13 May 2010

Update

BRE Bank Securities

Construction

Poland

PBG

Sell

PBGG.WA; PBG.PW

(Reiterated)

Current price	**PLN 233.5**
Target price	**PLN 194.0**
Market cap	PLN 3.33bn
Free float	PLN 1.37bn
Average daily trading (3M)	PLN 11.30m

Shareholder Structure

Jerzy Wiśniewski	29.63%
Pionier Pekao IM	11.26%
ING Nationale-Nederlanden Polska OFE	8.81%
AVIVA OFE Avila BZ WBK	9.39%
Others	40.91%

Industry Outlook

As builders complete high-margin contracts captured in 2008, they become increasingly risky investments. The prospects are good for power-engineering companies, and we recommend overweighting them vs. the rest of the construction sector.

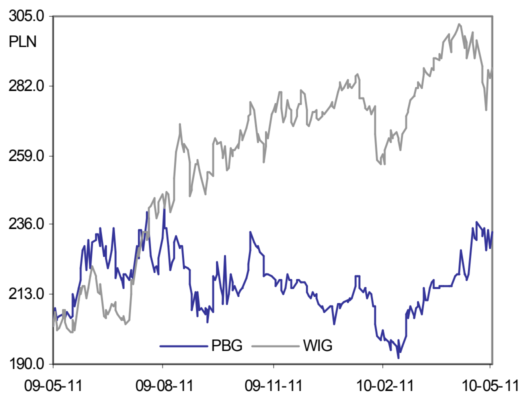
Company Profile

PBG is a highly specialized construction company focusing on environmental projects, natural gas and petroleum installations and fuel storage constructions. It also operates in the general construction segment. The Company also manufactures steel frames, and it is planning to enter real-estate development.

Important Dates

31 August 2010 - H1 2010 report
15 November 2010 - Q3 2010 report

PBG vs. WIG



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PBG Goes 'All In'

In our view, PBG remains hostage to high expectations about its ability to keep profit margins at levels twice as high as industry averages. The company is trying to prevent an otherwise inevitable decline in profits through a rapid expansion in road construction and power engineering – areas where its track record is limited. Moreover, the builder is reaching for the largest and most prominent job opportunities available, which have the downside of carrying the greatest risks. According to our forecasts, PBG's newest markets (power-plant construction, roads, real estate) are going to generate about 40% of 2012 revenues. Based on our updated valuation model, we concluded that the revenue growth prospects (including those stemming from involvement in two power-plant projects, and the road contracts expected to generate a revenue of PLN 1bn in 2012) are already fully discounted in the current price of PBG shares. The company expects to have accumulated an order backlog worth between PLN 4.5 and 6.5bn by the end of 2010, which compares to our (optimistic) forecast of PLN 6.25bn. To account for recently announced potential road jobs totaling PLN 2.5bn, we raised our financial forecasts and valuation of PBG, without changing the investment rating. We believe that companies like Polimex Mostostal, Mostostal Warszawa, and Rafako, offer a much better way in to the power-engineering sector than PBG since their stock prices discount future margins at levels in line with industry averages. As for the profit-driving power of the road business, the contract boom in this industry sector is already over. We recommend selling PBG.

Q1 2010 results were only seemingly better than expected

PBG's reported first-quarter EBIT and net-profit figures exceeded expectations, but they were owed solely to higher revenues that we had expected to be recognized in future quarters, and that therefore do not change our outlook for the whole year. Moreover, the gross profit was boosted by a one-time charge reversal in the amount of PLN 8m.

Our forecasts vs. PBG's guidance

PBG has issued a conservative revenue forecast which, we think, can be exceeded by 10% owing to expected contracts awards totaling PLN 5 billion (of which PBG will book PLN 2.5bn). However, the profit guidance is overly optimistic in our view, since it is based on unrealistic expectations with respect to margins achievable on new road contracts.

(PLN m)	2008	2009	2010F	2011F	2012F
Revenues	2 089.3	2 578.0	3 295.0	3 923.6	4 501.4
EBITDA	270.6	333.6	338.9	330.8	339.5
EBITDA margin	*12.9%*	*12.9%*	*10.3%*	*8.4%*	*7.5%*
EBIT	223.4	286.5	288.6	280.1	288.6
Net income	158.0	210.6	214.9	221.2	228.3
P/E	19.8	15.8	15.5	15.1	14.6
P/CE	15.3	13.0	12.6	12.3	12.0
P/BV	3.1	2.4	2.1	1.9	1.8
EV/EBITDA	14.8	12.1	10.8	10.7	10.0
DYield	0.0%	0.0%	1.3%	1.3%	2.1%

2010 First-Quarter Results

Were First-Quarter Results Really Better Than Expected?

At first glance, PBG's first-quarter earnings data exceeded expectations, with revenues beating our estimate by 34.3% and topping the consensus estimate by 25.7%. The gross margin missed our 11.3% forecast at 10.4%. SG&A expenses amounted to PLN 24.8m (we expected PLN 27.9m). Strong revenues led to an EBIT of PLN 23.9m, ahead of our PLN 11.6m forecast and a PLN 19.6m consensus, and produced a higher-than-predicted bottom-line profit for the quarter. That said, we also have to point out the following about PBG's Q1 earnings performance:

- the better-than-expected Q1 2010 earnings figures stemmed from an overestimated negative impact of unfavorable winter weather on the period's revenues;
- first-quarter revenues are not representative of PBG's future revenue potential which should be assessed based on the company's PLN 2.3bn Q2-Q4 order book, and a PLN 3bn revenue target set for 2010 (our full-year forecast is PLN 3.3bn);
- the Q1 gross margin was below expectations (at 10.4% vs. 11.3%);
- on the plus side, general expenses were lower than predicted (PLN 24.8m vs. PLN 27.9m);
- PBG's subsidiary Hydrobudowa 9 reversed an PLN 8m provision booked in COGS. Adjusted for this reversal, the Q1 gross margin is 8.8%, EBIT is PLN 15.9m, and net profit is PLN 11.3m;
- the Road Construction segment displayed very weak performance in Q1 2010, with Aprivia reporting a PLN 4.4m net loss. The Hydroengineering segment generated a margin of 7.5%;
- Housing and Industrial Construction posted a strong margin of 9.7% (in spite of the effects of stadium contracts);
- the share of Q1 2010 results in full-year forecasts is small, and amounts to 15.6% at revenue level, 8% at EBIT level, and 8.1% at net level;
- delivery of the full-year earnings forecasts hinges on PBG's performance in subsequent quarters.

Reported vs. forecasted Q1 2010 results

(PLN m)	Q1 2010	Q1 2010F	differ.	consensus estimates	differ.	Q1 2009	change
Revenue	469.0	349.3	34.3%	373.1	25.7%	349.1	34.3%
Gross profit	48.7	39.5	23.3%	-	-	60.3	-19.3%
%	*10.4%*	*11.3%*	-	-	-	*17.3%*	-
EBIT	23.9	11.6	106.4%	19.6	22.1%	34.8	-31.2%
Pre-tax income	22.8	2.6	769.8%	-	-	25.3	-9.7%
Net income	17.8	2.1	735.9%	10.8	64.5%	23.2	-23.6%

Source: PBG, F – forecasts by BRE Bank Securities, Consensus estimates by PAP

Q1 2010 results after adjustment for PLN 8m charge reversal

(PLN m)	Q1 2010 adjusted	Q1 2010F	differ.
Revenue	461.0	349.3	32.0%
Gross profit	40.7	39.5	3.0%
%	*8.8%*	*11.3%*	-
EBIT	15.9	11.6	37.4%
Pre-tax income	14.8	2.6	465.0%
Net income	11.3	2.1	431.1%

Source: PBG, F – forecasts by BRE Bank Securities

Like most analysts, we overestimated the negative effects of unfavorable winter weather on first-quarter profits when making our predictions. At the same time, we did not make an adequate allowance for the changes that occurred in the structure of PBG's order portfolio (which now features a larger number of typical construction jobs that were easier to perform during winter than specialized jobs).

First-quarter profits as percentage of full-year profits (2004-2010F)

	2004	2005	2006	2007	2008	2009	2010F*
Q1/full-year earnings	7.8%	9.4%	11.4%	9.7%	14.8%	12.8%	14.2%

Source: BRE Bank Securities, PBG,
**Q1 earnings represent 14.2% of our full-year forecast and 15.6% of the company's guidance; The winters of 2007 and 2008 were mild, while the winters of 2006 and 2010 were marked by low temperatures and heavy snowfall*

On PLN 120m higher-than-forecasted revenues, the Q1 gross margin fell short at 10.4% (we predicted 11.3%), and proved even lower (8.8%) after adjustment for a PLN 8.8m provision reversal made in the period. As always, the strongest gross profit was generated from gas and oil engineering services (old contracts for PGNiG). Hydroengineering disappointed with a low margin, while Industrial and Housing Construction posted a surprisingly good margin. In the Road Construction segment, profitability was low in the first quarter, with subsidiary Aprivia generating revenues of a little over PLN 20m, a gross loss of PLN 2.9m, an EBIT loss of PLN 5.2m, and a net loss of PLN 4.4m, because of unfavorable weather and an order shortage.

Gross margins by business segment

Segment	Share in revenues	Gross margin
Gas and oil engineering	20.0%	19.1%
Hydroengineering	27.0%	7.5%
Housing & industrial construction	47.0%	9.7%
Roads	3.0%	-22.6%
Other	3.0%	19.5%

Source: PBG, BRE Bank Securities

Higher-than-expected revenues paired with lower-than-expected gross margins and SG&A expenses pushed EBIT ahead of expectations. First-quarter “other” operations had a neutral impact on the period’s profits, and financial expenses proved much lower than anticipated (at PLN 1.1m vs. PLN 9.0m) thanks to lower interest expenses. After a PLN 5.4m tax and PLN 0.33m minority losses, the Q1 2010 bottom-line income came in at PLN 17.8m.

Q1 2010 Results of Hydrobudowa Polska

PBG’s subsidiary Hydrobudowa Polska posted better-than-expected first-quarter results for the same reasons as its parent (higher revenues, in-line margins, a PLN 8m provision reversal).

Reported vs. forecasted Q1 2010 results of Hydrobudowa

(PLN m)	Q1 2010	Q1 2010F	differ.	consensus estimates	differ.	Q1 2009	change
Revenues	322.7	242.2	33.2%	300.0	7.6%	209.4	54.1%
Gross profit	24.9	18.2	37.3%	-	-	25.1	-0.6%
Gross margin	*7.7%*	*7.5%*	-	-	-	*12.0%*	-
EBIT	11.6	5.5	109.3%	8.4	38.2%	14.9	-22.1%
Pre-tax income	11.4	2.2	419.5%	-	-	3.7	212.6%
Net income	8.9	1.8	399.2%	6.0	48.4%	7.1	24.9%

Source: Hydrobudowa Polska, F – forecasts by BRE Bank Securities, Consensus estimates by PAP

Gross margins by business segment

Segment	Share in revenues	Gross margin
Hydroengineering	34.9%	5.2%
Housing & industrial construction	62.3%	9.3%
Roads	1.0%	1.9%
Other	1.8%	6.2%

Source: Hydrobudowa Polska, BRE Bank Securities

2010-2014 Forecasts

2010 Outlook

Financial Forecasts

PBG's 2010 earnings growth forecasts do not take into account all of the best bids that the company submitted on road contracts totaling PLN 5bn (of which PLN 2.5bn is attributable to PBG). Our less conservative revenue estimate is 10% higher than the company's, but we are not as optimistic about the margins achievable on these road jobs.

2010 earnings forecast

(PLN m)	PBG	Our Forecast	2009 results
Revenues	3000.0	3295.0	2578.0
EBIT	300.0	288.6	286.5
Net income	220.0	214.9	210.6

Source: PBG, BRE Bank Securities

PLN 2.5m Contract Opportunities

PBG is competing for road contracts with a total value of PLN 5bn, that can potentially add PLN 2.5 billion to the company's future revenues as 50% consortium partner. PBG's offer has already been selected as the best one in one of the tenders, and we reckon that this order is factored in the 2010 earnings guidance. In the two other tenders that PBG revealed it was competing in, its bids are already known to be the lowest, but an official selection has not been made yet. We think that these two contracts are included in the financial forecasts with 50% probability. The three contracts have a combined value of PLN 2.6bn (PBG's share is a combined PLN 1.3bn). The other contracts that PBG is bidding for are confidential.

Contract opportunities

Project	Value (PLN m)	PBG 's share (PLN m)	Status
S5 road section including two bypass roads	948.2	474.1	awarded to PBG
Section of A1 motorway (Brzezie – Kowal)	707.0	353.5	PBG made lowest bid
Section of A1 (Czerniewice – Brzezie)	934.0	467.0	PBG made lowest bid
Other (confidential)	2410.8	1205.4	-
Total	5000.0	2500.0	-

Source: PBG, BRE Bank Securities

Gross Profits Achievable On New Road Contracts

We reckon that PBG can earn gross profit margins of 7-7.5% on new road contracts, suggesting EBIT margins of 3.1-3.6% after SG&A expenses of 3.9%. PBG does not have any special advantages over competition, except maybe for the short distance between Hydrobudowa's headquarters and the A1 motorway construction sites, which can help in subcontractor hiring. Some small advantage might also arise from the closeness of Aprivia's subsidiary Dromost from the S5 expressway, and Betpol's proximity to the A1 site. PBG's quarries are too far away from road sites to provide an advantage.

2010-2014 Outlook

Roads, Power Plants, Real Estate

When making five-year earnings predictions for PBG, we applied a segmental breakdown into Power Engineering, Roads, and Real Estate, and combined the former gas-and-oil engineering and fuel engineering segments into one (in line with PBG's Q1 2010 presentation). Our forecasts are based on PBG's existing order backlog and expected contract opportunities.

2010-2014 forecasts

(PLN m)	2010F	2011F	2012F	2013F	2014F
Total					
Revenues	3 295.0	3 923.6	4 501.4	4 765.9	5 023.5
Gross profit	397.2	428.9	460.1	487.5	515.2
Gross margin	*12.1%*	*10.9%*	*10.2%*	*10.2%*	*10.3%*
Gas, Oil, Fuels					
Revenues	815.0	1 025.0	1 096.8	1 173.5	1 255.7
Gross profit	191.5	194.8	164.5	176.0	188.4
Gross margin	*23.5%*	*19.0%*	*15.0%*	*15.0%*	*15.0%*
Hydroengineering					
Revenues	815.0	815.0	855.8	907.1	970.6
Gross profit	69.3	66.0	69.3	73.5	78.6
Gross margin	*8.5%*	*8.1%*	*8.1%*	*8.1%*	*8.1%*
Power Engineering					
Revenues	0.0	300.1	565.0	632.8	683.4
Gross profit	0.0	24.3	45.8	51.3	55.4
Gross margin	-	*8.1%*	*8.1%*	*8.1%*	*8.1%*
General Construction					
Revenues	1030.0	680.6	728.3	779.2	833.8
Gross profit	83.8	55.1	59.0	63.1	67.5
Gross margin	*8.1%*	*8.1%*	*8.1%*	*8.1%*	*8.1%*
Road Construction					
Revenues	605.0	1088.9	1121.5	1132.7	1132.7
Gross profit	45.4	78.9	84.1	85.0	85.0
Gross margin	*7.5%*	*7.3%*	*7.5%*	*7.5%*	*7.5%*
Real-Estate Development					
Revenues	25.0	0.0	119.7	125.7	131.9
Gross profit	4.7	0.0	27.3	28.3	29.7
Gross margin	*18.8%*	-	*22.8%*	*22.5%*	*22.5%*
Rental Properties					
Revenues	5.0	14.0	14.4	14.9	15.3
Gross profit	2.5	9.8	10.1	10.4	10.7
Gross margin	*50.0%*	*70.0%*	*70.0%*	*70.0%*	*70.0%*

Source: PBG, BRE Bank Securities

2010-2012 order backlog (PLN m)

Segment	2010 Q2-Q4	Q1 2010	2010	2011	2012
Gas, oil, fuels	724	91	815	621	286
Hydroengineering	687	128	815	424	14
Construction	809	221	1030	340	
Roads	80	13	93	15	
		16	16		
Total	2300	469	2769	1400	300

Source: PBG, BRE Bank Securities

Steady Growth In Gas, Oil, and Fuel Engineering

We think that PBG can count on steady earnings growth in the segment of Gas, Oil & Fuel Engineering, where the supply of orders is steady, and competition is moderate. Upcoming opportunities include an LNG loading terminal with infrastructure, and capacity upgrades planned by Poland's gas monopoly PGNiG. We included the LNG contract in our financial forecasts for PBG, setting the probability of its capture at 33%. If awarded, it would add PLN 300m to the company's revenues in 2011-2013. Future margins in the segment are expected to contract as PBG completes existing jobs for PGNiG.

Hiatus In Hydroengineering

The hydroengineering business faces a standstill in revenues (and possibly a drop in 2011) because of a thin order book, a limited supply of major jobs, and intense competition. In fact, the company seems to be scaling back its operations in this area, as evidenced by the planned divestment of subsidiary Infra, and the expected reallocation of resources into other segments (power plants, roads). Profit margins in hydroengineering are similar to those achievable on general construction.

Expansion In Power Engineering

We expect PBG to expand in the market for power-engineering services by striking a partnership with an international player. Our prediction is that the company's revenues from this business will increase from zero in 2010 to PLN 565m in 2012, based on the assumption that, by then, PBG will be involved in the delivery of 1500 MW of power-generating capacity (and assuming project expenses of EUR 1.25m per megawatt, the EUR/PLN exchange rate at 4, project duration at 4 years, and PBG's consortium share at 30%). For comparison, our 2010-2012 revenue growth projections for rival Rafako are higher at PLN 638.6m, which stems from a higher backlog and a much longer track record. The margins we expect PBG to earn on power-plant projects (8.1% gross margins and 4.2% EBIT margins) are the same as Rafako's (EBIT margins at 4.1-4.3%), but our forecasts for the latter are more conservative relative to its competitive advantages (including the capacity to single-handedly design and produce a large boiler, which automatically implies higher shares in bidding consortia, and the long-standing experience). The partner that newspapers most commonly pair PBG with is Alstom, the leading player in the Polish market and one of the world leaders in energy infrastructure, which is likely to be the dominant stakeholder in the prospective consortia. Moreover, as provider of run-of-the-mill construction services, PBG is up against stronger competition, and it can easily be replaced as consortium partner.

Revenue Shrinkage In General Construction After Stadium Completions

PBG and Hydrobudowa's decision to compete for Euro 2012 stadium contracts was dictated by the need to fill the backlog gaps left by a shortage of environmental-infrastructure contracts. Once the stadiums are finished, equally big opportunities in the general-construction sector will be much fewer, and the company will probably reallocate its resources to road and power-plant construction. Future margins on the general construction business are expected to hover around the levels achieved by other leading industry players (e.g. Erbud).

Rapid Growth In Road Construction

As mentioned above, pending contract opportunities can give a PLN 2.5bn boost to PBG's future revenues, with margins at levels typical for the road industry. Assuming that, if won, these contracts will engage the company's full capacity, we did not take any other opportunities into account in our forecasts.

Growth In Real Estate

We expect the PBG Dom real-estate operations to launch two housing projects in 2010, one in Gdańsk (4,000 square meters, revenues forecasted at PLN 20m), and the other in Poznań (5,500 sqm, PLN 33m revenues). Moreover, the company has a residential project underway in Kiev, Ukraine (ca. 16,000 sqm, expected revenues: PLN 66.7m, gross margin: 25%). We expect these revenues to be fully recognized in 2012, and we assume that PBG will keep building real-estate on a similar scale in the future. Our long-term margin and inventory predictions for PBG's real-estate business are the same as for Dom Development. Our forecasts also include future rental income from the Skalar Office Center project in Poznań, scheduled for completion in mid-2010.

One-Time Events

No contribution to minority interests from Hydrobudowa 9

We expect PBG to report profits attributable to minority shareholders of only PLN 4.2m in 2010 (compared to PLN 11.4m in 2009 and PLN 29.7m in 2008), because of:
- an expected deterioration in the earnings of Hydrobudowa Polska
- zero contributions from Hydrobudowa 9
- the expected composition of Hydrobudowa Polska's consolidated 2010 results (including weak earnings of the parent and a decent showing from Hydrobudowa 9).

PBG purchased 69.16% of the shares of Hydrobudowa 9 for PLN 55.35m in 2007, then took over the remaining interests, made a capital injection, and, in 2008, transferred the company to its subsidiary Hydrobudowa Polska for PLN 326.4m. Since before its acquisition by PBG Hydrobudowa 9 booked a large charge-off in 2006, its net result for that year was a PLN 176.6m loss, and its equity decreased to a negative amount (PLN -125m at year-end 2009). As per IFRS requirements, subsidiaries with negative equities are fully consolidated.

Summing up, if it were not for Hydrobudowa 9's negative equity, the 2010 profits attributable to the minority shareholders of PBG would be PLN 10m higher, which means that the profits attributable to the shareholders of the parent would be PLN 10m lower. We expect Hydrobudowa 9 to continue reporting negative equity for three more years. Moreover, we think that Hydrobudowa Polska's future margins will match the levels generated by Hydrobudowa 9.

Adjusted 2010 Earnings Forecast For PBG

The tables below show our 2010 financial forecasts for the PBG Group after adjustment for the following one-time events:
- reversal of a PLN 8m provision credited to COGS
- other net operating income in the amount of PLN 20.5m (including PLN 9m from revaluation of Hydrobudowa 9's properties, and PLN 5.5m from revaluation of the Skalar Office Center)
- no contribution from Hydrobudowa 9 to minority interests

Core 2010 earnings forecast for PBG

(PLN m)	2010F	2010F adjusted
Sales	**3 295.0**	**3 287.0**
Gross profit	397.2	389.2
gross margin	*12.1%*	*11.8%*
EBIT	**288.6**	**260.1**
EBIT margin	*8.8%*	*7.9%*
Minority interests	-4.2	-11.2
Net income	**214.9**	**184.8**
change	*2.0%*	-12.3%
net margin	*6.5%*	*5.6%*
P/E	15.6	18.1
EV/EBITDA	10.7	11.7

Source: PBG, BRE Bank Securities

2010 earnings forecasts for Hydrobudowa Polska

(PLN m)	2010F
Sales	**1 730.0**
change	*3.2%*
COGS	1 612.7
Gross profit	117.3
gross margin	*6.8%*
Selling expenses	0.0
General and administrative expenses	-55.5
Other net operating income	-4.0
EBIT	**57.7**
change	*-49.9%*
EBIT margin	*3.3%*
Profit/loss on financial activity	-10.3
Extraordinary gains/losses	0.0
Other profits/losses on investment	0.0
Pre-tax income	**47.5**
Tax	-7.6
Other charges	0.0
Net income	**39.9**
change	*-59.3%*
net margin	*2.3%*
P/E	***19.0***
EV/EBITDA	***11.7***

Source: BRE Bank Securities

Risky Growth Strategy

High-Risk Strategy

Our forecasts suggest that PBG's future revenues will be increasingly generated by new lines of business, giving rise to risks related to the costs of entry into new markets.

Risks In Power Engineering

PBG has no previous track record in power-plant projects. Its sole, albeit small advantage, is a 25% ownership stake in power-plant-component provider Energomontaż Południe. PBG companies have performed jobs for energy producers in the past, but they were non-specialized mainstream works that can be done by many others (buildings, water pipes, steel structures). According to media rumors, PBG has approached Alstom to become its bidding partner in future power-plant tenders. The problem with this potential partnership is that Alstom has a considerable upper hand over the Polish firm, represented by its multi-national scale, the capacity to make boilers, generators, and turbines, and an established track record in catering to power producers across the world. The implication of this is an uneven distribution of potential contract profits between the two partners, with PBG getting only the portion of the margins that is typically earned from standard construction work (EBIT margins at 3-4%). Further, Alstom is in the position to hire any other contractor should it decide that PBG is asking too much money. The situation looks slightly better in case of gas-fired power plant projects, where PBG's capacity and track record are somewhat stronger, and where it can therefore look for a more equal partner.

Roads: High Revenues, High Risk

The PLN 2.5bn road contracts that PBG expects to sign in mid-2010 have budgets that were calculated toward the end of 2009. Meanwhile, the company can start hiring subcontractors only after these contracts are signed, which means that it is exposed to the risk that changing prices of construction services, and its lack of experience as general contractor in road projects, will cause it to earn lower-than-expected margins. We wonder how PBG is going to handle its role as general contractor given its complete lack of experience.

Expected contributions of new revenue sources to future revenues

(PLN m)	2010F	2011F	2012F	2013F	2014F
Total PBG	3 295.0	3 923.6	4 501.4	4 765.9	5 023.5
Power-engineering, roads, real-estate	635.0	1 403.0	1 820.6	1 906.0	1 963.4
As percentage of revenues	19.3%	35.8%	40.4%	40.0%	39.1%

Source: PBG, BRE Bank Securities

Valuation of PBG

Based on relative valuation and DCF analysis, we set the nine-month per-share price target on PBG at PLN 194, and we recommend selling the stock.

	Value per share	Weight
DCF Analysis	176.8	75%
Relative Valuation	189.3	25%
Average	179.9	
Cost of equity (9M)	7.8%	
Target Price	**194.0**	

Relative Valuation

By comparing the forecasted 2010-2012 P/E and EV/EBITDA multiples of PBG with those of its construction sector peers, we found that the company was traded at a nearly 19.0% premium.

Relative valuation of PBG

	2010F P/E	2011F P/E	2012F P/E	2010F EV/EBITDA	2011F EV/EBITDA	2012F EV/EBITDA
Budimex	13.7	15.8	15.7	11.0	11.0	10.6
Erbud	12.9	13.3	11.8	9.1	8.6	7.3
Elektrobudowa	17.0	15.3	13.1	10.5	9.1	7.6
Mostostal Warszawa	12.8	14.5	13.0	7.0	7.4	6.3
Polimex Mostostal	15.0	14.5	10.3	8.8	8.1	6.3
Rafako	17.2	14.5	13.1	9.4	7.4	6.2
Trakcja Polska	16.6	16.4	12.5	8.8	8.2	5.6
Unibep	13.8	13.0	12.6	9.2	7.4	6.8
Median	14.4	14.5	12.8	9.2	8.2	6.6
PBG	**15.5**	**15.1**	**14.6**	**10.8**	**10.7**	**10.0**
Premium (discount)	7.8%	4.0%	14.6%	18.3%	31.1%	52.3%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

DCF Analysis

Assumptions:
- Risk-free rate = 5.6% (10Y T-bond yield).
- Expected FCF rate growth after FY2017 = 3%.
- Long financing cycles in hydroengieering contracts.
- We accounted for PBG's investment properties as value-enhancing factors.
- Margins will follow a decreasing trend going forward.
- The forecasts factor in the future earnings prospects arising from PBG's expansion in power engineering, road construction, and real-state development.

DCF Valuation Model

(PLN m)	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2019+
Sales	**3 295.0**	**3 923.6**	**4 501.4**	**4 765.9**	**5 023.5**	**5 281.3**	**5 554.0**	**5 794.6**	**6 005.5**	**6 205.3**	
change	*27.8%*	*19.1%*	*14.7%*	*5.9%*	*5.4%*	*5.1%*	*5.2%*	*4.3%*	*3.6%*	*3.3%*	
EBITDA	**338.9**	**330.8**	**339.5**	**356.9**	**374.8**	**392.7**	**410.9**	**426.9**	**440.8**	**453.9**	
EBITDA margin	*10.3%*	*8.4%*	*7.5%*	*7.5%*	*7.5%*	*7.4%*	*7.4%*	*7.4%*	*7.3%*	*7.3%*	
D&A expenses	50.4	50.7	50.9	51.1	51.3	51.5	51.7	51.7	51.7	51.7	
EBIT	**288.6**	**280.1**	**288.6**	**305.8**	**323.5**	**341.2**	**359.2**	**375.1**	**389.1**	**402.2**	
EBIT margin	*8.8%*	*7.1%*	*6.4%*	*6.4%*	*6.4%*	*6.5%*	*6.5%*	*6.5%*	*6.5%*	*6.5%*	
Tax rate on EBIT	54.8	53.2	54.8	58.1	61.5	64.8	68.2	71.3	73.9	76.4	
NOPLAT	**233.7**	**226.9**	**233.8**	**247.7**	**262.0**	**276.3**	**290.9**	**303.9**	**315.1**	**325.8**	
CAPEX	-144.9	-53.5	-53.8	-53.0	-53.2	-53.4	-53.6	-53.6	-53.6	-51.7	
Working capital	311.3	-30.0	-14.7	-30.3	-37.7	-35.9	-33.2	-36.3	-32.2	-30.9	
Other	-0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	**450.0**	**194.1**	**216.3**	**215.5**	**222.4**	**238.5**	**255.8**	**265.7**	**281.0**	**294.8**	**303.7**
WACC	*10.5%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	
discount factor	*93.6%*	*84.6%*	*76.5%*	*69.2%*	*62.5%*	*56.5%*	*51.1%*	*46.2%*	*41.8%*	*37.8%*	
PV FCF	421.1	164.3	165.4	149.0	139.1	134.9	130.8	122.8	117.5	111.4	

	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F
WACC	***10.5%***	***10.6%***	***10.6%***	***10.6%***	***10.6%***	***10.6%***	***10.6%***	***10.6%***	***10.6%***	***10.6%***
Cost of debt	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*
Risk-free rate	*5.6%*	*5.6%*	*5.6%*	*5.6%*	*5.6%*	*5.6%*	*5.6%*	*5.6%*	*5.6%*	*5.6%*
Credit risk premium	*1.2%*	*1.2%*	*1.2%*	*1.2%*	*1.2%*	*1.2%*	*1.2%*	*1.2%*	*1.2%*	*1.2%*
Effective tax rate	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*
Net debt / EV	*3%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*	*0%*
Cost of Equity	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*	*10.6%*
Risk premium	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0

FCF growth after the forecast horizon	*3.0%*
Terminal value	3 995.9
Present value of the terminal value (PV TV)	1 510.1
Present value of FCF in the forecast horizon	1 656.3
Present value of FCF	3 166.4
Net debt	474.6
Other non-operating assets	134.5
Minority interests	299.1
Equity value	2 527.2
Number of shares (millions)	14.3
Equity value per share (PLN)	**176.8**
Cost of equity (9M)	7.8%
Target Price	**190.7**

Sensitivity Analysis

FCF growth in perpetuity

	2.0%	**2.5%**	**3.0%**	**3.5%**	**4.0%**
WACC -1.0ppt	177.8	184.5	192.1	200.8	210.8
WACC -0.5ppt	177.1	183.8	191.4	200.1	210.0
WACC	176.5	183.2	**190.7**	199.3	209.3
WACC +0.5ppt	175.9	182.5	190.1	198.6	208.5
WACC +1.0ppt	175.3	181.9	189.4	197.9	207.7

EV/EBITDA('09) for the target price	10.3
P/E('09) for the target price	12.9
TV to EV	48%

Income Statement

(PLN m)	2006	2007	2008	2009	2010F	2011F	2012F
Sales	**674.3**	**1 376.8**	**2 089.3**	**2 578.0**	**3 295.0**	**3 923.6**	**4 501.4**
change	*65.1%*	*104.2%*	*51.8%*	*23.4%*	*27.8%*	*19.1%*	*14.7%*
COGS	558.2	1 191.7	1 751.2	2 185.9	2 897.8	3 494.7	4 041.3
Gross profit	116.1	185.0	338.1	392.1	397.2	428.9	460.1
gross margin	*17.2%*	*13.4%*	*16.2%*	*15.2%*	*12.1%*	*10.9%*	*10.2%*
Selling expenses	-1.4	-0.4	0.0	0.0	-0.7	-0.8	-0.9
General and administrative expenses	-52.8	-79.6	-106.8	-109.8	-128.5	-153.0	-175.6
Other net operating income	10.0	4.3	-7.8	4.1	20.5	5.0	5.0
EBIT	**72.0**	**109.4**	**223.4**	**286.5**	**288.6**	**280.1**	**288.6**
change	*74.1%*	*52.0%*	*104.3%*	*28.2%*	*0.7%*	*-2.9%*	*3.0%*
EBIT margin	*10.7%*	*7.9%*	*10.7%*	*11.1%*	*8.8%*	*7.1%*	*6.4%*
Profit/loss on financial activity	-2.0	34.7	-9.9	-23.9	-18.0	7.4	13.9
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross profit	**69.9**	**144.1**	**213.5**	**262.6**	**270.5**	**287.5**	**302.5**
Tax	-15.0	-26.7	-25.8	-40.6	-51.4	-54.6	-57.5
Minority interests	-2.7	-15.4	-29.7	-11.4	-4.2	-11.7	-16.7
Net income	**52.2**	**102.1**	**158.0**	**210.6**	**214.9**	**221.2**	**228.3**
change	*44.6%*	*95.6%*	*54.9%*	*33.3%*	*2.0%*	*2.9%*	*3.2%*
net margin	*7.7%*	*7.4%*	*7.6%*	*8.2%*	*6.5%*	*5.6%*	*5.1%*
D&A expenses	16.6	28.8	47.1	47.1	50.4	50.7	50.9
EBITDA	**88.5**	**138.2**	**270.6**	**333.6**	**338.9**	**330.8**	**339.5**
change	*76.5%*	*56.1%*	*95.8%*	*23.3%*	*1.6%*	*-2.4%*	*2.6%*
EBITDA margin	*13.1%*	*10.0%*	*12.9%*	*12.9%*	*10.3%*	*8.4%*	*7.5%*
Shares at year-end (millions)	12.0	13.4	13.4	14.3	14.3	14.3	14.3
EPS	4.3	7.6	11.8	14.7	15.0	15.5	16.0
CEPS	5.7	9.7	15.3	18.0	18.6	19.0	19.5
ROAE	*19.2%*	*18.3%*	*18.0%*	*17.5%*	*14.5%*	*13.4%*	*12.5%*
ROAA	*6.1%*	*6.1%*	*6.1%*	*6.1%*	*5.8%*	*6.4%*	*6.1%*

Balance Sheet

(PLN m)	2006	2007	2008	2009	2010F	2011F	2012F
ASSETS	**1 045.1**	**2 289.3**	**2 857.0**	**4 008.3**	**3 404.9**	**3 529.7**	**3 919.6**
Fixed assets	**373.6**	**717.9**	**909.3**	**1 011.5**	**1 127.0**	**1 136.0**	**1 145.2**
Intangible assets	4.7	13.3	14.6	33.0	33.0	33.0	33.0
Equity value	72.0	267.4	333.1	319.0	319.0	319.0	319.0
Property, plant and equipment	266.5	307.0	411.5	368.3	370.6	373.4	376.2
Long-term investments	0.7	62.0	53.6	166.4	279.6	285.8	292.1
Other	29.8	68.2	96.6	124.9	124.9	124.9	124.9
Current assets	**671.4**	**1 571.3**	**1 947.6**	**2 996.8**	**2 277.9**	**2 393.7**	**2 774.4**
Inventories	19.4	40.1	69.3	233.7	148.2	245.6	269.0
Receivables	293.6	602.6	725.1	1 135.8	1 101.3	1 311.5	1 504.6
Construction contract receivables	275.8	445.2	777.8	725.6	593.7	564.0	592.2
Short-term prepayments	7.7	14.7	21.1	24.2	24.2	24.2	24.2
Cash and cash equivalents	51.3	410.3	289.7	660.3	193.1	31.1	167.1
Other	23.5	58.4	64.7	217.3	217.3	217.3	217.3

(PLN m)	2006	2007	2008	2009	2010F	2011F	2012F
LIABILITIES	**1 045.1**	**2 289.3**	**2 857.0**	**4 008.3**	**3 404.9**	**3 529.7**	**3 919.6**
Equity	**367.2**	**748.0**	**1 010.9**	**1 395.3**	**1 567.2**	**1 744.2**	**1 904.0**
Minority interests	12.1	34.6	103.7	228.2	228.2	228.2	228.2
Long-term liabilities	**212.7**	**330.0**	**364.8**	**561.8**	**168.7**	**68.7**	**68.7**
Loans, financial leases	180.2	258.6	323.1	493.1	100.0	0.0	0.0
Reserves and other	32.4	71.4	41.7	68.7	68.7	68.7	68.7
Short-term liabilities	**453.1**	**1 176.7**	**1 377.7**	**1 823.1**	**1 440.8**	**1 488.7**	**1 718.7**
Loans	205.0	466.7	717.8	641.8	200.0	0.0	0.0
Trade creditors	232.1	543.2	538.0	1 046.2	1 005.9	1 213.1	1 402.8
Construction contract payables	0.9	19.6	15.4	60.5	160.3	200.9	241.2
Other	15.1	147.2	106.4	74.6	74.6	74.6	74.6

Debt	385.2	725.2	1 040.9	1 134.9	300.0	0.0	0.0
Net debt	333.9	314.9	751.2	474.6	106.9	-31.1	-167.1
(Net debt / Equity)	*90.9%*	*42.1%*	*74.3%*	*34.0%*	*6.8%*	*-1.8%*	*-8.8%*
(Net debt / EBITDA)	3.8	2.3	2.8	1.4	0.3	-0.1	-0.5
BVPS	30.5	55.7	75.3	97.6	109.6	122.0	133.2

Cash Flows

(PLN m)	2006	2007	2008	2009	2010F	2011F	2012F
Cash flows from Operating Activities	**-134.2**	**-117.6**	**-255.2**	**306.5**	**574.1**	**228.3**	**244.3**
Net income	52.2	102.1	158.0	210.6	214.9	221.2	228.3
D&A expenses	16.6	28.8	47.1	47.1	50.4	50.7	50.9
Working capital	-57.1	-177.7	-469.2	121.0	311.3	-30.0	-14.7
Other	-145.8	-70.7	8.8	-72.2	-2.5	-13.5	-20.3
Cash flows from investing activities	**-112.5**	**-179.0**	**-191.7**	**-352.0**	**-145.4**	**-53.5**	**-53.8**
CAPEX	-88.1	-131.8	-191.9	-151.0	-144.9	-53.5	-53.8
Equity investments	-42.2	-41.7	19.7	14.5	-0.5	0.0	0.0
Other	17.8	-5.5	-19.6	-215.5	0.0	0.0	0.0
Cash flows from financing activities	**217.0**	**655.5**	**325.1**	**416.9**	**-895.9**	**-336.9**	**-54.6**
Stock offering	187.3	333.1	292.3	181.8	0.0	0.0	0.0
Debt	46.1	342.2	74.0	278.5	-834.9	-300.0	0.0
Dividends (buyback)	0.0	-1.9	0.0	0.0	-43.0	-44.2	-68.5
Other	-16.4	-17.9	-0.4	-1.2	0.0	0.0	0.0
Change in cash	**-29.7**	**358.9**	**-121.9**	**371.4**	**-467.1**	**-162.0**	**135.9**
Cash at end of period	51.3	410.3	289.7	660.3	193.1	31.1	167.1
DPS (PLN)	0.0	0.1	0.0	0.0	3.0	3.1	4.8
FCF	-76.6	-207.7	-473.6	249.2	450.0	194.1	216.3
(CAPEX / Sales)	*13.1%*	*9.6%*	*9.2%*	*5.9%*	*4.4%*	*1.4%*	*1.2%*

Market multiples

	2006	2007	2008	2009	2010F	2011F	2012F
P/E	53.8	30.7	19.8	15.8	15.5	15.1	14.6
P/CE	40.9	24.0	15.3	13.0	12.6	12.3	12.0
P/BV	7.7	4.2	3.1	2.4	2.1	1.9	1.8
P/S	4.2	2.3	1.5	1.3	1.0	0.9	0.7
FCF/EV	*-2.4%*	*-6.0%*	*-11.9%*	*6.2%*	*12.3%*	*5.5%*	*6.4%*
EV/EBITDA	35.6	25.2	14.8	12.1	10.8	10.7	10.0
EV/EBIT	43.8	31.9	17.9	14.1	12.7	12.6	11.8
EV/S	4.7	2.5	1.9	1.6	1.1	0.9	0.8
DYield	*0.0%*	*0.1%*	*0.0%*	*0.0%*	*1.3%*	*1.3%*	*2.1%*
Price (PLN)	**233.5**						
Shares at year-end (millions)	12.0	13.4	13.4	14.3	14.3	14.3	14.3
MC (PLN m)	2809.0	3135.9	3135.9	3337.9	3337.9	3337.9	3337.9
Equity attributable to minority shareholders (PLN m)	12.1	34.6	103.7	228.2	228.2	228.2	228.2
EV (PLN m)	3 155.0	3 485.4	3 990.8	4 040.7	3 672.9	3 535.0	3 399.0

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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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HOLD – we expect that the rate of return from an investment will range from –5% to +5%
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Previous ratings issued for PBG

Rating	Hold	Accumulate	Hold	Hold	Reduce	Sell
Date issued	2009-08-14	2009-10-05	2009-11-04	2009-11-12	2010-02-22	2010-04-07
Price on rating day	235.00	210.00	218.80	218.50	197.20	216.00
WIG on rating day	35998.12	37045.62	37391.24	39879.92	38650.00	43562.01