue target for 2017 is EUR 11bn (9.3% 2013-2017 CAGR), with the EBITDA margin maintained above 6.5%. Keeping margins high is a challenge in the current market where CPI is falling and costs are rising (Biedronka's EBITDA margin in 9M 2014 was 7% vs. 8% in 9M 2013) and JM intends to meet that challenge by expanding the sales mix, modernizing store interiors, remaining the price leader, expanding the network by 100 new stores per year, and practicing greater cost discipline. In 2013, Biedronka generated revenue per square meter of PLN 5500 compared to PLN 5000 achieved by the next best player. Going forward, the per-sqm sales will be hard to maintain at this level as the sales network expands and the new locations increasingly cannibalize sales from existing stores.

### Biedronka launches premium label

Biedronka's new strategy resulted in the launch in December of premium products under the label "La Speciale." At the moment the La Speciale range consists of 50 products but it can be expected to expand in the future. By launching premium lines retailers are able to grow the value of their sales mix (and ifls) and achieve higher margins. One example is the "De Luxe" range offered by Lidl. At the same time, Biedronka's regular customers will need time to get used to the "La Speciale" range.

## Other

Work Service		Buy										
Analyst: Paweł Szpigel		Current price:		PLN 18.5				Last rating		2014-10-07		
		Target price:		PLN 22.5								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	727.4	918.4	26.2%	1 783.3	94.2%	2 360.9	32.4%	Number of shares (m)		67.4		
EBITDA	43.3	52.8	21.9%	91.2	72.7%	134.4	47.4%	MC (current price, PLNm)		1 246.1		
EBITDA margin	6.0%	5.7%		5.1%		5.7%		EV (current price, PLNm)		1 382.2		
EBIT	39.1	48.0	22.8%	84.1	75.2%	121.9	45.0%	Free float		26.2%		
Net profit	20.4	26.5	30.0%	40.4	52.7%	66.6	64.9%					
P/E	55.8	43.0		30.8		18.7		Price change: 1M		-2.6%		
P/CE	46.2	36.3		26.2		15.7		Price change: 6M		21.6%		
P/BV	9.3	4.8		3.2		2.6		Price change: 12M		46.7%		
EV/EBITDA	28.8	23.2		15.2		10.8		Low (52 weeks)		12.1		
Dyield (%)	0.4	0.0		0.0		0.0		High (52 weeks)		20.0		

**After successfully completing four acquisitions, Work Service has become the leader in personnel services in the CEE region. Going forward, the Company is poised for consistent profit growth through cross-selling of high-margin products (especially HR consulting and outsourcing of IT and finance experts, and merchandising and sales personnel) and capitalizing on high demand for skilled workforce in Germany. As the share of temporary work in total sales increases while the share of international sales increases, Work Service is set to improve its operating margin from an estimated 4.7% in 2014 to 6.4% in 2018. By moving out of Poland, the Company will also be able to shorten the cash conversion cycle and reduce exposure to regulatory risk. We maintain a positive outlook for WSE.**

### Q3 2014 results

Work Service reported in-line Q3 2014 results with revenue at PLN 488.3m vs. PLN 477m anticipated by us. Q3 marked the beginning of recognition in the consolidated financial statements of a German acquisition, resulting in a drop from 78.1% in Q3'13 to 53.9% in Q3'14 in the share of domestic sales in the total topline. The gross margin slightly missed our 11.3% estimate at 11.1%, but this was offset by slightly

lower-than-expected SG&A (at PLN 32.4m vs. PLN 33.1m). Other operating activity produced net costs of PLN 0.4m in Q3 2014. EBIT came in line at PLN 21.1m and the EBIT margin expanded to 4.32% from 4.15% in the previous quarter. Financing costs amounted to PLN 6.5m in Q3 2014, including unrealized FX differences of PLN 0.6m. The Q3 2014 tax burden was slightly higher than our PLN 3.1m forecast at PLN 3.7m, while minority interests exceeded expectations considerably at PLN 5.6m vs. PLN 3.2m. Work Service generated strong OCF of PLN 17.5m in Q3 2014 owing to reduced receivables and a lack of tax outflows. After payment for an increased stake in the German SPV, quarterly CFI at PLN 27.7m included expenditures on financial assets.

### Work Service on future outlook

Work Service is planning more acquisitions in 2015 using internal cash resources and bank financing, but not share issue proceeds. 90% of the proceeds from the last public offering were used to pay for the four acquisitions completed this year. As for dividends, Work Service prefers to allocate any cash flow in growing the business. WSE is hoping that after a strong fourth quarter its annual topline for 2014 will come close to PLN 2bn. 2015 revenue is expected to continue expanding at a rate of 20%.

**Recent ratings for companies re-rated as of the date of this Monthly Report:**
**ABC Data**

rating	Suspended
rating day	2014-12-05
price on rating day	3.50
WIG on rating day	53346.86

**Cyfrowy Polsat**

rating	Accumulate	Hold
rating day	2014-06-06	2014-12-05
price on rating day	22.10	24.14
WIG on rating day	52901.29	53346.86

**Enea**

rating	Accumulate	Accumulate	Accumulate	Hold
rating day	2014-04-07	2014-06-03	2014-10-31	2014-12-05
price on rating day	16.00	16.07	16.00	17.00
WIG on rating day	52660.68	52230.73	53492.00	53346.86

**Famur**

rating	Hold	Hold	Buy
rating day	2014-05-07	2014-07-23	2014-12-05
price on rating day	4.46	3.66	3.16
WIG on rating day	50873.54	51667.60	53346.86

**Pekao**

rating	Hold	Reduce	Hold	Reduce
rating day	2014-07-14	2014-09-08	2014-11-05	2014-12-05
price on rating day	175.00	191.00	178.50	186.45
WIG on rating day	51085.89	54412.52	53905.66	53346.86

**PGE**

rating	Reduce	Sell	Reduce	Sell	Reduce	Reduce	Hold
rating day	2014-03-06	2014-05-07	2014-06-03	2014-09-08	2014-10-07	2014-10-31	2014-12-05
price on rating day	18.35	20.30	21.25	22.35	20.21	21.45	20.02
WIG on rating day	52216.05	50873.54	52230.73	54412.52	53992.31	53492.00	53346.86

**PKN Orlen**

rating	Buy	Accumulate
rating day	2014-08-04	2014-12-05
price on rating day	36.88	48.03
WIG on rating day	50390.94	53346.86

**Tauron**

rating	Accumulate	Buy	Buy	Accumulate
rating day	2014-04-07	2014-06-03	2014-10-31	2014-12-05
price on rating day	5.20	5.40	5.17	5.27
WIG on rating day	52660.68	52230.73	53492.00	53346.86

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%  
 Recommendations are updated at least once every nine months.

The present report expresses the knowledge as well as opinions of the authors on day the report was prepared.

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DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.

Comparative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

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