

Monday, January 26, 2015 | periodic publication

# Equity Market in 2015: Investment Strategy

## Equity Market, Macroeconomics

A war in Ukraine, a slowdown in the Eurozone, pension reform, unfavorable changes in bank regulations, withdrawals from investment funds, and Poland given underweight grades by the world's leading investment banks – these are the factors that shaped the Polish stock market in 2014. Against all odds, however, the WIG index ended the year with an 0.26% gain compared to a 2.7% rise in DAX and a 4.6% fall in MSCI EM.

For 2015, our outlook is more positive when it comes to political and economic factors which should support an upward trend on equity stocks (with WIG reaching 60,000 points by the end of the year). The room for upside surprises is considerable given that markets have been playing out the same trends on the USD, commodities, bonds, and equities, for months now. **Our projections for the year ahead can be summarized as follows:**

**1)** Russia will roll back its military offensive in Ukraine as it feels the impact of the international sanctions and the economic crisis.

**2)** A weakened euro (+0.2/0.3% of GDP), low prices of oil supporting consumption (Eurozone consumption is up 1% y/y), the ECB's quantitative easing program (EUR 60bn a month), and more relaxed lending policies expected to drive investment (borrowing by the non-financial sector is increasing for the first time since 2011), will combine to fuel GDP growth in the Eurozone throughout the course of the year.

**3)** In the US, the general consensus on growth (+2.9% GDP) may be undermined by a strong dollar, affecting exports, and by low oil prices which hurt resources-based industries and their suppliers (US manufacturing has been slower to grow, with ISM now on a downward trend; moreover there are concerns over the financial health of mining companies and the possible impact on banks in the event of bankruptcies).

**4)** With this in mind, the Fed is holding off the tightening cycle (now set for the end of the year). The EURUSD exchange rate is capped by strong technical resistance defined by the downward curve formed since 1980. Against this backdrop, the dollar should stop its upward movement (record long position in US dollar), allowing for a price rebound in commodities (record short position in copper) and a shift in sentiment toward emerging markets, including Poland with its exposure to the Euro Area.

**5)** In Poland, even though real GDP growth in the last two quarters averaged 3%, the nominal growth in 2014/2015 is expected to decelerate below 2% (such sluggish nominal growth was not recorded even in 2008-2009). This affects the earnings of Polish companies. Beginning Q2 2015, however (recovery in Eurozone, weak PLN, increased infrastructure spending, recovering consumer demand fueled by low interest rates and a firming job market), economic growth in Poland is set to accelerate in real as well as nominal terms, indicating a trough in the earnings cycle.

**6)** 2015 should bring relief for Polish funds. At the end of 2014 pension funds (OFEs) held over PLN 10bn in cash, and the net inflows in 2015 are projected at PLN 2.8bn (including dividends). In the best-case scenario where the liquidity of their portfolios remains sound, OFEs have no reason to sell off equities or suddenly take all their cash to foreign markets (and face risk of PLN appreciation without an option to hedge). As for investment funds (TFIs), in the last three years they recorded net inflows of PLN 32bn, channeled mainly into debt and money market funds. In 2014, equity and mixed funds reported withdrawals totaling PLN 0.98bn after PLN 2.9bn receipts the year before. In 2015, however, funds are set to operate in a market where the value of household deposits will soon exceed debt amid a growing job market and a stabilizing economic environment. According to our calculations 0.5% of deposits equals 3 billion zlotys. TFI assets as percentage of deposits and GDP are currently at their lowest level since 2003-2005.

In a positive stock market scenario, the following are our top sector recommendations and stock picks:

**Financial Sector** (OW Polish banks from Q2): B: PKO BP, Millennium, Erste Bank, Kruk, S: BZ WBK;

**Gas & Oil, Chemicals** /MW/: B: PKN Orlen, Synthos, S: PGNIG;

**Power Producers** /MW/: B: Enea, Tauron, S: CEZ;

**Resources** /OW/: B: KGHM, LW Bogdanka;

**Retail** /MW/: B: CCC, S: LPP;

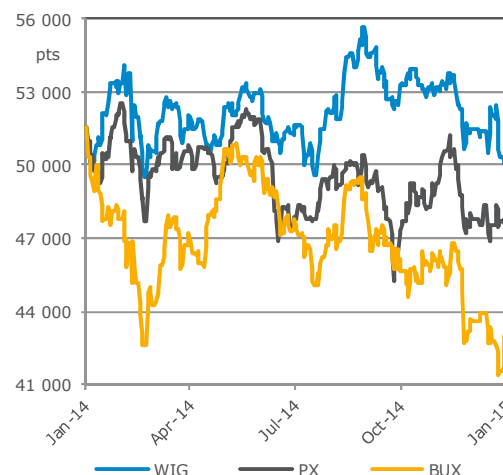
**TMT** /MW/: B: Asseco Poland;

**Industrials** /OW/: B: Elemental Holding, Famur, Feerum, Hydrotor, Tarczyński, S: Alchemia, AC, Boryszew, Radpol, PGO;

**Construction & Real Estate** /OW/: B: Elektrobudowa, LC Corp, Erbud, Elektrotrim, Polnord, Capital Park.

WIG ..... 51,680  
Average 2014E P/E..... 14.7  
Average 2015E P/E..... 13.1  
Avg. daily trading volume (3M)... PLN 799m

## WIG vs. indices in the region



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## Equity Market

### 2014: Bull Market Lives In US, Poland and EMs Underperform, What's In Store For 2015?

- In the US, strong economic momentum and company earnings drove S&P500 stock gains in 2014. The Polish WIG benchmark outperformed MSCI EM despite a weaker market environment and the pension reform. An appreciating dollar sent commodities and EM stocks tumbling.
- The predictions for 2015 include a gradual de-escalation of the conflict in Ukraine, a stabilization of variables, and a neutral impact of pension funds on the market, with inflows channeled mostly to investment funds.
- The dollar will stop its upward climb in 2015.
- After March interest rate cuts, there will be a shift in sentiment toward banks. Once the downturn in commodity prices is stemmed, mining companies will regain positive earnings momentum.

2014 was a year full of surprises. At the beginning of the year, the emerging consensus among investment banks indicated that the outlook for the months ahead would be marked by the following developments: 1) a reversal of the trends in the debt market, 2) a slowed rally in main world markets (0+), 3) stable prices of oil, 4) a slight appreciation in the USD, 5) economic recovery in the Euro Area, and 6) EM underperformance vs. DM. Of all these, only the last prediction actually came true, as evidenced by the performance of the Polish stock market (WIG +0.26%, WIG20 -3.5% vs. S&P500 +11.4%, DAX +2.7%, MSCI World +2.9%, MSCI EM -4.6%), additionally impacted by a pension reform and the conflict raging across the eastern border. Despite low nominal interest rates, Polish pension fund managers (TFIs) suffered withdrawals from equity and mixed funds to the tune of PLN 1 billion. In 2015, we expect that most of the factors responsible for the Polish market's underperformance the year before will either diminish or disappear completely:

**War in Ukraine:** The sudden escalation in 2014 of the conflict between Russia and Ukraine, and the consequent international sanctions imposed on Moscow, promoted downward revisions to the growth projections for the whole region, including Poland, as well as raising the risk premium required by investors. The hostilities will continue to influence the region in 2015, though the consequences will be of the economic (more predictable) rather than the military kind (continued fighting maintains a sense of danger which scares away investors). We believe Russia will become less willing to engage in warfare once it inevitably starts crumbling under the weight of the sanctions and the economic crisis. For investors, this will be a sign political risks have abated.

**Economic slowdown in Eurozone and Poland:** Early 2014 projections put last year's GDP growth in the Euro Area at 0.9-1.1%, including 1.7-2.0% in Germany. By the end of the year, however, the growth expectations were revised downward to respective 0.8% and 1.5% in the wake of the crisis in Russia, the slowdown in China, and a lack of reforms in France and Italy. The slowdown in the Euro Area, particularly Germany, combined with reduced exports to the east, had spill-over effects on the Polish economy where disappointing economic data prompted interest cuts by the central bank. In 2015, the prediction is that the economic momentum in the Euro Area will remain

steady at 0.8-0.9% though it will improve from quarter to quarter.

ECB balance sheet (EUR bn)

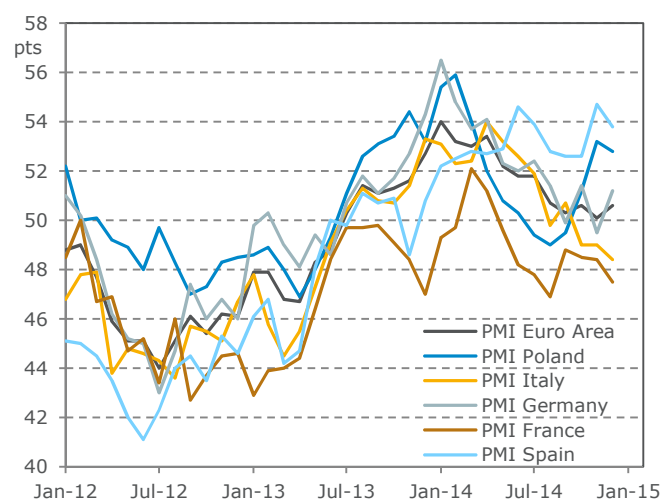


Source: Bloomberg

The following support the improving shape of the economy:

1) EUR depreciation (+0.2/0.3% GDP), 2) decline in crude oil prices and their positive impact on consumption (which has for several quarters remained relatively strong – growth by more than 1% y/y), 3) implementation of QE by the ECB (EUR 60bn per month), 4) relaxed bank lending policies, resulting in increasing interest in investment credit (borrowing by the non-financial sector is up y/y for the first time since 2011). Poland will additionally be affected by the impact of infrastructure investments and the sharp weakening of PLN.

Manufacturing PMI for selected Euro Zone states



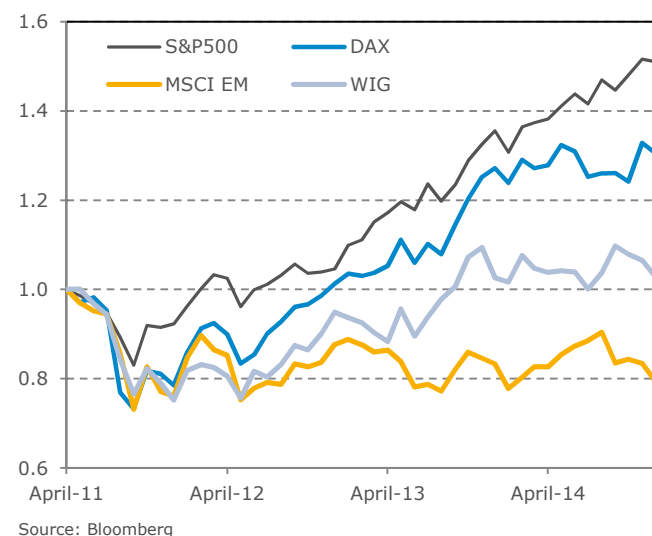
Source: Bloomberg

**Pension reform** – the fate of Polish pension funds (OFE), including which exactly which of them would be able to continue investing in the Polish capital market, was being decided right up to the end of July, when future retirees had to decide whether they want to continue saving with OFEs or have their pension contributions transferred to the Social Security Institution (ZUS). In the meantime, very bleak scenarios were being drafted (the equity portion of AUM also goes to the Social Security Institution), which have at the very least deterred investors from making purchases.

As a result OFEs scaled back their activity on the WSE and foreign investors – expecting a share sell-off by the funds – responded negatively to the situation on the Polish market. We believe that the negative impact of the pension reform has already been discounted by the market. OFEs hold over PLN 10bn in cash and will obtain a further net PLN 2.8bn during the year (including dividends). In the positive macro scenario we see no justification for the funds to sell shares or for there to be a mass move of their investments onto foreign markets. In effect, in our opinion, OFEs will have a positive impact in 2015 on the prices of shares listed on the WSE (more on page 9).

**Weakness of emerging markets:** Weaker economic growth, growing political risk and depreciation of local currencies have, on a global level, caused a flight of capital out of emerging markets (the one exception being strongly underpriced Chins). According to EPFR data, in 2014 5% of AUM left EM equity funds, of which as much as 13% EMEA dedicated funds. In the same period, developed market funds obtained 2% of the AUM. Despite the numerous negative local factors, Polish equities were performing better over the last two years than the broad EM indices, including in 2014. Last year's WIG gains placed somewhere between DAX and MSCI EM, which may just give grounds to the theory that Poland, due to its strong economic ties and political stability, is perceived by foreign investors as a country straddling the developed and emerging worlds.

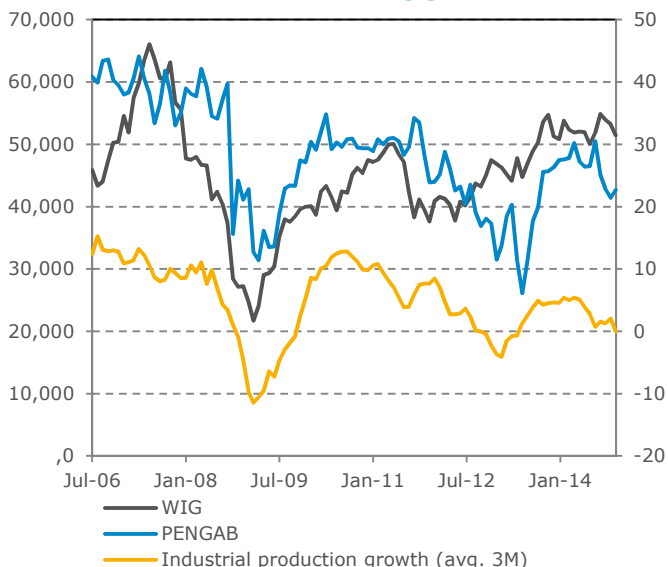
#### WIG performance vs. major stock market indices



Supply pressures experienced by the biggest sectors represented in **WIG: banks and resource companies:** Weaker-than-projected economic growth, adverse legal regulations dampening results and expectations of interest rate reductions (affecting interest margins) have led to the consensus forecasts for banks to be systematically reduced. At the same time, the drop in raw material prices (also resulting from oversupply and slower GDP growth in China) reduced the valuations of extraction companies. Both sectors constitute 49% of the value of the WIG20 index (in which banks represent 38%). The interest rate cut expected by us (March, 50bps) should mark the bottom of the downgrading momentum by sector analysts. Based on our estimations, the consensus should drop by ca. 10-12% vs. current levels. In our opinion, the strengthening of the USD and the falling prices have had a significant impact on the drop in prices of all raw materials. This has led to divestment and the closing down of funds dedicated to resources. Considering the oil extraction costs, new investments and the fact that low prices should translate

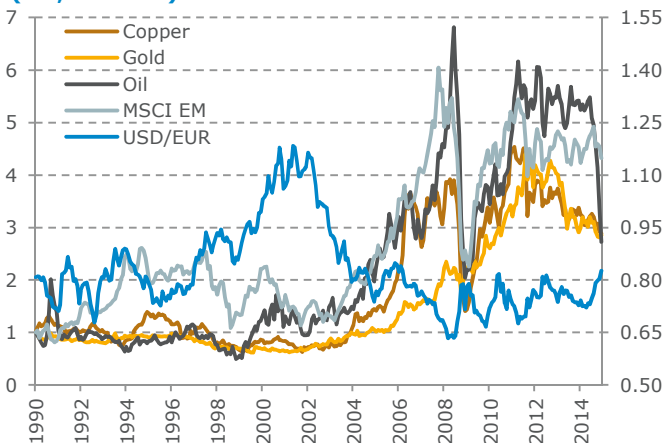
into greater fuel consumption, we expect the \$45 per-barrel level to determine the bottom of the cycle. Prices are expected to stabilize during the year, also stabilizing the prices of industrial metals. For Polish extraction companies, prices are assumed to remain at the Q3 2014 level due to the weakened Polish zloty.

#### WIG vs. Poland's banking sentiment indicator PENGAB index and manufacturing growth



**USD appreciation:** Commodity prices (particularly industrial and precious metals) maintain a close correlation with USD trends. The dollar is also a determinant of sentiment toward emerging markets.

#### USD/EUR (rhs) vs. selected metal prices and MSCI EM (lhs, 1990=1)



Relatively strong economic growth, low inflation, the prospect of monetary policy becoming normalized in the US, an unstable Euro Zone economy and QE expectations, and the aggressive liquidity measures taken by the Bank of Japan have led to an appreciation of the USD against other major international currencies. Investors are assuming that this trend will continue in 2015 (with consequences for commodities and EM).

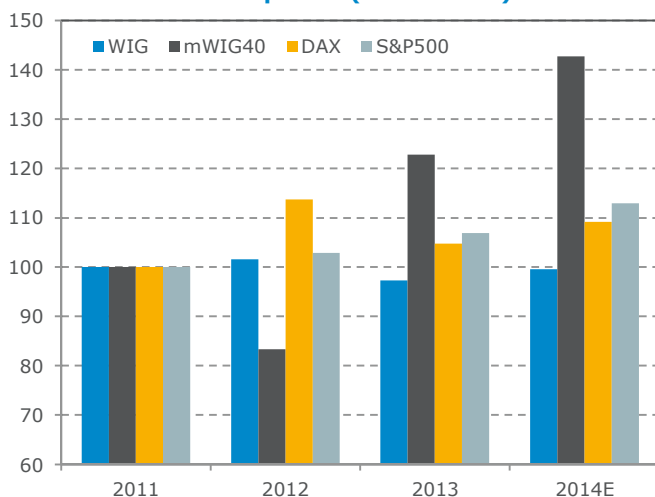
### Long-term EUR/USD trend facing strong resistance



Source: Bloomberg

We would like to point out, however, that there is fierce technical resistance designated by the downward channel formed in 1980 to the current level of euro/USD quotations. What scenario would it require to suppress the USD appreciation? The European QE is succeeding and the euro-area economy is beginning to grow faster than investors expected (+0.8% y/y). The expectations for US economic growth, on the other hand, are overly optimistic (+2.9%, more on page 6). At the same time, investors are underestimating CPI in the US (+0.2%), which, after the achievement by the local industry of high capacity utilization rates and an improvement in the situation on the labor market, will slowly begin to exert wage pressure. In this scenario, foreign investors should return to the WSE.

### EBITDA of listed companies (2011 = 100)



Source: Bloomberg

### WIG company earnings outpaced by DAX companies, S&P500 remains beyond reach:

The weak WIG performance vs. main indices in developed countries can be explained differences in company earnings. As demonstrated by the diagram in the opposite column, accumulated annual EBITDA results over the last four years have clearly grown for S&P500 companies, and at DAX companies they have also maintained a positive momentum (despite the Euro Zone weakness), while WIG company EBITDA have been on a downward trend driven mostly by the weaker results of companies with the largest market capitalizations, mainly commodity companies. It is worth pointing out that the results of Polish midcaps look much better. However, due to their limited liquidity, these companies are often outside the scope of interest of foreign investors (in the past year local equity funds investing in midcaps saw an outflow of capital). For 2015 we anticipate an inflow of capital into TFIs, which, combined with the growing profits of small and mid-cap companies, will boost the performance of WIG.

### Marginalization of WSE – Czech and Hungarian option?

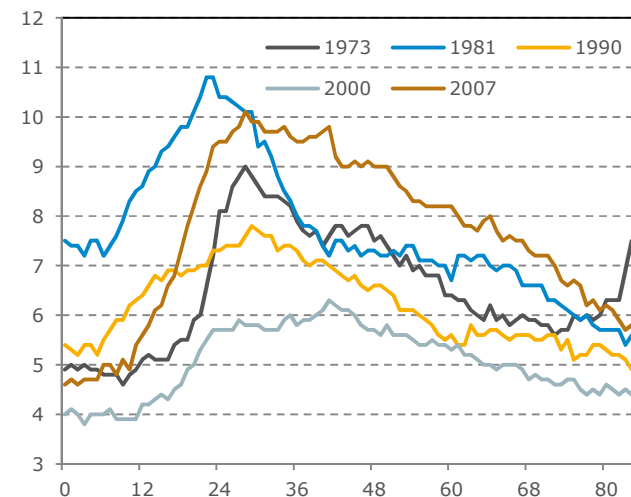
In H2 2014/Q4 2014, the average daily trading volume on the WSE amounted to PLN 1.56/1.55bn, down 10%/14.7% from the year before. Considering the breakdown of the trading volumes by class of customer, the actual reduction in investor activity was much greater. Based on the most recent WSE data, in H1 2014, the share of foreign customers in WSE volumes amounted to 48.7% compared to 37.8% domestic financial institutions and 13.5% retail clients. Among Polish financial institutions as much as 41% of the trade came from market makers and proprietary trading by brokerage houses, which means that the contribution of OFEs and TFIs to the total trading volume was only 19.3% across the entire market. In the structure of trades generated by foreign investors, a large part came from proprietary trading by banks or passive management (ETFs, algorithms, etc.). This means that even small amounts of speculative capital are capable of relatively easily moving the market in any desired direction.

## Economic Outlook Bodes Well for Equity Market

- Growth in the Euro area lags, US growth slows down, ECB launches European QE, Fed holding off on rate hikes.
- Fed will normalize monetary policy if the economy is strong enough – notwithstanding the initial downward correction, this adds to the positive scenario for stocks.
- Nominal GDP growth in Poland clearly set to accelerate in 2015 after Q1 bottom, NBP to cut interest rates in March by another 50bps.
- Emerging scenarios should encourage investors to invest capital in the equity market barring unforeseen crisis situations.

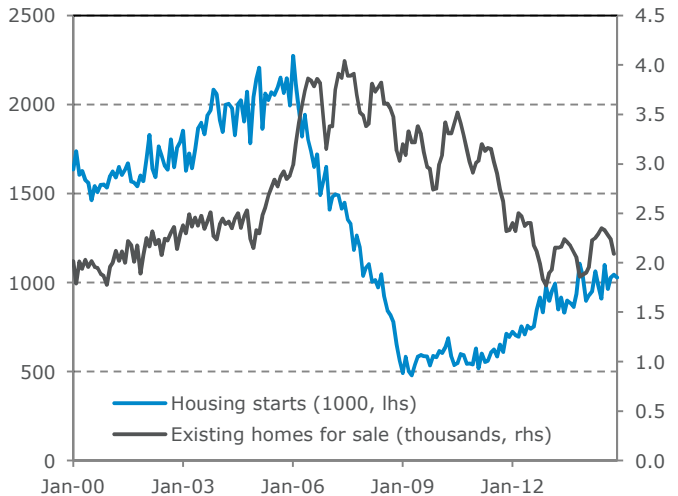
**Investment bank consensus for 2015** assumes the continuation of economic good times in the US which around mid-year should trigger a series of interest rate hikes by the Fed. The key US labor market indicators achieved the targets set by the Fed (even participation and weekly work hours are on the rise). The revival in the housing market has not yet exhausted its potential as analyzed in terms of the historical data on the number of housing starts (1.46m average in 1959-2013, currently 1.0m) or the number of houses sold (ca. 746m in 1992-2013, currently 440m). Households are still deleveraging (76% debt-to-GDP ratio vs. 96% in Q1 2009), and as asset prices rise (stocks, bonds, real estate) consumer confidence continues to improve (Conference Board at 92.6 vs. 77.5 a year ago). The Conference Board indicator is currently on the level it was before the 2007 crisis.

### US unemployment rate during economic cycles



Source: Bloomberg

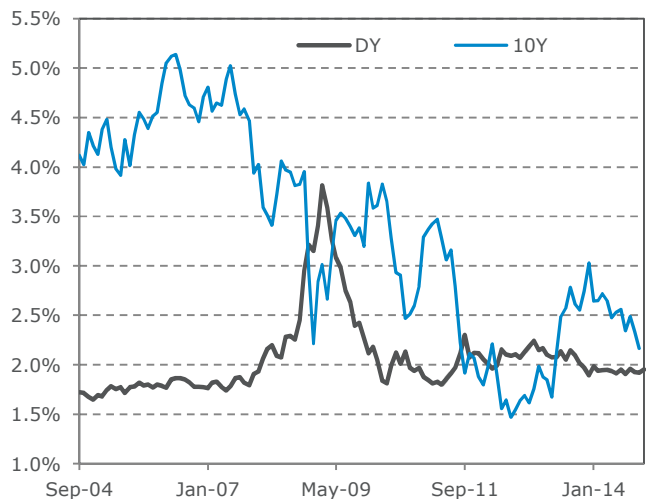
### US housing market movements



Source: Bloomberg

Macroeconomists at Commerzbank are expecting that in the middle of the year Fed will even switch on an autopilot for monthly hikes in the Fed Funds Rate which at the end of the year is expected to rise to 1.5% from the current 0.25%. The rate hikes, which denote a standardization of interest rates rather than monetary tightening, are not likely to derail the economic recovery. At the current market interest rates the 10-Year bond yield is below the projected S&P500 dividend yield.

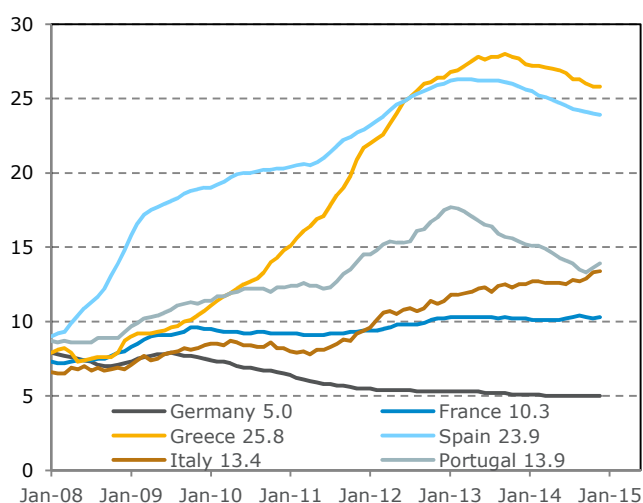
### US 10-year government bond yields vs. S&P500 DY



Source: Bloomberg

Despite rising unemployment in Italy and France, the consensus assumes that a slow economic recovery in the Euro Area has begun, resulting from a weaker euro and the reforms under way in certain peripheral countries (Spain, Portugal – noticeable drop in the unemployment rate). The current leading indicators and hard data are weak, which is why the ECB's QE program serves as an important driver of positive sentiment (buying €60 billion a month in asset-backed securities starting in March). Another important piece of the puzzle is the stable economic situation in China.

### Unemployment rate in selected Eurozone countries

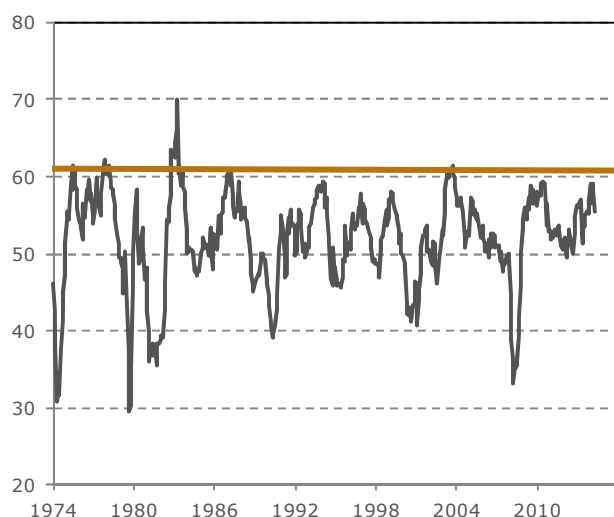


Source: Bloomberg

### What consensus means for the stock market.

Considering the current level of stock valuations, the full-year impact of such a scenario taking place should mean a positive push for the global market. The spacing in time of the different factors would give the following scenario: investors already have QE in the Euro Area priced in, which is why its announcement is being used as an excuse to take profits – in the weeks that follow, markets will begin to "play out" the US interest rate hikes, which will lead to a downward correction in the main indices (10-15% on S&P500, DAX). Its end will mark the beginning of the next wave of growth (economy in the growth phase, far from showing overheating symptoms) and the establishment of new peaks on the major indices in the course of the year.

### ISM Manufacturing cycles



Source: Bloomberg

**Possible surprises:** We have doubts as to whether the American economy can maintain its momentum. What could slow US growth relative to expectations? The external environment for the US economy (situation in the Euro Area and in China) poses the greatest risk, as repeatedly stated by J. Yellen. This is clear from the leading indicators for manufacturing in the major economic zones (will the world be aiming to catch up with the US in the near term, or will the opposite be true?). It is worth noting that the gains in ISM have not been confirmed by the leading indicator

describing the condition of SMEs (NFIB Small Business Optimism). Moreover, the positive picture of the economic situation in the US may be changed by the strengthening of the USD, which weakens exports, and the drop in oil prices which hits resources-based industries and their suppliers (affecting the aggregated indicators for industry, with positive impact on consumption). The drop in oil prices also raises concerns regarding the soundness of resources companies in the context of their debt and the possible effect of their bankruptcies on the situation in banks.

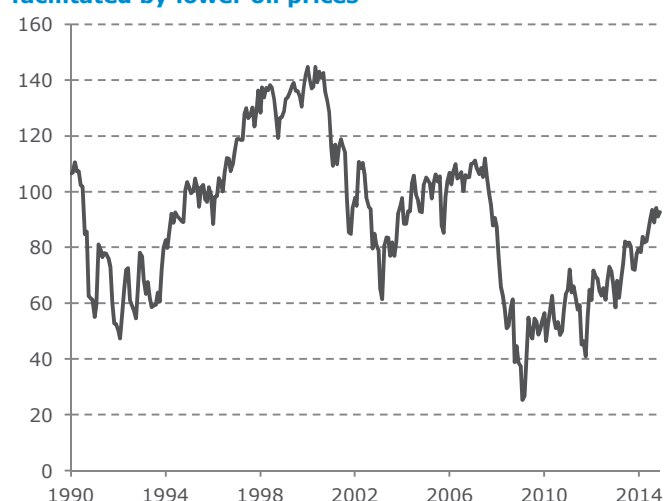
### ISM Manufacturing vs. NFIB Small Business Optimism



Source: Bloomberg

In our opinion, this scenario means a flat adjustment in equity indices (reaction to disappointing performance) and a return to the upward trend as a result of postponed expectations as to rate increases by the Fed. As the dollar slows down its upward climb, this is having a positive impact on commodity prices and valuation of assets on EMs.

### US consumer sentiment returns to pre-crisis levels, facilitated by lower oil prices

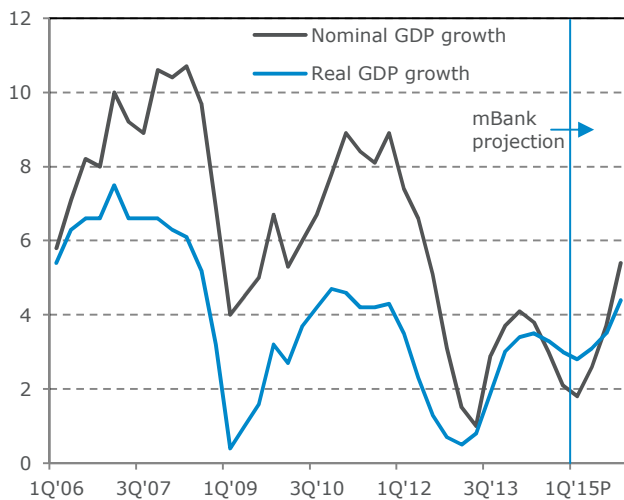


Source: Bloomberg

### Poland: nominal GDP growth supports businesses

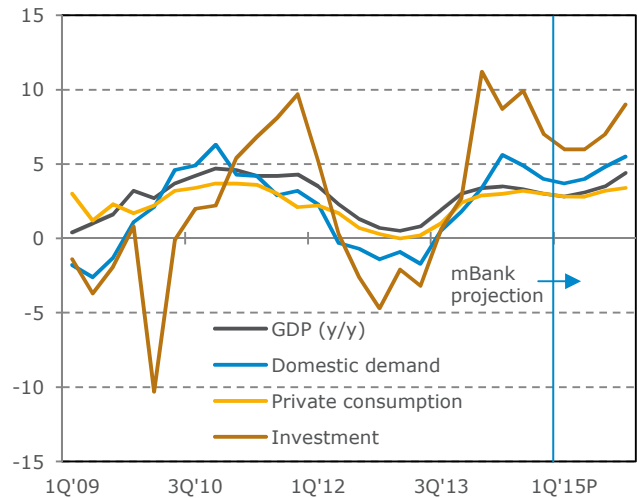
In 2013, the real GDP growth rate in Poland was 1.7% after an acceleration of 1.8% from 2012. The Polish economy gathered momentum more clearly in 2014, accelerating to some 3.4% according to our macroeconomists, and in 2015 GDP growth is projected to remain at 3.5%. As for growth in nominal terms, however, which influences company earnings, especially quarter over quarter, it paints a different picture. Despite the fact that real GDP growth over the last two quarters remained around 3% y/y, the nominal increase in late 2014 and early 2015 (Q4 and Q1) will be less than 2%. As illustrated by the diagram below the nominal growth rates indicate a "double bottom" for the economy evident at the turn of Q4 2013/Q1 2014. Such low nominal increases were not even recorded during the 2008-2009 economic slowdown. This situation is directly reflected in the results of companies listed on the Warsaw Stock Exchange.

### Real and nominal GDP growth in Poland



Source: mBank SA

### Components of real GDP growth in Poland



Source: mBank SA

Starting from Q2 2015, both on the level of real and nominal growth the Polish economy is expected to pick up again, which will be down to several factors: 1) A slow recovery in the European economy, 2) A weakening of PLN vs. EUR and USD, 3) The start of infrastructure programs in road construction, 4) Consumer demand restored by low interest rates and, more importantly, an improving job market. One element which will continue to be detrimental to earnings and GDP in Poland and in the region will be the deepening crisis in Russia (-4% GDP).

The price deflation observed in Poland, expected to last through to mid-2015, combined with actions undertaken by the ECB (QE) and the negative impact of external factors on economic growth will encourage the central bank to make further interest rate reductions (50bps in March) which will help the general economic climate but which will have negative consequences for the earnings of banks (a key sector on the WSE; leading to the further downgrading of the forecast consensus). The first interest rate increases can be expected in 2016 at the earliest. On the upside, such a low interest rate environment should strongly stimulate growth in the industrial and housing sectors.

## How to Get More Money Into WSE

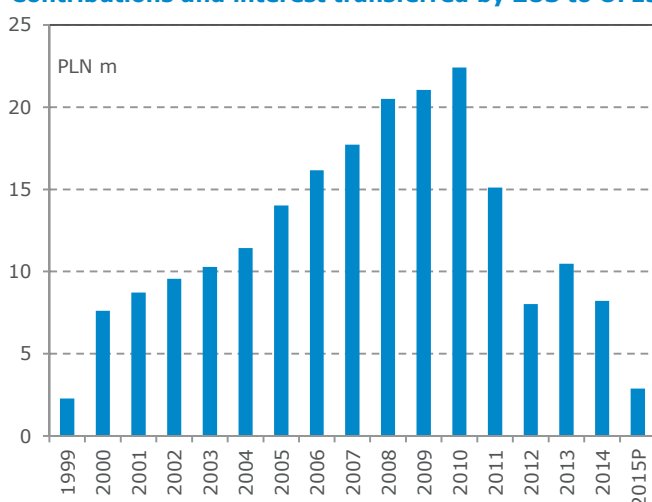
After a very poor 2014 both in domestic (pension reform, outflows from equity investment funds to debt and money funds) and foreign funds (rising USD historically means outflow of capital from EMs), we believe the negative trend, particularly in the case of TFIs, will be reversed this year.

- **"Reformed" OFEs will no longer spoil sentiment.**
- **At the end of 2014, OFEs held PLN 10bn in cash – since liquidity issues no longer pose a risk, OFEs may potentially invest a portion of their funds, particularly since...**
- **...the inflows/outflows balance in 2015 is expected to be positive at PLN 2.8bn (including dividends).**
- **OFEs may have increased their foreign investment in 2014 without waiting for an official raise in the foreign investment cap – the average holdings are currently at 3.7% (plus foreign shares listed on the WSE, below 8% in total).**
- **The negative factors which in 2014 undermined the confidence of investors channeling their savings into TFIs will abate in 2015. With more and more speaking in favor of investment funds 2015 will be a ground-breaking year for TFIs.**

### OFE cash flow projection 2015

Until July 2014 Polish pension funds (OFEs) received close to PLN 1 billion a year in pension contributions transferred from the Social Security Institution (ZUS). Since August, after only 15% of the insured opted for their contributions to be left in the OFEs, the transfers from ZUS decreased to ca. PLN 240m per month. Assuming a 3% increase in the value of pension contributions resulting from rising salaries, OFEs can be expected to obtain PLN 2.9bn in new funds in 2015, additionally strengthened by PLN 440m interest on bonds, and most of all by PLN 4bn dividends from investments in Polish and foreign companies. All in all, we expect OFEs to raise PLN 7.3bn in fresh inflows in 2015.

### Contributions and interest transferred by ZUS to OFEs



Source: Polish Social Security Institution (ZUS)

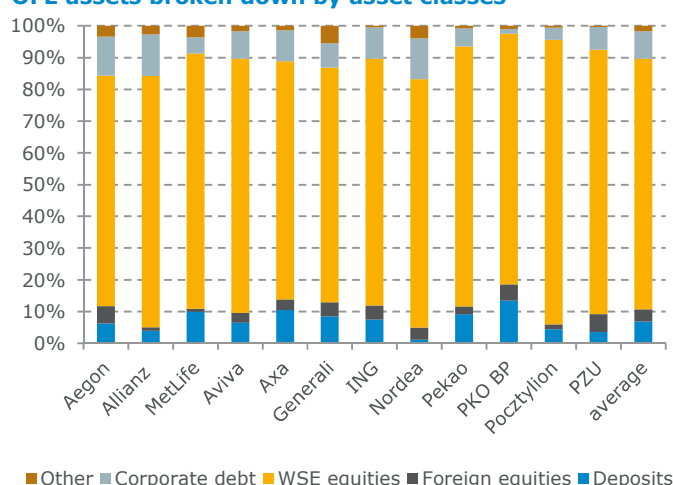
In November 2014, OFEs transferred PLN 362.8m as the first monthly payment to the ZUS as part of the "zipper" requirement. On top of that, as part of the reform, the ZUS was credited with a one-time sum of PLN 3.3bn resulting from the transfer of funds of 1.3 million people who have reached 10 years to retirement. Assuming a 3% increase in the value of the monthly pension contributions this year, OFEs will have to transfer ca. PLN 4.45bn to ZUS in 2015.

This means that net cash flows (inflows minus outflows) in 2015 will amount to ca. PLN +2.8bn. This is much less than in previous years (on account of the ZUS contribution in 2008-10 alone: PLN 21bn on annual average, 2012-14 – two stages of the reform: PLN 8.9bn on annual average), but this is a more favorable scenario than discounted by investors still in the middle of last year (net outflows, a the need to sell off assets).

### OFE asset structure and two myths

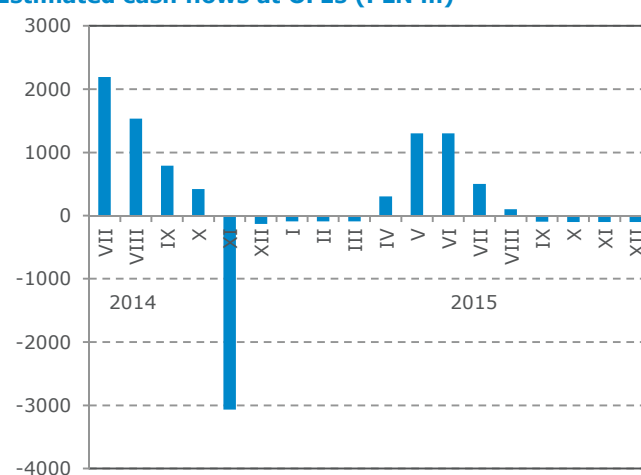
At the end of December, OFEs were managing a sum of PLN 149bn, 82.8% of which was invested in equities (79.1% in shares listed on the Polish market), 8.6% in non-Treasury debt instruments, and 6.9% constituted deposits (PLN 10bn). Based on AUM held, we can see that the market is very concentrated at the moment, with the top-3 funds holding 60.1% of all Polish shares and the top-5 controlling 74.2%.

### OFE assets broken down by asset classes



Source: OFEs

### Estimated cash flows at OFEs (PLN m)



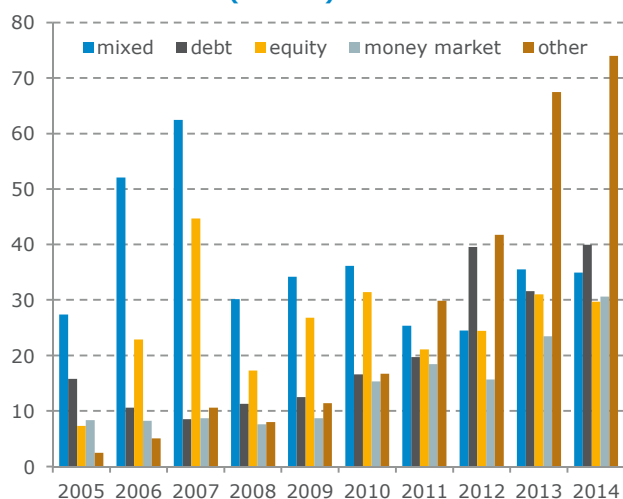
Source: OFEs

Investment in shares listed on foreign markets accounted for merely 3.7%, and after including foreign shares listed in Poland for less than 8% of total OFE AUM. Considering the fact that OFEs cannot hedge their currency positions and, in the long-term, given the expected appreciation in the zloty, we believe looking at current valuations of Polish stocks compared to foreign stocks that OFEs will not want to significantly increase their involvement in foreign markets.

This theory is also backed by the fact that the risk of maintaining portfolio liquidity has diminished (vs. expectations in the middle of 2014) for OFEs thanks to investment in foreign shares. The scale of outflows resulting from the "zipper" is currently easy to predict (deposits at PLN 10.3bn, outflows to ZUS over the next 6 months adding up to PLN 2.2bn, meaning that OFEs stand to receive PLN 1.45bn from pension contributions). Furthermore, for SMEs, given the current low liquidity of the market a desire to sell Polish shares would mean significant markdowns on their prices. In the context of the expected economic rebound, it would be completely irrational to sell Polish shares cheaply and buy more expensive foreign shares.

A factor that in the medium-term could have a negative impact on the equity market is the strategic decision to reduce the equity allocation cap for OFEs from the current level of 82.8%. One reason in support of such reduction is a desire to mitigate the volatility of portfolios and the risk profile. Today, OFEs are operating like equity funds but they lack the important risk mitigation instruments (hedging). Over the last 6 months, since the effect of the OFE reform has become evident, the funds, with a few exceptions, are not scaling down their involvement in the equity market. Why? As the economic recovery unfolds, divestment of shares at the current price levels would be unreasonable, particularly given the lack of investment alternatives. The corporate bond market in Poland is still underdeveloped. Foreign investments are also an FX risk; in the case of euro debt, investments practically boil down to taking positions in the currency. In the long term, it can be expected that funds will continue to diversify further, however, this will be a lengthy process and 2015 will bring no significant changes in this respect.

#### TFI asset structure (PLN bn)



Source: Chamber of Fund and Asset Management (IZFA)

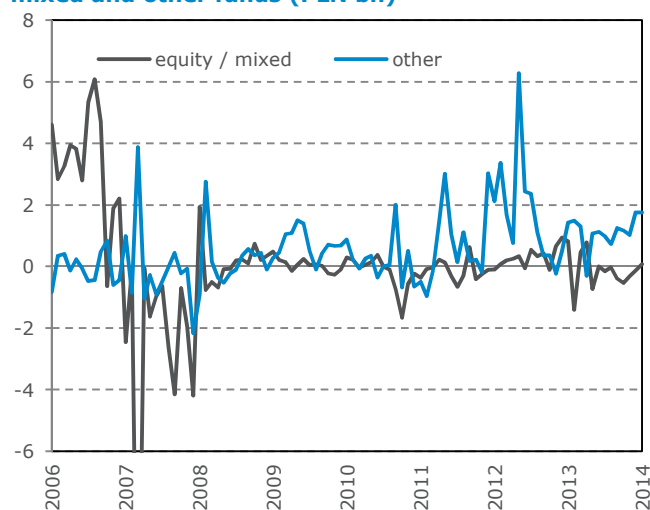
#### Will 2015 finally mark a breakthrough for investment funds?

At the end of December 2014, the total assets of Polish investment funds (TFIs) amounted to PLN 209bn, of which equity funds managed a total PLN 29.7bn (14.2% of total - the lowest share since 2005), and mixed funds held PLN 34.9bn (16.7% of total). Total assets and the sum of the equity- and mixed-fund assets are equivalent to 5.0%/6.0%, respectively of household deposits and 1.7%/2.0% GDP. These are levels close to the ones observed in 2003-2004.

TFIs recorded net inflows over the last three years, with most of the cash deposited in closed-end funds allocating

investments to non-public assets (FIZAN) and debt and money market funds. In 2014, equity funds saw an outflow of capital of PLN 840m (until November), and mixed funds posted withdrawals of PLN 135m. By way of comparison, in 2013, which was a better year for the equity market, the balance was positive at PLN +2.9bn.

#### Monthly net inflows to TFIs broken down into equity/mixed and other funds (PLN bn)



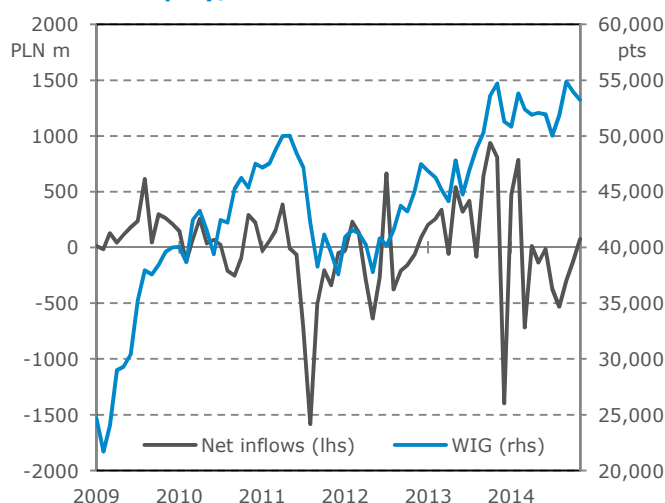
Source: Chamber of Fund and Asset Management (IZFA)

In 2015, the conditions necessary for the inflow of new equity to TFI funds, including to funds dedicated to the equity market, will improve. In our opinion, the environment to do business for TFIs has not been this favorable since 2007. The increasing allocation of savings in higher-risk assets is driven by a combination of several factors shaping the external environment for households:

- 1) a sense of security (stable political and social environment, strong labor market - shrinking unemployment),
- 2) unattractive alternative forms of saving (low interest rates on deposits, bonds),
- 3) spare cash available (amount of deposits, level of indebtedness) and
- 4) attractive rates of return achievable on the equity market.

In 2014, despite the improving situation on the labor market and the percentage of households carrying debt dropping, several negative factors occurred like growing real interest rates on deposits coupled with falling inflation, an on-going T-bond rally, and high risks and escalating fears associated with the conflict in the east (resulting, among others, in declining share prices). What will 2015 bring?

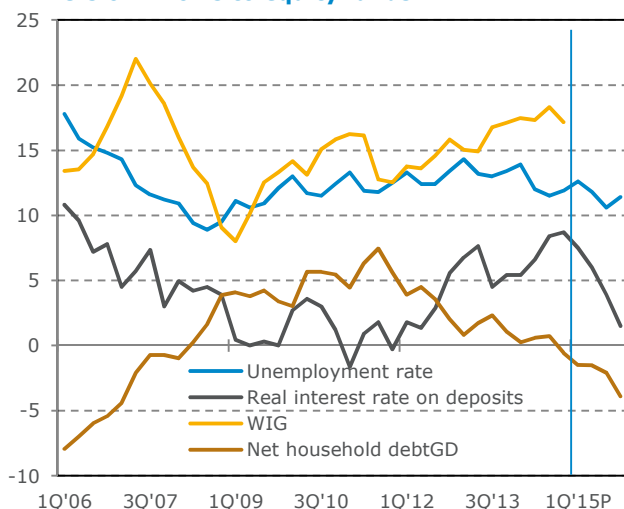
## Inflows to equity/mixed funds vs. WIG



Source: Dom Maklerski mBanku

**Global policy/environment:** 2008-09 were the years of the financial crisis and the collapse of the Lehman Brothers, 2010-12 were years marked by concerns about the bankruptcy of peripheral countries and the stability of the euro area, and 2013 marked the start of the discussion on a pension reform in Poland, whereas 2014 saw the eruption of the Ukrainian-Russian conflict. We expect the Russian-Ukrainian borderland situation in 2015, alongside the growing economic crisis in Russia, to become more stable (President Putin will be forced to deal with internal endogenous problems), or at least we hope that Moscow will be too busy to "threaten and intimidate" to the same extent as it did in the first half of 2014. Greece may be a returning risk factor, however, ECB measures should effectively neutralize this risk. 2015 will bring a further rise in nationalist sentiments (repercussions of terrorist attacks and the economic downturn in the euro area), which, in the context of the next general elections in each country, will raise concerns for the stability of the euro area – particularly in Great Britain (referendum on Britain's membership of the European Union – no earlier than in 2016).

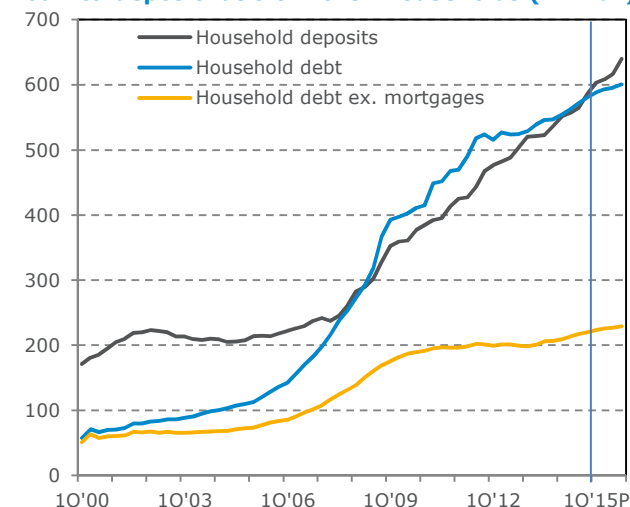
## Drivers of inflows to equity funds



Source: Dom Maklerski mBanku

**Household debt:** In Q3 2011, the difference between the value of household deposits and the loans raised through them (including mortgages) amounted to PLN -74.4bn. The net debt has been systematically decreasing since then. According to our macroeconomists, at the end of December 2014, it will amount to PLN +5.6bn – which means that this is the first time since Q1 2008 that households will have surplus cash. Our macroeconomists project that this surplus will increase to PLN +39bn during the year (end of December 2015). The decision of the Swiss National Bank to unpeg the Swiss frank from euro will have a negative impact on the level of indebtedness and the willingness of households to spend and invest.

## Loan-to-deposit ratio of Polish households (PLN bn)

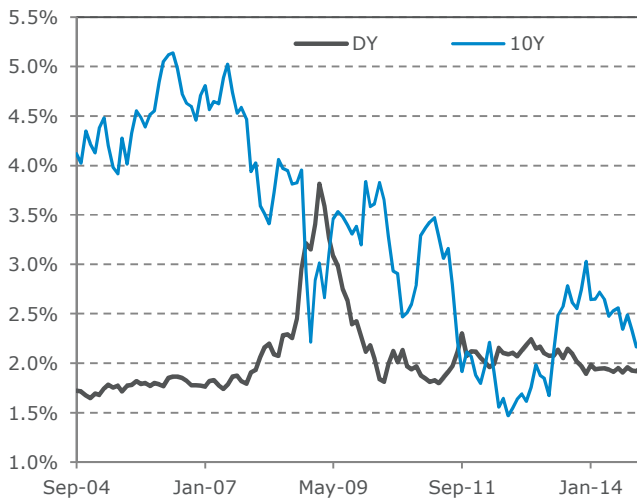


Source: Dom Maklerski mBanku

**Labor market:** In the years 2006-07 when equity funds reported record net fund inflows, the unemployment rate dropped in Poland from 18% down to 11%. From mid-2008 to 2013, the unemployment rate continued to go up (14.3% in Q1 2013 vs. 8.9% in Q3 2008). At the moment, however, the Polish job market is a recovery mode and the unemployment rate should drop to 11.4% by the end of 2015.

**Debt and deposits as investment alternative:** In 2013, PLN 7.9bn, and in 2014, PLN 11.4bn (until November) of new funds arrived to debt and money-market funds. The ongoing T-bond rally since 2011 made debt a valid alternative to the equity market. We expect yields on bonds in 2015 to just reach their minimum levels and from the middle of the year, to begin to rise. This was also the baseline scenario in 2014, which turned out to be incorrect. The DY for WIG currently expected is 3.4%, and the 10-Year Bond yield is 2.3%. The falling interest rates and slowly accelerating inflation rates will bring the real deposit rate down. We do not expect the boom on the bond market to continue.

### DY for WIG vs. Poland 10Y Bond Yield (%)

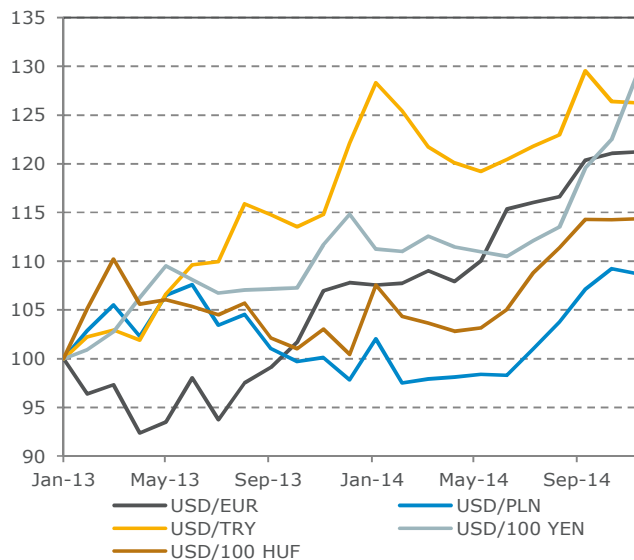


### Foreign funds underweight Poland, EM withdrawals

All the factors (described above) which had a negative impact on the investment decisions of domestic equity investors also affected the behavior of foreign investors. The strategies of global investment banks in most cases known to us put Poland at underweight to neutral at best. This is exacerbated by an overall negative consensus on emerging markets as a whole, based on: 1) weakened local currencies, particularly vs. USD, and the consequences for debt ratios; 2) falling commodity prices (the largest EM countries are suppliers of commodities which have a high share in GDP); and 3) growing political risk (also in CEE region).

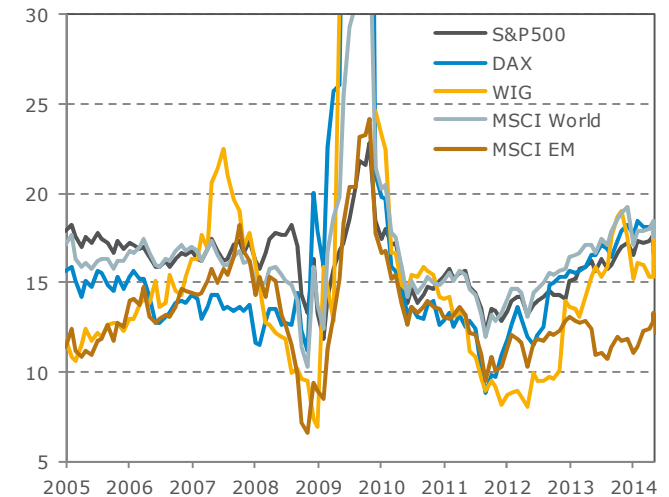
In effect, in 2014, a total 5% of AUM were withdrawn from EM equity funds, of which as much as 13% was taken out of EMEA funds

### USD vs. selected EM currencies and euro



If the scenario of US slowdown and European recovery pans out contrary to consensus expectations, the appreciation in the USD should come at least come to a halt (the European QE is, in our opinion, already discounted). With GDP growth in emerging markets on an upward momentum (except Russia /-4%/ and China /+6.5%/) this year, this should lead to better performance of EM stock indices.

### P/E of selected world indices



As the year progresses, foreign investors will be able to see that Polish pension funds are not the supply side and that household savings here are being pumped into TFI funds. After the earnings expectations for banks are inevitable lowered, once the appreciation on the US dollar is stemmed, this will help reverse the downward trend in commodity stocks, resulting in a shift in the way the Polish market is perceived by foreign investors.

### MSCI EM P/E Discount vs. MSCI World



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## 2015 Outlook by Sector

### Financial Sector

- We would recommend investors take a selective stock-picking approach in 2015 when it comes to the bank sector. For Polish banks, we anticipate 10% contraction in core net earnings this year, while for other CEE we expect a considerable recovery after the massive one-time losses incurred in 2014. The slump in financial stocks which occurred over the last 12 months (with MSCI Financials down 29.5% and WIG Banks in dollars falling 24.2%) has created a range of good investment opportunities.
- The profit slowdown anticipated in the Polish bank sector will be led by further reductions in central bank interest rates combined with raised mandatory contributions to the Bank Guarantee Fund and reduced interchange fees. In case of CEE banks, the downward pressure on operations in Russia and Ukraine will be offset by gradual recovery elsewhere (e.g. Romania).
- Banks will continue to experience contraction through Q2 2015, but afterwards their momentum will start to pick up.
- The analysts' consensus assumes 5% earnings growth for Polish banks and a return to profitability for CEE banks. To us, the actual outlook ahead of the sector is less optimistic, as evidenced by the fact that our aggregate net income projections for 2015 and 2016 are 13% and 6.6% lower, respectively, than the consensus projections.
- Key ratings: PKO BP (buy), Bank Millennium (accumulate), Erste Bank (buy), BZ WBK (reduce). Among non-banks we have a buy rating for Kruk.

### Gas & Oil

- We expect oil prices to stabilize at relatively low levels this year as suppliers take their time in adjusting production volumes to match demand, and as OPEC refuses to cut its targets. A further strengthening of the dollar and the lifting of oil sanctions on Iran if a nuclear deal is reached would provide a downside catalyst for oil.
- The same factors that cut into the profitability of crude oil production support the profitability of oil refining through higher margins (facilitated by lower costs of crude inputs and wider cracks on heavy residue and niche products) and the price flexibility of demand. Also helping European refiners is a narrower Brent-WTI price spread and a high discount offered on Urals crude. Last but not least, Polish refiners are benefitting from a high USD/PLN exchange rate, especially as retail prices of fuel continue to decline.
- Petrochemical producers are enjoying better competitive advantage on naphtha-based products thanks to a narrow ethane-naphtha spread combined with strong demand which tightens supply as world capacity remains stable. All this will result in 2015 margin growth in petrochemicals.
- Key ratings: PGNiG (reduce), PKN Orlen (accumulate).

### Chemicals

- Grain markets have stabilized and appear to fully price in the increased 2015 inventory projections for corn and wheat. As a result, the weakening purchasing power of crop farmers should not put any more pressure on fertilizer producers who additionally should benefit from falling costs of natural gas.
- As the market for soda ash continues to strengthen, with benchmark prices raised edging several percent higher,

the Polish producer Ciech stands to enjoy widening margins this year supported by a high EUR/PLN exchange rate and a strong dollar which restricts exports from the US.

- The synthetic rubber producer Synthos is benefitting from falling prices of oil which drive down the costs of butadiene and hence indirectly also the prices of synthetic rubbers, which as a result are becoming an increasingly cost-competitive substitute for natural rubbers. With its margins quoted in euros, Synthos is also benefitting from a higher EUR/PLN exchange rate.
- Key ratings: Synthos (buy).

### Power Producers

- European electricity prices are falling amid a coal price slump, with the German benchmark currently hovering around EUR 32/MWh. For the Czech utility CEZ, this means a downward shift in profits in the years ahead as price hedging effects wind down. For the Polish energy sector the outlook for 2015 looks much better, supported by shorter hedging periods and sales prices boosted by capacity payments and insufficient grid interconnection.
- A key factor shaping the energy sector's performance this year is the impending industry consolidation planned by the Polish government. The most likely tie-ups as per best media guesses are ENA/TPE and PGE/ENG. If the speculation proves accurate, the winners at the tail end of the process will be the shareholders of Enea and Tauron (cost synergies, stronger FCF), while Energa's owners will lose out on a shift toward increased exposure to power generation.
- As far as the regulatory environment is concerned, we expect that lawmakers will finally put in place a clearly-defined subsidy mechanism for renewable energy this year, and decide a new model for RAB calculations in power distribution. On a European level, the ongoing process of reforming the ETS carbon market should be completed by the end of the first half of the year.
- The one downside catalyst that can affect the Polish power sector this year are the government's plans to involve power plants in rescuing the ailing cola industry and the rampant speculation that these plans invite.
- Key ratings: Tauron (buy), Enea (accumulate), CEZ (reduce).

### Telecoms, Media, IT

- The 2015 outlook for Polish telecoms is shaped by a high mobile penetration rate and downward pressure on prices of B2B services stemming from intense competition combined with the fact that B2B connectivity rates are higher than prices charged from individuals and with the popularity of SIM only deals and mass switchovers to unlimited calling plans. Broadband revenues are decelerating as the customer base loses expansion potential and price pressures increase. Fixed-line voice revenues continue on their downward curve. The competitive pressures for Polish telecoms have intensified recently after the entry of T-Mobile.
- Huge opportunities for expansion lie in rural areas of Poland where mobile Internet reach today is rather limited (mobile Internet traffic is expected to increase ten-fold in 2013-2019). The saturation rate with integrated telecom services is 28% in Poland vs. 43% in EU. Triple play today is delivered mostly to customers in metropolitan areas where infrastructure is more developed. This will change as mobile Internet coverage increases.

- One of the major events upcoming in 2015 is the LTE auction which is expected to fetch a whopping PLN 3.3bn for the Polish government.
- Thanks to a slightly more relaxed approach to the responsibilities required of the incumbent telecom (reflected in the partial deregulation of bitstream access in certain regions of Poland), the telecoms regulator has allowed for more competition in broadband, providing an incentive for Orange to invest in FTTx infrastructure.
- In media, the rebound anticipated in the global advertising market, combined with 3.0% GDP growth projected for Poland in 2015, should drive advertising expenses by an estimated 4% this year. Expenditures are set to grow at the fastest rate in Web and TV advertising (+5% y/y), while print media marketing falls in line with the double-digit slump in newspaper sales. For TV broadcasters, the competitive landscape may change after the takeover of TVN by a new owner (possibly Time Warner or Discovery).
- The plan to replace the current license fee with an "audiovisual fee" in an upcoming media financing reform will benefit commercial TV broadcasters (as it will result in more public service programming on public TV channels, driving more viewers to commercial channels).
- Technology companies can look forward to a 4-5% increase in IT expenditures projected in Poland in 2015. We expect a small rebound in software sales in 2015, driven by higher demand for billing systems, CRM solutions, SaaS, and solutions for logistics and healthcare. The main factor weighing on the profits of IT companies this year will be increasing payroll costs.
- A budget of EUR 82.5bn allocated to Poland for the years 2014-2020 under the EU Cohesion Policy means increased IT spending by the public sector, with investment under the main programs totaling PLN 15.5bn. The funding is currently being appropriated, and the orders set to come on line throughout 2015 will start contributing to company revenues in 2016. In the mean time, public expenditures are frozen, affecting the biggest government vendors: Asseco Poland and Sygnyty.
- Key ratings: Asseco Poland (accumulate), TVN (accumulate), Cyfrowy Polsat (accumulate).

## Resources

- Prices of mining resources have reached lows which make production unprofitable in many cases and which necessitate a phasing out of capacity. Sentiment to the sector remains negative. The downturn in prices has been led by the dollar and the outflow of capital from hedge funds after they incurred massive losses on oil investments. That said, we believe prices of commodities have bottomed out at this point.
- Copper has taken a rapid downturn for which we can find no good reason in the fundamentals. The price fall to USD 5500/t has been driven by a strengthened dollar and speculation of short-term investors (short positions in COMEX are the highest in history) fueled by an increasing inventory. At today's level the price is 10% of the industry's highest cash cost. In 2008 and 2002, at this level the ratio marked the trough of the price cycle. Going forward, any positive developments in the metals market will result in fast-paced unwinding of positions, with strong implications for prices.
- Prices of coking coal are expected to remain low at USD 120/t in the first half of 2015 and in the second half they may rebound slightly to USD 125/t in 3Q and USD 130/t in 4Q. Our long-term projection is a return to the USD 150-160 range, a level which supports replacement investment and sustained production. In Poland, prices

of thermal coal are set to contract by a further 2-3% this year due to excess supply and high stockpiles, and in 2016 they are poised for 1% expansion.

- Sentiment toward the coal sector is additionally weighed down by the ongoing restructuring of Polish coal mines.

## Industrials

- Polish manufacturers are poised to see growing revenues this year facilitated by an expected acceleration in private spending (driven by low fuel prices and low interest rates) and public spending (driven by EU funding).
- Exporters will additionally benefit from a weak zloty, and the slump in crude oil prices should reduce the costs of logistics for the whole industry.
- Our 2015 cumulative EBITDA growth projection for manufacturers is 6.2%, marking a slowdown from 12.1% in 2014. The EBITDA margin should remain stable close to last year's level of 10.4% (the highest since 2011 when EBITDA margin was 12.0%). We expect the strongest EBITDA growth this year at Biomed Lublin, Elemental Holding, Famur, Feerum, Izostal, and Orzeł Biały thanks among others to lower interest expenses and FX losses (especially in the case of exporters to the East).
- The year-ago comparable bases for the Q4 2014 and Q1 2015 earnings of Polish industrial companies are high as those periods witnessed net profit growth at 57% and 66%, respectively, of the tracked companies. Starting from Q2 2015, however, the year-on-year momentum in profits is set to accelerate.
- Like in 2014, we expect a fair amount of M&A activity in the manufacturing sector this year, with the most likely candidates to make acquisitions defined as Alchemia, Amica, Apator, Boryszew, Elemental Holding, Libet, Synthos, and Zamet Industry and the most likely acquisition targets identified as Biomed Lublin, Elemental Holding, Oponeo, Pozbud, and Tarczyński.
- Out top sector picks are Biomed Lublin, Cognor, Elemental Holding, Famur, Feerum, Hydrotor, Orzeł Biały, Pozbud, Relpol, and Tarczyński, and our least favorable stocks are Alchemia, AC DSA, Boryszew, Radpol, Patentus, PKM Duda, and PGO.
- Key ratings: Elemental Holding (buy), Famur (buy), Tarczyński (buy)

## Construction

- After posting EBITDA and net profit growth of 17% and 35%, respectively, in 2014, Polish construction companies are should see further growth this year at respective rates of 17% and 32% (2015E EV/EBITDA=5.9x, P/E=11.5x).
- 2015 revenues in the sector will be driven by record expenditures planned by the power industry (PLN 21bn, +45% y/y) and railways (PLN 9bn, +28% y/y). Investment in road infrastructure is set to stabilize at some PLN 15bn this year, but afterwards it is likely to rebound to the record levels seen in 2011-2012.
- The Polish infrastructure budget put in place for 2014-2020 with the help EU funding provides for investment of PLN 93bn in roads and PLN 59bn in railroads. In the same period, the capacity investment in the power industry is expected to reach PLN 95bn. From the point of view of builders, these projects will start translating into higher business volumes after 2015.
- In 2015 we see the most growth potential in Elektrobudowa, Erbud, and Elektrotim.

## Property Developers

- The market outlook this year (low interest rates, demand, competition, regulatory issues) looks better for residential developers than for commercial developers.
- After a year of strong sales, residential developers are poised for 40% earnings growth in 2015 (2015E P/E=15.8x, P/B=0.78x), and in 2016 they are expected to continue experiencing increasing profits driven by good sales, gradual industry consolidation, and large land banks (2016E P/E=8.7x, P/B=0.74x).
- As for commercial developers, they face a risk of impairment losses on investment properties this year, however at 0.6x BV they should not experience dramatic shrinkage in valuations. For each developer upside catalysts lie in individual projects planned for the near future, waiting to be triggered once the start dates are announced. For this reason, the commercial sector is more risky but also potentially more profitable than residential stocks.
- In 2015, we see the most growth potential in LC Corp, Polnord, and Capital Park.

## Retail

- Polish retailers are poised to grow sales volumes in the home market this year thanks to accelerating consumption (+3.1% y/y vs. 3.0% in 2014). As for revenues, however, they are under pressure amid a price deflation observed in Poland, expected to persist at least through the first half of the year.
- 2015 is shaping up to be a tough year for the Polish retail industry due to increasing saturation with retail spaces which combined with price deflation may result in shrinking like-for-like sales. An additional strain on margins in the fiercely competitive market will be put by aggressive price offers.
- Retailers who pay in dollars for their merchandise (CCC, LPP) will feel additional pressure from a strong USD. On the other hand, they may look forward to reduced rental prices assuming the EUR/PLN exchange rate decreases as anticipated.
- We see potential for earnings growth in CCC (which has less exposure to the dollar than LPP and which continues to expand in Western markets), while for LPP we project shrinking profits (through 90% COGS exposure to the dollar and the slowdown experienced by stores in Russia and Ukraine).

## Current Ratings by Dom Maklerski mBanku

Company	Recommendation	Date issued	Price on report date	Target price	Current price	Upside / Downside	P/E 2014	P/E 2015	EV/EBITDA 2014	EV/EBITDA 2015
<b>Banks</b>										
BZ WBK	Reduce	2015-01-26	343.15	310.36	343.15	-9.6%	16.5	18.1		
GETIN NOBLE BANK	Buy	2015-01-26	1.80	2.26	1.80	+25.6%	11.6	16.9		
HANDLOWY	Reduce	2015-01-26	108.80	95.35	108.80	-12.4%	14.7	17.2		
ING BSK	Hold	2015-01-26	136.50	135.20	136.50	-1.0%	17.3	16.5		
MILLENNIUM	Accumulate	2015-01-26	7.50	8.36	7.50	+11.5%	14.0	15.9		
PEKAO	Reduce	2015-01-26	179.00	166.96	179.00	-6.7%	17.5	18.3		
PKO BP	Buy	2015-01-26	33.00	38.59	33.00	+16.9%	12.8	15.2		
KOMERCNI BANKA	Reduce	2014-12-11	4920	4549 CZK	4851	-6.2%	14.5	14.7		
ERSTE BANK	Buy	2015-01-26	19.98	25.43 EUR	19.98	+27.3%	-	10.8		
RBI	Buy	2015-01-26	10.21	18.27 EUR	10.21	+79.0%	-	8.5		
OTP BANK	Accumulate	2015-01-26	3779	4048 HUF	3779	+7.1%	-	8.6		
<b>Insurance</b>										
PZU	Hold	2013-11-06	468.00	425.00	508.65	-16.4%	16.0	15.9		
<b>Financial services</b>										
KRUK	Buy	2015-01-26	113.00	143.10	113.00	+26.6%	12.3	11.0		
<b>Fuels, chemicals</b>										
CIECH	Hold	2015-01-26	48.40	46.90	48.40	-3.1%	27.8	15.0	7.5	6.4
LOTOS	Hold	2015-01-08	26.56	26.80	24.74	+8.3%	-	13.8	38.4	7.3
MOL	Accumulate	2015-01-08	153.60	174.00	154.70	+12.5%	17.6	13.1	5.1	4.7
PGNiG	Reduce	2015-01-08	4.38	4.03	4.36	-7.6%	10.8	11.6	4.9	5.4
PKN ORLEN	Accumulate	2015-01-08	49.94	55.50	53.31	+4.1%	-	8.7	-	5.8
POLWAX	Buy	2014-11-06	15.05	24.20	16.65	+45.3%	7.7	7.2	7.3	6.4
SYNTHOS	Buy	2015-01-26	4.07	5.20	4.07	+27.8%	15.0	12.2	8.8	8.4
<b>Power Utilities</b>										
CEZ	Reduce	2015-01-26	88.30	84.00	88.30	-4.9%	10.5	13.0	6.9	7.6
ENEA	Accumulate	2015-01-26	16.96	18.00	16.96	+6.1%	8.2	9.5	4.8	5.7
ENERGA	Hold	2015-01-26	23.30	23.40	23.30	+0.4%	9.8	10.9	5.7	6.0
PGE	Hold	2014-12-05	20.02	20.10	19.07	+5.4%	10.2	10.9	4.6	5.7
TAURON	Buy	2015-01-26	5.01	6.10	5.01	+21.8%	7.3	8.5	4.3	5.2
<b>Telecommunications</b>										
NETIA	Hold	2015-01-26	5.70	5.80	5.70	+1.8%	166.4	99.2	4.8	5.1
ORANGE POLSKA	Hold	2015-01-26	8.20	8.40	8.20	+2.4%	21.0	38.6	3.7	4.3
<b>Media</b>										
AGORA	Hold	2015-01-26	8.35	8.20	8.35	-1.8%	-	-	5.3	6.3
CYFROWY POLSAT	Reduce	2015-01-26	22.90	21.80	22.90	-4.8%	36.9	18.2	9.9	7.1
GLOBAL CITY HOLDINGS	Under Review	2014-05-13	34.30	-	41.53	-	-	-	-	-
TVN	Accumulate	2015-01-26	17.60	19.00	17.60	+8.0%	26.4	15.3	13.6	13.0
<b>IT</b>										
ASSECO POLAND	Accumulate	2015-01-26	53.80	59.00	53.80	+9.7%	12.5	12.9	7.2	7.1
COMARCH	Suspended	2013-03-11	89.60	-	110.00	-	-	-	-	-
SYGNITY	Suspended	2013-02-05	16.80	-	13.60	-	-	-	-	-
<b>Mining &amp; Metals</b>										
JSW	Hold	2015-01-26	20.40	27.00	20.40	+32.4%	-	-	4.0	2.8
KGHM	Buy	2015-01-26	108.25	127.00	108.25	+17.3%	8.8	10.4	4.6	4.9
LW BOGDANKA	Buy	2015-01-26	99.00	121.50	99.00	+22.7%	12.1	11.0	5.4	5.1
<b>Manufacturers</b>										
ELEMENTAL	Buy	2015-01-08	3.28	4.00	3.43	+16.6%	17.9	14.0	14.2	9.2
FAMUR	Buy	2015-01-26	3.28	4.00	3.28	+22.0%	18.4	10.5	6.1	4.8
KERNEL	Hold	2015-01-26	32.48	31.00	32.48	-4.6%	-	7.6	6.1	4.8
KĘTY	Hold	2015-01-26	280.00	275.80	280.00	-1.5%	15.0	13.5	9.0	8.3
KOPEX	Hold	2015-01-26	10.82	11.40	10.82	+5.4%	7.9	14.8	4.4	4.9
TARCZYŃSKI	Buy	2015-01-26	12.75	15.00	12.75	+17.6%	15.2	10.0	7.4	6.2
VISTAL	Buy	2015-01-26	9.59	16.40	9.59	+71.0%	9.5	7.8	7.7	6.8
<b>Construction</b>										
BUDIMEX	Accumulate	2015-01-26	153.25	162.70	153.25	+6.2%	21.6	20.9	9.1	9.7
ELEKTROBUDOWA	Buy	2015-01-26	81.22	112.90	81.22	+39.0%	14.3	10.4	8.6	6.8
ERBUD	Buy	2015-01-22	25.20	34.50	25.86	+33.4%	14.0	11.8	7.1	6.0
UNIBEP	Buy	2015-01-22	8.59	10.40	8.60	+20.9%	16.0	12.4	8.9	7.6
<b>Property Developers</b>										
CAPITAL PARK	Buy	2014-10-22	4.59	6.70	4.15	+61.4%	46.5	26.5	37.0	41.6
DOM DEVELOPMENT	Buy	2015-01-26	46.70	57.90	46.70	+24.0%	20.3	15.4	16.0	12.5
ECHO	Buy	2014-10-22	6.25	8.00	6.64	+20.5%	5.4	20.2	7.8	26.8
GTC	Buy	2015-01-26	4.91	6.60	4.91	+34.4%	-	13.5	-	13.5
ROBYG	Buy	2015-01-26	2.16	2.95	2.16	+36.6%	17.0	12.5	12.8	11.0
<b>Retail</b>										
CCC	Accumulate	2014-12-19	140.00	158.00	149.35	+5.8%	17.5	17.1	20.0	16.7
LPP	Sell	2015-01-26	7716	6400	7716	-17.1%	35.9	34.8	18.6	19.2
<b>Other</b>										
WORK SERVICE	Buy	2015-01-26	18.11	21.90	18.11	+20.9%	39.9	25.1	15.1	11.7

## Ratings issued in the past month

Company	Rating	Previous Rating	Target Price	Rating Day
Asseco Poland	Accumulate	Accumulate	58.60	2015-01-13
Erbud	Buy	Buy	34.50	2015-01-22
Elemental	Buy	-	4.00	2015-01-08
Lotos	Hold	Hold	26.80	2015-01-08
MOL	Accumulate	Buy	174.00	2015-01-08
PGNiG	Reduce	Reduce	4.03	2015-01-08
PKN Orlen	Accumulate	Accumulate	55.50	2015-01-08
Unibep	Buy	Buy	10.40	2015-01-22

## Ratings Statistics

Rating	All		For Issuers who are clients of Dom Maklerski mBanku	
	Count	Pct. of total	Count	Pct. of total
Sell	1	2,0%	0	0,0%
Reduce	7	14,0%	4	13,8%
Hold	13	26,0%	7	24,1%
Accumulate	9	18,0%	5	17,2%
Buy	23	46,0%	14	48,3%

## Rating changes as of the date of this 2015 Investment Strategy

Company	Rating	Previous Rating	Target Price	Rating Day
Agora	Hold	Reduce	8.20	2015-01-26
Asseco Poland	Accumulate	Accumulate	59.00	2015-01-26
Budimex	Accumulate	Buy	162.70	2015-01-26
BZ WBK	Reduce	Sell	310.36	2015-01-26
CEZ	Reduce	Reduce	84.00	2015-01-26
Ciech	Hold	Hold	46.90	2015-01-26
Cyfrowy Polsat	Reduce	Reduce	21.80	2015-01-26
Dom Development	Buy	Buy	57.90	2015-01-26
Elektrobudowa	Buy	Buy	112.90	2015-01-26
Enea	Accumulate	Hold	18.00	2015-01-26
Energa	Hold	Hold	23.40	2015-01-26
Erste Bank	Buy	Hold	EUR 25.43	2015-01-26
Famur	Buy	Buy	4.00	2015-01-26
Getin Noble Bank	Buy	Accumulate	2.26	2015-01-26
GTC	Buy	Buy	6.60	2015-01-26
Handlowy	Reduce	Sell	95.35	2015-01-26
ING BSK	Hold	Hold	135.20	2015-01-26
JSW	Hold	Hold	27.00	2015-01-26
Kernel	Hold	Hold	31.00	2015-01-26
Kęty	Hold	Hold	275.80	2015-01-26
KGHM	Buy	Hold	127.00	2015-01-26
Kopex	Hold	Buy	11.40	2015-01-26
Kruk	Buy	Buy	143.10	2015-01-26
LPP	Sell	Reduce	6,400	2015-01-26
LW Bogdanka	Buy	Hold	121.50	2015-01-26
Millennium	Accumulate	Hold	8.36	2015-01-26
Netia	Hold	Hold	5.80	2015-01-26
Orange Polska	Hold	Reduce	8.40	2015-01-26
OTP Bank	Accumulate	Hold	HUF 4,048	2015-01-26
Pekao	Reduce	Reduce	166.96	2015-01-26
PKO BP	Buy	Buy	38.59	2015-01-26
RBI	Buy	Buy	EUR 18.27	2015-01-26
Robyg	Buy	Buy	2.95	2015-01-26
Synthos	Buy	Buy	5.20	2015-01-26
Tarczyński	Buy	Buy	15.00	2015-01-26
Tauron	Buy	Accumulate	6.10	2015-01-26
TVN	Accumulate	Buy	19.00	2015-01-26
Vistal	Buy	Buy	16.40	2015-01-26
Work Service	Buy	Buy	21.90	2015-01-26

## Financial Sector

BZ WBK		Reduce						
Analyst: Michał Konarski		Current price:		PLN 343.15		Last rating:		2015-01-26
		Target price:		PLN 310.36				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Net interest income	3 346.4	4 682.5	39.9%	3 946.8	-15.7%	3 868.8	-2.0%	Number of shares (m) 98.9
Net interest margin	5.6%	3.9%		3.3%		2.9%		MC (current price, PLN/m) 33 947.5
Total income	4 136.3	6 089.8	47.2%	6 507.5	6.9%	6 578.2	1.1%	Free float 30.0%
Operating income*	2 194.5	2 670.9	21.7%	3 400.0	27.3%	3 414.2	0.4%	
Pre-tax income	1 704.0	1 969.4	15.6%	2 612.7	32.7%	2 551.5	-2.3%	
Net income	1 367.6	1 611.5	17.8%	1 920.7	19.2%	1 871.1	-2.6%	
ROE	16.8%	11.9%		12.5%		10.8%		Price change: 1M -8.5%
P/E	18.3	19.9		17.7		18.1		Price change: 6M -4.4%
P/BV	2.8	2.3		2.0		1.9		Price change: 12M -9.2%
DPS	8.0	7.6		10.7		10.3		Low (52 weeks) 332.4
Dyld (%)	2.3	2.2		3.1		3.0		High (52 weeks) 422.0

\* before provisions

We are upgrading BZ WBK from sell to reduce with the price target lowered to PLN 310.36 per share after a 29.3% price drop (in US dollars) logged in the last 12 months, stronger than the 26.2% fall in the WIG-Banks index. BZ WBK's financial outlook for 2015 is supported by one-time events such as divestment of asset-management and insurance units, but on the other hand profits are under pressure from falling margins. That said, by expanding its deposit base by 18% in Q4 2014 on the same period in 2013, the Bank will be able to mitigate the deposit margin contraction anticipated this year. For the last two years, BZW shares have been trading at a 7% premium to the Polish peers on 12-month forward P/E, but this premium is expected to contract this year in the wake of falling ROE and worsened solvency ratios.

### Downward pressure on profits

We expect 5.2% contraction in BZ WBK's net profit for 2015 led by interest rate cuts and raised mandatory contributions to the Bank Guarantee Fund (BFG). Further, through a high share in total lending of consumer loans the Bank will experience pressure on margins resulting from further decreases in the lending rate. Unlike during the previous monetary easing cycle in Poland, this time the falling prices of deposits will deal a more severe blow to BZ WBK as demand for financing increases in the wake of the zloty's depreciation versus the Swiss franc. After downward revisions of respective 23% and 15.7% our 2015 and 2016 net earnings forecasts for BZ WBK are 18.5% and 12.1%, respectively, lower than consensus projections. Note that our estimates do not factor in what is expected to be a considerable profit on the divestment of the insurance unit Aviva.

### Margin contraction

BZ WBK was left unaffected by interest rate cuts in the last cycle after having appropriately adjusted deposit prices at its subsidiary Kredyt Bank. Between Q3 2012 and Q3 2013, the Bank's NIM expanded by 27bps (pro-forma estimates). In the current easing cycle, however, the impact of lower interest rates will be more severe due to a) a high share of interest rate-sensitive consumer loans (17% at 30 Sep. 2014) and b) downward pressure on deposit prices which will make it impossible to offset the contraction in loan margins. In addition, BZ WBK's subsidiary Santander Consumer Bank is extremely sensitive to interest rate fluctuations as evidenced by the fact that from end 2012 to end 2013 its NIM shrunk by a whopping 155bps according to our calculations, resulting from a high, 52% share in the balance-sheet total of high-margin loans. Overall, we expect to see margin shrinkage of 54bps in Q4 2014 at BZ WBK followed by further contraction by a projected 48bps in the margin for 2015.

### Big exposure to CHF

BZ WBK has relatively big exposure to CHF-denominated mortgage loans which at the end of 2014 together with other FX loans accounted for an estimated 17.3% of the total portfolio. As a result, the zloty's depreciation vs. CHF is expected to bring the Bank's solvency ratio down by 73bps as well as raising the BFG burden in 2016 through increased RWA. At the same time, calculated in zlotys, the ratio of loans to deposits at the end of 2015 should remain at a safe 97%. Finally, despite the worsened solvency ratio, BZ WBK should be able to maintain its dividend payout ratio at the usual 50% in 2016 (with dividend yield implied at 2.9%).

### Premium valuation

BZW trades at a 6.3 premium on 18.1x 2015E P/E relative to the Polish bank sector (17.1x) which we consider unjustified given its low solvency ratios and the below-average ROE of 10.7% expected in 2015.

**Getin Noble Bank**
**Buy**

Analyst: Michał Konarski

Current price:

PLN 1.8

Target price:

PLN 2.26

Last rating:

2015-01-26

(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Net interest income	1 348.6	1 297.8	-3.8%	1 436.8	10.7%	1 333.4	-7.2%	Number of shares (m)	2 650.1
Net interest margin	2.4%	2.1%		2.2%		1.9%		MC (current price, PLN/m)	4 770.3
Total income	2 190.8	1 886.0	-13.9%	1 969.7	4.4%	1 882.7	-4.4%	Free float	49.8%
Operating income*	1 356.9	1 007.3	-25.8%	1 036.9	2.9%	913.2	-11.9%		
Pre-tax income	409.1	388.0	-5.2%	316.6	-18.4%	258.9	-18.2%		
Net income	333.2	399.7	20.0%	411.3	2.9%	281.8	-31.5%		
ROE	7.9%	8.8%		8.3%		5.3%		Price change: 1M	-18.2%
P/E	14.3	11.9		11.6		16.9		Price change: 6M	-38.6%
P/BV	1.1	1.0		0.9		0.9		Price change: 12M	-41.2%
DPS	0.0	0.0		0.0		0.0		Low (52 weeks)	1.8
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks)	3.7

\* before provisions

**We are upgrading our investment rating for Getin Noble Bank from accumulate to buy while lowering the price target to PLN 2.26 per share. GNB shares have plummeted 51.8% (in US dollars) in the last twelve months on concerns over a possible capital raise combined with the zloty's depreciation vs. CHF and a deteriorating earnings outlook for the coming years. By adopting a conservative approach to assessing the impact of the weakened zloty, we concluded that the Bank is likely to experience downward pressure on margins this year. At the same time, we maintain that GNB deserves to be valued at a higher discount than any of its peers given its low ROE and solvency ratios. With all that being said, the bleak prospects lying ahead of Getin seem to be already fully priced in.**

### Downgraded forecasts

The January Swiss franc shock has prompted downward revisions to our financial forecasts for GNB, with the 2015 and 2016 net profit projections cut by respective 35.3% and 13.1%. The reasons behind the expected profit contraction include downward pressure on margins combined with upward pressure on risk reserves led by a worsened ability of FX borrowers to repay loans on time. At the revised level, our 2015 and 2016 forecasts are 35.9% and 12.0%, respectively, lower than the average market consensus.

### Margins resistant to interest rate shocks

GNB showed little sensitivity to interest rate movements during the last easing cycle than any other bank, owing to a small share in assets of equity and current deposits (15.8% in Q3 2014) coupled with a high share in total loans of low-margin mortgage loans (71.1% in Q3 2014). After an expansion in the loan portfolio in Q1 2015, however, GNB has to intensify deposit acquisition efforts and this will increase its sensitivity to rate cuts while forcing a delay in planned financing cost cuts. We expect to see NIM shrinkage at the Bank in Q4 2014 and Q1 2015 followed by a rebound in subsequent quarters. As a result, our annual

NIM projections assume an increase of 7bps to 2.19% in 2014 followed by a decrease of 29bps to 1.91 in 2015 and a rebound of 33bps to 2.23% in 2016.

### Declining risk reserves

Getin's risk provisions surged 37.1% in Q3 2014 relative to Q2 following an asset quality review and the Bank expects reserves to remain high at PLN 163m in Q4 2014 with high cost of risk as per the Bank's Management incurred on mortgage loans and stable CoR in auto loans and corporate loans. As for the NPL ratio, we expect it to remain flat in Q4 2014 at the quarter-before level of 13.7% with the decrease from an annual ratio of 35.2% last year to 26.0% this year in consumer NPLs offset by increases from 23.8% to 26.6% in auto loans, from 10.3% to 11.0% in mortgage loans, and from 7.6% to 9.7% in corporate loans. For 2015 and 2016, we project a gradual improvement in the NPL ratio to respective annual levels of 13.0% and 12.4%, accompanied by improving cost of risk (to average loans) at projected annual levels of 138bps in 2014, 122bps in 2015, and 118bps in 2016.

### Capital and dividends

Getin Noble Bank decided not to pay dividends this year as a way of strengthening its capital base. After the zloty's depreciation vs. CHF, this should result in a stable Tier-1 ratio of 9.1% in 2015. After retaining the whole of the annual profit again in 2015, in 2016 the bank should see its Tier-1 ratio improve further to 10%, eliminating the need for a capital raise. At the same time, a lack of dividends can spur a GNB share sell-off by pension funds.

### Valuation discount

GNB is trading at a discounts of 1% and 29% to the respective sector averages of 17.1x and 13.9x on 2015E and 2016E price-to-earnings ratios of 16.9x and 9.8x. In our view, the considerable discount is justified by the Bank's Tier-1 ratio of 9% (at 30 Sep. 2014), the lowest in the sector, and a low expected 2016 ROE of 8.5%.

Handlowy		Reduce						
Analyst: Michał Konarski		Current price:		PLN 108.8		Last rating:		2015-01-26
		Target price:		PLN 95.35				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Net interest income	1 488.3	1 242.2	-16.5%	1 195.0	-3.8%	1 086.1	-9.1%	Number of shares (m) 130.7
Net interest margin	3.5%	2.8%		2.4%		2.0%		MC (current price, PLN/m) 14 215.8
Total income	2 780.0	2 540.9	-8.6%	2 491.0	-2.0%	2 349.3	-5.7%	Free float 25.0%
Operating income*	1 297.1	1 182.2	-8.9%	1 185.7	0.3%	1 048.5	-11.6%	
Pre-tax income	1 239.0	1 218.1	-1.7%	1 190.2	-2.3%	1 017.5	-14.5%	
Net income	970.1	972.7	0.3%	964.6	-0.8%	824.9	-14.5%	
ROE	14.0%	15.3%		13.2%		11.3%		Price change: 1M 2.6%
P/E	14.7	14.6		14.7		17.2		Price change: 6M -3.7%
P/BV	1.9	1.9		1.9		2.0		Price change: 12M 6.3%
DPS	2.8	5.8		7.2		7.4		Low (52 weeks) 102.4
Dyield (%)	2.5	5.3		6.6		6.8		High (52 weeks) 127.2

\* before provisions

**We maintain a reduce rating for Handlowy while lowering our 9-month price target to PLN 95.35 per share after an 15.2% price drop (in US dollars) logged in the last 12 months compared to a 26.2% fall in the WIG-Banks index. We believe the Bank deserves to be valued at a premium to the sector given its conservative balance sheet, high solvency ratios, and above-average dividends though at the same time we expect its 2015 profits to be negatively impacted by a further interest rate cut of 50bps anticipated in the course of the year.**

#### Profits under pressure

We project that Handlowy's net profit for 2015 will post a contraction of 14.5% led by a 9.1% drop in net interest income and normalized risk reserves. At the same time, we believe the Bank will keep costs under control this year after a recent restructuring even despite the raised BFG contributions. After factoring in stronger-than-originally-expected downward pressure on NIM we have lowered our 2015 and 2016 net earnings forecasts for Handlowy by 19.0% and 21.9%, respectively, and at the current level our projections are 6.4% lower than the consensus estimate for 2015 and 11.7% lower than the analysts' forecast for 2016.

#### Interest rates affect margins

Handlowy displays the most sensitivity to interest rate fluctuations of all the banks in our coverage. During the last easing cycle, the Bank experienced NIM declines by an average 52bps after every 100bp interest rate cut. Such high sensitivity is due mainly to the asset structure (with consumer loans accounting for 30% of the balance-sheet total); liabilities, with 28.8% made up of current deposits and equity, play a lesser role. During the last cycle, Handlowy was very reluctant to reduce deposit rates on fears of losing accounts in the 'affluent' segment. The high share of consumer borrowing means that the Bank remains

extremely sensitive to the rate cuts expected in the current easing cycle. As a result, we expect a drop of a further 44bps in its 2015 NIM followed by a 20bp rebound in 2016.

#### Low sensitivity to strong CHF

Swiss-franc mortgages have a fractional share in Handlowy's loan portfolio and what is more the Bank had a low loans-to-deposits ratio of just 62% at the end of September 2014 which makes it more resistant to the downward pressure on deposit prices coming from an increased demand for savings among banks with big exposure to CHF. The minimal CHF-related risks mean that Handlowy's RWA are not likely to increase considerably this year, allowing for a continuation of the regular dividend policy. With the 2015 and 2016 payout ratios at 100%, we believe Handlowy will be able to offer dividend yields of 6.8% and 5.8%, respectively, this year and next.

#### Lending driven by corporations

Handlowy has the lowest ratio of loans to deposits of all Polish banks at 62%, and this should be a source of competitive advantage in a market characterized by low interest rates and economic growth. Given its business profile, we anticipate that the Bank will be able to grow its market share in corporate lending from 2.5% at the end of 2013 to 2.9% in 2016. As for consumer lending, however, we have a less optimistic outlook given that in a growing market for consumer loans its share in the total portfolio fell to 37% in Q3 2014 from 47% in 2009.

#### Inflated valuation premium

At 16.7x 2016E P/E, Handlowy is trading at a 19.7% premium to the Polish bank sector reflecting a conservative balance sheet (loans/deposits at 62%), high solvency ratios, and a high dividend payout ratio (100%). At this level the premium is too high in our view in light of the earnings contraction expected this year.

**ING BSK**
**Hold**

Analyst: Michał Konarski

Current price:

PLN 136.5

Target price:

PLN 135.2

Last rating:

2015-01-26

(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Net interest income	2 048.9	2 042.6	-0.3%	2 333.7	14.3%	2 413.0	3.4%	Number of shares (m)	130.1
Net interest margin	2.8%	2.5%		2.5%		2.3%		MC (current price, PLN/m)	17 758.7
Total income	3 209.4	3 245.1	1.1%	3 549.8	9.4%	3 673.6	3.5%	Free float	25.0%
Operating income*	1 343.2	1 417.0	5.5%	1 618.3	14.2%	1 647.2	1.8%		
Pre-tax income	1 016.1	1 192.9	17.4%	1 308.3	9.7%	1 326.0	1.4%		
Net income	832.3	961.5	15.5%	1 024.7	6.6%	1 073.7	4.8%		
ROE	11.4%	11.5%		11.6%		11.7%		Price change: 1M	-2.4%
P/E	21.3	18.5		17.3		16.5		Price change: 6M	5.0%
P/BV	2.2	2.1		2.0		1.9		Price change: 12M	19.2%
DPS	0.0	0.0		4.4		4.7		Low (52 weeks)	114.6
Dyield (%)	0.0	0.0		3.2		3.5		High (52 weeks)	150.5

\* before provisions

**We maintain a hold rating for ING BSK with the 9-month price target lowered to PLN 135.20 per share. ING's share price (in US dollars) declined 6.7% in the last twelve months, outperforming the WIG-Banks index which fell 26.2% as well as MSCI Financials which logged a downturn of 27.1%. The Bank owes the positive sentiment to a conservative balance sheet, high solvency ratios, low sensitivity to changes in interest rates, and low exposure to CHF loans, however despite of all these advantages we believe it is fairly priced at the current level.**

### Set for 2015 earnings growth

We project that ING BSK will post 4.8% net earnings growth in 2015 followed an acceleration to 18% in 2016. By expanding its loan portfolio, the Bank will be able to offset the impact of interest rate cuts on the profits for Q4 2014 and Q1 2015, moreover it will fill the dent made by the raised BFG contributions with a PLN 90m divestment gain. That said, after factoring in the hike in BFG contributions, the 50bp interest rate cut expected in Q1 2015, and reduced interchange fees, our 2015 and 2016 net profit projections for ING have been adjusted downward by respective 17.2% and 15.8%, and at the current level they are 6.5% and 2.6%, respectively, lower than the consensus forecasts for the two years.

### Resilient interest income

ING BSK has little sensitivity to interest rate movements, with its NIM during the last easing cycle contracting by an average of 15bps after every 100bp cut. This is thanks to a low share (16.9%) of current deposits and equity in the balance-sheet total combined with a low share of consumer loans in assets (10%). What is more, ING has a low ratio of loans to deposits, which means it can make up for any NIM drops by stepping up lending. Thanks to low exposure to CHF risks, ING does not feel pressure to increase its deposit base although the downward pressure on deposit prices is bound to be reflected to some extent in its financing costs. With all this in mind, we expect that after a 3bp expansion in 2014 ING's NIM (over average assets) will contract by 19bps to 2.32% in 2015 only to rebound by 9bps in 2016. At the same time, we expect to see 3.4% growth in 2015 in net interest income.

### Increasing market share

Low interest rates and a low loans/deposits ratio are expected to drive loan volumes at ING BSK at a rate of 14% in 2015 and 2016 after 15% expansion seen in 2014. As a result, we predict the Bank will increase its market share from 3.4% in 2013 to 4.1% in 2016 in retail loans and from 9.1% to 10.6% in corporate lending. The loans/deposits ratio is expected to rise from 78% in 2013 to 88.0% in 2016, remaining below the 90% threshold set by ING.

### Low cost of risk

ING BSK's loan portfolio is characterized by low cost of risk which is expected to be maintained in 2015. In 2014, cost of risk was kept down by the retail portfolio (with CoR at 39bps) as well as the corporate portfolio (55bps), supporting improvement in the NPL ratio which decreased from 2.7% in Q4'13 to 2.6% in Q3'14 for retail accounts and, more importantly, from 5.8% to 5.1% for corporate accounts. The healthy asset quality is expected to improve further going forward amid economic growth, resulting in cost-of-risk shrinkage from 54bps in 2014 to 49bps in 2015 and 46bps in 2016.

### Dividend prospects

The zloty's depreciation relative to CHF is expected to drive down ING's solvency ratios by 15bps, and with CAR approximating 14.0% at the end of 2015 the Bank will have the capacity to distribute 50% of its net profit for the year as dividends to shareholders, implying dividend yield at 3.0%. That said, there is a possibility that the Bank's Management will revert to the conservative profit-sharing stance used during previous market turmoil (2012-2013) and decide to retain the whole profit in the Bank.

### Justified premium

ING is trading at a 1% premium to the average sector 2015E P/E of 13.9x at 14.0x. We believe the Bank deserves premium valuation given its above-average earnings growth (3-year CAGR at 9.6%), high solvency ratios, and conservative balance sheet, however at the current level it seems to us to be adequately priced.

Millennium		Accumulate						
Analyst: Michał Konarski		Current price:		PLN 7.5		Last rating:		2015-01-26
		Target price:		PLN 8.36				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Net interest income	1 161.2	1 270.8	9.4%	1 460.8	14.9%	1 382.1	-5.4%	Number of shares (m)
Net interest margin	2.2%	2.3%		2.5%		2.1%		MC (current price, PLN/m)
Total income	2 008.2	2 006.4	-0.1%	2 320.7	15.7%	2 254.5	-2.9%	Free float
Operating income*	832.0	916.8	10.2%	1 102.2	20.2%	995.1	-9.7%	
Pre-tax income	593.8	680.6	14.6%	835.6	22.8%	705.8	-15.5%	
Net income	472.2	535.8	13.5%	648.4	21.0%	571.7	-11.8%	
ROE	10.0%	10.5%		11.7%		9.7%		Price change: 1M
P/E	19.3	17.0		14.0		15.9		Price change: 6M
P/BV	1.9	1.7		1.6		1.5		Price change: 12M
DPS	0.0	0.0		0.2		0.3		Low (52 weeks)
Dyield (%)	0.0	0.0		2.9		3.6		High (52 weeks)

\* before provisions

**We are upgrading Millennium from hold to accumulate with the price target lowered to PLN 8.36 per share. MIL shares fell nearly 23.2% (in US dollars) in the last twelve months, performing more or less in line with the WIG-Banks index which shed 26.2%. The negative sentiment, especially in January 2015, reflects investors' concerns over the zloty's depreciation vs. CHF and its impact on the Bank's large portfolio (65% of all mortgages and 29% of the balance-sheet total) of FX mortgage loans. In our view, Millennium will try to make up for the rapid surge in the loan portfolio by intensifying acquisition of deposits, with implications for 2015 NIM. At the same time, the weakened zloty should not affect too severely the quality of the Bank's assets. On the other hand, increased risk-weighted assets may reignite speculation about Millennium being earmarked for sale by its owner. In our view, the 14.7% (in USD) share price drop logged in January is a good opportunity to invest in Millennium.**

### 2015 outlook

We revised our 2015 and 2016 net earnings estimates for Millennium downward by respective 23% and 17.5% to reflect downward pressure on margins stemming from a need to boost liquidity, rising costs driven by hikes in BFG contributions, and falling interchange rates. Costs (mainly BFG fees) this year and next will be driven by the zloty's depreciation vs. CHF which will also bolster risk-weighted assets and worsen solvency ratios. At the revised levels our earnings projections for Millennium are 15.2% and 5.2%, respectively, lower than the analysts' forecasts for 2015 and 2016.

### Margin pressure

During the last easing cycle, despite its balance-sheet composition, Millennium showed very little sensitivity to interest rate movements, experiencing NIM contraction by an average of 3bps after every 100bp interest rate cut. This was owed to strong sales of consumer loans combined with an effective policy of cutting deposit rates. Current deposits and equity account for 32% of Millennium's balance-sheet total, and consumer loans account for 11% of assets, but in

2015 we expect the bank will continue to make deposit acquisition efforts in a bid to maintain the loans/deposits ratio safely below 100%. Moreover as the central bank cuts interest rates Millennium will no longer be able to reduce its financing costs at the same rate as in previous years. All in all, we expect NIM contraction of 37bps to 2.11% in 2015 followed by a rebound of 10bps in 2016.

### Sustainable asset quality

The zloty's depreciation versus the Swiss franc is not likely to affect greatly the quality of Millennium's assets as a negative CHF LIBOR rate will mitigate to some extent the higher monthly loan burden of franc borrowers. At the end of September 2014, Millennium's NPL ratio stood well below the market average of 3.19% at 1.46%, and its ratio of reserves to mortgage loans was in line with the average of 53%. The outstanding quality of retail as well as corporate loans is also reflected in a low cost of risk of 63bps at 30 September 2014 (31bps in retail). Supported by economic growth, cost of risk is expected to remain low at 59bps in 2015 and 57bps in 2016.

### Solvency and dividends

According to our estimates, the increase in risk-weighted assets driven by the zloty's depreciation vs. CHF will reduce Millennium's solvency ratio by 113bps to 13.3%. Even so, the Bank will still retain the capacity to distribute up to 50% of its annual net profit as dividends. At 50%, the dividend yield which may be offered in 2016 could figure to 3.1%. At the same time, note that Millennium's solvency ratio may improve considerably in 2015 if the financial regulator agrees to the adoption of the advanced internal ratings-based approach.

### Deservedly low valuation discount

At 15.9x 2015E P/E, MIL is trading at a 3.6% discount to the sector average of 17.1x. In our view the Bank should be valued on a par with sector averages given its strong solvency ratios and high dividends combined with potential for improvement in the capital base after the adoption of the AIRB approach which will reduce RWA and hence also the amount of costs to be incurred in 2016.

Pekao Reduce								
Analyst: Michał Konarski			Current price: PLN 179		Last rating: 2015-01-26			
			Target price: PLN 166.96					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Net interest income	4 862.0	4 505.6	-7.3%	4 466.4	-0.9%	4 402.2	-1.4%	Number of shares (m) 262.5
Net interest margin	3.3%	2.9%		2.7%		2.5%		MC (current price, PLNm) 46 982.1
Total income	7 790.2	7 407.9	-4.9%	7 251.8	-2.1%	7 136.2	-1.6%	Free float 49.9%
Operating income*	4 248.7	4 055.3	-4.6%	3 798.9	-6.3%	3 622.3	-4.7%	
Pre-tax income	3 619.4	3 433.2	-5.1%	3 306.9	-3.7%	3 160.5	-4.4%	
Net income	2 906.0	2 767.8	-4.8%	2 680.3	-3.2%	2 562.5	-4.4%	
ROE	13.1%	11.9%		11.5%		11.1%		Price change: 1M -1.2%
P/E	16.2	17.0		17.5		18.3		Price change: 6M 1.1%
P/BV	2.0	2.0		2.0		2.0		Price change: 12M 1.6%
DPS	5.4	8.4		10.0		10.2		Low (52 weeks) 166.0
Dyield (%)	3.0	4.7		5.6		5.7		High (52 weeks) 199.8

\* before provisions

**We maintain a reduce rating for Pekao while lowering our 9-month price target to PLN 166.96 per share after a 21% price drop (in US dollars) logged in the last 12 months compared to a 26.2% fall in the WIG-Banks index. Historically Pekao did not experience much sensitivity to interest rate reductions but nevertheless the market expectations as to its 2015 and 2016 earnings results have been cut severely by 19.4% and 21.9%, respectively, reflecting concerns over the impact on profits of monetary easing, reduced interchange fees, and higher 2015 BFG contributions. In our view, Pekao has little exposure to Swiss franc loans, moreover, it is likely to continue paying dividends in the coming years, and this combined with a conservative balance sheet and high solvency ratios makes it deserving of premium valuation. Last but not least, the Bank is well positioned to benefit from M&A opportunities this year.**

### Overestimated 2015 consensus

Consensus expectations for Pekao assume net profit growth of 2.4% in 2015 but we believe this is too optimistic given the expected interest rate cut by 50bps in March and the lower bond proceeds achievable this year. Our own projections for Pekao assume a 4.4% drop in 2015 net profit followed by a rebound of 16% in 2016, and at the current level they are 5.6% lower than the 2015 consensus but match the 2016 consensus.

### Margin pressure

During the last easing cycle, Pekao experienced NIM contraction by an average 12bps after every 100bp rate cut. This time, we expect more sensitivity from the Bank after a reduction of the lending rate last October by the central bank. Our expectations are backed by Pekao's Q4 2014 guidance which assumes NIM contraction by some 30bps, and in H1 2015 we anticipate continuing pressure on margins led by further interest rate cuts combined with downward pressure on prices of deposits in the wake of the Swiss franc shock. All in all, after an expected decrease by 14bps to 2.73% in 2014, we expect continued NIM shrinkage by 22bps in 2015 followed by a rebound of 20bps in 2016.

### Stable cost of risk

Pekao reduced its cost of risk considerably from 63bps in Q4 2013 to 46bps in Q3 2014 and at the same time it improved the NPL ratio from 7.3% to 6.9%, with the coverage ratio at 30 September 2014 reported at 69%. Faced with heightened revenue and cost pressures, we expect the Bank to maintain a conservative approach to lending risks in 2015. Pekao has a substantial portfolio of corporate loans which, however, is not likely to affect the quality of its overall lending business given that the exposure to industries which may face issues with debt servicing this year (e.g. food producers with a 3.5% share in the corporate loan portfolio) is marginal. Accordingly, we anticipate improvement from 49bps in 2014 to 43bps in 2015 in Pekao's cost of risk, supported by economic growth.

### Dividends

We believe Pekao will maintain the capacity to distribute 100% of annual profits as dividends in the next two years, and we do not expect the financial regulator to lower the already stringent requirements imposed on dividend-paying banks this year despite the increased earnings pressures. Consequently, despite an increase in RWA driven by the zloty's depreciation vs. the Swiss franc, Pekao is likely to meet the Tier-1 requirement of 12% and CAR requirement of 15.5% in 2015 and 2016, offering dividend yield at a projected 5.7% this year and 5.5% next year.

### Overpriced

At 18.3x 2015E P/E and 15.8x 2016E P/E Pekao is trading at respective premiums of 7.4% and 13.5% to the Polish sector and 20.7% and 43.8% to rival PKO BP. We believe some premium is justified by the Bank's high Tier-1 ratio (18.3%), dividend-paying potential, safe balance sheet with the L/D ratio below 100%, and low exposure to CHF mortgage loans, but at the current level the premiums are too high. A better pick in the Polish bank sector in our view is PKO BP which in spite of much greater earnings pressures faced in 2015 is valued at a wide discount to the sector.

PKO BP		Buy						
Analyst: Michał Konarski		Current price:		PLN 33		Last rating:		2015-01-26
		Target price:		PLN 38.59				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Net interest income	8 089.3	6 722.0	-16.9%	7 467.2	11.1%	7 053.7	-5.5%	Number of shares (m)
Net interest margin	4.2%	3.4%		3.4%		2.8%		MC (current price, PLN/m)
Total income	12 007.4	10 706.9	-10.8%	11 507.7	7.5%	11 053.8	-3.9%	Free float
Operating income*	6 939.1	6 047.4	-12.9%	6 000.0	-0.8%	5 377.8	-10.4%	
Pre-tax income	4 613.9	3 959.9	-14.2%	3 990.0	0.8%	3 281.7	-17.8%	
Net income	3 738.6	3 233.8	-13.5%	3 215.3	-0.6%	2 716.3	-15.5%	
ROE	15.9%	13.0%		12.2%		9.7%		Price change: 1M
P/E	11.0	12.8		12.8		15.2		Price change: 6M
P/BV	1.7	1.6		1.5		1.4		Price change: 12M
DPS	1.3	1.8		0.8		1.0		Low (52 weeks)
Dyield (%)	3.8	5.5		2.3		3.1		High (52 weeks)

\* before provisions

**We maintain a buy rating for PKO BP while lowering our 9-month price target to PLN 38.59 per share after a price 35.6% downturn (in US dollars) logged in the last twelve months, far worse than the 26.2% drop in the WIG-Banks index. We believe the weak performance was due to concerns over the impact of the Swiss franc shock combined with expectations of a 6% share sale by the Polish government and downward pressure on profits caused by interest rate cuts, reduced interchange fees, and raised contributions to the Bank Guarantee Fund. We agree that PKO should be valued at a discount to the sector considering its relatively low solvency ratio, however at the current level the discount is too high in our view, implying 17% upside potential to our target price.**

### Overinflated FY2015 expectations

Analysts have cut their 2015 and 2016 earnings projections for PKP BP by 22.4% and 26.5%, respectively, in the course of the last 12 months to account for falling interest rates, downward pressure on deposit prices expected in 2015, reduced interchange fees, and higher BFG contributions. Even at the current downgraded level, we consider the consensus for 2015 to be overstated by 20.3% in light of resumption of monetary easing by the Polish central bank underpinned by the severe depreciation in the zloty vis-à-vis the Swiss franc which indirectly affects costs of financing. Accordingly, we have adjusted our own expectations as to PKO's profits in 2015 and 2016 by 32.9% and 23.5%, respectively, though note that this year's profit has potential to receive a boost from the planned divestment of the insurance business.

### Interest margins under pressure

PKO BP remains more sensitive to interest rate movements than most other Polish banks through a high deposit base combined with a high ratio of equity to assets (34% in Q3'14). The Bank estimates the impact on Q4 2014 NIM of the October 2014 rate cuts, especially the lending rate, at ca. 30bps. The continuing monetary easing expected in March 2015 is bound to put even more downward pressure on interest margins in Q1 and Q2 2015, additionally exacerbated by falling prices of deposits as banks experience an increased need for financing in the wake of

loan portfolio expansion driven by the zloty's sudden plunge against the Swiss franc. Consequently, we project shrinkage in annual NIM by 61bps to 2.75% in 2015 followed by a rebound of 22bps in 2016.

### Declining C/I ratio

PKO BP is poised to report improving profits in 2016 thanks to cost synergies which in 2015 will still be outweighed by post-merger integration costs. The Bank projects the 2016-2017 cost synergies at respective PLN 174m and PLN 200m. In the mean time, the 2014 annual integration costs estimated at PLN 85m imply Q4 costs of PLN 57m (up from PLN 15m in Q3), with synergies reaching some PLN 6m. Considering the pressures faced by its core banking business in the years ahead, we expect the achievement by PKO BP of the target 2015 C/I ratio of <45% will be pushed back to 2016.

### Nordea funds CHF loan portfolio

Loans denominated in foreign currencies accounted for 28% of PKO's mortgage portfolio and 10% of the balance-sheet total at 30 September 2014. As a reminder, at the time of the acquisition last year of Nordea Bank its owner Nordea Bank AB made a commitment to refinance FX loans in the amount of PLN 15.2bn (61% of PKO's total exposure) for a period of seven years. As a result, we anticipate that the increase in RWA this year driven by the CHF shock will result in a decrease in PKO's CAR by 62bps to 12.9%, without affecting the Bank's dividend-paying potential under the current regulatory guidance. Assuming a payout ratio of 40%, the dividend yield which investors may expect in 2016 would be 2.6%.

### Excessive discount

On 11.0x forward 2016 P/E, PKO is trading at discounts of 21.1% relative to the Polish bank sector (13.9x) and 30.4% when compared to Pekao (15.8x). Though we agree that a relatively low Tier-1 ratio (11.5%) and ROE (projected at 10% in 2015 and 12% in 2016) justifies discount valuation in case of PKO, we recognize that the Bank is poised to see considerable earnings improvement in the coming years including thanks to the interest rate increases expected to start in 2016.

## Komerční Banka

Reduce

Analyst: Michał Konarski		Current price:		CZK 4851				Last rating:		2014-12-11	
		Target price:		CZK 4549							
(CZK m)	2012	2013	change	2014E	change	2015E	change	Key metrics (CZK m)			
Net interest income	21 969.0	21 207.0	-3.5%	21 396.0	0.9%	21 642.1	1.2%	Number of shares (m)		37.8	
Net interest margin	2.9%	2.6%		2.4%		2.4%		MC (current price, PLNm)		183 228.0	
Total income	32 663.0	30 894.0	-5.4%	30 482.8	-1.3%	30 669.5	0.6%	Free float		39.6%	
Operating income*	19 179.0	17 746.0	-7.5%	17 456.4	-1.6%	17 600.7	0.8%				
Pre-tax income	16 940.0	16 940.0	0.0%	15 731.0	-7.1%	15 752.3	0.1%				
Net income	13 954.0	12 528.0	-10.2%	12 666.7	1.1%	12 467.7	-1.6%				
ROE	15.8%	13.1%		13.3%		12.9%		Price change: 1M		2.3%	
P/E	13.1	14.6		14.5		14.7		Price change: 6M		6.6%	
P/BV	1.9	2.0		1.9		1.9		Price change: 12M		12.8%	
DPS	160.0	230.0		230.0		300.0		Low (52 weeks)		4 300.0	
Dyield (%)	3.3	4.7		4.7		6.2		High (52 weeks)		5 179.0	

\* before provisions

**We maintain a reduce rating for Komerční Banka with the price target at CZK 4549/share. KOMB shares (in US dollars) have retreated 9.3% in the last 12 months, outperforming the Polish WIG-Banks index which fell 26.2% and MSCI EM Financials which plummeted 27.1%. Komerční offers one of the highest dividend yields in the sector but at the same time it faces a challenging market environment through 2016 (e.g. falling interchange fees). We believe that given dividends the Czech bank deserves to be valued at a discount (though smaller than the historical average) to Polish banks.**

### Overoptimistic market expectations

We are skeptical that Komerční can deliver even the less-than-challenging targets it set for itself for 2014 as regards interest income, NIM, loan growth, and total income. We expect the Bank to post a 1.1% rise in the annual net profit for 2014, however this will be achieved solely thanks to lower-than-assumed risk reserves. For 2015 and 2016, our current forecasts for the Bank are 2.8% and 4.9% lower, respectively, than the consensus projections compiled by Bloomberg.

### Earnings pressure persists in 2015

Komerční Banka expects stable growth in total income in 2015 on rising interest income combined with 2-3% contraction in fee income. Interest margins next year will remain under pressure from low market rates. Loans are set to increase at a rate of 5-6%. Costs will remain under tight control next year but cost of risk is set to normalize at around 35bps. The Bank's guidance matches our own forecasts for Komerční, implying a 1.6% decline in net profit in 2015.

### High dividend yield

Enjoying one of the highest solvency ratios in the region, Komerční decided to increase future dividend distributions to 70-100% of annual earnings. To keep the Tier-1 ratio at or over the internal target of 15-16%, we believe the payout ratios in the coming years will hover around 90%, implying dividend yield at % in 2015 and 2016.

### Low cost of risk

Komerční owes its low risk reserves to the corporate lending business where CoR (to average loans) averaged 22bps in 9M 2014 vs. 34bps in 9M 2013. In retail, cost of risk in the period improved as well to 36bps from 44bps the year before. In 2015, Komerční anticipates CoR normalization at 35-40bps but looking at recovering economic growth we have a more optimistic view on the future quality of its loan assets. and we anticipate an increase in CoR from 27bps in 2014 to 31bps in 2015 and 36bps in 2016.

### Margin pressure persists

Komerční' NIM (over average assets) has been under pressure since 2011, and it is expected to continue declining throughout 2015, underpinned by falling market interest rates, an increasing share of low-margin loans in the total portfolio, and deposit price pressure. Local competition in the Czech Republic is feeling pressure on interest margins as well, with CSOB posting year-on-year NIM contraction from 2.64% to 2.41% in Q3 2014, though CS and Reiffeisen both posted improvement of respective 9bps and 20bps in the period. Going forward, on low interest rates expected to persist until 2016, bank net interest margins in the Czech Republic are set to remain tight for at least one more year. Assuming a 50bp hike in the central bank rates in 2016, in line with the Bloomberg consensus (with monetary tightening by the same amount anticipated in Poland), coupled with the deposit price war, we predict that Komerční will see NIM contraction by 14bps to 2.43% in 2014 followed by further tightening of 6bps to 2.36% in 2015 and a small rebound by 4bps to 2.40% in 2016.

### Deserving of discount to Polish banks

At 14.0x 2016E P/E KOMB is not valued at a discount to Polish banks (13.9x) at the moment although it should in our view given its less good growth prospects. In our view even with the slowdown projected this year Polish banks are set for a three-year earnings CAGR of 4% compared to 1% expected at Komerční. That being said, the 13% discount at which KOMB shares have displayed historically was excessive given the high dividend yield it offers and looking at its conservative balance sheet.

Erste Bank		Buy						
Analyst: Michał Konarski		Current price:		EUR 19.98		Last rating:		
		Target price:		EUR 25.43		2015-01-26		
(EUR m)	2012	2013	change	2014E	change	2015E	change	Key metrics (EUR m)
Net interest income	5 235.3	4 673.5	-10.7%	4 496.1	-3.8%	4 406.4	-2.0%	Number of shares (m)
Net interest margin	2.5%	2.3%		2.2%		2.1%		MC (current price, PLNm)
Total income	7 229.5	6 812.0	-5.8%	6 638.6	-2.5%	6 549.2	-1.3%	Free float
Operating income*	2 781.2	2 148.7	-22.7%	1 357.5	-36.8%	2 547.8	87.7%	
Pre-tax income	801.2	374.3	-53.3%	-836.8		1 341.1		
Net income	342.4	245.8	-28.2%	-1 515.1		793.8		
ROE	3.2%	2.2%				7.8%		Price change: 1M
P/E	23.0	34.9				10.8		Price change: 6M
P/BV	0.7	0.8		0.9		0.8		Price change: 12M
DPS	0.0	0.4		0.2		0.0		Low (52 weeks)
Dyield (%)	0.0	2.0		1.0		0.0		High (52 weeks)

\* before provisions

**We are upgrading Erste from hold to buy with the price target lowered to EUR 25.43. EBS shares fell 33.1% (USD price) in 2014, and shed a further 3.8% year to date, in the wake of the charges incurred last year on deferred tax assets, Romanian goodwill, and the Hungarian business, combined with sales of non-performing loans. The consequence will be a 2014 net loss of an estimated EUR 1,515m, followed by a net profit of EUR 794m projected for 2015, with ROTE at 8%. The Bank's earnings outlook for the coming years is strong thanks to the improving performance of the Romanian business (BCR) which serves as a meaningful driver for consolidated profits. Given its lack of exposure to Ukraine and Russia, we believe Erste should be valued at a premium over RBI and OTP Bank.**

### Set for strong 2015 earnings momentum

Erste Bank expects to report a net loss of EUR 1.4-1.6 billion in 2014 (we anticipate EUR 1.5bn), with risk reserves reaching EUR 2.1-2.4bn and the CET 1 (Basel 3) ratio exceeding 10%. For 2015, the Bank expects ROTE to be in the range of 8-10%, and according to our projections its annual net profit may reach EUR 794m, implying ROTE at 8%. Further, Erste anticipates improvement in cost of risk in Romania (100-150bps in 2015) and in Hungary (150-200bps p.by the end of 2016). Our 2015 and 2016 net income forecasts for Erste are 5.5% and 7.1%, respectively, lower than the consensus projections.

### Earnings driven by Czech business

Czech operations remain the pillar of Erste's earnings with a contribution of 64.6% projected for 2015. Due to low interest rates, the profit growth experienced by the Czech unit this year will be small at just 0.8%, and in Austria we predict expanding profits as well driven by 'Savings Banks' and 'other Austria.' As for CEE markets, the Bank expects an improvement from a net loss of EUR 649m in 2014 to a net profit of EUR 89m in Romania thanks to normalized cost of risk (projected at 180bps in 2015 and 145bps in 2016). The Hungarian business is expected to reduce the annual net loss to EUR 23m in 2015, and in 2016 we predict that it will remain in the red after losing interest income in the wake of this year's FX loan conversion.

### Asset quality

Erste's NPL ratio fell to 8.9% at 30 September 2014 from 9.6% at the end of 2013, led mainly by Romania (-17.2% y/y), Hungary (-10.0%), and Austria (-7.6%), combined with a forced sale of an NPL portfolio (ca. EUR 400m in Q3 2014). In the core Czech and Slovak markets, the NPL volumes in the period posted slight expansion of 2.0% and 3.8%. Going forward, we expect further decreases in the NPL ratio to 8.3% in 2015 and 7.9% in 2016 driven by improving asset quality in Romania and stabilization in Hungary. Consequently, loan-loss reserves are expected to drop by 45.0% in 2015 and by 3.9% in 2016. On a negative note, the destabilized situation in Ukraine and Russia may have negative consequences for Erste's business in the CEE region and in Austria.

### CHF exposure

Erste has the most exposure to the strengthened CHF through its operations in Austria (EUR 6.9bn, 8.7% of local loan portfolio), followed by Hungary (EUR 2.3bn, 48% of local portfolio), and Croatia (EUR 0.6bn, 8.4% of local portfolio). At this level, only the Austrian loans carry a (we believe unlikely) risk of default as in Hungary alongside the forced FX loan conversion local banks hedged FX risks for Q4'14.

### Upside potential

Erste Bank is trading at discounts of 15% and 16% respectively on 10.8x 2015E and 8.9x 2016E P/E relative to CEE peers (12.8x and 10.6x). In our view, the discount should turn to a premium given the high share in valuation of premium-valued countries (Czech Republic, Slovakia) and a lack of exposure to Russia and Ukraine. Further, with 2015E P/B (adjusted for intangible assets) at 0.80x, EBS is trading at a discount to the five-year average for regional banks as well as to its own five-year average of 1.0x. Finally, in our view Erste's market capitalization reflects only the value of the Czech and Slovakian business, ignoring the growth potential enjoyed in Romania and Hungary.

RBI Buy								
Analyst: Michał Konarski		Current price: EUR 10.205		Target price: EUR 18.27		Last rating:		2015-01-26
(EUR m)	2012	2013	change	2014E	change	2015E	change	Key metrics (EUR m)
Net interest income	3 472.2	3 728.9	7.4%	3 760.9	0.9%	3 513.1	-6.6%	Number of shares (m)
Net interest margin	2.5%	2.8%		2.9%		2.7%		MC (current price, PLNm)
Total income	5 304.3	5 477.3	3.3%	4 858.0	-11.3%	4 837.6	-0.4%	Free float
Operating income*	2 046.2	1 990.3	-2.7%	1 753.5	-11.9%	1 922.9	9.7%	
Pre-tax income	1 037.4	834.7	-19.5%	-44.1		451.8		
Net income	752.0	602.9	-19.8%	-534.2		349.5		
ROE	10.1%	8.0%				3.8%		Price change: 1M
P/E	2.6	3.3				8.5		Price change: 6M
P/BV	0.3	0.3		0.3		0.3		Price change: 12M
DPS	1.1	1.2		1.0		0.0		Low (52 weeks)
Dyield (%)	10.3	11.5		10.0		0.0		High (52 weeks)

\* before provisions

**We maintain a buy rating for Raiffeisen Bank International (RBI) with the price target lowered to EUR 18.27 per share after a price slump (in US dollars) of a whopping 48.9% logged in 2014, marking the worst performance among the bank stocks in our coverage and considerable underperformance relative to MSCI EM Financials which fell 27.1%. The downturn was caused by a shift in sentiment triggered by warnings about losses in Hungary and impairment charges in Poland combined with worsened negative exposure to Russia and Ukraine. In addition, a falling ruble and hryvnia drove RBI's solvency ratios down, prompting speculation about a capital raise. Finally, sentiment was further dampened by the announcement of restructuring in 2015 combined with an exit from the least profitable markets. Regardless of all these events, we predict that RBI is set for a rebound in profits and overall growth in 2015. Moreover, we believe instead of raising capital the Bank will reduce risk-weighted assets as a way of improving solvency ratios. We consider RBI undervalued at the current level with a P/B ratio of 0.3x showing inflated discounts even relative to Russian banks (e.g. Sberbank). At the same time, we realize that the negative sentiment to the Bank is likely to persist until a turnaround begins in Russia or until the capital base is strengthened.**

### Overstated guidance

RBI's growth strategy sets the medium-term ROE at 11%, and assumes stable loan volumes and risk reserves at EUR 1.8bn in 2014. Further, RBI expects to write off goodwill in Poland (EUR 197m) and in Russia (up to EUR 148m) against the 2014 earnings, as well as recognizing losses on a deferred tax asset (EUR 158m max). For 2016, the Bank has a lower cost projection than reported in 2012 (EUR 3.3bn). For our part, we assume much more conservatively that RBI's ROE will amount to 4% in 2015 and 7% in 2016, and we allow for the fact that our forecasts carry downside risk stemming from the unstable situation in Russia and Ukraine. For 2015, we project a 7% drop in interest income and a 6% drop in fee income, partly offset by a 6% reduction in operating expenses and 18% lower risk

reserves. Our updated forecasts are 36% lower than the consensus estimate for 2015 and 20.2% lower than the analysts' forecast for 2016.

### Restructuring in Poland and Russia

RBI has defined its strategic markets recently as being the Czech Republic, Slovakia, Romania, and Austria, and for the other markets (Russia, Poland, Hungary, Slovenia, Albania, BiH, Bulgaria, Croatia, Kosovo, Serbia, Belarus, and Ukraine) the Bank will work out a restructuring plan by June 2015 in which it will decide which countries to exit or where to scale down its presence. We believe a divestment of the Polish operations is a very likely scenario, especially given the EUR 197m (max) goodwill write-off in Q4 2014 and the considerable exposure (EUR 2.9bn) to CHF loans which puts pressure on solvency ratios. RBI has also been looking for buyers for its Hungarian and Ukrainian units and we think the Hungarian business will sell faster after the recent FX loan conversion.

### Capital under pressure

RBI's CET1 ratio (Basel 3) was 10.2% at the end of September 2014 but by year-end it will have dropped by an estimated 50bps in the wake of the ruble crash. RBI stated in the Q3 2014 report that it was not planning a capital raise in the foreseeable future, but in our view the likelihood of a share issue increased with the ruble's depreciation to 73.5 vs. EUR at the end of 2014. Going forward, we agree with the analysts' consensus that the RUB/EUR exchange rate will not weaken any further. Moreover, RBI has another option for improving capital ratios at its disposal, namely a divestment of the Polish business which could free up about 13% of its RWA.

### Risky upside

With 2015E P/E at 8.5x, RBI is trading at a 33.1% discount to CEE banks (12.8x) and a 21% discount to Erste Bank (10.8x) and at the current level its value is much lower than the value implied by our SOTP valuation model. RBI deserves to be valued at a discount given that its solvency ratio is the lowest in the region, however, at 0.3x its year-end 2015E P/B ratio (adjusted for intangible assets) is too low compared to a five-year average of 0.9x calculated for the regional banks.

OTP BANK		Accumulate									
Analyst: Michał Konarski		Current price:		HUF 3779				Last rating:		2015-01-26	
		Target price:		HUF 4048							
(HUF bn)	2012	2013	change	2014E	change	2015E	change	Key metrics (PLN bn)			
Net interest income	647.8	653.8	0.9%	620.1	-5.2%	551.0	-11.2%	Number of shares (m)		251.7	
Net interest margin	6.4%	6.4%		6.0%		5.4%		MC (current price, PLNm)		951.1	
Total income	1 488.6	1 528.4	2.7%	1 457.2	-4.7%	1 317.1	-9.6%	Free float		100.0%	
Operating income*	445.9	457.4	2.6%	428.3	-6.4%	375.7	-12.3%				
Pre-tax income	192.2	184.9	-3.8%	141.5	-23.5%	160.5	13.4%				
Net income	121.7	64.2	-47.2%	-116.5		110.0					
ROE	8.3%	4.3%				7.4%		Price change: 1M		-0.7%	
P/E	7.8	14.8				8.6		Price change: 6M		-8.9%	
P/BV	0.6	0.6		0.6		0.6		Price change: 12M		-11.1%	
DPS	101.7	121.7		156.0		137.4		Low (52 weeks)		3 479.0	
Dyild (%)	2.7	3.2		4.1		3.6		High (52 weeks)		4 875.0	

\* before provisions

**We are upgrading OTP from hold to accumulate with the price target lowered to HUF 4,048 per share. OTP stock fell 33.0% in the last 12 months, underperforming the Hungarian BUX (-30.4%) as well as the BEBANKS 500 (-27.1), affected by the losses incurred in the wake of the Hungarian borrower relief measures. In our view, OTP deserves to be valued at a discount in light of the uncertain situation in Hungary, Russia, and Ukraine.**

### One-time losses in 2014

Our 2015 and 2016 net income forecasts for OTP are 12.5% and 14.2%, respectively, lower than the consensus projections, reflecting our concerns over the earnings outlook for the Bank's operations in Ukraine and Hungary. At the same time, we expect the 2015-16 profits to be supported by falling risk reserves. In 2014 OTP incurred huge losses caused by the Hungarian borrower relief measures (HUF 168bn), goodwill write-offs (HUF 12bn), and impairment of the Ukraine business (HUF 36bn). At the same time, even adjusted for these losses the net profit for the year showed a y/y drop of 14% led by 4.3% contraction in total income and a 5.2% increase in provisions. Moreover, OTP may recognize further goodwill impairment in Russia in Q4 2014 after charges of HUF 58.5bn booked through September.

### Income under pressure

OTP's banking income is under pressure from the upcoming FX loan conversion in Hungary combined with the depreciation in the ruble and hryvnia relative to the forint. The Hungarian loan conversion will take place on 1 February at HUF exchange rates of 256.47 for 1 CHF and 308.97 for 1 EUR. The interest on the converted loans will be tied to 3-month Bubor, and the loan margins cannot be lower than 1% or higher than 4.5% for mortgage loans and 6.5% for mortgage-backed loans. In our view, these caps are going to cause 5% shrinkage in OTP's Hungarian interest income in 2015.

### Lower reserves, costs, and taxes in 2015

The ruble's depreciation vs. HUF is going to result in lower risk reserves and administrative costs for OTP in 2015. Moreover after increasing its Ukrainian reserves by 200% last year the local risk exposure is fully covered in our view and does not need the recognition of additional provisions in 2015. In addition, after the high charges incurred in Ukraine in 2014 OTP will pay lower bank tax of ca. HUF 4bn.

### Pressure in Russia and Ukraine

OTP's operations in Russia and Ukraine are set to generate losses throughout 2015 and 2016 though in Russia the Bank expects gradual recovery and a return to profits in the second half of the year. We have a much less optimistic outlook for Russia where the worsening economic situation is affecting the quality of bank loans. The cost of risk that OTP Russia incurs on cash loans and credit cards is very high at 18%-19%. In 2015 we anticipate 14% expansion in the local ruble risk reserves, and we predict that the annual net loss will widen by 88% relative to 2014. In Ukraine, we project a 46% reduction in risk reserves this year, with the annual net loss narrowing by 56% from the HUF 80bn expected in 2014 (vs. OTP's own guidance of HUF -50bn).

### Inflated discount

OTP Bank is trading at 8.6x 2015E P/E, showing a 32% discount to the CEE region (12.8x). The discount on the forward P/B multiple is even wider at 0.6x OTP vs. 1.3x CEE. We believe such considerable valuation gaps are justified by regulatory risk, most notably the changes in Hungarian foreign-currency mortgage lending legislation and exposure to Russia and Ukraine. Added to this is the fact that most of OTP's value is provided by operations located in countries that are generally characterized by low value multiples: Hungary, Ukraine, and Russia. Our value calculations for OTP factor in the Hungarian bank tax which we expect to remain in effect in the coming years.

PZU		Hold						
Analyst: Michał Konarski		Current price:		PLN 508.65		Last rating:		
		Target price:		PLN 425		2013-11-06		
(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)
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)
life insurance	7 454.0	7 745.0	0.0	7 745.0	0.0	8 656.2	0.1	Free float
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
P/E	13.5	13.3		16.0		15.9		Price change: 6M
P/BV	3.1	3.6		3.5		3.5		Price change: 12M
DPS	22.4	29.7		58.6		31.8		Low (52 weeks)
Dyield (%)	4.4	5.8		11.5		6.3		High (52 weeks)

**We maintain a neutral rating on PZU. Thanks to low bond yields, we expect that sentiment to the insurer remained robust through the fourth quarter of 2014 as investors anticipated a strong investment income. In addition, the strategy update scheduled for a January release is designed to make PZU less dependent on volatile investment income through greater focus on core income growth and development of healthcare services. Finally, PZU is set to enjoy firmly positive sentiment going forward supported by interest rate cuts and new Tier-2 capital regulation.**

### 2015 profit contraction

We agree with the consensus predictions that PZU's net profit for 2015 is set for a slight contraction of about 5%. This will be due to downward pressure on gross written margins in the non-life business caused by an auto insurance price war between the leading market players, combined with favorable weather observed in 2013 and 2014 which kept claims low at levels that do not seem sustainable to us in the medium term. On the upside, PZU believes the strong growth in administrative costs recorded in 9M 2014 can decrease to a pace slower than the growth in gross written premium. Our 2015 earnings estimate for PZU is 7% lower than the consensus estimate.

### Capital policy

Under the capital policy adopted in 2013, PZU is aiming to increase returns for shareholders through 2015.

Accordingly, the Insurer paid out advance dividends of PLN 20 per share in 2013 and PLN 17 each in October 2014 and January 2015. For 2015 and 2016, based on the dividend policy, we expect payouts of 100% of the standalone annual net profits plus distributions from surplus capital (PLN 1.3bn) provided the Polish Parliament passes new rules for calculating Tier-2 capital. Given its strong capital position, we do not think PZU faces restrictions on its dividend policy by the financial regulator KNF.

### 2015-2020 strategy

PZU is scheduled to reveal a new 2015-2020 growth strategy on January 28th. According to media reports, the strategy focuses on growing the asset management business as a key income driver in the future. Moreover, the Company wants to expand in healthcare services where through investment in private medical services it expects to be able to upsell medical insurance. The plan does not involve hospital acquisitions. For our part, we also expect the new strategy to place emphasis on M&A activity targeting insurance providers based in the CEE region.

### Premium valuation

PZU is trading at 15.9x 2015E P/E, well above the average for the insurance sector (at 11.7x), as well as the 2016E average for Polish banks (13.9x). The premium is justified in our view given the Company's high ROE and unmatched dividend yield.

Kruk		Buy									
Analyst: Michał Konarski		Current price:		PLN 113				Last rating:		2015-01-26	
		Target price:		PLN 143.1							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Income	343.0	405.6	18.3%	496.1	22.3%	553.3	11.5%	Number of shares (m)		17.0	
Debt purchases	303.0	355.7	17.4%	449.8	26.5%	502.7	11.7%	MC (current price, PLNm)		1 916.4	
Collection	32.9	39.9	21.4%	32.7	-18.2%	35.5	8.5%	Free float		87.0%	
Indirect margin	194.1	222.9	14.8%	300.8	35.0%	337.6	12.2%				
Pre-tax income	85.1	98.5	15.7%	155.2	57.6%	179.7	15.8%				
Net income	81.2	97.8	20.4%	155.2	58.8%	174.3	12.3%				
ROE	29.2%	26.7%		31.5%		26.5%		Price change: 1M		2.6%	
P/E	23.5	19.6		12.3		11.0		Price change: 6M		25.8%	
P/BV	6.0	4.6		3.4		2.6		Price change: 12M		33.7%	
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 with the price target raised to PLN 143.10 per share. Kruk continues its reign over the Polish and Romanian debt management markets, and its future growth prospects are confirmed by the recent foray into home loan management and the 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. KRU stock is trading at 11.0x 2015E P/E and 9.3x 2016E P/E, showing respective discounts of 10% and 19% relative to international peers which we consider to be entirely undeserved. At the current price level, Kruk shows 26% upside potential to our target.**

### Sustainable growth

We believe Kruk can continue to grow annual earnings at the fast rate seen to date, and we expect a net profit CAGR of a whopping 28.0% in the next three years. The key to maintaining the momentum is balance sheet growth through expansion in international markets and in the new segment of mortgage debt. Our 2016 and 2016 earnings forecasts for Kruk are 11% and 9%, respectively, higher than the consensus forecasts, moreover they place close to the low end of the Company's own guidance which assumes 10-20% net profit growth in 2015.

### Decreasing debt

By maintaining high ROE (>20% in the last five years) and retaining all annual earnings, Kruk has been able to gradually reduce its net debt. As debt continues to decrease in the years ahead, we expect the net debt-to-equity ratio to be brought down from 1.6x in 2013 to 1.1x in 2016 – all levels well below the 2.5x cap set forth in financing agreements. As for ROE, we expect it to fall in the range of 24-26% in the next three years.

### No distributions for a few more years

Even though its debt is decreasing, Kruk has no plans to start making distributions to shareholders in the foreseeable future. We are of the opinion that the Company can afford to pay dividends today while maintaining strong growth momentum, but for valuation purposes we assume that the first payout will occur in 2017 (with payout ratio at 50%). Note that, in reality, Kruk's no-dividend policy may be eventually put into question by private pension funds which control over 50% of its voting stock.

### New markets

In August 2014 Kruk announced it was expanding into Germany by setting up a greenfield debt collection business there, with part of the functions outsourced to Poland where labor costs are lower. The Company estimates value of the German bad debt market at several hundred million euros per year. In the next stage, Kruk is also planning to set up operations in the UK, Spain, and Italy among others within 4-5 years. We expect Kruk to make its first portfolio purchases in Germany in Q1 2015, however these transactions will not yet have much of an impact on its full-year results.

### Capital expenditures

Kruk invested a total of PLN 570m in new debt portfolios in 2014, marking a 55% increase from the previous year. For 2015, we anticipate a surge in investment to a record PLN 718m including a PLN 317m mortgage portfolio acquired in Q1, combined with continued expansion in all geographic markets. We expect increased investment in domestic consumer and corporate debt to an annual total of PLN 169m in 2015 from PLN 97m in 2014. The expenses on consumer receivables will be driven by a rise in non-performing debt, and the spending on corporate debt will be driven by overall market growth (+10% y/y in nominal value) and Kruk's market share expansion to 30%. For Romania, we anticipate a slight increase from PLN 141m to PLN 146m in portfolio expenditures with the market share steady at 35%. The contribution of the new German market to the total PLN 718m spend (+26% y/y) expected this year will be small at 7%.

### Undeserved discount

At 11.0x 2015E P/E and 9.3x 2016E P/E, Kruk is valued at discounts of 10% and 19%, respectively, to the market averages of 12.3x and 11.6x. We consider this discount to be undeserved given its outstanding earnings momentum (2013-16 CAGR at 28%), the sector's highest ROE of 31.5%, and decreasing debt. At the same time, a premium valuation would also be undeserved in light of Kruk's no-dividend policy.

## Gas & Oil, Chemicals

Ciech				Hold							
Analyst: Kamil Kliszcz		Current price:		PLN 48.4				Last rating		2015-01-26	
		Target price:		PLN 46.9							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	4 378.0	3 501.0	-20.0%	3 144.0	-10.2%	3 133.8	-0.3%	Number of shares (m)		52.7	
EBITDA	38.5	356.3	826.6%	496.9	39.5%	574.9	15.7%	MC (current price, PLNm)		2 550.7	
EBITDA margin	0.9%	10.2%		15.8%		18.3%		EV (current price, PLNm)		3 751.2	
EBIT	-198.2	139.7		296.6	112.3%	364.1	22.8%	Free float			
Net profit	-430.6	49.4		91.6	85.3%	170.1	85.6%				
P/E		51.6		27.8		15.0		Price change: 1M		12.6%	
P/CE		9.6		8.7		6.7		Price change: 6M		31.5%	
P/BV	2.9	2.8		2.7		2.3		Price change: 12M		59.7%	
EV/EBITDA	97.8	10.5		7.5		6.4		Low (52 weeks)		30.3	
Dyld (%)	0.0	0.0		2.3		0.0		High (52 weeks)		48.4	

**Ciech investors could earn a total return including dividend of 37% last year, making the Company one of the top performers in the WIG index. Market sentiment is likely to be held buoyant in the coming months by continued earnings growth and the upcoming refinancing of expensive bonds. The market for soda ash looks stable, and Ciech's profits going forward will be additionally supported by a higher EUR exchange rate combined with cheap raw materials (gas, coal). We have lowered the risk-free rate used in our valuation model for Ciech, and after factoring in updated market projections we are raising our price target from PLN 41.60 PLN to PLN 46.90 with the investment rating maintained at hold. CIE is trading at a ca. 10% discount to peers on 2015 and 2016E P/E and EV/EBITDA multiples.**

### Earnings momentum continues

Ciech delivered upside earnings surprises throughout 2014 thanks to restructuring effects which resulted in the SG&A expenses for 9M 2014 being reduced by PLN 27m. Moreover, the Company increased capacity utilization in soda ash and through the launch of a new plant protection product it managed to stem the seasonal sales slowdown in the second half of the year. For 2015, we anticipate continuation of the positive trends that shaped the 2014 results, including small hikes in soda prices facilitated by FX movements, an increase by 120,000 tons in the production volumes (through capital investment in Poland and Romania), falling costs of German natural gas (through a price formula partly linked to oil), and reduced costs of coal. All in all, we project that Ciech's 2015 annual EBITDA will increase to PLN 575m.

### Bond refinancing

Much of Ciech's upside potential lies in the planned refinancing of overpriced eurobonds which may take place still this year. Assuming no negative shifts in the corporate debt market, we believe the Company can reduce the interest rate from 9.5% to as low as 5%, which at EUR 245m total nominal value means annual savings of PLN 40-45m. An early redemption of the outstanding debt obviously entails a one-time cost of PLN 70m which, however, will probably be recognized in increments (possibly through amortization in line with the repayment schedule for the new bonds).

### Slower debt reduction

Ciech reduced net debt by PLN 80m in the first nine months of 2014 though this was facilitated by the unlocking of over PLN 100m cash under a receivables factoring arrangement. Ciech plans to spend PLN 350-400m a year on capital investment over the next few years, and in the recent past it has had to pay 'overdue' dividends and buy out silent partners in Germany (spending a total of PLN 100m-plus). With the divestment push now reduced to a few small subsidiaries (Transoda, Transclean, Ciech Pianki) with a combined value of no more than PLN 100m, the rate at which Ciech is able to reduce debt can slow down in the coming quarters, with the net debt/EBITDA ratio staying above 2.0x. That said, the debt will no longer be a burden on valuation thanks to decreasing costs of servicing.

### Updated growth 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 3.3bn and expected 2014 revenue of PLN 3.1bn), and pegs adjusted EBITDA at PLN 660m (vs. PLN 595m expected by us and PLN 497m anticipated last year), with margin at 17%. Other strategic goals include average annual dividend yield of 3% and net debt/EBITDA below 1.90 by 2019. We consider these objectives (especially the doubling of pesticide sales) to be quite ambitious, and so we chose not to factor some of them into our forecasting model (for example Ciech believes it can add PLN 35m to EBITDA by streamlining soda sales).

### Expansion plans

Ciech executives have stated repeatedly that the Company is looking to expand into new markets (including through acquisitions of soda facilities in Africa or pesticide capacity in Asia) and although for now it has not committed to any specific projects its acquisition financing potential is limited in our view. That is why we cannot rule out that Ciech will want to raise capital in the future through a new share issue or a capital injection from its owner KI Chemistry, and depending on the terms these efforts could give rise to risks for the current minority shareholders.

Lotos		Hold										
Analyst: Kamil Kliszcz		Current price:		PLN 24.74				Last rating		2015-01-08		
		Target price:		PLN 26.8								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	33 111.0	28 597.3	-13.6%	28 516.3	-0.3%	20 129.2	-29.4%	Number of shares (m)		184.9		
EBITDA	979.2	802.6	-18.0%	262.3	-67.3%	1 419.3	441.1%	MC (current price, PLNm)		4 573.8		
EBITDA margin	3.0%	2.8%		0.9%		7.1%		EV (current price, PLNm)		10 060.8		
EBIT	312.8	146.5	-53.2%	-554.1		610.5		Free float		46.8%		
Net profit	927.8	39.4	-95.8%	-553.2		331.6						
P/E	3.5	81.5				13.8		Price change: 1M		-5.0%		
P/CE	2.0	4.6		17.4		4.0		Price change: 6M		-25.5%		
P/BV	0.4	0.3		0.5		0.5		Price change: 12M		-23.5%		
EV/EBITDA	9.7	11.1		38.4		7.3		Low (52 weeks)		23.1		
Dyild (%)	0.0	0.0		0.0		0.0		High (52 weeks)		36.8		

Lotos shares took a dive last year on news of a planned float and on falling oil prices, and they are not likely to experience a turnaround for months to come given their sensitivity to the net present values of ongoing investment projects whose timelines (and hence the impact on earnings) are longer than the typical investment schedules practiced by public companies. In the current market environment (low prices of hydrocarbons, tighter gas-oil spread, higher margins on heavy products) the expected returns on projects like the DCU, B4/B6, or HRU are not looking very attractive. Moreover, the improvement in profits expected to be generated this year by the core refining business is not enough to attract investors at an estimated EV/LIFO-based EBITDA at 6.8x (a high USD/PLN exchange rate inflates net debt). After taking into account the share issue, the current market conditions, and the new capital projects, we have recently lowered our price target for Lotos from PLN 38.60 to PLN 26.80 with the investment rating maintained at hold.

#### PLN 4bn CAPEX...

Lotos is planning to spend PLN 4 billion on capital projects over the next three years – an amount almost equal to its current market capitalization. Aside from their sheer scale (a tight balance sheet calls for deleveraging), the net present value of these projects in the current environment is far from attractive (e.g. today's low prices of hydrocarbons suggest poor returns on investment in offshore drilling in B8 and B4/B6 deposits). The profitability of the hydrogen recovery unit (HRU) as well does not look good given the reduced price gap between natural gas and LPG, and the flagship initiative to install a delayed coking unit at current prices of oil derivatives is not able to improve the benchmark margin by the expected \$2/Bbl (wider cracks on HSFO and asphalts lowers the profits achievable on the conversion of these heavy products into diesel).

#### ... absorbs any increase in cash flow

Though huge, Lotos should have no problem financing the planned CAPEX through the stock issue as well as through improving cash flows in the refining segment. Thanks to higher refining margins, better profitability of heavy products facilitated by cheap inputs (asphalt, basic oils), increasing retail sales of fuel, and reduced costs of gas (Lotos uses 0.6 billion m3 of natural gas per year), we expect the 2015 Refining LIFO-based EBITDA to be over

PLN 300m higher than in 2014 (when EBITDA was weighed down by FX effects). For E&P, we anticipate a slowdown in profits which, however, will be offset by cash released from working capital under new strategic reserve quotas. That said, huge capital investment combined with a weakened zloty means investors should not expect Lotos to reduce debt in any meaningful way in the next few years.

#### Oil slump continues

The US Energy Information Administration estimates the current global oil oversupply at 0.7mmboe/d, equivalent to 0.7%-0.8% of global consumption. With OPEC refusing to cut production as a way of defending its market share in global oil sales, as the dollar continues to strengthen, we believe crude oil is set for at least several more quarters of falling prices. Production readjustments to stem the global surplus are set to be a gradual process, and Rystad Energy estimates that even at \$60 a barrel North American shale producers can be expected to continue increasing production this year without cutting back investment. Other possible downside catalysts for oil include removal of US export restrictions and progress in the nuclear negotiations with Iran. For our purposes, we assumed that the price of Brent crude would average \$65 in 2015, to increase to \$80 in 2017, which means our assumptions are about 5% higher than the current forward curve.

#### Balance-sheet outlook

We estimate Lotos's operating cash flow including EBITDA for Q4 2014 at PLN 0.4 billion. After capital expenditures of PLN 200m, PLN 40m interest expenses, a PLN 440m loss on FX loan adjustments, and PLN 1bn raised through a stock issue, for 2014, we expect to see net debt reduced to PLN 5.45bn at 31 December. In 2015 we predict that operating cash flow before interest payments will reach PLN 1.7bn, including PLN 200m unlocked from the strategic oil reserves, offset by an expected increase in inventory due to higher sales achieved in 2014. With the CAPEX budget set at PLN 1.8bn, net debt should increase to PLN 5.9bn by the end of the year. In 2016, despite continuing expenses on DCU and oilwell development, Lotos's cash flow should be balanced against debt thanks to the launch of the B8 field, making for a net debt/EBITDA ratio of 2.9x (projected based on the assumption of a stronger zloty and revaluation of dollar debt). Lotos may be able to reduce debt through divestments in the next two years, most notably through the potential sale of the railroad carrier Lotos Kolej (ca. PLN 0.3-0.4bn) in 2015.

MOL		Accumulate									
Analyst: Kamil Kliszcz		Current price:		PLN 154.7				Last rating		2015-01-08	
		Target price:		PLN 174							
(HUF bn)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	5 521.3	5 401.1	-2.2%	4 587.2	-15.1%	3 457.1	-24.6%	Number of shares (m)		104.5	
EBITDA	524.9	520.4	-0.9%	434.1	-16.6%	483.5	11.4%	MC (current price, PLNm)		16 169.1	
EBITDA margin	9.5%	9.6%		9.5%		14.0%		EV (current price, PLNm)		29 920.2	
EBIT	205.3	-18.7		174.0		194.4	11.8%	Free float		31.3%	
Net profit	151.5	21.6	-85.7%	67.5	212.6%	91.1	34.9%				
P/E	7.9	55.1		17.6		13.1		Price change: 1M		-2.1%	
P/CE	2.5	2.1		3.6		3.1		Price change: 6M		-1.5%	
P/BV	0.7	0.7		0.7		0.7		Price change: 12M		-20.7%	
EV/EBITDA	4.8	4.0		5.1		4.7		Low (52 weeks)		142.0	
Dyild (%)	3.2	3.3		5.0		3.9		High (52 weeks)		195.0	

**MOL shares took a 20% plunge last year, breaking their long-running correlation with the local debt market which had a good year, led by production cuts and the ongoing dispute with the Croatian government. Most recently the Hungarian oil group has come under additional pressure from falling crude prices, though in this case market reactions despite E&P being a major driver of MOL's EBITDA have been calm as investors took note that any price-driven slowdown in E&P revenues would be offset by improving refinery earnings and increasing sales of hydrocarbons facilitated by recent acquisitions. In this context, MOL shares can be treated as a hedging instrument against a rebound in oil prices. That said, after revising our long-term projections, we have recently lowered our price target for MOL to HUF 12,850 (PLN 174) from HUF 15,652 and we downgraded our investment rating from buy to accumulate.**

#### **Cheap oil offset by higher sales and improved refinery results**

All other things held constant, the recent oil crash would imply a drop by some HUF 66bn in MOL's core EBITDA for 2015. In actuality, however, we believe the Company can make up for the lower sales prices with higher volumes as hydrocarbon production this year is set to increase to about 15 mboe/d, and this in projects achieving high operating margins (production sharing agreement in Kurdistan, low costs of North Sea drilling). Moreover, MOL's refining business has a successful year ahead in our view marked by higher margins and CCS-based EBITDA (+HUF 46bn) achieved through higher capacity utilization (lack of long downtimes) and a lack of one-time charges in Italy (+HUF 10bn now that conversion of the local refinery into a logistics hub is complete). Further, the Gas Midstream segment should see improvement this year thanks to a lack of inventory losses incurred in Croatia. At bottom-line level, MOL's earnings this year are expected to show year-on-year contraction led by high taxes paid in the UK and Hungary.

#### **INA dispute drags on**

We have pointed out before that a resolution of MOL's dispute with Croatia over the co-owned local unit INA, either through a compromise or a divestment of INA, would provide an upside catalyst to MOL shares. In the current market environment, however, the chances of getting a good price for what are mostly E&P assets are slim, and as for a compromise the two sides do not seem to be any closer to reaching any kind of understanding (with INA being targeted with tax audits and canceled exploration licenses and MOL requesting that INA pay a special dividend). With this in mind, we would not expect a resolution of the INA situation this year, though on the upside this prospect seems to be already fully priced in.

#### **Strong balance-sheet position guarantees dividend**

MOL's balance sheet for Q4 2014 should reflect a US \$130m payment for Premier Oil's North Sea assets (the cash outflow will be smaller) and higher working-capital inflows in Downstream owed to falling oil prices. For 2015, we project that MOL's CAPEX will be similar to last year's (including equity investment) at approximately US \$1.7bn, this year consisting mostly in organic development of the new deposits in Kurdistan and on the North Sea and in final payments for petrochemical plant upgrades. MOL has put its own CAPEX plans for the next three years at up to US \$2 billion annually, but amid the crude slump we believe the Company will have to take a more measured approach to new ventures, focusing instead on the development of the existing projects. Even after the considerable capital expenditures, we expect that MOL's net debt/EBITDA ratio at the end of the year will be low at some 1.3x, and we anticipate that the Company will offer dividend yield close to 4% to shareholders this year.

PGNiG		Reduce						
Analyst: Kamil Kliszcz		Current price:		PLN 4.36		Last rating		2015-01-08
		Target price:		PLN 4.03				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	28 730.0	32 120.0	11.8%	31 614.0	-1.6%	28 652.1	-9.4%	Number of shares (m)
EBITDA	4 609.0	5 612.0	21.8%	6 007.5	7.0%	5 449.2	-9.3%	MC (current price, PLNm)
EBITDA margin	16.0%	17.5%		19.0%		19.0%		EV (current price, PLNm)
EBIT	2 540.0	3 149.0	24.0%	3 457.3	9.8%	2 884.4	-16.6%	Free float
Net profit	2 242.0	1 918.0	-14.5%	2 379.3	24.1%	2 211.4	-7.1%	
P/E	11.5	13.4		10.8		11.6		Price change: 1M
P/CE	6.0	5.9		5.2		5.4		Price change: 6M
P/BV	0.9	0.9		0.9		0.8		Price change: 12M
EV/EBITDA	7.4	5.4		4.9		5.4		Low (52 weeks)
Dyield (%)	0.0	3.0		3.4		4.6		High (52 weeks)

**PGNiG's share price has fallen 13% since our November update, and at the same time the zloty prices of oil and natural gas have retreated by over 20% and 15%, respectively. Further, the Company had to face a potential loss to the tune of PLN 250m on the take-or-pay arrangement with Qatargas as well as unsatisfying changes in the new gas tariff in light of a weakened zloty. Moreover, PGNiG's new growth strategy proved a bit of a disappointment (high CAPEX, conservative earnings targets, dividends matching expectations) and it is not likely to provide an upside catalyst in the coming months. Finally, the gas giant faces an inevitable deregulation of the Polish gas market where prices today are 20% higher than their German counterparts. We see potential for a downward revision of about 10% in the analysts' consensus as to PGNiG's future annual EBITDA results, and we have recently lowered our own earnings projections for the Company as well as downgrading the price target to PLN 4.03 from PLN 4.64, with the investment rating maintained at reduce.**

#### Qatargas contract, new tariff

PGNiG reached an agreement with Qatargas which minimized the risk of it having to pay for untaken gas but which did not divert losses on the unfavorable price formula that the Polish gas utility will not be able to pass onto end customers, estimated at PLN 250-300m this year (gas prices have been falling in line with oil, but this was accompanied by a drop in the spot prices of LNG). The 2015 outlook for the gas trade business is additionally clouded by a 4% cut by the regulator in the wholesale price tariff for the first four months of the year, expected to result in Q1 margin deterioration even relative to the already weak Q4 2014. As a consequence, we expect PGNiG's Trade segment to incur an EBIT loss of PLN 0.4bn this year – a prospect which is not factored into the current analysts' consensus. Finally, PGNiG has still not determined the formula for settling LNG regasification costs on the new terminal or the manner of financing strategic energy reserves as it loses market share.

#### Disappointing strategy

PGNiG wants to put in place strategic initiatives (including an increase in hydrocarbon production by 10-15mboe

through foreign acquisitions, and cost cuts by PLN 700-800m) aimed at achieving annual EBITDA of PLN 7bn by 2022. Without knowing the underlying assumptions as to the future market conditions, given that the 2015 EBITDA target is PLN 6bn, the long-term goals look very overcautious, though they probably take into account the consequences of market deregulation and losses on long-term supply contracts which are not yet necessarily factored into market expectations. Finally, the promise in the new strategy a 50% dividend payout did not exceed any expectations given PGNiG's strong balance sheet, moreover CAPEX plans of PLN 40-50bn seem like they will put a big strain on FCF (our own 2014-2022 CAPEX assumptions are only PLN 31bn). What disappointed us the most when it came to the strategy announcement was the fact that PGNiG did not take the time to answer analysts' questions during a meeting or even a conference call.

#### Gas market risks

The process of establishing a free market in natural gas in Poland is taking longer than originally thought, but the implications for PGNiG as the incumbent monopoly remain as serious as ever. The Company has managed to temporarily raise prices on the Polish energy exchange TGE in Q4 by booking all the available reverse flow capacity, but this manner of battle against price arbitrage can prove very costly and is definitely a one-off measure given that as of next year the annual firm reverse flow capacity will increase from 2.3 to 5.5 billion cubic meters. The other risk factors affecting the natural gas business include the pressure that PGNiG's largest customers are putting on the Company for changes in the terms of their gas supply contracts, the fact that PGNiG is losing its monopoly over gas imports, and the unresolved issue of take or pay supply arrangements. These risks cannot be remedied through adjustments to the regulated price tariff which, anyway, will probably be lowered next year to reflect the reduced gas costs and we would expect also the current oil slump. In addition, the chances that PGNiG can quickly reach an agreement with Gazprom on a new pricing formula are slim in light of the political tensions in the former Soviet region combined with the downturn in the price of Russian gas led by the oil slump and the narrowing in the spread between the contract price and the market price.

**PKN Orlen**
**Accumulate**

Analyst: Kamil Kliszcz		Current price:		PLN 53.31					Last rating		2015-01-08	
		Target price:		PLN 55.5								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	120 101.6	113 853.0	-5.2%	106 832.0	-6.2%	81 323.0	-23.9%	Number of shares (m)		427.7		
EBITDA	4 284.5	2 503.0	-41.6%	-2 720.0		5 678.6		MC (current price, PLNm)		22 801.2		
EBITDA margin	3.6%	2.2%		-2.5%		7.0%		EV (current price, PLNm)		34 336.2		
EBIT	2 024.4	333.0	-83.6%	-4 711.0		3 692.3		Free float		72.5%		
Net profit	2 344.8	176.0	-92.5%	-5 811.0		2 635.8						
P/E	9.7	129.6				8.7		Price change: 1M		9.9%		
P/CE	5.0	9.7				4.9		Price change: 6M		37.1%		
P/BV	0.9	0.9		1.2		1.0		Price change: 12M		40.4%		
EV/EBITDA	7.3	12.6				5.8		Low (52 weeks)		36.9		
Dyield (%)	0.0	2.8		2.7		3.5		High (52 weeks)		53.3		

**PKN Orlen was the top performer of 2014 among WIG20 stocks, but it still has upside potential in our view as a major beneficiary of falling oil prices, with the positive exposure provided by (i) lower costs of crude inputs which through advanced petrochemical systems account for 9-10% of total throughput, (ii) annual capacity of 34 million tons providing plenty of room to benefit from improving refining margins, (iii) increasing retail sales of fuel driven by low prices, (iv) improving competitiveness of naphtha-based petrochemicals, and (v) a small share in EBITDA of E&P operations. Moreover, PKN's value as an investment is reinforced by a weak zloty, expected positive earnings surprises, and increasing FCF which should facilitate dividend yield close to 5%. In addition, PKN is poised to benefit from the impending deregulation of the Polish gas market (a 10% price cut with annual usage at 1.6 billion cubic meters implies savings to the tune of PLN 0.2 billion). We have recently raised our price target on PKN to PLN 55.50 from PLN 49.10 with the investment rating maintained at accumulate.**

### 2015 guidance revision

Despite a slower first half of the year, we expect PKN's core LIFO-based EBITDA for 2014 to reach PLN 4.8bn. In 2015, with market conditions in refining as well as petrochemicals likely to remain favorable for quarters to come, the average margin should be higher (supported by a 13% increase in the USD/PLN exchange rate). Also driving this year's profits will be increased refining capacity in the Czech Republic (2.8mmt acquired from ENI) and an improved product slate in Lithuania combined with fewer maintenance downtimes, expanded wholesale margins, and lower costs of gas. All told, we expect the 2015 annual LIFO-based EBITDA to be at least PLN 1.1bn higher than in 2014 at PLN 5.9bn. This compares to a market consensus of just PLN 4.6bn, bound to be revised upwards as the year progresses.

### FCF set for improvement

We expect improvement in PKN's balance-sheet position in the coming quarters owing to a better ratio of EBITDA to CAPEX. In 2014, CAPEX was boosted by a Canadian

acquisition (PLN 0.7bn) and expenditures on a gas and steam power plant in Włocławek (PLN 1.2bn). Further improvement will come from reduced quotas for strategic oil reserves (ca. PLN 0.5bn at current prices) and falling oil prices positively affecting working capital. With net debt at 30 September 2014 at just 1.3x EBITDA, given its cautious approach to acquisitions and a promise to unlock PLN 1bn in cash through divestments, contrary to the concerns of investors, PKN has plenty of dividend-paying potential. For our part, we expect the average dividend yield in 2015-2017 to be 4.8%.

### Petrochemicals regain competitiveness

Margins on petrochemicals have been high thanks to low inventories and high demand. The world's largest players (Dow, Lyondell) believe the cyclical recovery is just beginning and the gap between demand and supply is set to widen even further. IHS Chemical has trimmed its ethylene supply projection for 2014-2017 by 7.6mmt (i.e. by nearly 30%) while raising the forecast for annual demand growth from 5.9% to 6.2%. For European producers, the halving of the price spread between naphtha and ethane has been an extra margin-driving factor. With all this in mind, we have updated our baseline forecasts for the petrochemical business in that we have moved our slowdown expectations forward from 2017 to 2018 while raising the average benchmark margins for 2015-2018.

### Refining margins buck consensus

After a slow first half of 2014, refining margins rebounded in the latter part of the year on a number of positive factors (strong demand from South America and Africa, falling costs of crude inputs and increasing fuel consumption, expanding margins on heavy products). Refiners continue to operate at high capacity (few scheduled downtimes) in contradiction to the generally accepted oversupply story, suggesting the supply cushion in the event of unplanned downtime is thin. We expect the price elasticity of demand to become more and more obvious going forward, resulting in reduced petroleum stocks and consistently high margins. That said, our measured assumption for the average annual refining margin benchmark is US \$4 vs. \$3.2 in 2014 and \$4.8 in H2 2014.

Synthos		Buy									
Analyst: Jakub Szkopek		Current price:		PLN 4.07				Last rating		2015-01-26	
		Target price:		PLN 5.2							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	6 206.5	5 359.3	-13.7%	4 816.1	-10.1%	4 768.8	-1.0%	Number of shares (m)		1 323.3	
EBITDA	932.1	605.3	-35.1%	699.5	15.6%	753.3	7.7%	MC (current price, PLNm)		5 385.6	
EBITDA margin	15.0%	11.3%		14.5%		15.8%		EV (current price, PLNm)		6 160.9	
EBIT	776.1	453.0	-41.6%	547.6	20.9%	593.9	8.4%	Free float			
Net profit	586.3	416.9	-28.9%	359.5	-13.8%	443.2	23.3%				
P/E	9.2	12.9		15.0		12.2		Price change: 1M		-1.2%	
P/CE	7.3	9.5		10.5		8.9		Price change: 6M		-11.3%	
P/BV	1.8	2.4		2.4		2.2		Price change: 12M		-21.0%	
EV/EBITDA	5.7	9.8		8.8		8.4		Low (52 weeks)		3.9	
Dyild (%)	12.3	18.7		7.6		3.3		High (52 weeks)		5.4	

**Falling prices of oil are driving down the prices of butadiene, putting indirect downward pressure on synthetic rubbers, and the resulting narrowing of the price gap to natural rubbers contributes to an increasing demand for synthetic products. In the near term, vertically-integrated rubber producers like Synthos are set to benefit from the widening spread between the prices of butadiene and crude oil (the ratio in Asia has been at the highest level since March 2013 for the last few weeks). Moreover, demand for synthetic rubber is likely to increase this year as owners of vehicles purchased during the 2005-2008 auto boom start to replace worn tires. For Synthos, we anticipate this can turn into annual sales growth of 16% this year. We maintain a buy rating for Synthos with the price target raised from PLN 5.10 to PLN 5.20.**

### Venturing into America

Synthos is planning to venture beyond Asia as the main export market and move into America where butadiene prices have been trading higher than in Europe and transport costs are on a par with those incurred in Asia (with freight rates to the US at EUR 70-75/t compared to EUR 60/t paid for shipments to China). To gain a firm foothold in the US market where the tire industry has to date relied mostly on local rubber suppliers, Synthos wants to acquire an existing business there.

### Natural rubbers under pressure

Falling prices of crude oil which drag down the prices of butadiene have put downward pressure on the prices of natural rubbers which have been on a downtrend anyway since 2011. As a result, the cumulative total net debt of the largest producers according to our calculations today exceeds 2.0x of 12M EBITDA. The EBITDA margins of

natural rubber producers as well have been shrinking since 2011. Rubber tree growers are not tempted to expand their plantations in this environment, implying that the supply of natural rubber is likely to remain steady at best in the coming years, and this of course can prove beneficial for producers of synthetic rubbers.

### Butadiene outprices naphtha

The crude slump has driven up the multiple at which butadiene is priced relative to naphtha from a low average of 1.46x in 2014 to a projected 1.5x in 2015 and 1.55x in subsequent years (the average since 2005 is 2.07x). The widening price gap is working to the advantage of synthetic rubber producers like Synthos.

### SSBR plant nears launch

Synthos's main capital project at the moment is a state-of-the-art SSBR plant in Oświęcim being built at a total cost of PLN 550m (of which PLN 147m is covered by EU funding and PLN 141m will be covered by special economic zone tax breaks at 35% of eligible costs through 2023). After a launch scheduled for Q3 2015, the SSBR plant will start contributing noticeably to Synthos's revenues in 2016 as the capacity utilization rate rises from an expected 50-60% in 2016 to 100% in 2018.

### Brazil plant delay may boost dividend

Synthos is reviewing the viability of its capital projects at the moment. One of these projects is a US\$ 170m synthetic rubber factory in Brazil conditioned among others on securing long-term butadiene supply contracts from local partner Braskem. Braskem is building a petrochemical facility in Mexico at a cost of US \$3.2bn (0.6x 2013 EBITDA) and its debt as of 30 September 2014 was 2.7x 12M EBITDA. A delay in Synthos' Brazil project could result in a higher dividend payout this year.

## Power Utilities

CEZ										Reduce	
Analyst: Kamil Kliszcz			Current price:		PLN 88.3			Last rating		2015-01-26	
			Target price:		PLN 84						
(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%	64 250.1	-9.9%	MC (current price, PLN/m)		47 504.5	
EBITDA margin	39.4%	33.9%		34.9%		30.5%		EV (current price, PLN/m)		75 019.6	
EBIT	57 083.0	45 755.0	-19.8%	43 236.6	-5.5%	35 709.3	-17.4%	Free float		29.5%	
Net profit	41 429.0	35 885.0	-13.4%	29 889.7	-16.7%	24 161.5	-19.2%				
P/E	7.6	8.7		10.5		13.0		Price change: 1M		-5.6%	
P/CE	4.5	4.9		5.4		5.9		Price change: 6M		0.5%	
P/BV	1.3	1.2		1.2		1.1		Price change: 12M		9.0%	
EV/EBITDA	5.8	6.7		6.9		7.6		Low (52 weeks)		76.0	
Dyild (%)	7.7	6.9		6.9		5.7		High (52 weeks)		100.6	

**CEZ shares gained 25% in 2014, displaying performance similar to the WSE average. Given no obvious reasons for such strong performance in the market fundamentals, we believe the gains can be attributed to the increased popularity of dividend-paying stocks amid falling interest rates. In case of CEZ, however, we think investors should be aware that its earnings momentum is set for a slowdown in the coming years which will entail decreasing dividend yields. Prices of electricity on the German market are currently EUR 12/MWh lower than the prices achieved by CEZ in 2014, and this outlines the price trajectory for the Czech power producer for the coming years. The analysts' consensus already assumes EBITDA flattening in 2016. What is more, investors seem to be completely ignoring the Czech utility's nuclear power ambitions and M&A plans. Our updated valuation model for CEZ assumes a lower risk-free rate, but this is largely offset by downgraded electricity price projections, resulting in a maintained reduce rating with the price target raised slightly to PLN 84/share.**

### CEZ prices lag market

German electricity contracts have fallen 10% in the past year and while the EUR/CZK remained steady CEZ's share price during the period increased by over 25%, breaking the 90% correlation observed in the last few years. In our opinion, the divergence will not last long and CEZ must catch up with the market sooner or later. The current EEX price is EUR 32/MWh, EUR 12/MWh less than CEZ's effective sales price achieved last year, and the implied drop in revenues suggests a shrinkage in EBITDA by as much as CZK 15-18bn by 2017. This in turn implies a reduction in the dividend base by CZK 12-14bn, i.e. by half relative to 2014. CEZ has hedged two-thirds of the 2016 sales volume at EUR 36/MWh, which means that the effective sales price can reach EUR 34-35/MWh vs. less than EUR 40/MWh expected this year.

### Emissions remain a key issue

Most projections as to CEZ's future earnings factor in to some extent the potential impact of an increase in prices of carbon allowances on clean energy producers. Meanwhile,

the measured reaction of green certificates to the backloading decision, the conclusions of the latest climate summit, and the planned creation of a market stability reserve, have all given rise to concerns about whether the European Trading System can be fixed within the next few years in light of the huge oversupply of EUAs. The concerns are predicated on the timing of the entry into force of the market stability reserve and on the fact that greenhouse emissions going forward are set to follow a decreasing trend (having already reached the target originally set for 2020) as utilities install more and more renewable energy capacity. Another issue faced by clean energy producers are falling prices of coal which are putting downward pressure on prices of coal-fired power (loosening the correlation between prices of electricity and prices of CO<sub>2</sub>), underpinned by the capacity payment mechanism planned in Germany. All of this may result in forecast revisions for CEZ in the next few quarters.

### Acquisitions vs. dividends

Dividend yield is the single most important factor responsible for the premium that CEZ continues to show relative to peer valuations. Going forward, however, we believe shrinking profits combined with the Company's desire to keep the net debt/EBITDA ratio at 2.0-2.5x, will cut into the shareholder distributions. Another potential source of downward dividend pressure are the nuclear energy plans of the Czech government (possibly including a return to the upgrade plans for the existing nuclear plants in Temelin and Dukovany), combined with the M&A plans of CEZ's Management. According to our estimates, the acquisition of either Energa or Slovenske Elektrarne alone would boost the debt/EBITDA ratio over 3.0x.

### Savings potential

CEZ is planning to implement savings measures aimed at offsetting the negative impact of deteriorated market conditions. Through cost-cutting and gross margin-boosting initiatives, we believe the Company can improve EBITDA by CZK 4.6bn in 2015 and CZK 4.9bn in 2016. The savings plan also includes the elimination of 3.7% or about 1000 jobs. Given that the targets mentioned above are relative to what was originally budgeted, they were already partly achieved in 2014. We would quantify the impact of the

Enea		Accumulate						
Analyst: Kamil Kliszcz		Current price:		PLN 16.96		Last rating		2015-01-26
		Target price:		PLN 18				
(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)
EBITDA	1 574.6	1 658.8	5.3%	1 846.1	11.3%	1 802.0	-2.4%	MC (current price, PLNm)
EBITDA margin	15.6%	18.1%		19.6%		18.7%		EV (current price, PLNm)
EBIT	824.9	897.0	8.7%	1 184.7	32.1%	1 105.4	-6.7%	Free float
Net profit	699.7	715.4	2.2%	909.7	27.2%	786.4	-13.6%	
P/E	10.7	10.5		8.2		9.5		Price change: 1M
P/CE	5.2	5.1		4.8		5.0		Price change: 6M
P/BV	0.7	0.7		0.6		0.6		Price change: 12M
EV/EBITDA	3.8	3.9		4.8		5.7		Low (52 weeks)
Dyield (%)	2.8	2.1		3.4		3.0		High (52 weeks)

After taking a dive toward the end of the year, Enea shares delivered a return in 2014 similar to the sector average. We believe the stock is a good investment opportunity at the current reduced price level and so we are upgrading our rating from hold to accumulate while raising the price target from PLN 17.2 to PLN 18.0 (after lowering the risk-free rate). Enea's dividend profile differs from that of a typical public utility but its earnings potential is rife for positive surprises this year (savings, increasing electricity prices, falling costs of coal). Moreover, Enea is valued at a 13% discount to peers, and based on SOTP valuation its value is underestimated by as much as PLN 2bn. The main factor weighing on the valuation to date has been a 1GW power plant project which, however, is sufficiently advanced at this point (50% capex, 65% construction progress) that, combined with the fact that it will be eligible for free emission credits after 2020 and for capacity payments (ensuring stable cash flows and lower investment risks), it should put less and less pressure on Enea's value going forward. Another source of upside potential for Enea is its rumored future merger with Tauron (cost synergies).

### 21015 earnings drivers

We expect a 15% increase in Enea's adjusted EBITDA in 2015 driven by lower costs and higher revenues. For EBIT, we project an increase of about PLN 85 this year thanks to higher sales prices, lower costs of coal (with the drop just relative to the high Q1 2014 base potentially reaching PLN 20m), and a lack of plant failures which in 2014 put a PLN 23m dent in profits. Further, Enea is set to book extra margin of PLN 30m on electricity trade tanks to a lack of losses incurred on operations as supplier of last resort (as regulated prices next year will be lower than market prices). In the distribution business, a slight decline in WACC should be offset by RAV growth and cost savings, though in Q2 these effects may be neutralized by a high year-ago base boosted with one-time charge reversals in excess of PLN 20m.

### Overestimated financing costs

Our annual net earnings projections for Enea are 40% higher on average than the consensus projections which, we are guessing, do not take into account the reduced D&A

expenses at the power station in Koźienice (an extended useful life will lower the annual D&A charges by about PLN 100m) while overestimating the future financing costs. Enea's debt today consists only of a single loan obtained at very attractive terms and zloty bonds priced at the WIBOR 6M rate. In the future, the Company intends to secure necessary financing through more zloty bond issues, which means that the average cost should not exceed 3.0-3.5%. Enea does not use swap hedging, which means it is set to fully benefit from the fall in benchmark rates observed today and on narrowing spreads on corporate paper.

### Status of Koźienice power plant project

Enea's power station in Koźienice is more advanced at this point than any other major new capacity-building project by power producers. The completion rate was 65% at the end of 2014 and by December 2015 it is expected to be 80%. The ratio of capital expenditures incurred to date relative to the budget is 50% and by the end of the year it will be 75%. Amid rising electricity prices and capacity-payment plans (with potential to turn power generation into a stable, regulated business), investors should start looking more favorably at the Koźienice project (at the moment, the discount placed on the project relative to our SOTP valuation estimates is as high as PLN 2bn). Note that the negative FCF caused by the project will be lower this year than last, and by 2018 it is expected to turn positive. While Enea may not be able to offer dividend yield as high as required by some investors, keep in mind that it is a growth stock which will achieve its full dividend-paying potential in about three years once annual EBITDA reaches PLN 3.4-2.4bn while CAPEX drops to PLN 1.6bn.

### Savings

Enea put in place a savings plan lasting from 2014 through 2016 with a view to reducing costs by PLN 0.5bn, including PLN 189m in 2014 (PLN 124m was saved in 9M 2014). The savings potential is best illustrated by the ratio of RAV per distribution employee, 16% above the market average, with annual payroll costs in distribution currently totaling PLN 0.5bn. The actual savings will likely not match the targets exactly, however in the first three quarters of 2014 Enea managed to reduce the costs of payroll and services by a combined PLN 50m.

Energa		Hold										
Analyst: Kamil Kliszcz		Current price:		PLN 23.3				Last rating		2015-01-26		
		Target price:		PLN 23.4								
(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%	10 627.5	3.8%	Number of shares (m)		414.1		
EBITDA	1 629.2	1 965.5	20.6%	2 307.9	17.4%	2 315.0	0.3%	MC (current price, PLNm)		9 647.8		
EBITDA margin	14.6%	17.2%		22.6%		21.8%		EV (current price, PLNm)		13 051.2		
EBIT	906.0	1 194.8	31.9%	1 461.0	22.3%	1 405.0	-3.8%	Free float		50.0%		
Net profit	457.0	764.0	67.2%	982.5	28.6%	882.9	-10.1%					
P/E	21.1	12.6		9.8		10.9		Price change: 1M		1.3%		
P/CE	8.2	6.3		5.3		5.4		Price change: 6M		10.3%		
P/BV	1.3	1.2		1.1		1.1		Price change: 12M		42.1%		
EV/EBITDA	6.8	6.4		5.7		6.0		Low (52 weeks)		16.1		
Dyield (%)	6.8	5.2		4.3		5.2		High (52 weeks)		25.1		

**Energia was the undisputed top performer among Polish utilities last year with a gain of 50% which it owed to an attractive dividend yield combined with benchmark index reshuffling. By now, the market has started to price in the regulatory risks (reduced WACC, the regulator's arbitrary interference with the formula for calculating returns on distribution, the introduction of quality targets) and the political risks (consolidation of the energy industry) faced by the Company. The planned industry tie-ups especially can weigh on ENG in the coming months given that its prospective merger with PGE is expected to completely change its investment profile (through increased exposure to generation, likely involvement in CCGT projects, and less generous dividends). We are raising our price target for Energia to PLN 23.40 per share to reflect a raised risk-free rate in distribution, but our investment rating remains neutral due to the dividend risks which affect relative valuation through its sensitivity to dividend yields.**

#### Cooling expectations for Q4 2014

Energia generated EBITDA of PLN 1.8bn in the nine months through September 2014, which makes surprising the recent media statements from the Company's executives to the effect that the FY2014 annual consensus estimate of PLN 2.2bn may be too optimistic. Such statements imply some major one-time losses in the fourth quarter. Aside from adjustments for a reduced discount rate to the actuarial reserves, we suspect the other charges may include allowances set aside for delayed allocations of free emission allowances and asset impairment losses (Energia recognizes PLN 144m goodwill on its balance sheet, most of which arose on the acquisition of wind farms). More importantly, fourth-quarter cash flow after a 27% y/y drop in 9M 2014 may have been disappointingly weak again in Q4.

#### Earnings risks

Energia's dividend-paying potential this year is boosted by low market interest rates, but investors should keep in mind that the Company generates nearly 70% of its annual EBITDA from power distribution – a business whose profitability is under pressure from falling bond yields. If we factor the current market conditions into the valuation model for Energia's regulated sales, this implies a drop by as much as PLN 150m in the EBITDA for 2016 (our model uses 1% higher WACC). Further, even as a new renewable energy law nears, prices of green certificates today have stabilized at relatively low levels about PLN 30/MWh below

our baseline assumptions (implying an over-40m squeeze on next year's EBIT). Moreover, the strong financials generated by Energia's conventional power plants last year to some extent already factored in the price hikes in electricity prices for delivery in 2015 (the core power station in Ostrołęka sells much of its output on the balancing market), which means that to expect a strong increase in the average sales price next year would be a mistake. On the upside, thanks to the falling prices of coal, the generation segment this year may see a reduction in costs to the tune of PLN 15-20m. Energia's trade business should fare better as well in 2015 thanks to a lack of losses (ca. PLN 100m in 2014) incurred as a provider of last resort (as regulated prices will be lower than market prices). That said, note that the 2014 comparable base for earnings was boosted by PLN 100m one-time gains (reversal of allowances for severance pay and carbon emissions, gains on valuation of green certificates).

#### Capital investment update

Energia is planning to spend PLN 18.2 billion on capital investment between 2014 and 2022, of which PLN 11.8bn is earmarked for primary projects and PLN 6.4bn is set aside for contingent projects conditioned among others on regulatory developments. Given that our cumulative EBITDA forecast for Energia for the years 2014-2022 is PLN 22.8bn, and taking into account Energia's tentative interest in acquiring PKP Energetyka (the value of the deal could exceed PLN 1bn), we see a risk to future dividend payments. Note also that the planned capacity payments may prompt Energia to revive some of the shelved renewable capacity-building projects. Our current financial forecasts for Energia imply average annual dividend yield of 5.4% in the next few years.

#### New tariff pricing model for distribution underway

Energia is discussing changes in the tariff scheme for power distribution for 2016-2020. We expect regulated revenue to remain the core of the pricing formula, with the URE setting additional adjustment factors determined based on the performance of the transmission network (without having to make amendments to existing legislation). DNOs will be accountable to the regulator based on improvements in SAIDI and SAIFI. The URE says it is not planning any revolutionary changes in the system, but the risk of unfavorable regulatory rulings has been raised recently by its arbitrary decision to reduce 2015 return on RAV.

PGE		Hold						
Analyst: Kamil Kliszcz		Current price:		PLN 19.07		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)
EBITDA	7 310.1	8 017.8	9.7%	7 817.3	-2.5%	7 326.0	-6.3%	MC (current price, PLNm)
EBITDA margin	24.0%	26.6%		28.3%		26.2%		EV (current price, PLNm)
EBIT	4 377.8	5 060.4	15.6%	4 786.8	-5.4%	4 264.5	-10.9%	Free float
Net profit	3 616.3	4 118.5	13.9%	3 502.7	-15.0%	3 259.4	-6.9%	
P/E	9.9	8.7		10.2		10.9		Price change: 1M
P/CE	5.4	5.0		5.5		5.6		Price change: 6M
P/BV	0.9	0.8		0.8		0.8		Price change: 12M
EV/EBITDA	4.5	4.1		4.6		5.7		Low (52 weeks)
Dyield (%)	9.6	4.5		5.8		4.9		High (52 weeks)

**PGE delivered a return of 24% in 2014 including dividend, performing roughly in line with the sector despite enjoying better sentiment in the first half of the year. The worsened performance in the latter part of 2014 was caused by speculation about its possible involvement in the bailing out of the coal industry. In the end, the government's coal mine restructuring plan has pushed the risk further into the future but the uncertainty as to how it will impact the energy industry continues to loom. Moreover, PGE has high exposure to coal price risks as a virtually integrated producer. Against this backdrop, we do not see potential for upward revisions to future EBITDA projections for PGE. We have a PLN 20.10 per-share price target for PGE, with the investment rating maintained at hold.**

### 2015 outlook

We expect PGE to report 2014 annual EBITDA of approximately PLN 8bn including one-offs like PLN 1.6bn PPA compensation, PLN 0.75bn reversal of carbon allowances, and a PLN 0.65bn reserve set aside for land reclamation. This year reported EBITDA is not likely to be as high but the core operating profit after one-offs should show year-on-year growth of about PLN 1bn driven by higher margins achieved on generation (an increase in the sales price by PLN 10/MWh implies additional profit of PLN 0.5-0.6bn), PPA compensation of PLN 0.2bn, profits instead of losses generated in retail (+PLN 0.2-0.3bn thanks to abandoned efforts to grow sales volumes at any cost), and stable distribution profits despite reduced WACC. The bottom-line profit for 2015 will receive an additional boost from a lack of bond valuation losses (PLN 0.4bn in 2014).

### Cheap coal puts double squeeze on profits

PGE power plants burn 6 million tons of hard coal a year, and in the last few quarters their fuel costs went considerably down thanks to a global slump in coal prices (the year-on-year cost reductions reported in H2 2014 were not as dramatic as in previous quarters due to a lower year-ago base). In actuality, a persistent downturn in coal cannot work to PGE's advantage in the long term given that 75% of its power output comes from captive brown coal and renewable sources, at a virtually flat fixed cost. A rebound in coal, while driving up costs for power plants, at the same time would facilitate an upward shift in the prices of electricity. Unfortunately, such a rebound is not likely to happen any time soon given the stockpile buildup accumulated globally as well as at local mines, giving rise to additional political risks as the Polish government

devises plans to involve the power industry in bailing out the ailing coal industry (for example through PLN 0.4bn advances against future coal deliveries paid in Q2).

### Polish prices firmly below German prices

Electricity prices in Poland continue to show a premium of over PLN 30/MWh relative to prices in Germany owed largely to the operating reserve mechanism and structural differences in the demand-supply balance. We expect this premium to remain in place in the years to come if the ORM is maintained on similar terms and if a capacity market mechanism is put into operation in Poland (in the near term, the premium could widen in the wake of the launch of a cold reserve and planned power plant closures). We believe the concerns that the premium would shrink in the wake of the interconnector expansion plans made during the climate summit are completely unfounded. As a reminder, the small, 500 MW import capacity of the German-border interconnector is not set for expansion until 2016-2018, and real opportunities for Poland-Germany price arbitrage will not emerge until 2023-2025 after the launch of the third section (+1500 MW). As for the interconnector between Poland and Lithuania planned for 2015-2020, it should be neutral to market prices given the price trends in the two countries.

### Role in coal industry bailout

For weeks now, we have seen mounting speculation as to the rescue plans for Poland's ailing coal industry. One of the solutions being considered by the government is to involve its state-controlled power utilities in the bailout either through long-term coal purchase agreement or through mine acquisitions. Based on these speculations, we postulated not long ago that the forced acquisition scenario was quite likely if the coal market did not turn around soon (in the current market, for each million of coal capacity PGE would lose PLN 0.2 per share of its value). In the end, the mine rescue plan outlined by the government has pushed PGE's involvement in the process into a more distant future though given the persistent slump in coal prices the 'reformed' Kompania Węglowa may need an injection of capital within the next few months in order to survive. PGE buys over 6 million tons of coal a year from external suppliers, and this quantity will increase even further after the launch of new power plants in Opole, which makes the Company the perfect mate for coal mines (the rival Tauron will be set for coal after acquiring one of the KW mines, KWK Brzeszcze). The uncertainty about the terms of the potential future mine acquisitions remains a major risk factor for PGE.

Tauron		Buy									
Analyst: Kamil Kliszcz		Current price:		PLN 5.01			Last rating		2015-01-26		
		Target price:		PLN 6.1							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	24 753.0	19 131.1	-22.7%	18 195.5	-4.9%	18 875.3	3.7%	Number of shares (m)		1 752.5	
EBITDA	3 851.6	3 661.5	-4.9%	3 631.7	-0.8%	3 575.6	-1.5%	MC (current price, PLNm)		8 780.3	
EBITDA margin	15.6%	19.1%		20.0%		18.9%		EV (current price, PLNm)		15 629.5	
EBIT	2 165.1	1 934.1	-10.7%	1 808.2	-6.5%	1 675.0	-7.4%	Free float		54.5%	
Net profit	1 476.4	1 308.3	-11.4%	1 195.6	-8.6%	1 030.7	-13.8%				
P/E	5.9	6.7		7.3		8.5		Price change: 1M		1.6%	
P/CE	2.8	2.9		2.9		3.0		Price change: 6M		-0.8%	
P/BV	0.5	0.5		0.5		0.5		Price change: 12M		21.9%	
EV/EBITDA	3.6	3.9		4.3		5.2		Low (52 weeks)		4.1	
Dyield (%)	6.2	4.0		3.8		3.4		High (52 weeks)		5.6	

**Tauron has been consistently delivering upside earnings surprises for many quarters now, prompting upward revisions to consensus expectations which, however, have found 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. We are raising our price target for TPE to PLN 6.10 to reflect a lowered risk-free rate, with the investment rating upgraded to buy. If the market speculation about Tauron being tied up with Enea as part of the government's energy industry consolidation plan proves correct, Tauron shareholders can look forward to considerable cost synergies (with SG&A savings in the merged company not unlikely to reach PLN 240m, representing 10% of market capitalization) and improved cash flows (through the launch of the new power plant in Koźienice ahead of schedule). Tauron's bid on the KWK Brzeszcze coal mine can sour sentiment somewhat though in our view the acquisition of a restructured mine without any debt does not necessarily have to be as destructive as some investors seem to think.**

### 2015 earnings outlook

Tauron delivered an upside surprise again with its earnings results for 2014 even after a series of upward revisions to the EBITDA consensus in the course of the year amounting to 13%. In 2015, thanks to an expected increase by PLN 7-10/MWh in the average electricity price, we expect a reduction in the operating losses incurred by Tauron's generation segment by about PLN 90m relative to 2014. In distribution, despite lower WACC and reduced returns on RAV, we anticipate a small, PLN 40m increase in EBIT supported by a strong expansion (+PLN 0.7bn) in the regulatory asset base. For trade, we see margin risks stemming from increasing wholesale price on the one hand, but on the other hand we anticipate decreasing regulatory pressures and falling costs of green certificates (PLN 160 vs. PLN 186/MWh in 2014). Finally, we predict a slowdown in the heat segment this year after a spin-off of part of the assets to a JV with Arcelor Mittal. With that said, like last year, the main driver of positive earnings surprises this year will be cost savings, most notably payroll savings achieved through the voluntary employee turnover scheme.

### Low interest expenses

Low interest rates and high demand for corporate debt have been driving down financing costs for Tauron (the margin over the WIBOR rate in Tauron's latest bond issue was below 100 points) to as little as less than 3%. Tauron has about 50% of its gross debt hedged by interest rate swaps, but given its investment plans for the coming year, expected to double the leverage relative to the current level, the Company is poised to benefit from the current trends in the debt market. We estimate the savings at PLN 50m more than what has been assumed to date.

### Tauron planning wind farm sales

Tauron is working on spinning off four of its wind farms into a separate vehicle and selling them subject to a buyback option exercisable in a few years. According to our estimates, the four wind farms generate annual EBITDA of about PLN 120m and net profit of approximately PLN 50m. For the prospective buyer, the key consideration is dividend yield (we believe Tauron will commit to guaranteed power purchases and green certificates at fixed rates). At dividend yield in the range of 5%-6%, the valuation of the spun-off wind power company would be PLN 0.8-1.0bn. Tauron could use this cash to further develop its renewables business, moreover, its EV/EBITDA and P/E multiples would improve.

### Tauron mulls coal mine purchase

Tauron has expressed an interest in acquiring KWK Brzeszcze, a coal mine currently owned by Kompania Węglowa which is earmarked to be restructured by the newly-formed government-run mine restructuring vehicle SRK. KWK Brzeszcze is located in the close vicinity (20km) of Tauron's combined-cycle power plants in Bielsko-Biała. It produced only 0.9mmt of coal last year, marking a decrease of 1mmt over the four years from 2011 to 2014 which resulted in an EBIT loss of PLN 230m. KWK Brzeszcze's recoverable reserves are still 11.8mmt, with a further 52.3mmt of resources waiting to be unlocked through investment (estimated at PLN 0.5bn) in new mine development. Tauron acquired a minority stake last year in another Kompania Węglowa mine for PLN 119 per ton of annual coal production. At this price, the value of KWK Brzeszcze can be estimated at PLN 107m. Investors disapprove of the acquisition plan but in our view the takeover of KWK Brzeszcze will be the sole effort that Tauron has to make as part of its involvement in the mine rescue (resulting in Tauron's annual coal demand being fully met), moreover keep in mind that by the time of the acquisition the mine will be restructured and unburdened by labor demands.

## Telecommunications

Netia		Hold									
Analyst: Paweł Szpigel		Current price:		PLN 5.7				Last rating		2015-01-26	
		Target price:		PLN 5.8							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	2 121.4	1 876.0	-11.6%	1 675.7	-10.7%	1 562.3	-6.8%	Number of shares (m)		347.9	
EBITDA	461.5	532.8	15.4%	463.0	-13.1%	421.8	-8.9%	MC (current price, PLNm)		1 983.1	
EBITDA margin	21.8%	28.4%		27.6%		27.0%		EV (current price, PLNm)		2 214.5	
EBIT	-21.0	92.8		41.8	-54.9%	41.6	-0.4%	Free float			
Net profit	-87.7	46.3		11.9	-74.2%	20.0	67.7%				
P/E		42.8		166.4		99.2		Price change: 1M		1.6%	
P/CE	5.5	4.1		4.6		5.0		Price change: 6M		1.8%	
P/BV	0.9	0.9		1.0		1.0		Price change: 12M		16.3%	
EV/EBITDA	5.6	4.3		4.8		5.1		Low (52 weeks)		4.6	
Dyld (%)	0.0	0.0		7.4		7.5		High (52 weeks)		6.0	

**We maintain a neutral stance on Netia while raising our price target to PLN 5.80. We adjusted our financial forecasts for the Telecom to reflect (1) lower revenues from direct voice services resulting from faster-than-assumed ARPU erosion, (2) higher revenues from pay-TV and mobile services, and (3) reduced CAPEX on development of B2C network infrastructure. At the same time, Netia's valuation received a boost from a PLN 145m payoff by Orange Polska and a PLN 81.5m tax refund. Netia is reportedly interested in acquiring TK Telekom which in 2014 is expected to generate EBITDA of ca. PLN 45m. The acquisition can widen Netia's fiber-optic network (TK Telekom's network spans 7,400 kilometers) and generate cost synergies.**

### Cost cuts

Netia put in place a cost-cutting plan in Q3 2014 expected to generate annual savings of PLN 50m through a downsizing of top management positions, a streamlining of the organizational structure, and reduced expenses. In mid-December the Company started negotiations with unions as regards job cuts set to generate additional savings of PLN 50m a year.

### B2C/B2B split

Netia revealed a new growth strategy for the next few years last November. In B2B, the Telecom wants to reduce exposure to voice and extend partnerships in convergent services through dynamic growth in ICT (data centers, cloud services) and selective acquisitions aimed at improving competencies and/or upgrading infrastructure. We assume Netia will focus on improving EBITDA margins by implementing optimized spending models. In B2C, Netia's main focus is on increasing value through customer retention efforts, cutting costs of customer service, and acquisition of direct customers, without expanding the

network. As well as intensifying 2P/3P sales efforts, the Company wants to upgrade and streamline the network infrastructure and optimize computer systems as a way of reducing costs. Eventually, Netia wants to split its B2B and B2C networks (separation of B2C infrastructure, SLAs with B2B networks) and possibly spin off and sell parts of the business.

### SOTP valuation update

We have updated our sum-of-the-parts-based assessment of Netia's value in a spin-off scenario based on the following assumptions: (1) We assigned PLN 115.1m costs of unallocated revenue to the B2B and B2C segments at respective weights of 70% and 30%, (2) We subtracted from B2C EBITDA the amount of fees that we think would be payable to B2B under telecommunications service level agreements in the event of a spin-off (we assumed fees of PLN 10 per each of the 360,000 direct B2C fixed-line subscribers and PLN 10 per each of the 251,000 direct B2C broadband users – a conservative assumption given the access fees paid to Orange which are PLN 20.0 a month for WLR and PLN 21.2-38.7 for BSA), (3) We calculated the B2B EV/EBITDA ratio at 6.3x (based on the GTS/ Deutsche Telekom deal in November 2013), (4) The EV/EBITDA ratio determined for B2C is 2.5x, reflecting regulatory risks, especially the possible deregulation of broadband access, and (5) We assigned net debt of PLN 299.7m plus PLN 146.1m dividend paid in 2014, a PLN 145m payment from Orange Polska, and a PLN 81.5m tax refund, to the B2B segment. At PLN 6.80 per share, the result of the SOTP valuation implies upside potential in Netia.

### Settlement with Orange, 2003 tax refund

Orange paid a PLN 145.0m settlement to Netia in 2014, adding PLN 0.42 to the value of its shares. In addition Netia received a refund of tax overpaid in 2003 in the amount of PLN 81.5m including interest.

## Orange Polska

Hold

Analyst: Paweł Szpigel		Current price:		PLN 8.2				Last rating	2015-01-26
		Target price:		PLN 8.4					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	14 141.0	12 923.0	-8.6%	12 135.7	-6.1%	11 681.9	-3.7%	Number of shares (m)	1 312.0
EBITDA	4 841.0	3 895.0	-19.5%	4 014.2	3.1%	3 575.0	-10.9%	MC (current price, PLNm)	10 758.4
EBITDA margin	34.2%	30.1%		33.1%		30.6%		EV (current price, PLNm)	15 021.8
EBIT	1 574.0	788.0	-49.9%	961.2	22.0%	721.4	-24.9%	Free float	
Net profit	855.0	296.0	-65.4%	513.2	73.4%	278.5	-45.7%		
P/E	12.6	36.3		21.0		38.6		Price change: 1M	-3.1%
P/CE	2.6	3.2		3.0		3.4		Price change: 6M	-17.3%
P/BV	0.8	0.9		0.9		0.9		Price change: 12M	-15.5%
EV/EBITDA	3.3	3.9		3.7		4.3		Low (52 weeks)	7.8
Dyield (%)	18.3	6.1		3.0		6.1		High (52 weeks)	11.9

After an over-18% price drop since November, we are upgrading Orange Polska from reduce to hold and lowering the price target to PLN 8.40. Orange faces increased competition for large B2B accounts from T-Mobile which by acquiring GTS has become the second carrier in Poland able to offer convergent services. Another major rival in the B2B segment is Netia which has recently outbid Orange for a contract to administer the WAN network of the Polish Post Office with a price quote of PLN 40m. Orange's much higher bid of PLN 79m is an indication in our view that its services are overpriced, suggesting downside potential in revenues from the B2B segment and a continuing erosion of EBITDA. We have lowered our 2015 EBITDA estimate for Orange to PLN 3,575m. Orange is scheduled to release FY2014 earnings on 12 February and we expect it to reduce the dividend from last year's profit from PLN 0.50 to PLN 0.25 per share, causing negative reactions from the market. We believe Orange may eventually bring DPS back up to PLN 0.50 depending on whether it decides to invest in the expansion of FTTx infrastructure to capitalize on the recent partial deregulation of the broadband market in Poland.

### Deregulation of wholesale broadband

A reduction by Orange Polska in the retail prices of fixed-line broadband services was met with a counter-offer from cable operators and the rival fixed-line provider Netia on slower connections. The Polish telecoms authority recently deregulated wholesale broadband access in 76 areas in Poland (housing 3.9 million households), and we expect Orange to take steps to boost the sales and competitiveness of its services in these regions though investment in fiber-optic infrastructure.

### Apparent EBITDA stabilization

Orange posted relatively small 2% y/y declines in its adjusted EBITDA for Q2 and Q3 2014 which may have led some to believe that it had contained the erosion in operating profits. However, it is important to note that the reported figures had received a boost of over PLN 150m following a change of the accounting approach to sales of mobile devices; the adjusted EBITDA shows year-on-year shrinkage of 9%. The change of accounting approach is also reflected in the CFO and lower receivables. In the quarters ahead, Orange's EBITDA will be under pressure from low prices of mobile B2B services stemming from intense competition combined with the fact that the prices are higher than charged from individuals, and from the popularity of SIM only deals and mass switchovers to unlimited calling plans. As for the adjusted EBITDA result for Q4 2014, due to more or less the same trends, we expect to see year-on-year shrinkage of over 10%.

### T-Mobile on synergies with GTS

All of the telecommunications services to date provided under the GTS name have been rebranded as T-Mobile as of 15 January, marking the next milestone in the integration of the two telecoms after their 2014 merger. According to T-Mobile's B2B executive Igor Matejov thanks to acquiring GTS T-Mobile signed contracts with a total value of PLN 70m in Q4 2014. The integration has negative implications for Orange Polska which faces increased competition and decreasing market share now that it is no longer the sole telecom authorized to offer convergent services.

## Media

Agora		Hold										
Analyst: Paweł Szpigel		Current price:		PLN 8.35				Last rating:		2015-01-26		
		Target price:		PLN 8.2								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	1 138.6	1 073.9	-5.7%	1 077.6	0.3%	1 094.8	1.6%	Number of shares (m)		50.9		
EBITDA	80.7	103.4	28.2%	88.4	-14.5%	79.0	-10.6%	MC (current price, PLNm)		425.3		
EBITDA margin	7.1%	9.6%		8.2%		7.2%		EV (current price, PLNm)		470.0		
EBIT	-13.1	7.3		-6.7		-12.1	79.2%	Free float		81.4%		
Net profit	-9.0	0.6		-11.2		-17.9	60.1%					
P/E		688.2						Price change: 1M		10.0%		
P/CE	5.0	4.4		5.1		5.8		Price change: 6M		5.7%		
P/BV	0.4	0.4		0.4		0.4		Price change: 12M		-10.2%		
EV/EBITDA	5.6	4.3		5.3		6.3		Low (52 weeks)		7.4		
Dyld (%)	12.0	0.0		0.0		0.0		High (52 weeks)		11.4		

We are raising our price target for Agora from PLN 7.60 to PLN 8.20 and we are upgrading our rating from reduce to hold to reflect strong cinema ticket sales in Q4 2014 and the potential box-office hits coming up in 2015 including the new Bond film *Spectre*, the next installments of *Star Wars* and *The Hunger Games*, *50 Shades of Grey*, and the return of franchises like *Jurassic Park*, *the Avengers*, *Terminator*, and *Mad Max*. The cinema segment is expected to make up for EBITDA losses in the press segment this year. After factoring in a bus shelter contract and the prospects of the outdoor segment, we have raised our 2014 EBITDA estimate for Agora from PLN 77.4m to PLN 91.3mm with the 2015 projection revised upward from PLN 75.7m to PLN 82.0m.

### Cinemas report good 2014

Preliminary estimates by Boxoffice.pl suggest that 2014 was a record year for Polish cinemas with 40.2 million tickets sold nationwide, marking an increase of 11% from the previous year and the best sales since 1989. The box office record was owed mainly to the Polish films *Gods* (2.15 million viewers) and *City 44* (1.74 million viewers), in Q4 additionally boosted by *The Hobbit* (1.29 million viewers). We estimate the Q4 2014 attendance at Agora's Helios cinemas at 2.7 million tickets after a y/y increase of 18% which after small price hikes should result in a revenue of PLN 49.5m. Driven by improving sales of food at concession stands, the quarterly EBITDA could come in at PLN 21.3m (up 22% from PLN 17.4m in Q4 2013). Our 2015 projections for the cinema segment had to be adjusted downward to account for the delay in the launch of an 11-screen multiplex in Jelenia Góra combined with the timing of the launch of three new cinemas with a combined 23 screens in Białystok, Łódź, and Wrocław set for the fourth quarter. The slower expansion should be offset to some extent by the potential box-office hits coming up in 2015 including the new Bond film *Spectre*, the next

installments of *Star Wars* and *The Hunger Games*, *50 Shades of Grey*, and the return of franchises like *Jurassic Park*, *The Avengers*, *Terminator*, and *Mad Max*.

### Outdoor not mitigating revenue slowdown

Going forward, Agora's financial results in Outdoor will be shaped by a contract for 1580 bus shelters with the City of Warsaw. Together with its partner Stroer, AMS was hired to put up 180 shelters in 2014, followed by 720 in 2015 and 680 in 2016 at a total cost for the City estimated at PLN 80m. In a turn of events which may have consequences for the profitability of the contract, Stroer handed over all the costs and future shelter maintenance revenue to Agora, which to us means it has effectively backed out of the project. Moreover, the installation of the bus shelters may face delays in some locations, especially ones deemed heritage sites where special permits are required. We would venture a guess that Agora failed to deliver the 180 shelters scheduled for 2014 and we believe it may not be able to build the 720 more set for 2015. Moreover, note that outdoor generated weak earnings results in Q3 2014 with ad sales revenues down nearly 4%. We have lowered our ad sales growth projection for AMS from 7% to 4%. In 2015, outdoor advertising expenditures in Poland may be set for a slowdown as a major portion of the advertising spaces will be taken up by election campaign posters and messages.

### Inefficient asset management

Assets attributed to Agora's printing business (including land properties in three cities), valued at PLN 204.7m, account for nearly half (PLN 4.02/share) of Agora's current market valuation. Meanwhile, the Company's long-term ambition when it comes to Print is to merely maintain steady profitability. 29% of the market value is Agora's headquarters. In our view, maintenance of such a high asset base is not economically viable and not beneficial for shareholders.

## Cyfrowy Polsat

Reduce

Analyst: Paweł Szpigel		Current price:		PLN 22.9				Last rating	2015-01-26
		Target price:		PLN 21.8					
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	2 778.2	2 910.8	4.8%	7 397.1	154.1%	9 756.5	31.9%	Number of shares (m)	639.5
EBITDA	1 032.3	1 046.3	1.4%	2 716.9	159.7%	3 562.5	31.1%	MC (current price, PLNm)	14 645.5
EBITDA margin	37.2%	35.9%		36.7%		36.5%		EV (current price, PLNm)	26 878.7
EBIT	789.2	789.9	0.1%	1 404.3	77.8%	1 761.4	25.4%	Free float	33.5%
Net profit	598.3	525.4	-12.2%	397.2	-24.4%	804.1	102.5%		
P/E	13.3	15.2		36.9		18.2		Price change: 1M	-5.2%
P/CE	9.5	10.2		8.6		5.6		Price change: 6M	-3.8%
P/BV	3.2	2.7		1.6		1.5		Price change: 12M	16.8%
EV/EBITDA	9.7	9.1		9.9		7.1		Low (52 weeks)	19.4
Dyild (%)	0.0	0.0		1.1		0.0		High (52 weeks)	27.8

Adjusted for the effects of its business relationship with the data supplier Midas, Cyfrowy is valued at a considerable premium on 2015E EV/EBITDA relative to CEE peers in the telecoms sector. In our view, CPS does not deserve premium valuation for reasons which can be summarized as follows: (1) Its mobile telecom unit Polkomtel reported y/y EBITDA shrinkage of 13.5% in Q3 2014 despite the launch of mobile device installment plans, moreover its CFO for 9M 2014 fell 22.1% compared to 9M 2013, (2) Cyfrowy faces stiff competition and downward pressure on the prices of mobile services which will weigh on the profits for Q4 2014, (3) Cyfrowy has large debt which it is addressing at a slower rate than we originally thought and which makes its equity valuation much more sensitive than in case of comparable telecoms, (4) Unlike most telecoms, Cyfrowy does not pay dividends, and (5) We suspect Cyfrowy may have targeted for acquisition its data provider Midas as a way of reducing the costs of broadband, giving rise to investment risk stemming from the fact that the two companies share the same principal shareholder. On a positive note, Cyfrowy and Midas are negotiating lower prices for data megabytes, but on the downside the prices matter less than the form of payment for the data which does not necessarily have to change to Cyfrowy's advantage. Further, Cyfrowy is planning a PLN 1 billion debt issue which may give rise to speculation that it is planning acquisitions or a high bid on LTE frequencies. We have updated our financial forecasts for Cyfrowy's television business which faces increased competition after the upcoming sale of the rival network TVN to a strategic investor. Moreover, in our DCF model we have lowered the risk-free rate to 3.50% while raising beta from 1.0 to 1.1 to reflect the upcoming increase in debt. As a result, our price target on CPS has gone down to PLN 21.80 from PLN 22.0 with the investment rating maintained at reduce.

### Cyfrowy to increase debt despite solid cash flow

The stated goal of Cyfrowy's planned PLN 1 billion debt issue is to ensure access to new sources of financing. We are guessing the new bond issue is designed to give Cyfrowy more financial flexibility in the upcoming LTE auction. Note that Polkomtel's controlling shareholder Elieme 2 reported having net cash of PLN 1,700.9m at 30 September 2014 while in Q4 2013 it had generated operating cash flow of PLN 603.3m. In light of such ample cash resources, the debt issue may give rise to speculation about acquisitions which are likely to worsen sentiment to Cyfrowy.

### TVN set to change owners

Cyfrowy's television business faces increased competition after the sale of the rival TVN to a new strategic investor who will no doubt step up the fight for market share and bring cost synergies on television content, with implications for Cyfrowy's profit margins.

### NetNet & Midas vs. Cyfrowy's CAPEX

The involvement of NetNet, a company associated with Cyfrowy's owner Mr. Solorz-Żak, in the LTE auction is a mark in our view of Cyfrowy's commitment to acquiring two 800 MHz frequency blocks without relying on Midas with its already high debt and CAPEX. Regardless of whether NetNet gets the frequencies, we assume that Cyfrowy will remain Midas's key account. Note that Midas's and NetNet's WACC is lower than Cyfrowy's, hence the NPV of the LTE frequency project and RAN infrastructure is lower for them). This means that it is reasonable for us to include LTE CAPEX of PLN 1,600m into Cyfrowy's valuation.

### Risk of Midas acquisition

In our view, sales of Internet plans, increasing smartphone usage, and the widespread of mobile video, will continue to weigh on EBITDA going forward through increasing data costs. For 2015, assuming Cyfrowy and Midas agree on price discounts, we estimate the total charge against annual EBITDA at PLN 130m. With this in mind, we cannot rule out that Cyfrowy will want to take Midas over as an internal data provider, and this obviously gives rise to increased investment risk.

TVN		Accumulate										
Analyst: Paweł Szpigel		Current price:		PLN 17.6				Last rating		2015-01-26		
		Target price:		PLN 19								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	1 584.3	1 554.6	-1.9%	1 612.9	3.8%	1 692.8	5.0%	Number of shares (m)		337.2		
EBITDA	456.0	372.4	-18.3%	586.0	57.4%	599.5	2.3%	MC (current price, PLNm)		5 935.2		
EBITDA margin	28.8%	24.0%		36.3%		35.4%		EV (current price, PLNm)		7 996.3		
EBIT	374.3	297.2	-20.6%	519.0	74.7%	530.7	2.2%	Free float		46.2%		
Net profit	485.9	-197.8		224.8		388.9	73.0%					
P/E	12.5			26.4		15.3		Price change: 1M		3.5%		
P/CE	10.7			20.3		13.0		Price change: 6M		19.0%		
P/BV	4.5	6.4		6.1		5.5		Price change: 12M		17.4%		
EV/EBITDA	17.5	22.1		13.6		13.0		Low (52 weeks)		13.3		
Dyid (%)	0.6	3.6		0.0		0.0		High (52 weeks)		18.0		

Even after gaining 20% since our September update, TVN still has upside potential in our view. We have adjusted our valuation model for the TV Broadcaster to reflect updated 214 earnings estimates, higher CAPEX, and a reduction in the risk-free rate from 4.25% to 3.5%. Investors' sentiment toward TVN has been buoyed by the announcement by its owners Canal+ and ITI that they were looking for a buyer for a 53.8% stake. The twelve prospective investors include Time Warner, Discovery Communications, and Axel Springer, all of which can generate cost synergies for TVN when it comes to content and financing. We are raising our price target from PLN 17.5 to PLN 19.0 while downgrading the investment rating to accumulate.

### TVN goes up for sale

Among the 12 media groups that expressed interest in acquiring a majority stake in TVN are Time Warner, Discovery Communications, 21st Century Fox, and Ringer Axel Springer. For Time Warner, the owner of a vast library of Warner Bros movies and the TV networks HBO and CNN, the acquisition can produce synergies when it comes to costs of content. Time Warner already controls CME, the media company which owns TV stations in six CEE countries, and expansion into a new, duopolistic TV advertising market in a growth economy may prove a successful strategy. Similarly, content monetization would also be the rationale behind the acquisition of TVN by Discovery. In 2014, Discovery jointly with Liberty Global (owner of UPC which has a 17% stake in TVN's DTH platform nC+) acquired All3Media, a leading creator of media content in the world. As for Axel Springer, by acquiring TVN it stands to gain a controlling stake in Poland's leading TV advertising medium as well as the top Polish Web portal Onet. Note that whoever wins the bid, they will have to make a public tender offer for 12.2% of TVN shares to reach the required voting stake of 66%.

### 2014-2016 earnings guidance

Based on economic projections for Poland and the earnings results achieved in the nine months through September

2014, TVN's expectations for the three years from 2014 to 2016 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 in line with the current market expectations. TVN's guidance is consistent with our expectations which peg adjusted EBITDA (including dividends from nC+ and Onet as per the definition of adjusted EBITDA provided by the Company) at PLN 545.9m in 2014, PLN 591.3m in 2015, and PLN 630.9m in 2016.

### Note refinancing

TVN's 7.875% Senior Notes have an option adjusted spread of 471.1bps which means that now would be a good time for TVN to refinance them and benefit from ca. 3ppt better financing terms (the call option price is 3.94%). After the sale by its owner of a controlling stake, however, TVN will have access to even cheaper sources of financing.

**IT**

Asseco Poland		Accumulate										
Analyst: Paweł Szpigiel		Current price:		PLN 53.8				Last rating:		2015-01-26		
		Target price:		PLN 59								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	5 529.1	5 898.1	6.7%	6 182.2	4.8%	6 443.6	4.2%	Number of shares (m)		83.0		
EBITDA	888.9	875.0	-1.6%	915.3	4.6%	918.3	0.3%	MC (current price, PLNm)		4 465.4		
EBITDA margin	16.1%	14.8%		14.8%		14.3%		EV (current price, PLNm)		6 576.0		
EBIT	649.9	610.5	-6.1%	650.1	6.5%	656.2	0.9%	Free float		65.4%		
Net profit	370.1	393.9	6.4%	358.2	-9.1%	345.6	-3.5%					
P/E	12.1	11.3		12.5		12.9		Price change: 1M		1.5%		
P/CE	7.3	6.8		7.2		7.3		Price change: 6M		33.1%		
P/BV	0.6	0.6		0.6		0.6		Price change: 12M		18.0%		
EV/EBITDA	6.9	7.6		7.2		7.1		Low (52 weeks)		39.3		
Dyild (%)	3.8	4.5		4.8		5.2		High (52 weeks)		54.5		

By changing the approach to handling the key long-term IT contract from the national social insurance institution ZUS, Asseco improved its standalone profits in Q3 2014, and in October it acquired a four-year systems maintenance contract from the Agricultural Social Insurance Fund (KRUS) which is set to stabilize revenues in the public services segment. A major growth driver for Asseco in 2015 is its Israeli unit Formula Systems, especially its subsidiary Sapiens International which is generating record sales. ACP is trading at respective discounts to peers of 15% and 17% on 2014E EV/EBITDA and P/E which are not justified given the high dividend it is expected to offer this year (we anticipate DPS at PLN 2.81 and 5.3% DivYield) and the fact that it has no debt. Moreover, Asseco with its proven track record in public IT projects is the vendor of choice for Polish government agencies, and as such it stands to benefit from the public spending funded under the new 2014-2016 EU budget (with the first contract tenders expected in mid-2015). We have an accumulate rating on ACP with the price target raised to PLN 59.00

### EU funding drives IT market growth

Poland has been allocated EUR 82.5bn in EU Cohesion Policy funding for the years 2014-2020, and part of this money will be spent on IT solutions for the public administration of which Asseco Poland is a leading supplier. The funding is currently being appropriated, meaning that the actual orders will not come on line until 2015, with delivery deadlines mostly in 2016 (except smaller projects which may be due in H2 2015). In the mean time, public IT spending is effectively frozen but Asseco can weather the tough period thanks to the restructured ZUS contract, the

new KRUS contract, the acquisition of Unizeto Technologies, and new orders from telecoms and power plants.

### Reorganization and new approach to M&A

Asseco has recently won its first order from Ethiopia where it is also planning to make a small acquisition, and it has plans to create a start-up in Nigeria. The Company seems to have toned down its aggressive M&A strategy. Recently Asseco sold a 49% stake in Slovakian telecoms unit Slovanet for EUR 11m (2013 EV/EBIT = 14x), and it is looking for a buyer for the building automation unit Sigilogic. We expect continued divestment of non-core and underperforming assets in the quarters ahead. As for M&A activity, Asseco has adopted a more cautious approach to such deals. In 2014 it paid PLN 11m for Unizeto Technologies, provider of IT services to the public sector with a proven track record and potential to drive revenues in the future.

### Positive trends continue into Q4 2014

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. We expect Q4 2014 EBITDA to increase to PLN 250m from PLN 192.3m the year before (+30% y/y) driven by stronger sales generated by Sapiens International and Magic Software combined with the improving profitability of the parent company. Note that the year-ago base for Q4 profits was weighed down by the recognition of a PLN 28m one-time allowance for late fees which in September 2014 were levied in the amount of PLN 4.17m.

## Resources

JSW		Hold										
Analyst: Michał Marczak		Current price:		PLN 20.4				Last rating		2015-01-26		
		Target price:		PLN 27								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	8 821.0	7 632.2	-13.5%	6 723.2	-11.9%	8 473.6	26.0%	Number of shares (m)		117.4		
EBITDA	2 374.8	1 382.1	-41.8%	764.2	-44.7%	1 160.4	51.8%	MC (current price, PLNm)		2 395.2		
EBITDA margin	26.9%	18.1%		11.4%		13.7%		EV (current price, PLNm)		3 021.2		
EBIT	1 308.2	201.9	-84.6%	-531.8		-157.6	-70.4%	Free float		44.8%		
Net profit	985.1	77.3	-92.2%	-473.0		-243.7	-48.5%					
P/E	2.4	31.0						Price change: 1M		21.1%		
P/CE	1.2	1.9		2.9		2.2		Price change: 6M		-52.9%		
P/BV	0.3	0.3		0.3		0.3		Price change: 12M		-54.7%		
EV/EBITDA	0.2	0.6		4.0		2.8		Low (52 weeks)		16.3		
Dyld (%)	26.4	12.3		0.0		0.0		High (52 weeks)		54.0		

**JSW is set to regain positive earnings momentum going forward, reporting decreasing losses in the course of 2015 thanks to higher sales volumes and rising prices. Thanks to its strong cash position, the Miner is not in need of a capital raise. Starting in Q3, we anticipate a recovery in the global prices of coking coal which implies upside potential in JSW. In the near term, JSW's value will be weighed down by an escalating battle with workers exacerbated by the government's soft stance in the negotiations with miners from the Upper Silesian region. With all this in mind, we maintain a hold rating for JSW with the price target set at PLN 27 per share.**

#### Tough 2014

2014 was a difficult year for JSW both in terms of external factors (coking coal price drop to USD 120/t from an avg. USD 158 in 2013) and internal factors (decrease in output by 1.2mmt in Q2 and Q3 due to geological obstacles). Moreover JSW acquired the Knurów-Szczygłowiec (KS) mine last year for the exorbitant price of PLN 1.5bn which added adds 3mmt to the annual coal output.

#### Better 2015

We expect 2015 will be a better year for JSW as assuming no more geological inroads the Miner should bring production back to the regular volume of 13.8mmt plus 3mmt (50% semi-soft coal) from KS, making for a total annual output of 17mmt including 11.5mmt of coking coal. Coke production is stable at 4mmt. Further, after a 1.2mmt boost following the acquisition of KS JSW should be reducing the coal inventory in the course of the year, suggesting sales volumes slightly higher than the production volumes. As for sales prices, they expected to remain low at USD 120/t in the first half of 2015 followed by a small rebound to USD 125 in Q3 and USD 130 in Q4, though at these levels the prices will still be well below break-even levels for most world producers. One factor

supporting sales revenues in case of JSW will be the zloty's weakness vs. the dollar which makes today's zloty prices close to the levels seen at the beginning of 2014. In the scenario outlined above, JSW stands to post a net loss of an estimated PLN 159m in H1 2015 after improvement from 2014 when the core bottom line showed a net loss of PLN 770m. As for debt, JSW had net debt of an estimated PLN 650m at the end of 2014 after PLN 1.47bn debt and PLN 0.8bn cash. We expect the Company to continue generating negative FCF (PLN -135m) in 2015 however the cash resources are enough to weather the tough times without having to issue shares.

#### Coking coal poised to rebound to USD 150 in 2017

Our positive future outlook for JSW is predicated on the assumption that prices of coking coal are poised for a rebound to USD 150-160 by 2017, a level facilitating plant replacements and steady production (assuming increasing global demand, mainly from China and India).

#### Restructuring

JSW's outlook depends critically on cost restructuring, among others through job cuts. The unions are willing to talk, but they have certain conditions including the development of a turnaround plan covering all aspects of JSW's operations and the signing of a collective bargaining agreement. Moreover the other party with which the unions seem to have picked for negotiations is the Polish government rather than JSW's actual Management Board, after the leniency the Prime Minister has recently shown in the negotiations with Kompania Węglowa miners. In these circumstances, the Management Board has no choice but to use forceful measures (it has terminated the old collective bargaining agreement, and it intends to freeze salaries and cut bonus benefits for the miners). This means before it can be turned around JSW faces a period of battles, protests, and strikes which will affect its market value.

KGHM Buy									
Analyst: Michał Marczak		Current price: PLN 108.25						Last rating	2015-01-26
		Target price: PLN 127							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	26 705.0	24 110.0	-9.7%	21 874.1	-9.3%	22 991.0	5.1%	Number of shares (m)	200.0
EBITDA	8 199.0	5 952.0	-27.4%	5 506.7	-7.5%	5 192.2	-5.7%	MC (current price, PLNm)	21 650.0
EBITDA margin	30.7%	24.7%		25.2%		22.6%		EV (current price, PLNm)	25 109.3
EBIT	6 475.0	4 372.0	-32.5%	3 599.5	-17.7%	3 140.3	-12.8%	Free float	68.2%
Net profit	4 753.0	3 033.0	-36.2%	2 462.8	-18.8%	2 074.2	-15.8%		
P/E	4.6	7.1		8.8		10.4		Price change: 1M	-2.0%
P/CE	3.3	4.7		5.0		5.2		Price change: 6M	-17.3%
P/BV	1.0	0.9		0.9		0.9		Price change: 12M	-1.6%
EV/EBITDA	2.7	4.0		4.6		4.9		Low (52 weeks)	99.9
Yield (%)	26.2	9.1		4.6		4.6		High (52 weeks)	138.0

The slump in copper prices is a consequence of a strong USD and speculation by short-term investors (short COMEX positions are the highest in history) and it does not seem to have any fundamental justification. Today, prices are down to 10% of the industry's highest cash cost, a level which in 2008 and 2002 marked the trough of the price cycle. For KGHM, the weakened zloty is keeping sales prices close to the levels seen in Q1-Q3 2014 when the Company reported quarterly profits of ca. PLN 600m. Taking into account the price slump of the past few weeks, we are upgrading KGHM from hold to buy with the price target at PLN 127 per share.

### Copper inventory on the rise

The global exchange-monitored copper inventories are currently 360,000 tons, including 57% kept in Asian locations. Stockpiles shrunk by nearly 130kt contrary to expectations of a 300-500kt surplus due to delays in supplies from new projects combined with large mine shutdowns (Grasberg) and strong demand from China. Last August, however, the copper inventory started to rebuild, increasing by ca. 100kt of which 77kt gains recorded since December, resulting in a downturn in prices. Today we are seeing a global oversupply of copper which, however, is set for a seasonal reduction through March. The official inventory including producer stockpiles is equivalent to 2.7 weeks of global usage compared to historical averages of 3.4 weeks in 2009-2014 and an average since 2000 of 4.0 weeks. To match the average since 2009, the inventory would have to increase by 300kt.

### LME prices drop to 10% of highest cash cost

In 2014 the C1 cash cost incurred by the most expensive copper producer amounted to USD 5430/t, a level close to today's LME sales price (USD 5500/t). A similar situation was observed at the bottom of the copper price cycle in 2008 (USD 3100/t) and the long 2001-2002 commodity cycle (USD 1500/t). The copper inventory is currently similar to the 2008 stockpiles and much lower than the 2002 stockpiles.

### Investors lose faith in copper

In mid-January the short net position in COMEX High Grade Copper Non-Commercial consisted of 41,000 contracts - the highest negative deviation since at least 1993. The variation is due to the taking of a whopping 89 thousand short positions while long positions remain stable since last August. Going forward, any positive developments in copper will result in fast-paced unwinding of short positions, with strong implications for prices.

### Copper set for Q2 rebound

We expect copper prices to bottom out at USD 5550/t in the first quarter of 2015 followed by gradual recovery to USD 5900 in Q4. At the current USD/PLN exchange rate, this makes for a market environment similar to that observed in Q1-Q3 2014 (when the zloty price was ca. PLN 21,500) when KGHM reported quarterly standalone net earnings of ca. PLN 600m.

### Sierra Gorda boosts volumes

The Sierra Gorda mine reached a capacity utilization rate of 70% at the end of 2014, expected to increase to 80% in Q1 2015, resulting in an annual copper output of 22,000 tons. With CUR reaching 100% later in the year, we estimate the annual production from Sierra Gorda at 95,000 tons, with KGHM owning half. We expect KGHM to reveal more details about the cash costs incurred by the mine, and the schedule for the launch of the second stage of production, during the Q4 2014 earnings conference.

### Impairment risks

Falling copper prices may necessitate the recognition of impairment losses by KGHM on its mines in North America which will not impact its value but which may dampen investors' sentiment.

### Dividends

We expect KGHM to pay dividends of PLN 1 billion total or PLN 5.0 per share out of 2014 earnings, implying dividend yield of 4.6%.

LW Bogdanka		Buy						
Analyst: Michał Marczak		Current price:		PLN 99		Last rating		2015-01-26
		Target price:		PLN 121.5				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	1 835.8	1 899.8	3.5%	2 053.3	8.1%	2 224.9	8.4%	Number of shares (m)
EBITDA	658.1	754.9	14.7%	731.8	-3.1%	781.4	6.8%	MC (current price, PLNm)
EBITDA margin	35.8%	39.7%		35.6%		35.1%		EV (current price, PLNm)
EBIT	357.3	424.8	18.9%	358.8	-15.5%	393.7	9.7%	Free float
Net profit	289.7	329.7	13.8%	278.5	-15.5%	306.7	10.1%	
P/E	11.6	10.2		12.1		11.0		Price change: 1M
P/CE	5.7	5.1		5.2		4.8		Price change: 6M
P/BV	1.5	1.4		1.3		1.3		Price change: 12M
EV/EBITDA	5.6	5.0		5.4		5.1		Low (52 weeks)
Dyield (%)	5.1	5.9		5.9		5.0		High (52 weeks)

**The negative sentiment toward the coal sector underpinned by restructuring has brought LWB share price down below PLN 100, making for a perfect buy opportunity in our view. Accordingly, we are upgrading the Miner from hold to buy with the price target set at PLN 121.5. Bogdanka is offering dividend yield of 5% this year with EPS set for growth driven by increasing production volumes and next year also by recovering prices of coal.**

#### Production set for 2015 rebound

LW Bogdanka produced 9.19mmt of coal in 2014 after a 10% increase from the year before which was not enough to achieve the original 9.3-10.0mmt volume target, later revised to 9.3-9.6mmt, due to geological obstacles. This marked the second year straight of missed production targets however we expect this to change in 2015 when we the volume of commercial coal is set to increase to 10.5mmt driven by the launch at the beginning of the year of a new coal-rich deposit. Moreover already in Q4 2014 the coal output reached a record level at 2.57mmt. In 2016 we project KLWB's coal output will increase by a further 1mmt.

#### Coal prices

In the first three weeks of January prices of thermal coal at ARA fell to just USD 58/t (-31% y/y) – the lowest level since March 2009. At the same time a ton of coal at Baltic ports costs USD 57. A weak ruble may eventually prompt Russian producers to use more aggressive sales efforts directed at Western markets, though such efforts do not seem to be reflected yet in official statistics. Note that in Poland the biggest buyers of Russian coal are industrial plants and local power plants, and individuals. LW Bogdanka's customer base consists mainly of commercial power stations (92% of annual revenues come from Enea's Kozienice power plant, GDF Suez Energia, PGNiG Termika, Energa's plant in Ostrołęka, and ZA Puławy). Adjusted for freight costs the price of coal imported from ARA to Poland hovers around PLN 10.9 per gigajoule, and the price paid for Russian coal is PLN 10.6/GJ, compared to Bogdanka's sale price of ca. PLN 10/GJ. For 2015 we assume the per-GJ price will go down by 2.5% followed by a 1% rebound in 2016 which combined with growing production volumes will result in strong expansion in EPS.

#### FCF

Bogdanka is due to make the last plow payment in the first half of 2015, thus completing the investment pumped into the development of the Stefanów mine. We estimate the annual replacement CAPEX at PLN 350-400m. Now the Company has to consider its future growth plans. In an uncertain coal market, we do not think Bogdanka will want to commence the exploration of a new coal deposit this year. With net debt at 0.8x EBITDA and FCF expected to reach PLN 300m after 2015 (8% EV) the Company faces increasing expectations as to dividends. We assume in our valuation model that Bogdanka will pay DPS of PLN 4.9 this year (60% of 2014 profit), implying dividend yield of 5%.

#### Disappointing end to coal restructuring efforts

The Polish government yielded to pressure from miners and decided not to close four loss-making mines which instead are to be restructured and sold to an investor or turned into employee-owned enterprises. The restructuring will be done by a government vehicle which will guarantee employment to all miners who decide not to partake of a voluntary turnover program. One of the KW mines, Bobrek Centrum, will be taken over by the state-owned coal trader Węglkokoks. The terms of employment by the new restructuring vehicle will be worked out in the next few weeks. In our view this means the reform is set to be a failure. With payroll constituting 50% of most mine costs, the involvement of unions in the restructuring means any streamlining will not be enough. Accordingly, the money pumped into the coal restructuring plan will go to waste and the weakest mines will fail anyway. From the point of view of LW Bogdanka, such failures would be beneficial in the long term as they would make more room on the market for its coal. In the short term, the government's plans give rise to a risk that the power industry will be ordered to buy up coal from the state-owned mines of the Upper Silesia region. That said, given the penalties involved in the termination of long-term supply contracts with LWB and the lack of guarantees of uninterrupted supplies from the Silesian mines, we believe power plants will do their best to retain with LWB as their trusted supplier.

## Industrials

After 0.9% contraction in 2014 and a 5.3% drop in 2013, we expect the cumulative 2015 **annual revenue of the forty-seven industrial companies that make up our tracking portfolio to rebound by 6.3% in 2015** on higher sales facilitated by an expected **acceleration in private spending** (driven by low fuel prices and low interest rates) and **public spending** (driven by EU funding). For **exporters**, additional support will come from the continued **weakness of the zloty** vis-a-vis the euro which increases their competitiveness price-wise compared to Western European producers. **That said, companies selling mostly to eastern markets like Russia and Ukraine** are expected to experience a drop of about 10% in their revenues for the year in the wake of the economic slump in these regions combined with depreciated currencies.

The 2015 earnings prospects of Polish manufacturers are further reinforced by **stable-to-falling costs of raw materials and steady costs of natural gas fuel**. Moreover, the **slump in crude oil prices should reduce the costs of logistics**. Amid low inflation and a firm job market we further anticipate only **slight upward pressure on salaries** (ca. +2.5% y/y). At the same time, we do not expect significant hikes by manufacturers in the prices of their end products.

**On the losing side of the oil crash** are manufacturers of OCTG and other oilfield machinery and equipment (Alchemia, Vistal Gdynia, Zamet Industry) and companies that benefit when oil prices are high (AC SA). **Further, a strong dollar** is set to diminish the profit margins of Ferro (importer of semi-finished products from China) and Kęty (through higher zloty costs of aluminum inputs).

Our 2015 cumulative **EBITDA growth projection for the 47 companies in our industrials index is 6.2%**, marking a slowdown from 12.1% in 2014. The EBITDA margin should remain stable close to last year's level of 10.4% (the highest since 2011 when EBITDA margin was 12.0%). **We expect the strongest EBITDA growth this year at Biomed Lublin, Elemental Holding, Famur, Feerum, Izostal, and Orzeł Biały. As for net earnings, they set to rebound by 13.9% in 2015** after rising just 1.8% in 2014 thanks among others to lower interest expenses and FX losses (especially in the case of exporters to the East). As a result, we anticipate expansion in the cumulative annual net profit margin to 5.0% (the highest level since 2011 when net margin was 7.2%) from 4.7% in 2014.

**The year-ago comparable bases for the Q4 2014 and Q1 2015 earnings of Polish industrial companies are high** as those periods witnessed net profit growth at 57% and 66%, respectively, of the tracked companies. **Starting from Q2 2015**, however, the year-on-year **momentum in profits is set to accelerate**.

As for debt, our **2015 year-end net debt/EBITDA ratio projection for our industrials sample is 1.31x** vs. 1.44x in December 2014. Like in 2014, we expect a fair amount of M&A activity in the manufacturing sector this year, with the **most likely candidates to make acquisitions defined as Alchemia, Amica, Apator, Boryszew, Elemental Holding, Libet, Synthos, and Zamet Industry**, and the **most likely acquisition targets identified as Biomed Lublin, Elemental Holding, Oponeo, Pozbud, and Tarczyński**.

According to our calculations, the aggregate dividend distribution in 2015 by our 47-strong sample will fall by some 53.5% due to a lack of extra payouts from equity offered last year by companies like ACE (EUR 5.1m), Famur (PLN 404.5m), Ferro (PLN 21.2m), and Mercor (PLN 145.0m). After adjustment for the one-off distributions and for an expected dividend reduction at Synthos, the total **2015 payout would be 30.8% higher than in 2014**. At current valuation levels, the **cumulative estimated 2015 dividend yield figures to 2.1%** (median 2.3%) compared to 4.5% in 2014 (median 2.2%). **We expect the most generous payout this year from ACE, AC SA, Berling, Ferro, Hydrotor, Mercor, Kęty, Koelner, Kruszwica, and Relpol**.

**Our Industrials price tracker fell 27% in 2014 while at the same time MSCI Industrials Europe gained 0.2% and MSCI Industrials World posted a decline of 3.4%**. Part of the reason behind the price falls were **concerns about an equity sell-off by pension funds** in a bid to raise enough cash to comply with the requirements of a reformed pension system. The **Ukraine crisis** as well has contributed to the weakness of the Polish industrial sector (triggering withdrawals from small- and mid-cap investment funds on the heels of Russia's import ban on Polish goods, combined with decreasing demand from Ukraine and falling exports to Russia).

Today, the 47 stocks in our industrials index are valued at discounts of **27-28% on 2015E P/E (11.6x) and 23%-27% on EV/EBITDA (7.0x)** relative to global MSCI Industrials World and Europe.

Our top picks among industrials are **Biomed Lublin** (set to launch sales of human plasma-derived medications by June 2015), **Cognor** (benefitting from an improving steel market and widening margins on steel recycling), **Elemental Holding** (strong growth through acquisitions), **Famur** (growing profits through increasing exports), **Feerum** (working on profitable contracts at home and abroad), **Hydrotor** (offering high regular DYield), **Lena** (high recurring DYield), **Mercor** (high DYield combined with earnings growth), **Orzeł Biały** (benefitting from higher margins on recycled battery scrap), **Pozbud** (completion of plant upgrades), **Relpol** (DYield + cheap share price), and **Tarczyński** (benefitting from low costs of fresh pig meat).

Our least favorite investments include **Alchemia** (trading at an expensive price despite a lack of earnings growth), **AC SA** (falling prices of gasoline and diesel dampen demand for LPG autogas systems), **Boryszew** (overpriced compared to other European automotive suppliers), **Radpol** (high price despite a lack of any positive effects of recent acquisitions), **Patentus** (high debt, high exposure to the troubled Polish coal industry through sales contracts), **PKM Duda** (risks in merger with Cedrob, weak earnings prospects for 2015), and **PGO** (which is overvalued).

## Recommended portfolio allocations for small industrials

Company	Rating	Price	P/E			EV/EBITDA			DY			P/(BV-goodwill)			2014 Net Debt/ EBITDA
			'13	'14	'15	'13	'14	'15	'13	'14	'15	'13	'14	'15	
AC Auto Gaz	UW	27.60	9.6	10.4	12.7	6.4	6.9	8.1	7.6%	8.3%	7.7%	2.7	2.6	2.6	-0.2
ACE	MW	8.79	21.9	18.1	11.4	5.2	5.4	4.6	3.5%	12.1%	3.9%	1.1	1.2	1.2	1.2
Alchemia	UW	5.05	-	201.9	58.7	23.6	20.1	17.5	0.0%	0.0%	0.0%	1.9	1.9	1.8	1.9
Amica	MW	105.00	9.1	11.4	8.9	7.1	6.4	6.3	4.4%	3.4%	3.1%	2.1	1.8	1.8	0.8
Apator	MW	35.21	18.0	15.4	14.0	11.3	10.8	9.5	4.0%	3.1%	2.6%	4.7	4.2	3.6	0.0
Berling	OW	3.79	6.1	7.2	7.4	3.3	3.5	3.5	5.5%	8.0%	6.9%	0.9	0.8	0.8	-2.2
Biomed Lublin	OW	3.28	53.5	-	-	22.1	36.2	26.0	0.0%	0.0%	0.0%	2.1	2.5	2.5	2.8
Boryszew	UW	5.45	95.3	14.7	14.8	13.4	9.4	9.5	0.0%	0.0%	0.0%	2.3	1.7	1.5	3.1
BSC Drukarnia	OW	27.70	14.9	13.6	12.8	8.0	7.4	6.9	1.9%	1.9%	3.3%	1.5	1.4	1.3	-0.6
Ceramika NG	MW	1.15	-	19.3	60.6	7.5	6.1	6.2	0.0%	5.7%	2.1%	0.4	0.4	0.4	2.3
Cognor	OW	1.33	-	11.0	3.8	9.9	6.4	5.8	0.0%	0.0%	0.0%	0.8	0.7	0.6	5.5
Duda	UW	7.18	8.7	12.0	13.1	5.5	6.2	7.1	0.0%	0.0%	0.0%	0.7	0.7	0.7	2.6
Elemental	OW	3.43	21.7	17.9	14.0	20.4	15.9	9.4	0.0%	0.0%	0.0%	3.5	2.9	2.4	0.6
Ergis Eurofilms	MW	4.14	14.3	10.1	9.5	5.9	6.0	5.8	0.5%	2.4%	3.0%	1.2	1.1	1.0	2.6
ES System	MW	2.44	23.8	12.8	12.8	8.4	6.2	6.0	2.0%	2.0%	3.1%	0.7	0.7	0.6	-1.7
Famur	OW	3.28	7.6	18.4	10.5	3.7	6.4	4.9	0.0%	25.6%	0.0%	1.6	2.4	1.9	-0.3
Fasing	OW	19.20	7.3	7.1	7.5	3.3	3.6	4.0	3.4%	3.7%	2.1%	0.5	0.5	0.5	1.4
Feerum	OW	16.64	13.1	22.4	9.1	9.1	13.5	6.2	0.0%	0.0%	1.6%	1.8	1.6	1.4	1.1
Ferro	MW	9.20	9.1	7.5	8.4	7.4	7.1	7.6	2.6%	10.6%	4.7%	2.6	2.4	2.1	2.1
Forte	MW	50.00	20.9	14.8	13.4	13.5	10.3	9.7	1.9%	2.9%	3.4%	3.1	2.8	2.5	0.0
Grajewo	MW	30.65	9.8	13.7	13.2	10.4	7.7	7.1	0.0%	0.0%	1.8%	2.7	2.3	2.0	0.5
Hydrotor	OW	32.15	10.7	9.2	8.9	6.1	4.5	4.4	6.3%	6.3%	7.6%	1.0	0.9	0.9	-0.5
Impexmetal	OW	2.62	7.2	7.2	7.5	8.1	6.8	6.5	0.0%	0.0%	0.0%	0.6	0.5	0.5	2.6
Izostal	MW	5.00	12.2	35.8	13.1	9.0	19.4	8.5	3.6%	2.4%	1.1%	1.0	1.0	0.9	3.4
Kety	MW	280.00	16.9	15.0	13.5	12.4	9.0	8.3	2.1%	3.6%	4.0%	2.3	2.2	2.1	0.7
Koelner	MW	6.49	21.2	37.2	11.7	7.4	8.3	6.3	1.4%	5.4%	5.4%	0.6	0.6	0.6	4.5
Kopex	MW	10.82	11.9	7.9	14.8	5.0	4.4	4.9	0.5%	0.0%	0.0%	0.6	0.6	0.6	1.6
Kruszwica	MW	55.80	11.6	14.6	14.1	7.5	9.5	8.7	0.2%	4.3%	5.2%	1.9	1.8	1.8	1.3
Lena Lighting	OW	4.26	11.7	10.9	11.2	7.3	7.2	7.4	6.9%	6.9%	7.0%	1.2	1.2	1.1	-0.1
Libet	OW	2.43	19.8	13.6	9.4	5.6	4.8	4.4	0.0%	2.0%	2.2%	0.6	0.6	0.5	2.0
Mercor	OW	8.77	11.9	11.9	10.8	2.7	7.4	7.1	0.0%	105.2%	4.2%	0.6	1.4	1.5	2.1
Oponeo	MW	9.99	40.4	33.6	21.5	10.4	10.2	8.8	0.3%	0.7%	1.0%	2.5	2.3	2.2	-1.9
Orzeł Biały	OW	6.29	-	14.5	6.2	-	7.8	4.1	3.6%	0.0%	2.4%	0.5	0.4	0.4	1.8
Patentus	UW	1.15	5.7	17.7	199.0	6.4	7.4	8.5	0.0%	0.0%	0.0%	0.4	0.3	0.3	4.5
PGOdlew	UW	5.50	24.4	29.0	27.1	14.4	15.7	13.5	0.0%	0.0%	1.2%	2.9	2.4	2.1	1.5
Pozbud	OW	4.40	10.1	9.9	9.1	6.8	6.8	6.0	2.0%	3.0%	3.5%	0.8	0.8	0.7	0.6
Radpol	UW	8.24	13.8	15.1	13.4	9.0	8.9	8.1	2.4%	3.4%	3.6%	2.4	2.2	2.1	1.9
Relpol	OW	5.70	11.3	9.9	9.8	5.3	4.4	4.3	6.4%	4.3%	4.5%	0.8	0.8	0.7	0.0
Seco Warwick	MW	23.73	16.5	44.6	17.4	9.1	20.2	9.8	0.0%	3.0%	1.1%	1.4	1.4	1.3	1.5
Selena FM	MW	16.55	18.3	9.4	12.1	6.1	5.3	6.5	2.3%	1.7%	2.1%	1.0	0.9	0.9	1.2
Synthos	OW	4.07	-	15.0	12.2	9.8	8.8	8.4	18.7%	7.6%	3.3%	2.5	2.5	2.2	1.1
Tarczyński	OW	12.75	15.5	15.2	10.0	7.4	7.4	6.2	0.9%	0.0%	0.0%	1.3	1.2	1.0	3.7
Vistal Gdynia	OW	9.59	6.7	9.5	7.8	7.5	7.7	6.8	0.0%	0.0%	0.0%	0.9	0.8	0.8	4.1
Zamet Industry	MW	2.85	8.7	9.4	11.1	7.1	6.8	7.0	11.9%	0.0%	3.2%	2.6	2.0	1.8	0.7
Zetkama	OW	64.79	12.5	10.3	10.3	8.5	7.0	7.0	0.0%	0.0%	3.4%	2.1	1.7	1.5	0.0
ZM Kania	MW	2.94	23.6	12.7	9.7	16.3	9.0	7.8	0.0%	0.0%	0.0%	2.5	2.1	1.7	2.5
ZM Ropczyce	MW	16.60	6.0	9.6	11.3	5.6	6.9	7.1	2.1%	3.9%	3.6%	0.4	0.4	0.3	3.7

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

Elemental										Buy									
Analyst: Jakub Szkopek				Current price:		PLN 3.43								Last rating		2015-01-08			
				Target price:		PLN 4													
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics											
Revenue	895.0	859.6	-4.0%	774.3	-9.9%	1 310.9	69.3%	Number of shares (m)						159.3					
EBITDA	29.5	28.6	-3.0%	40.4	41.2%	63.9	58.1%	MC (current price, PLNm)						546.5					
EBITDA margin	3.3%	3.3%		5.2%		4.9%		EV (current price, PLNm)						575.4					
EBIT	27.3	25.7	-5.8%	35.0	35.9%	54.9	56.8%	Free float						27.0%					
Net profit	19.2	24.4	27.5%	30.6	25.1%	39.0	27.7%												
P/E	18.4	21.7		17.9		14.0		Price change: 1M						6.9%					
P/CE	16.6	19.4		15.2		11.4		Price change: 6M						49.1%					
P/BV	3.0	2.1		1.8		1.6		Price change: 12M						39.4%					
EV/EBITDA	13.7	20.4		14.2		9.2		Low (52 weeks)						2.1					
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks)						3.4					

Through three foreign acquisitions (EMP Recycling, Evciler, Metal Holding) and continued expansion at home (with 2014 market share exceeding 26%) Elemental Holding is gaining momentum as a major recycler of e-waste in Europe. By acquiring Evciler, the Company has gained a foothold in a market with huge growth potential (assuming the per-capita WEEE collection volume in Turkey increases from the current 0.5 kilograms to 4 kg in 2018, local recyclers will have over 300,000 kg of electronic waste available to them per year vs. just 37,500 tons today; by comparison, the annual WEEE collection volume in Poland is currently 170,000 tons). Further, Elemental is planning to expand its supplier network to include Latvia, Estonia, Bulgaria, the Czech Republic, Romania, and the Middle East. The continuing geographic expansion is expected to drive dynamic revenue growth for Elemental in the coming years. For 2015, thanks to acquisitions and growing demand, we project the Company will post 58% growth in the annual EBITDA and an 28% increase in net profit. We are maintain a buy rating for EMT with the price target set at PLN 4.00 per share.

#### Market controls offer hope for stronger margins

In summer 2014, profit margins earned on non-ferrous metal scrap rebounded to levels last seen 2-3 years before. One of the reasons was the elimination of profit-shaving middlemen between scrap yards and recyclers who most of the time were too small to act as meaningful suppliers to metal smelters. Another factor which helped improve margins was a government clampdown on the grey scrap metal market which involved VAT fraud. Hopefully the tightened market controls and the elimination of intermediaries will continue to drive Elemental's margins in 2015.

#### Profits grow on increasing volumes

Through geographic expansion Elemental gains access to a wider base of customers (smelters, platinum producers, rare earth metals processors). Moreover, by securing steady e-waste supplies and cutting out the middleman the Company is able to sell directly to customers at higher prices. After reaching certain recycling capacity toward the end of 2015, Elemental will consider purchasing a plasma furnace for recovering precious metals which would lengthen the value chain.

#### Acquisition benefits

By acquiring EMP Recycling, Evciler, and Metal Holding, Elemental stands to see EBITDA growth of PLN 23.7m or 57% in 2015 (EMP PLN 6.15m, Evciler PLN 14.5m, Metal Holding PLN 3m), resulting in an 28% increase in net profit.

#### Tax optimization

Elemental will benefit from the tax breaks offered by its subsidiary "partnership limited by shares" vehicles through October 2015, and it is currently discussing alternative ways to optimize its tax burden beyond October. We assume in our financial forecasts that from 2016 on the Company will pay corporate taxes at an effective annual rate of 19% in Poland, 8% in Turkey (through operations in Dubai), 18% in Lithuania, and 19% in Slovakia. To date, the Company has paid corporate taxes in Poland at an effective annual rate of 3-4.5%.

#### Upcoming acquisition in the Balkans

Elemental has targeted for acquisition a waste recycler based in the Balkan region which generates about PLN 16m in annual EBITDA. Assuming the Company completes the acquisition this year at similar valuation multiples as achieved in last year's transactions (6.6x-8.5x), in the best-case scenario, this can add as much as PLN 29m (PLN 0.18 per share) to its equity value.

Famur		Buy										
Analyst: Jakub Szkopek		Current price:		PLN 3.28				Last rating		2015-01-26		
		Target price:		PLN 4								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	1 471.5	1 176.4	-20.1%	595.6	-49.4%	938.0	57.5%	Number of shares (m)		481.5		
EBITDA	455.6	384.7	-15.6%	246.5	-35.9%	313.2	27.1%	MC (current price, PLNm)		1 579.3		
EBITDA margin	31.0%	32.7%		41.4%		33.4%		EV (current price, PLNm)		1 508.7		
EBIT	348.9	224.6	-35.6%	92.6	-58.8%	184.6	99.3%	Free float		16.8%		
Net profit	271.1	207.6	-23.4%	85.8	-58.7%	149.8	74.6%					
P/E	5.8	7.6		18.4		10.5		Price change: 1M		-6.0%		
P/CE	4.2	4.3		6.6		5.7		Price change: 6M		-13.7%		
P/BV	1.8	1.4		1.9		1.6		Price change: 12M		-33.7%		
EV/EBITDA	3.5	3.7		6.1		4.8		Low (52 weeks)		2.9		
Dyield (%)	0.0	0.0		25.6		0.0		High (52 weeks)		5.3		

Polish coal mines had to cut coal production in the first nine months of 2014 by 6.7% relative to 2013, but at the same time their stockpiles of thermal coal were 5% higher than the year before at 8.4mmt, forcing cutbacks in capital investment for the foreseeable future (investment in mining equipment fell 15% y/y in 9M 2014). Consequently, local suppliers of mining machines and equipment are facing a shortage of domestic orders in 2015 which they are trying to offset by reaching out to prospective customers abroad. Famur acquired three large foreign contracts in 2014 for a total of PLN 465m. Two of these contracts have deadlines in 2015, and from a low year-ago base this means the Company is likely to report 30% EBITDA growth this year. Moreover, the share of exports in Famur's total sales is expected to increase to over 30% in 2015 from 20% in 2014, and this can contribute to improved sentiment among investors. We are raising our price target for Famur from PLN 3.80 to PLN 4.00 with the investment rating maintained at buy.

### Growing exports

Famur acquired orders totaling PLN 465m from foreign customers in 2014, including a EUR 25.85m contract from Russia, and EUR 20m contract from JSC ArcelorMittal, and a EUR 66m contract from Turkey, with exports representing about 20% of the total sales for the year. From a low 2014 base, depressed among others by PLN 20m costs of restructuring and the merger with Remag, we believe Famur is set to report rising profits throughout 2015.

### Famak acquisition

At the end of 2014 Famur acquired a controlling stake in Famak, a manufacturer of industrial cranes and conveyor systems, for PLN 69.1m. Famak has an order backlog of PLN 300m which includes a PLN 139.8m contract for a stoking system and a deslagging system for a local power plant with respective deadlines in 2018 and 2019. Famak's acquisition and earnings prospects are not yet factored into our financial forecasts for Famur.

### Overdue payments from coal mines

We estimate Famur's 2014 year-end receivables at PLN 20-40m from the coal miner KWH and ca. PLN 20m from Kompania Weglowa which, in the very unlikely event that the miner is forced to file for bankruptcy this year, would have to be written down, causing a 13% cut in our 2015 net profit estimate for Famur.

### Situation in coal industry

Polish coal producers saw a 7.7% increase in coal sales in 2013 but in 2014 they experienced a downward shift in sales which at 49.5 million tons in 9M 2014 were 10.4% lower than the year before and 5.0% lower than production even as the output of thermal coal fell by 8.1% to 43.1mmt. The hard coal stockpiles at mines in the Upper Silesian coal basin totaled 8.4mmt at 30 September 2014 after builds of about 400kt. As for sales prices, the 9M 2014 average for hard coal was 6.6% lower than the year before and the average for thermal coal dropped by 4.9%. The average sales price of hard coal was also 9.8% lower than the cost of its extraction. As a consequence, Upper Silesian mines generated a combined net loss of PLN 532m in 9M 2014 vs. PLN 71.8m in the same period the year before. At the same time, their accounts payable as of 30 September 2014 exceeded accounts receivable by a whopping PLN 10.05 billion (+9.4% y/y). Such disastrous performance caused the industry to cut capital expenditures by 15.1% y/y in 9M 2014 to PLN 1.8bn, with purchases of mining equipment down 20.4% to PLN 0.6bn. The 2015 outlook for Polish coal mines is far from rosy as coal prices are kept low by falling oil prices (at the beginning of the year prices of Russian coal were 5-8% lower than in 2014 while prices at ARA ports posted shrinkage of 19%). Compared to imported coal, Upper Silesian coal at the start of the year, adjusted for freight costs and calorific values, cost 5% more than ARA coal and 5.9% more than Russian coal, but the potential for price reductions remains slim while the zloty trades low relative to the dollar. Summing up, Polish mine investment is set to remain low throughout 2015.

Kernel		Hold										
Analyst: Jakub Szkopek		Current price:		PLN 32.48				Last rating		2015-01-26		
		Target price:		PLN 31								
(USD m)	2011/12	12/13	change	13/14F	change	14/15F	change	Key metrics				
Revenue	2 157.4	2 796.8	29.6%	2 393.3	-14.4%	1 880.5	-21.4%	Number of shares (m)		79.7		
EBITDA	322.0	290.7	-9.7%	223.0	-23.3%	266.8	19.6%	MC (current price, PLNm)		2 588.1		
EBITDA margin	14.9%	10.4%		9.3%		14.2%		EV (current price, PLNm)		3 269.7		
EBIT	256.5	200.9	-21.7%	128.7	-35.9%	173.6	34.9%	Free float		61.8%		
Net profit	206.7	111.3	-46.2%	-98.3		91.0						
P/E	3.3	6.2				7.6		Price change: 1M		9.7%		
P/CE	2.5	3.4				3.7		Price change: 6M		8.6%		
P/BV	0.6	0.5		0.7		0.6		Price change: 12M		-19.8%		
EV/EBITDA	2.7	3.0		3.9		3.2		Low (52 weeks)		22.0		
Dyield (%)	0.0	0.0		0.0		2.9		High (52 weeks)		41.2		

The Ukrainian inventory of sunflower seeds was 85% higher at the beginning of April 2014 than at the same time the previous year, driving production and sales of sunflower oil in 2014. As the reserves become depleted (sunflower harvest in the last season was 8.7% lower than the season before), however, we are likely to see contraction in sales as well as profits in 2015. Kernel's other business of grain trade also faces weaker volumes and margins after the Ukrainian Parliament decided not to reinstate VAT refunds. As for the crops segment, after increased soil fertilization in the 2013/2014 season, the EBITDA per ton of grains harvested from Kernel cropland is expected to increase to \$7.3 in the 2014/2015 season from a negative \$26.6 in the 2013/2014 season. After two quarters of rising profits, we expect a slowdown at Kernel starting in Q2 2015, underpinned by the bad economic situation in Ukraine (limiting access to financing) and difficulties in recovering VAT on sunflower oil exports. We are lowering our price target for KER from PLN 32.50 to PLN 31.00 per share with the investment rating maintained at hold.

#### No VAT refunds for Ukrainian exporters

The Ukrainian Parliament in December 2014 overturned earlier legislation reinstating VAT refunds for grain producers and exporters. Consequently, the EBITDA generated by local farmers on each ton of crops is likely to drop as low as to \$10/t this year. Moreover, the VAT reimbursements for which Kernel is still eligible as a vegetable oil producer are under a considerable risk of being held up given the tight Ukrainian budget.

#### Harvest projections

According to the agricultural market research agency APK-Inform, grain production in Ukraine will decrease to 63.2 million tons in the 2015/2016 season from 64.1mmt in the 2014/2015 season. As for exports, they amounted to 36.7mmt in the 2014/2015 season vs. 32.6mmt in 2013/2014, and in Q4 2014 they posted a 22.7% y/y drop

to 9.9mmt. Production of sunflower oil in the final quarter of 2014 was down 18% y/y at 1.0mmt, however exports for the period are expected to be higher than the year before.

#### Economic outlook for Ukraine

The Ukrainian GDP shrunk by 5.3% in Q3 2014, and in Q4 2014 the slowdown is estimated to have accelerated to -7%. The annual contraction in 2015 is expected to be in the range of 2% and 4.5%. The inflation rate in Ukraine amounted to 21.2% at the end of Q3 2014, and Bloomberg puts Q4 CPI at 20.6%. With 2015 inflation expected to continue climbing at an average annual rate of 14%, the real GDP contraction will be in the double digits. In the war-torn Ukrainian regions of Lugansk and Donetsk, industrial production in August 2014 plummeted by respective 85% and 59% from the same month the previous year. On a national level, August witnessed a shrinkage of 60% in Ukraine's coal production, with metallurgical output down 30% and machine production falling 31%. At the same time, retail sales fell 17% on an annual basis. In the unstable economic environment, Ukrainian businesses are cutting down investment to the bare minimum (fixed-asset expenditures in 2014 are estimated to have dropped by 30-35%). In November 2014 Ukraine's industrial production fell 16.3% and on a full-year basis it is expected to be 15% lower than the year before. Ukraine exports as well have been shrinking in the wake of the conflict with Russia and falling production.

Falling GDP and exports are accompanied by depletion in Ukraine's foreign-currency reserves (which from \$20.4bn at the end of 2013 dwindled to \$10bn at 30 November 2014) and a plummeting hryvnia (the UAH/USD collapsed 92% in 2014). The only way Ukraine is able to still maintain liquidity is with the help of the IMF, the EU, and the US. Throughout 2015, the economic situation there is set to remain unstable and on the brink of collapse though analysts are hopeful that the Ukrainian government will intervene with a set of reforms, including legislation to combat corruption.

Kęty		Hold									
Analyst: Jakub Szkopek		Current price:		PLN 280				Last rating		2015-01-26	
		Target price:		PLN 275.8							
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	1 568.1	1 593.8	1.6%	1 799.6	12.9%	1 958.8	8.8%	Number of shares (m)		9.4	
EBITDA	224.2	225.9	0.7%	315.0	39.5%	335.3	6.4%	MC (current price, PLNm)		2 626.6	
EBITDA margin	14.3%	14.2%		17.5%		17.1%		EV (current price, PLNm)		2 836.8	
EBIT	142.1	144.9	2.0%	232.1	60.1%	250.8	8.1%	Free float		48.0%	
Net profit	117.0	153.5	31.1%	175.2	14.1%	193.9	10.7%				
P/E	22.1	16.9		15.0		13.5		Price change: 1M		0.2%	
P/CE	13.0	11.1		10.2		9.4		Price change: 6M		32.1%	
P/BV	2.5	2.3		2.2		2.0		Price change: 12M		32.6%	
EV/EBITDA	12.6	12.4		9.0		8.3		Low (52 weeks)		190.0	
Dyield (%)	1.8	2.1		3.6		4.0		High (52 weeks)		297.6	

**Kęty posted 25% y/y EBITDA growth in Q4 2014, marking a deceleration from previous quarterly growth at annual rates of 32.9% in Q3, 53.4% in Q2, and 50.5% in Q1 - levels which will make for a high comparable base for this year's quarterly earnings results. Accordingly, after soaring 39.5% in 2014, we expect the 2015 annual EBITDA to slow down to just 6.4%, including due to downward margin pressure in the segment of aluminum systems after price hikes driven by increasing costs of aluminum. The effective zloty price of a ton of aluminum, including supplier premium, increased to PLN 8,200 at the beginning of 2015 from PLN 7,200 in 2014, necessitating a hike of 4% in the sales prices of Kęty's aluminum systems as a way of avoiding losing margins. KTY is currently trading at respective premiums of 12% and 13% on 2015E P/E and EV/EBITDA and after the expected gains following the upcoming publication of an updated guidance we would take the opportunity to sell the shares. In the mean time, we are reiterating a hold rating for Kęty while raising the price target from PLN 226.80 to PLN 275.80.**

### 2015 outlook for operating segments

We anticipate the strongest EBITDA growth (9.8% y/y vs. 43.2% in 2014) this year in the Extrusions segment led by rising sales volumes and an increasing share in the sales mix of higher-margin products. The EBITDA margin in the segment is expected to remain flat at last year's level despite an 8.9% hike in the costs of aluminum inputs. In Flexible Packaging, we predict EBITDA growth as well at an annual rate of 4.3% led by increasing sales and recently installed new production facilities. The segment's EBITDA margin this year will be under pressure from higher aluminum costs on the one hand, but on the other hand it will be supported by the falling costs of polyurethane film (led by falling prices of oil). Expensive aluminum (we expect the effective price to go up 8.9% this year) is also going to affect the profits of the Aluminum Systems this year, resulting in EBITDA deceleration after a surge of 31% posted in 2014. Aluminum prices including producer premiums are currently trading at PLN 8,200/t vs.

PLN 6,462 in H1 2014 and PLN 8,015 in H2 2014 (and PLN 7247 2014 average), and since they account for about one-third of the Aluminum segment's total costs Kęty has to raise its sales prices by an average 4.3% this year in order to maintain steady margins. We expect that in 2015 Aluminum Systems will post revenue growth of 5.8% (vs. 17.7% in 2014), accompanied by contraction in the EBITDA margin from a record 19.3% in 2014 to 18.6%. Finally, we anticipate an increase from PLN 4.0m to PLN 7.5m in the annual EBITDA of Building Services, and a rise from PLN 7.5m to PLN 7.9m in Building Accessories. With about 50% of the 2014 sales generated in euros, the depreciation of the zloty against the euro is likely to provide support to Kęty's profits this year.

### Kęty to unveil updated strategy in early 2015

Kęty is slated to release a new five-year strategy through 2020 together with a the financial results for 2014 a financial guidance for 2015 within the next few weeks. The new strategy is expected to put focus on the development of the existing business lines, though Kęty does not rule out acquisitions in the aluminum field. As part of the growth plan for the Flexible Packaging business, Kęty is planning to build a new facility to produce plastic film and engraved cylinders for roto packaging print at an estimated cost of PLN 150m. The launch date for the factory is tentatively set at Q1 2017. According to CEO Malina, at the current debt and cash flow levels Kęty is able to finance growth across all of its operating segments while sharing profits with the owners. Our interpretation of this is that despite the capital investment the Company will continue distributing 30-40% of its annual profits as dividends to shareholders.

### Management may cash in options

Kęty's management held 142,650 of the Company's shares (1.5% of equity) worth approximately PLN 40m at the end of September 2014. Most of these shares had been acquired as part of an incentive plan at prices ranging from PLN 67.05 to PLN 124.79 per share, and at the current high price level they offer an opportunity make a handsome profit.

Kopex		Hold						
Analyst: Jakub Szkopek		Current price:		PLN 10.82		Last rating		2015-01-26
		Target price:		PLN 11.4				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	2 022.2	1 395.1	-31.0%	1 368.4	-1.9%	1 255.1	-8.3%	Number of shares (m)
EBITDA	234.3	241.4	3.0%	292.4	21.2%	231.5	-20.8%	MC (current price, PLNm)
EBITDA margin	11.6%	17.3%		21.4%		18.4%		EV (current price, PLNm)
EBIT	109.6	91.2	-16.7%	141.6	55.2%	90.9	-35.8%	Free float
Net profit	54.7	67.6	23.5%	101.6	50.3%	54.2	-46.7%	
P/E	14.7	11.9		7.9		14.8		Price change: 1M
P/CE	4.5	3.7		3.2		4.1		Price change: 6M
P/BV	0.3	0.3		0.3		0.3		Price change: 12M
EV/EBITDA	6.6	5.0		4.4		4.9		Low (52 weeks)
Yield (%)	0.0	0.5		0.0		0.0		High (52 weeks)

**Polish coal mines had to cut production in the first nine months of 2014 by 6.7% relative to 2013, but at the same time their stockpiles of thermal coal were 5% higher than the year before at 8.4mmt, forcing cutbacks in capital investment for the foreseeable future (investment in mining equipment fell 15% y/y in 9M 2014). Consequently, local suppliers of mining machines and equipment are facing a shortage of domestic orders in 2015 which they are trying to offset by reaching out to prospective customers abroad. In Kopex's case after the delivery of a high-margin contract for an Argentinean customer in H1 2015 (for a remaining fee of PLN 150m) the Company, whose backlog has been on a decline for the last three quarters, will have to intensify the efforts to acquire new orders. A lack of a major contract matching the Argentinean one, combined with a high 2014 comparable base, a PLN 1.5bn mine construction plan, and a possible divestment by TDJ (holder of 4.7-7.4 million shares), are the main factors which can cause earnings shrinkage for Kopex in 2015. We are lowering our price target for KPX from PLN 14.50 to PLN 11.40 with the investment rating downgraded from buy to hold.**

### TDJ divestment risk

After Famur decided to pull out of its acquisition plans, the likelihood of a divestment of Kopex shares by its principal shareholder TDJ increased. We estimate the potential share volume for sale at 4.7 to 7.4 million shares worth between PLN 50m and 80m depending on TDJ's current ownership status.

### Mine project

Kopex is planning to commence construction of coal mine in Oświęcim this year in hopes of extracting the first batch of coal in 2018. The target annual capacity of the PLN 1.5 billion mine is 3 million tons. In our opinion, Kopex does not have the financial capacity to handle the project without external help. To reflect the heightened risk, we raised the Beta used in our valuation model to 1.2x.

### Argentinean customer holds payments

Kopex's amounts receivable from the Argentinean customer increased by PLN 155m to PLN 245m between Q2 and Q3

2014, but the revenue was recognized in the financial statements for the period. The Argentines halted payments in mid-2014 in the wake of currency depreciation and debt issues but according to Kopex they paid all overdue amounts back in Q4 2014. The remaining value of the Argentinean contract, which is due at the end of June, is PLN 150m. There is a risk that Kopex will not be able to fill the revenue gap after June.

### Overdue payments from coal mines

According to our estimates Kopex's receivables from Polish coal industry customers are about PLN 15m from KHW and about PLN 50m from Kompania Węglowa. In the very unlikely event that Kompania Węglowa is forced to file for bankruptcy this year, its dues would have to be written down, causing a 90% dent in Kopex's 2015 net profit.

### Situation in coal industry

Polish coal producers saw a 7.7% increase in coal sales in 2013 but in 2014 they experienced a downward shift in sales which at 49.5 million tons in 9M 2014 were 10.4% lower than the year before and 5.0% lower than production. The hard coal stockpiles at mines in the Upper Silesian coal basin totaled 8.4mmt at 30 September 2014 after builds of about 400kt. As for sales prices, the 9M 2014 average for hard coal was 6.6% lower than the year before and the average for thermal coal dropped by 4.9%. The average sales price of hard coal was also 9.8% lower than the cost of its extraction. As a consequence, Upper Silesian mines generated a combined net loss of PLN 532m in 9M 2014 vs. PLN 71.8m in the same period the year before. At the same time, their accounts payable as of 30 September 2014 exceeded accounts receivable by a whopping PLN 10.05 billion (+9.4% y/y). Such disastrous performance caused the industry to cut capital expenditures by 15.1% y/y in 9M 2014 to PLN 1.8bn, with purchases of mining equipment down 20.4% to PLN 0.6bn. The 2015 outlook for Polish coal mines is far from rosy as coal prices are kept low by falling prices of oil. Compared to imported coal, Upper Silesian coal at the start of the year, adjusted for freight costs and calorific values, cost 5% more than ARA coal and 5.9% more than Russian coal, but the potential for price reductions remains slim while the zloty trades low relative to the dollar.

Tarczyński		Buy						
Analyst: Jakub Szkopek		Current price:		PLN 12.75		Last rating		2015-01-26
		Target price:		PLN 15				
(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)
EBITDA	33.3	32.9	-1.1%	39.2	19.1%	42.4	8.1%	MC (current price, PLNm)
EBITDA margin	8.6%	7.3%		8.1%		7.8%		EV (current price, PLNm)
EBIT	21.2	17.3	-18.5%	19.1	10.3%	23.3	22.0%	Free float
Net profit	10.8	9.3	-13.8%	9.5	2.5%	14.4	51.2%	
P/E	7.5	15.5		15.2		10.0		Price change: 1M
P/CE	3.5	5.8		4.9		4.3		Price change: 6M
P/BV	1.2	1.3		1.2		1.0		Price change: 12M
EV/EBITDA	5.2	7.4		7.4		6.2		Low (52 weeks)
Yield (%)	5.6	0.9		0.0		0.0		High (52 weeks)

Tarczyński is expected to grow sales volumes by 12% in 2015 driven by the launch of a 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 51%. We are raising our price target for Tarczyński from PLN 14.60 to PLN 15.00 to reflect a lowered risk-free rate with the investment rating maintained at buy.

#### Low costs of raw meat

The Russian import ban is keeping down the prices of European raw pig meat, with the ytd euro price per kilogram at EUR 1.54 after a ytd drop of 6.8% and the ytd zloty price at PLN 6.45 after falling 7.3% from last year. The German ZMP pig meat index has dropped to its lowest level since 2012 at EUR 1.28/kg (PLN 5.48/kg), compared to a 2014 average of EUR 1.54/kg (PLN 6.45/kg), and this is working to the advantage of meat processors like Tarczyński. Underpinned by low prices of grains, we expect the low costs of raw meat to continue supporting Tarczyński's profits at least through Q1 2015.

#### Net debt set for reduction

The completion of the new processing plant means that by the end of 2014 Tarczyński's net debt/EBITDA ratio will have increased to 3.7x from 3.0x at year-end 2013. In 2015, after settlement of the PLN 14.4m subsidy obtained for the plant in the first quarter, the ratio is expected to go down to 2.8x, giving rise to expectations of the first dividend payout in 2016 since the 2012 WSE debut (DY 5.5%).

#### Increased capacity

The upgraded meat processing plant in Ujeździec Mały is expected to boost Tarczyński's total capacity by 20%. The plant's main product are dry sausages which generate the highest margins in the sales mix, and which are expected to give a boost to Tarczyński's operating profits.

#### Tarczyński meats destined for export

Thanks to increased capacity, Tarczyński can think about expanding its sales beyond Poland. The Company is planning to offer its meats and sausages in the Czech Republic and Slovakia under the label of the supermarket chain Lidl, as well as targeting big-box stores in the UK. Export revenues are also expected to offset the costs of raw meat incurred in euros (Tarczyński buys 60-70% of its meat inputs abroad).

#### Decreasing D&A expenses

Tarczyński intends to review the amortization rates it applies to its assets which today are 13% higher than at rival PKN Duda and a whopping 90% higher than at ZM Kania. The Company thinks that the current depreciation schedule is too fast relative to the useful life of the new plant. As a result, despite the recent launch of upgraded processing facilities, we expect D&A expenses in 2015 to decrease by PLN 1m to PLN 19m, with positive effects for operating- and net profit growth.

Vistal		Buy										
Analyst: Jakub Szkopek		Current price:		PLN 9.59				Last rating		2015-01-26		
		Target price:		PLN 16.4								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	230.2	283.4	23.1%	290.3	2.4%	334.2	15.1%	Number of shares (m)		14.2		
EBITDA	10.8	34.2	216.1%	37.7	10.1%	41.8	10.7%	MC (current price, PLNm)		136.3		
EBITDA margin	4.7%	12.1%		13.0%		12.5%		EV (current price, PLNm)		291.6		
EBIT	0.0	23.5		22.2	-5.5%	26.1	17.3%	Free float		29.6%		
Net profit	1.1	20.4	1789.3%	14.3	-29.8%	17.5	22.6%					
P/E	88.9	6.7		9.5		7.8		Price change: 1M		9.5%		
P/CE	8.0	4.4		4.6		4.1		Price change: 6M		-27.9%		
P/BV	1.2	0.9		0.8		0.8		Price change: 12M		-35.6%		
EV/EBITDA	18.4	7.5		7.7		6.8		Low (52 weeks)		8.7		
Dyild (%)	0.0	0.0		0.0		0.0		High (52 weeks)		17.9		

The value of new bridge projects in Poland can exceed PLN 400m this year according to our estimates (+10% y/y), and in 2016 it is expected to jump to PLN 1.1bn (vs. PLN 950m in the record year of 2010). As of September 2014, Vistal had submitted bids on civil engineering contracts worth a total of PLN 0.7bn, moreover it acquired infrastructure orders from foreign customers totaling PLN 89m, suggesting a positive sales momentum in the infrastructure segment in 2015. In the marine&offshore segment, revenues this year are expected to contract by 7% due to falling prices of oil and probable delays in North Sea drilling projects. In the long term, the oil crash can create more demand for the services of Polish offshore suppliers who can offer the same quality at lower cost (similarly to 2010 when the 2009 downturn in oil prices resulted in more business for Polish companies). We are lowering our price target for Vistal from PLN 16.90 to PLN 16.40 (reflecting reduced marine&offshore revenues and lower peer valuations) with the investment rating maintained at buy.

### Opportunities in bridge infrastructure

For 2015, the government has scheduled at least three major bridges with a budget in excess of PLN 50m each and at least eight smaller projects, adding up to total expenditure upwards of PLN 400m not counting the eleven projects planned next year for which the budgets have not yet been released. Development of Poland's bridge infrastructure will continue in 2016 with projects worth a total of PLN 1.1-plus billion. The 2015 national bridge budget is 10% higher than last year and it is the highest since 2012 when expenditures amounted to PLN 576m. The over-PLN 1.1bn expenditures projected for 2016 could beat the 2010 record of PLN 952m. Vistal had pending bids for a total of PLN 698m in bridge orders as of 30 September 2014, with many of the offers submitted jointly with major partners from the construction industry (Budimex, Warbud, Salini). In Q4 the Company won a bridge contract in Malbork but the award was canceled on appeal of rival

bidder Strabag. Vistal intends to file an appeal against the loss of the contract.

### Opportunities in Scandinavia

Outside of Poland, Sweden and Norway both have recently announced major infrastructure development plans for the next decade, with the former planning to spend EUR 72.6 billion between 2014 and 2025 and the latter's budget through 2023 set at EUR 56.1 billion. The bulk of the expenditures will be allocated to roads and railways which, given the topography of both countries, will require a number of bridges, overpasses, and similar structures. To date, Vistal has usually been hired by Scandinavian infrastructure builders as supplier of finished prefabricates, but in the future it hopes to acquire assembly and installation contracts in the region as well. At 30 September 2014 Vistal's international infrastructure order backlog was worth PLN 89m (after increasing six-fold relative to the beginning of the year).

### Customers report high backlogs but face delays

Falling prices of crude oil can cause delays in offshore drilling projects, affecting the revenues of equipment vendors. At 30 September 2014, the order backlogs of the global supplier of deep sea drilling infrastructure Aker Solutions and its subsidiary Kvaerner were similar to those acquired in 2012-2014 (at NOK 49.0bn and NOK 19.4bn, respectively).

### Opportunities in power plant construction

The Polish power industry's upgrade program includes more than ten new coal- and gas-fired power plants. PMR Research estimates the expenditures on developing new power capacity at PLN 135 billion between 2014 and 2024. Work in progress today is worth a total of PLN 19.4 billion, with a further PLN 32.1 billion-worth at the procurement stage. Vistal submitted a bid for a contract to deliver heavy steel components to a planned new power plant in Opole toward the end of 2014. The results of the tender are expected to be announced by the end of March 2015.

## Construction

### Recommended portfolio allocations for selected 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	10.65	106	-13	94	208	239	4	9	9	15	25.9	11.4	10.0	6.3
Herkules	OW	3.22	140	98	238	122	134	8	12	31	39	17.0	11.4	7.5	5.8
Ulma	UW	56.00	294	-6	289	201	221	-6	8	65	82	-	35.4	4.2	2.9
Torpol	OW	9.75	224	-96	128	802	1 039	23	26	43	50	9.8	8.5	4.6	4.3
Trakcja	OW	8,82	453	170	623	1 619	1 631	47	50	100	103	9,6	9,0	6,2	5,8
ZUE	MW	6.36	146	-23	124	634	570	6	12	17	23	26.2	12.3	8.0	5.5

Source: Companies, Dom Maklerski mBanku

**Within our selection of construction stocks outside the coverage universe we have upgraded Trakcja and Herkules from marketweight to overweight as well as raising our financial forecasts for both, and we have updated our earnings projections for Torpol.**

#### Elektrotim

Elektrotim accumulated a record order backlog of PLN 264m as of 31 October 2014 (+52% y/y) and in the fourth quarter it acquired a number of new major contracts from industrial and public sector customers. Accordingly, the Company should have no problem achieving its goal of 15% revenue growth as well as generating higher margins than those reported in the last few quarters. We believe Elektrotim's earnings results this year will return to the levels seen in 2007-2009. On our forecasts ELT is currently trading at 11.4x 2015E P/E and 6.3x EV/EBITDA. Finally, we expect the Company to pay DPS of at least PLN 0.60 in 2015, offering the sector's highest dividend yield at 5.6%. We maintain an overweight rating for Elektrotim.

#### Herkules

Herkules estimates that it grew revenue by 18% in 2014 and given its high operating leverage and improving profit margins we predict last year's net profit may have surged by over 120% from the year before to an estimated PLN 8.2m (2014 P/E=17.0x). We expect Herkules to increase annual net earnings further to PLN 12.2m in 2015 (2015E P/E=11.4x) led by a sustained high rental rate for its construction equipment combined with new equipment purchases done last year and the acquisition of the wind farm crane provider Viatron which generates annual profits of about PLN 2m. Thanks to scaled-back investment in new rental equipment Herkules should be able to reduce debt in 2015. Based on the Management's statements about possible dividends we are hoping to see DYield of 1.5-2.0% from Herkules this year. We are upgrading HRS to overweight.

#### Ulma

Ulma incurred an annual net loss of an estimated PLN 6m in 2014 stemming from delays in contract awards by the road authority GDDKiA and fierce competition in the markets for residential construction, power engineering services, and formwork. Roads were the main source of revenues for Ulma in 2010-2012. With Polish public infrastructure

spending 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~4x), the Company has been rebuilding its cash reserves 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.

#### Torpol

Torpol is the best pick among railroad construction companies in our opinion. It is trading on P/E ratios similar to Trakcja's but on EV/EBITDA it shows a 25% discount to the rival thanks to much lower debt. Torpol had an order backlog of PLN 2bn at the end of September 2014, including PLN 1.6bn scheduled for delivery in 2015-2016, which will keep it busy until the government starts spending the new infrastructure budget funded by the new EU framework. Torpol remains one of our top picks in the construction sector. We maintain an overweight rating for TOR.

#### Trakcja

Based on better-than-expected profit-generating potential of the current order backlog, we are raising our net profit estimates for Trakcja by 22% to PLN 47m for 2014 and by 40% to PLN 50m for 2015. Trakcja generated strong financial results and cash flow in the first nine months of 2014, reducing its net debt in the period by 37% y/y to PLN 169m. The improved liquidity may convince the Management to pay out dividends this year. After steady profits expected in 2015, we have concerns about Trakcja's outlook for 2016 given the low order backlog for the year as the Company waits for the government to launch the new railroad infrastructure orders which were supposed to come on line in 2014. That said, the 2016 revenue shrinkage does not necessarily have to be severe if Trakcja moves forward with its Scandinavian expansion plans. We are upgrading TRK from marketweight to overweight.

#### ZUE

ZUE generated weak financial results in 2014 due to charges incurred on several troubled contracts combined with a conservative approach to valuation of long-term contracts. In 2015 we expect considerable improvement in the Company's profits although the growth will be much slower than anticipated of the cheapest construction firms. We maintain a neutral rating on ZUE.

Budimex		Accumulate						
Analyst: Piotr Zybala		Current price:		PLN 153.25		Last rating		2015-01-26
		Target price:		PLN 162.7				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	6 077.7	4 749.5	-21.9%	4 943.7	4.1%	4 953.2	0.2%	Number of shares (m)
EBITDA	233.1	362.2	55.4%	254.7	-29.7%	245.9	-3.5%	MC (current price, PLNm)
EBITDA margin	3.8%	7.6%		5.2%		5.0%		EV (current price, PLNm)
EBIT	182.4	333.3	82.7%	231.7	-30.5%	223.6	-3.5%	Free float
Net profit	186.0	300.5	61.6%	180.8	-39.8%	187.3	3.6%	
P/E	21.0	13.0		21.6		20.9		Price change: 1M
P/CE	16.5	11.9		19.2		18.7		Price change: 6M
P/BV	9.0	6.2		7.7		7.6		Price change: 12M
EV/EBITDA	11.5	6.4		9.1		9.7		Low (52 weeks)
Yield (%)	7.2	2.9		7.7		4.6		High (52 weeks)

**Budimex acquired road orders totaling PLN 4.2 billion in 2014, making it the best year in history for the infrastructure business. Given that Poland's road authority GDDKiA last year awarded only 25% 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. After a good fourth quarter supported by mild weather, we believe Budimex will report an annual net profit of PLN 181m for 2014, fully earmarked for dividends. To reflect the fast rate of contract acquisition and expectations of measured margin growth in the construction business, we have raised our 2015 net profit estimate by 4.4% to PLN 187m, with the expected 2016 earnings increased slightly to PLN 280m based on strong sales generated by the residential real-estate business. We are downgrading BDX from buy to accumulate after the recent increase in share price, and at the same time we are raising our price target from PLN 160.6 to PLN 162.7.**

#### Government ups road spend by 27%

The updated six-year National Road Infrastructure Plan through 2020 announced at the beginning of November provides for total six-year expenditure of PLN 92.8bn on new roads (raised by 27% relative to the original plan) and a further PLN 48.7bn on maintenance and repairs. Looking at the detailed building schedule, we can see that the investment in new infrastructure is set to peak in 2016-2018 at about PLN 20 billion per year. In the mean time, the tenders expected to be held this year imply a period of intense backlog growth for Budimex.

#### 26% bid-to-hit rate

The GDDKiA awarded only about PLN 14 billion-worth of contracts to bidders in 2014, representing a meager one-fourth of the total national six-year budget. Of the total, PLN 3 billion in awards (26%) was raked in by Budimex – a result unmatched by any other bidder. Aside from the new projects, the Company also took over motorway construction work to the tune of PLN 0.6bn from two original contractors.

#### Poised for 2016 rebound

Most of Budimex's new road orders use the design-and-build formula which means they will not start generating notable revenues until 2016. We project that after posting road revenue below PLN 1.5bn in 2014 Budimex is poised for an annual topline rebound in the infrastructure segment to PLN 2.5-3.0bn in 2016-2018 assuming an average hit rate of 20%.

#### New leader in housing

Budimex's real-estate arm Budimex Nieruchomości sold 654 flats in Q4 2014, more than any of the listed developers, beating Robyg by 19% and Dom Development by 23%. Budimex owes such rapid growth in sales to the fact that it is currently developing eight multi-building residential complexes in Warsaw, Krakow, and Poznań, with homes in progress at 30 September 2014 exceeding 2400 units. Thanks to a strong cash position (ca. PLN 300m net cash) Budimex can plan more land acquisitions in 2015, and its real-estate business is set for a sharp upturn in profits in 2016 driven by closings of the homes currently in progress.

#### Budimex raises loss reserves

In Q3 2014 Budimex raised the reserves against potential contract losses by PLN 142m to PLN 387m, equivalent to 60% of our 2014 EBIT projection. We believe the reserves are designed to serve as a cushion against the risks entailed in the new road contracts.

#### Secure dividends

Budimex's balance-sheet position is expected to remain one of its main strengths going forward. The Company has consistently reported increasing cash balances for the last six quarters, and its net cash position at 30 September 2014 was PLN 1.2bn (+27% y/y), increasing to an estimated PLN 1.6bn by the end of the year. We do not expect a deterioration in the cash base in the next two years, on the contrary, we expect further support throughout 2015 from the 5-10% advances provided for in the new road contracts. We estimate Budimex's 2014 end-of-year working capital at PLN -1.71bn. A strong balance sheet and a lack of capital investment plans lead us to expect a continuation of the dividend policy which sets the annual payout ratio at 100% of net profit.

Elektrobudowa		Buy						
Analyst: Piotr Zybala		Current price:		PLN 81.22		Last rating		2015-01-26
		Target price:		PLN 112.9				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	1 018.0	905.6	-11.0%	1 123.0	24.0%	1 351.7	20.4%	Number of shares (m)
EBITDA	34.6	38.7	11.8%	51.0	31.8%	68.4	34.1%	MC (current price, PLNm)
EBITDA margin	3.4%	4.3%		4.5%		5.1%		EV (current price, PLNm)
EBIT	22.5	24.6	9.5%	37.5	52.6%	55.1	46.7%	Free float
Net profit	22.9	17.2	-24.8%	27.0	57.0%	37.2	37.6%	
P/E	16.8	22.4		14.3		10.4		Price change: 1M
P/CE	11.0	12.3		9.5		7.6		Price change: 6M
P/BV	1.2	1.2		1.1		1.1		Price change: 12M
EV/EBITDA	10.2	8.1		8.6		6.8		Low (52 weeks)
Dyield (%)	4.9	2.5		2.5		2.8		High (52 weeks)

**Elektrobudowa shares plunged to an eight-year low after the announcement of a disappointing guidance in April 2014 and at the current level the price already factors in a scenario where the industrial construction business continues forever to generate losses, cash flows remain weak, and margins from core business segments decrease by one-third. We have more optimistic expectations for Elektrobudowa based on the improvement posted in Q3 2014 by the industrial segment which may finally break even some time this year. Moreover, the two power engineering segments reported expanding margins in 9M 2014, but cash flow fears overshadowed the improved profit quality in the minds of investors. For 2015, we expect operating cash flow to be at least zero. We upgraded our 2014 earnings estimate for Elektrobudowa by 12% to PLN 27m and in 2015 we expect the Company to experience 38% net profit growth to PLN 37m (P/E=10.4x). We maintain a buy rating for ELB with the price target raised from PLN 107.0 to PLN 112.9.**

### Contract receivables

At 30 September 2015 Elektrobudowa's accounts receivable under construction contracts showed an unexpected surge to an unprecedented level of PLN 282m from PLN 135m the year before. Though undesirable, the increase can be explained with a rapid gain in the value of three power engineering contracts acquired from PSE and Tauron with a combined value exceeding PLN 1bn. The unbilled revenue is expected to remain high in 2015 and 2016 while these contracts are in progress (all are either on schedule or ahead of schedule according to recent status updates) and assuming no delays they may fall in 2017 (unless in the mean time Elektrobudowa acquires new equally large contracts). That said, we made the conservative assumption in our valuation model that the level of working capital will remain high going forward. If working capital fell

below the 2012-2013 average of 12% of annual sales, our valuation of Elektrobudowa would go up by 10%.

### Industrial construction approaches break even

The industrial segment generated a net loss of PLN 14.9m in 9M 2014 incurred on settlement of completed loss-making contracts. At the same time the segment underwent restructuring in the course of last year which resulted in reduced indirect costs and savings which could already be noticed in Q2 and Q3. In Q4, we anticipate that the segment's bottom-line may have come close to zero. Going forward, we expect continuing sustained improvement in the profits earned from industrial construction services.

### No threat from Russia

Elektrobudowa's international revenue fell 76% y/y to PLN 45m in 9M 2014, accounting for just 6% of the total sales for the period. In H1 2014, 38% of the falling exports were to Russia and Ukraine. This means the crisis in the east does not impact Elektrobudowa's profits. The Company estimates the 2014 as well as the 2015 profits of its Ukrainian unit at close to zero, and says the Russian unit would have posted a higher profit in 2014 had it not been for the Q4 ruble crash. Our conservative valuation model ignores the Russian operations in future earnings forecasts. We believe Elektrobudowa's revenue in 2014 was supported by a power plant contract in Finland which, if extended to include more services, will also drive revenues and profits in 2015.

### Core business tops expectations

The segments of services provided to power producers and power distributors, which account for 75% of total revenue, did very well in 9M 2014, with the former posting 14% y/y revenue growth and an operating margin of 5.9% (+1.0 ppt y/y) and the latter growing sales by 20% and operating margin by 2.1ppt to 8.4%.

Erbud		Buy								
Analyst: Piotr Zybala		Current price:		PLN 25.86			Last rating		2015-01-22	
		Target price:		PLN 34.5						
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics		
Revenue	1 384.5	1 225.1	-11.5%	1 583.4	29.2%	1 642.1	3.7%	Number of shares (m)		12.8
EBITDA	36.9	40.1	8.5%	48.5	21.0%	54.8	12.9%	MC (current price, PLNm)		330.0
EBITDA margin	2.7%	3.3%		3.1%		3.3%		EV (current price, PLNm)		342.5
EBIT	29.4	32.4	10.3%	40.6	25.2%	46.7	15.1%	Free float		
Net profit	17.2	17.5	1.4%	23.6	35.2%	27.9	18.0%			
P/E	19.0	18.8		14.0		11.8		Price change: 1M		0.3%
P/CE	13.2	13.1		10.5		9.2		Price change: 6M		3.4%
P/BV	1.4	1.3		1.2		1.1		Price change: 12M		-12.0%
EV/EBITDA	6.5	7.6		7.1		6.0		Low (52 weeks)		22.4
Dyield (%)	0.0	0.0		2.8		1.9		High (52 weeks)		34.2

**We expect Erbud to report 35% growth in the net profit for 2014 which will have reached its highest level in five years. By capitalizing on its strong financial position and the liquidity issues of its smaller rivals, the Company managed to increase revenues from domestic building construction by about 30% last year. More importantly, at the same time Erbud grew revenues from power engineering and infrastructure engineering by two-thirds, with the share of the two segments in total sales up to nearly 20%. At 4-5%, the EBIT margins achievable in the two segments are twice as high as in building construction, and Erbud intends to expand in power engineering and infrastructure in the coming years as a way of maximizing profits. Moreover, thanks to planned purchases of land for development in Warsaw, the Company can be expected to see a rebound in the profits of the real-estate segment in 2017. In anticipation of steady double-digit earnings growth in the coming years, we maintain a buy rating for ERB**

### A strong end to 2014

Erbud generated PLN 32.1m EBITDA (+23% y/y) and PLN 15.0m net profit (+50% y/y) in the first nine months of 2014 and in the fourth quarter we expect to see strong earnings results driven by a high order backlog and favorable weather. Our prediction for Q4 is a 17% y/y increase to PLN 16.4m in EBITDA and a 15% surge to PLN 8.6m in net profit.

### Shifting backlog structure

From 80% in the last few years, the share in Erbud's revenue mix of building construction services is estimated to have decreased to 78% in 2014, and in the future it is expected to continue decreasing in favor of road and power engineering services. This is reflected in the shifting structure of the order backlog which at 30 September 2014 was worth PLN 1.53bn (-1.6% y/y), with the ratio of building construction down to 75% from 79% the year before. In Q4 2014, Erbud acquired new orders totaling PLN 562m of which 72% were contracts for road and engineering services. As a result, we believe the 2014 end-of-year backlog was even higher than the record 2013 year-end backlog of PLN 1.60 billion.

### Roads and wind farms

The engineering segment experienced strong growth in 2014, with revenue soaring by an estimated 74% to PLN 168m. In December, Erbud was confirmed as the best bidder for the construction of a stretch of the S7 expressway with a price quote of PLN 243m. The Company outpriced the next lowest bidder Strabag by 0.1% and the third lowest bidder Budimex by 2.4% (there were only four bidders in total), and based on this we expect it to sign the contract in March/April. Erbud includes wind farms in the engineering segment, and in Q4 2014 it acquired wind farm orders totaling PLN 158m which added to the segment's backlog. Our projections for the engineering segment assume 34% growth in 2015 followed by 10% in 2016.

### Power engineering

'Energy' is Erbud's youngest business segment with the strongest growth potential as evidenced by fast-paced 57% 2014 revenue expansion to PLN 125m. Erbud's first power engineering orders acquired in 2014 included a flue gas denitrogenation plant, flue-gas channels, and construction and equipment services commissioned by a heat and power plant. Erbud's Management predict that the energy segment can triple or even quadruple its revenues in a matter several years.

### Increasing margins in power engineering

We estimate that Erbud's total operating margin amounted to 2.6% in 2014 after stable profitability witnessed across all operating segments. Going forward, we anticipate improvement in operating profitability led by an increasing share in the sales mix of higher-margin services. Erbud is able to achieve operating margins of ca. 2% from building construction compared to 5% from road-engineering and 3-4% from power engineering (for which the long-term target is 5-6%).

### Property sale may boost 2015 profit

Erbud is scheduled to complete an office/retail development in downtown Poznań in Q1 2015. The 'Deptak' building has 6,500 square meters of retail spaces, all leased out, and 2,500sqm of office spaces of which one-third are already rented. We believe that by selling the property Erbud stands to earn a profit of about 10m (not included in our financial forecasts).

Unibep		Buy						
Analyst: Piotr Zybala		Current price:		PLN 8.6		Last rating		2015-01-22
		Target price:		PLN 10.4				
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	837.8	920.5	9.9%	1 084.3	17.8%	1 253.1	15.6%	Number of shares (m)
EBITDA	25.8	34.0	32.1%	31.8	-6.5%	41.2	29.6%	MC (current price, PLNm)
EBITDA margin	3.1%	3.7%		2.9%		3.3%		EV (current price, PLNm)
EBIT	20.2	28.1	39.0%	25.0	-11.0%	34.6	38.5%	Free float
Net profit	16.8	13.6	-18.7%	18.9	38.5%	24.3	28.4%	
P/E	17.4	21.7		16.0		12.4		Price change: 1M
P/CE	13.1	15.1		11.7		9.8		Price change: 6M
P/BV	1.7	1.6		1.5		1.4		Price change: 12M
EV/EBITDA	15.1	8.2		8.9		7.6		Low (52 weeks)
Dyield (%)	1.4	1.4		1.4		1.7		High (52 weeks)

**Unibep strengthened its position in the Warsaw residential construction market in 2014 and going forward it is set to benefit from an accelerating housing activity combined with planned international expansion. The Company has accumulated a backlog of building orders for 2015 in an amount (ca. PLN 570m) which this early in the year already exceeds last year's revenue from residential construction. At the same time, aside from housing, Unibep is also working on acquiring orders from commercial developers so as to boost the current backlog of a little over PLN 80m. As for Unibep's own real-estate development business, it is poised for strong profit growth in 2016-2017 driven by investment made over the past year. We maintain a buy rating for UNI.**

### Growing construction business

In building construction, the bulk of Unibep's orders come from residential developers among which the Company is established as a reliable contractor (major customers include Dom Development, Layetana Developments, Dantex-Waryński, Turret Development, and Neocity). The residential real-estate backlog scheduled for delivery in 2015 currently approximates PLN 450m and it is sure to grow going forward as housing activity continues to expand in Poland, most importantly in Warsaw where most of Unibep's customers are based. In the future, Unibep wants to expand into Poznań and the coastline region of Poland with its residential construction services. Aside from residential buildings, Unibep also has in the backlog several office and retail projects with a combined value of PLN 100m, and going forward we expect it will realize its revenue-generating potential in commercial development on a larger scale. We estimate that Unibep generated revenue of PLN 550m in 2014 from building construction in Poland, and in 2015 the Polish sales are set to be higher given the current backlog of PLN 570m.

### Modular housing gets in the black

Unibep's young business of modular homes manufactured for the Norwegian market is approaching maturity with 2014 revenue stabilized at PLN 120m and gross margin expected to post a strong increase from 1.4% to 7.2%. Eventually, Unibep is planning to offer its modular homes in other countries (mainly Sweden, and potentially also Germany and Belgium). Moreover, it completed module factory upgrades last year which in addition to delivering better quality boosted the annual capacity by about 30%. If the expansion plans are successful, the Company is likely to exceed the segment's revenue target of PLN 150-160m.

### Housing business poised for 2016 rebound

Unibep made a series of deals aimed at boosting the residential real-estate business in 2014, including the purchase of two land properties in Warsaw and one in Poznań with an estimated total capacity for 820 homes. Moreover, the Company formed two joint ventures last year for two multi-stage residential complexes in the capital city. Once these developments are complete, they are set to become a major growth driver for Unibep's revenues and profits starting in 2016.

### Recovering margins in road construction

Unibep's road segment has expanded at a double-digit rate for last three years, with the assignments focused primarily in the north-eastern region of Poland. The Company can count on new business from the S8 expressway project which is still under development. We project that after 2015 annual road revenues will stabilize at PLN 160-170m. In 2014 the segment's margin is expected to expand to 4.0% from 1.7% the year before.

### Export revenues contract in 2014

Unibep's international building construction business, including the first job acquired in Germany, saw a slowdown in profits in 2014. In 2015 the Company is scheduled to finish two major contracts in Russia and continue working on new projects in Germany, and it hopes the foreign assignments will generate higher profit margins this year. Based on the current backlog, we can assume that building construction revenue in 2015 will be maintained at a stable level relative to 2014, but after 2015 it may contract depending on the economic situation in Russia and Belarus.

### Strong cash flow offers hope for higher dividend

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. In the course of the year, its working capital-to-sales ratio dropped from over 12% to just over 4%, and the difference between construction contract receivables and payables fell by over 40% to PLN 35m. This has boosted the health of the Company's balance-sheet position, offering hope for higher dividends (Unibep is one of the few construction companies who make regular distributions to shareholders).

## Property Developers

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

Company	Weight	Price (PLN)	MCap	Net Debt	EV	Revenue		Net Profit		Equity		P/E		P/B	
						2014	2015	2014	2015	2014	2015	2014	2015	2014	2015
BBI Dev.	MW	1.12	117	230	347	21	83	-23	13	247	261	-	8.7	0.47	0.45
JWC	MW	2.60	231	511	742	302	287	16	7	637	644	14.0	32.2	0.36	0.36
LC Corp	OW	1.80	806	700	1,506	326	360	65	30	1,250	1,280	12.4	26.9	0.64	0.63
PA Nova	OW	14.85	149	224	372	173	176	19	19	295	310	7.8	7.7	0.50	0.48
Polnord	OW	6.42	210	433	643	187	272	4	2	1,087	1,090	52.4	87.4	0.19	0.19
Ronson	MW	1.44	392	144	536	152	281	-5	25	460	485	-	15.5	0.85	0.81

Source: Companies, Dom Maklerski mBanku

**As part of our updated outlook on select real-estate stocks outside our coverage universe we have rerated BBI Development from overweight to marketweight and we have revised our financial forecasts for BBI Development, JWC, Polnord, and Ronson.**

#### BBI Development

BBI is set to step up building efforts in 2015 now that it has enough cash for development after the sale of the Plac Unii office/retail project and as it is making progress in securing necessary permits for new Warsaw developments (Centrum Marszałkowska, Koneser). News about the implementation status of the new projects can provide upside potential for BBD shares later in the year, but for the next few months we see no possible upside catalysts in the stock. The market reaction to the sale of Plac Unii was surprisingly muted, and the sentiment is not likely to change any time soon given the loss we expect the Developer to report in Q4 2014. Investors may start to look more favorably on BBD some time in mid-2015 once the new projects take shape and once they are given concrete start dates. In the mean time, we are downgrading BBD from overweight to marketweight.

#### JWC

According to our calculations, JWC went into the new year with just 1200 homes in progress, of which 964 not scheduled for completion before 2016 (the remaining 245 set to be finished in 2015 are located in Katowice and Łódź). Due to the ongoing delays in new project launches, 2015 is looking to be the fourth year straight when JWC is not able to break even without the help of property valuation gains. On a positive note, in 2014 JWC was able to reduce administrative and financing costs by 15% as well as scaling down debt by ca. 25% (thanks mainly to a share issue). Moreover, homes in the 'Bliska Wola' development scheduled for completion in 2016 are selling well, suggesting a considerable improvement in next year's profits. The first closings in the development made last year will result in a good Q4 2014 financial report from JWC, but in a longer term this will not be enough to make the Developer an attractive investment this year at the current price level. We maintain a neutral rating on JWC.

#### LC Corp

In the last two years LC Corp has been among the most active land buyers with purchases approximating PLN 280m. With such a vast land bank, the Developer has positioned itself for unparalleled sales growth in the years

ahead. Based on the existing land inventory, we expect LC Corp to post a sales increase of 26% to 1540 homes in 2015 and further by 21% to 1860 units in 2016. Consequently, we anticipate at least three years of growing profits for the Developer from an average PLN 32-34m (after valuation gains) in 2011-2013 to an estimated PLN 56m in 2014 (P/E=14.3x) and further to PLN 118m in 2017 after 2015-2017 CAGR of 28% (P/E=6.8x). We maintain an overweight rating for LCC.

#### P.A Nova

As a low-liquidity stock, P.A. Nova was mostly overlooked by investors in 2014. The Company is still set to incur high CAPEX in 2015 as it develops its biggest project in history, the 'Galeria Galena' shopping mall in Jaworzono, which is scheduled for completion in Q4 2015 and which is expected to add over PLN 10m to annual net profits starting in 2016 once it is open and fully leased. NVA shares are currently trading at attractive multiples of P/E~8x and P/B~0.5x. The Company is expected to pay per-share dividend this year of PLN 0.50 (DYield=3.7%), and in 2016 aside from reporting increasing profits we believe it will offer an even higher distribution to shareholders. With all this in mind, we are reiterating an overweight rating for NVA.

#### Polnord

Despite a downward adjustment of PLN 295m to the value of its assets made in 2014, Polnord is valued at 0.19x P/B. Last year the Developer reduced SG&A and financing costs by 18% and cut down debt by 14%, and this year we expect the streamlining will be continued. On an adjusted basis, we believe Polnord came close to achieving a profit on its core business in 2014, and we think it will end 2015 in the black and report considerable growth in earnings in 2016. Moreover, Polnord will soon cease to be a high credit-risk company. Market sentiment toward Polnord is likely to go up once its principal owner sells his stake. We maintain an overweight rating for PND.

#### Ronson

On our updated financial forecasts, Ronson is valued at 0.85x 2014E P/BV and respective 2015E and 2016E P/E ratios of 15.5x and 8.7x. Given its weak sales and earnings results for Q4 2014 and a slow outlook for Q1 2015, and considering the current owner is still looking for a buyer for his 80% stake, Ronson is one of the least attractive short-term picks at the moment in the real-estate sector, and so we give it a neutral rating.

Capital Park		Buy						
Analyst: Piotr Zybala		Current price:		PLN 4.15		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)
EBITDA	-87.9	40.8		31.8	-22.2%	35.1	10.6%	MC (current price, PLNm)
EBITDA margin	-212.0%	105.1%		71.2%		47.7%		EV (current price, PLNm)
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		17.0		46.5		26.5		Price change: 1M
P/CE		16.8		44.7		26.0		Price change: 6M
P/BV	0.4	0.4		0.4		0.4		Price change: 12M
EV/EBITDA		23.9		37.0		41.6		Low (52 weeks)
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks)

Capital Park can count 2014 as a success which, unfortunately, was not at all reflected in last year's market performance. In the course of 2014, the Company completed and leased out 67% of the first building in the Eurocentrum office complex with 42,300 sqm GLA, and it commenced the construction of the second building right on schedule. Other achievements include a 70% tenancy rate secured for the Royal Wilanów project half a year before it is scheduled to open, and the obtainment of a building permit for the Art Norblin project. In less than a year, 75% of Capital Park's investment portfolio will be completed income-generating properties, with 15% represented by Art Norblin, scheduled to start in autumn 2015. This means that two years from the IPO the Developer will have transformed a high-value land bank into a portfolio of fairly valued office buildings, rendering completely undeserved the 50% discount to NAV at which it is currently valued. The changing portfolio composition will be accompanied by dynamic earnings growth, with NOI CAGR in 2015-2018 projected at 37%. We maintain a buy rating for CPG.

#### Tenancy rate improves in 2014

Capital Park managed to improve the overall tenancy rate for its finished property portfolio from 78% to 88% in 2014. This included an increase from 51% to 67% in Eurocentrum building 1, expected to go up beyond 70% by March 2015, and a boost in the pre-let rate in Royal Wilanów from 29% to 70%.

#### Eurocentrum II: no tenants as yet but financing in place

Capital Park has not managed to find any tenants yet for offices in Eurocentrum building 2 which it started to build last September. On a positive note, the Company has been granted bank financing for the building regardless, based on the successful rate of tenant acquisition in the first Eurocentrum building.

#### Art Norblin set to break ground in autumn

After securing the building permit, Capital Park is free to commence construction of its largest development in history, Art Norblin, offering 64k sqm GLA. The first pre-let arrangements for Art Norblin are already in place, with the

eco-food bazaar Bioazar renting ca. 1900sqm and the grocery retailer Piotr i Paweł renting about 2000sqm. Competition is stiff in Art Norblin's neighborhood where many developers have located their office projects. Art Norblin's competitive advantage is a large retail area representing 37% of the total GLA which is easier to commercialize and which most likely be a big factor in favor of Capital Park when applying for an investment loan. We project the target NOI on Art Norblin at PLN 57m (at monthly rent of EUR 17 offices and EUR 22 retail spaces). We expect Capital Park to break ground on the development in the autumn which seems a more likely timing than the original one set for spring.

#### Strong earnings potential

After completing all the projects comprising its investment program, Capital Park will own a portfolio with potential of 217k sqm GLA, PLN 164m NOI, and ca. PLN 77m FFO. At the current price level, this implies FFO Yield of 16% compared to the 8-10% projected for Echo and GTC for 2014-2018 achieved at the same risk.

#### Capital needs and debt

Until financing is disbursed, Capital Park has to spend an estimated PLN 40m out of pocket on Eurocentrum II and PLN 60m on Art Norblin. As of 30 September 2014, the Company's cash position was PLN 113m, and the LTV ratio was 36%. In the course of last year Capital Park issued PLN 109m bonds and used the proceeds to call 90% of existing A bonds. The debt still outstanding is PLN 10m set to mature in July 2015. In our opinion this capital structure does not present an obstacle to Capital Park's building plans.

#### Divestment

After a period of intense investment in 2014, we expect divestments at Capital Park in 2015, including the sale of the Eurocentrum office complex after the second building is finished in Q3 2015. Such divestment should be facilitated by the continuation of strong demand for Polish commercial properties from foreign investors. Before Eurocentrum, we anticipate that Capital Park may sell some of its older properties through a new closed-end investment fund (FIZ). In 2013, by selling shares in its first FIZ, the Company raised net cash of PLN 64m, and we hope the second FIZ can fetch an equally handsome profit.

**Dom Development Buy**

Analyst: Piotr Zybala	Current price:		PLN 46.7					Last rating	2015-01-26
	Target price:		PLN 57.9						
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics	
Revenue	851.4	676.4	-20.6%	774.5	14.5%	823.8	6.4%	Number of shares (m)	24.8
EBITDA	116.5	76.5	-34.4%	74.5	-2.6%	98.5	32.2%	MC (current price, PLNm)	1 156.8
EBITDA margin	13.7%	11.3%		9.6%		12.0%		EV (current price, PLNm)	1 194.9
EBIT	113.5	73.3	-35.4%	71.3	-2.7%	95.3	33.6%	Free float	26.6%
Net profit	91.2	54.4	-40.3%	56.9	4.6%	75.1	31.9%		
P/E	12.7	21.2		20.3		15.4		Price change: 1M	13.7%
P/CE	12.3	20.1		19.2		14.8		Price change: 6M	6.6%
P/BV	1.3	1.3		1.3		1.3		Price change: 12M	-13.9%
EV/EBITDA	10.1	16.6		16.0		12.5		Low (52 weeks)	38.6
Dyield (%)	3.2	7.9		4.7		4.9		High (52 weeks)	59.0

**2015 is set to be a year of growth for Dom Development driven by an over-30% increase to 2500 units in housing starts. With seven out of the thirteen residential projects scheduled to start this year located in completely new locations, it is not unlikely that home sales this year will exceed 2000 units (we expect 2125 unit, +12% y/y). 2015 closings are expected to remain steady at ca. 1950 units, but this does not mean flat growth in profits since the homes poised for settlement this year have potential to generate higher margins. All in all, we expect Dom Development to report a net profit of PLN 75m in 2015 (+32% y/y) followed by a further 27% increase to PLN 96m. As for dividends, Dom Development distributed 100% of its annual profits as dividends in the last two years, and we believe given its healthy financial situation that the Company will continue this policy in the coming years. The dividend yields implied by our earnings forecasts are 4.9% in 2015, 6.5% in 2016, and 8.3% in 2017. We maintain a buy rating for DOM with the price target raised slightly from PLN 57.8 to PLN 57.9.**

### Faster land bank turnover

Dom Development's land bank at the end of September 2014 had capacity for 4800 flats (in addition to 3100 homes already in progress), which was 21% fewer than at the same time in 2013. In our view the depletion does not entail a slowdown in sales. At 30 September 2014 the land for development encompassed 11 projects (440 flats on average per project) compared to 10 projects (609 per project) the year before. In the past months, Dom focused on developing only small and medium-sized projects so as to achieve faster returns on capital and we expect it to acquire several new similar projects in the first half of 2015. This is based on recent statements by CEO Szanajca who said the Developer was planning to acquire new land for well over 1000 homes, with the 2015 land budget exceeding PLN 150m.

### Increasing listings

We estimate that Dom commenced construction of about 1900 new homes in 2014 (+4% y/y) and in 2015 it is

planning to start about 2500 units (+32% y/y) in thirteen developments of which seven are in new locations in Warsaw. Four of those locations are news to us so we suspect their purchases are still being negotiated and once bought we expect they will start to be developed within a year. All in all, Dom has noticeably stepped its building activity in recent periods.

### Measured but steady sales growth

Dom Development broke its sales record in 2014 by selling 1889 flats (+18% y/y), representing 99% of our June 2014 forecast. In 2015, we anticipate further sales growth at a rate of 12% to 2125 units driven by a high beginning inventory (2235 flats, 20% y/y), land still available for development in the three projects which in 2014 made big contributions to sales (Saska, Żoliborz Artystyczny, Wilno), new projects scheduled for this year, and favorable market conditions which include falling interest rates and a recovering job market.

### Flat closings at higher margins

In 2014 Dom Development settled 1958 homes in its earnings results, an amount close to the record closings made in 2012. As a result, its revenue for the year should come in at PLN 774m, but at 20% the gross margin will be one of the lowest in the last ten years. The main reason for the margin contraction is that some of the closings were flats sold during a housing price slump, exacerbated by disputes with contractors which boosted the costs of several projects. For 2015, we forecast that on a steady number of closings Dom can generate a 6% increase in revenue and grow the gross margin to 23%. This forecast is based on the structure of the projects currently in progress which on average seem to offer slightly higher margins, combined with an overall upward trend in home prices in Poland.

### Dividends

We expect Dom to pay out 100% of its net profit for 2014 again as dividends to shareholders, implying 2015 dividend yield of 4.7%. Assuming it keeps to the 100% payout policy, in the next two years the Developer will be able to offer 30% growth in annual dividend yields to 6.5% in 2016 and 8.3% in 2017.

Echo Investment		Buy						
Analyst: Piotr Zybala		Current price:		PLN 6.64		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	8.9		5.4		20.2		Price change: 1M
P/CE	7.2	8.7		5.4		19.4		Price change: 6M
P/BV	1.1	1.0		0.8		0.8		Price change: 12M
EV/EBITDA	26.4	10.1		7.8		26.8		Low (52 weeks)
Yield (%)	0.0	0.0		0.0		0.0		High (52 weeks)

Through organic growth solely, Echo Investment increased equity 4.5 times in the decade from 2004 to 2014, generating average annual return on capital of 16.2%. Going forward, the Developer has all that it takes to deliver attractive profits with advantages such as reasonable debt levels (LTV=42%) and easy access to external financing, a land bank of five years, and a seasoned and experienced management team. Echo is currently in the process of intense development activity expected to boost the size of the portfolio of completed properties by at least 40% in the next two years. During that time, we believe the Developer can become a dividend-paying company, raising its profile among investors. Echo's shares have been put up for sale by the principal owner, and this will weigh on the Company's fundamental value until the divestment is completed some time this year. We maintain a buy rating for ECH.

#### Can Echo be a dividend-paying company?

Dividend-paying real-estate developers in Western Europe offer average dividend yields of 4.0-4.5%. Echo can afford to pay more in our view which is based on the fact that in 2013-2014 the Company sold five properties which freed up EUR 95m (over PLN 400m) of cash equivalent to ca. 15% of the market cap. The divestment did not affect Echo's profits as the sold properties were replaced with new real-estate projects, however it did reduce LTV from 50% at the end of 2012 to an estimated 42% at end 2014. As well as funding ongoing real-estate projects, part of these cash proceeds could be used to pay dividends in the future.

#### Intense building activity

In the first half of 2014, Echo completed one shopping center and two office buildings with combined 60,300 square meters GLA and target NOI at EUR 9.7m. The buildings have 85% tenancy rates. Today, Echo is in the process of developing seven office projects and one mall with a combined GLA in excess of 170k sqm and expected NOI of EUR 35m. By the end of the year, the Company will have completed five of these projects and recognized gains from adjustments to their values in the annual net profit.

#### Commercial real estate fetches better profits outside of Warsaw

Warsaw-based commercial developers are operating in a

tough market where 12-month supply of new office spaces in excess of 300,000 square meters observed in the last seven quarters is driving the vacancy rate for the capital city which at the end of September 2014 stood at 13.8%. According to projections by CBRE, in the next two years, the Warsaw vacancy rate is set to increase to about 17% in the best-case scenario or to ca. 21% in the worst-case scenario. By comparison the average vacancy rate for other major cities is only 10.1%.

#### Office projects still have earning potential

The increasing supply of office space observed in Warsaw may lead some to worry about the profitability of Echo's office projects in the Capital City which account for 50% of the total rental space in progress and less than half of the existing land bank. Our financial projections for Echo factor in the potential future oversupply of office space through the assumption of 13% on average lower rent in the new projects than anticipated by the Company. This compares to our own assumptions for Echo at EUR 2000/sqm GLA in office buildings excluding Q22 and EUR 3400 for the COB-based Q22. What this means from the point of view of earnings projections and valuation is that our appraisal of Echo's ongoing projects is about 25% lower than the current market value of comparable properties, making for a solid cushion against any potential future slowdown in the Polish office market.

#### Cheap land bank

Our total cost estimate (including the land) for Echo's office projects is EUR 1400-1700 per sqm GLA. Land is a big cost factor when it comes to office developments, and Echo certainly did not overpay for the sites making up its land bank, paying ca. EUR 200-320 per sqm for locations in Warsaw and ca. EUR 80-220 elsewhere. The land site for the Q22 building is the one exception purchased for EUR 590/sqm GLA, implying total cost below EUR 3000/sqm GLA. At this cost and at 6.7% yield, Q22 should achieve break-even at monthly rent of EUR 17/sqm.

#### Sołowow selling ECH shares

Echo's 45% shareholder Mr. Michał Sołowow has put his total stake up for sale. Once done, the divestment should mitigate the uncertainty currently surrounding the Company's future and bring up the price of its stock.

GTC		Buy									
Analyst: Piotr Zybala		Current price:		PLN 4.91				Last rating		2015-01-26	
		Target price:		PLN 6.6							
(EUR m)	2012	2013	change	2014E	change	2015E	change	Key metrics			
Revenue	147.6	131.1	-11.2%	125.7	-4.1%	129.8	3.2%	Number of shares (m)		351.3	
EBITDA	-50.8	-121.0	138.1%	-120.6	-0.3%	89.3		MC (current price, PLNm)		410.3	
EBITDA margin	-34.4%	-92.2%		-95.9%		68.8%		EV (current price, PLNm)		1 406.2	
EBIT	-51.3	-121.4	136.8%	-121.1	-0.3%	88.8		Free float		58.8%	
Net profit	-96.0	-146.8	52.9%	-163.4	11.3%	30.5					
P/E						3.2		Price change: 1M		-8.9%	
P/CE						3.2		Price change: 6M		-32.7%	
P/BV	0.1	0.1		0.2		0.2		Price change: 12M		-31.3%	
EV/EBITDA						16.1		Low (52 weeks)		4.8	
Dyield (%)	0.0	0.0		0.0		0.0		High (52 weeks)		8.4	

**GTC recognized impairment losses of EUR 132m in Q4 2014, which was EUR 12m more than we had factored into our valuation model. Though we do expect further impairment of the Company's investment properties in the quarters ahead, the losses will be markedly lower than those incurred in 2011-2014. Our positive view on GTC is based principally on the two shopping malls that it is planning to develop in Warsaw, expected to generate valuation gains of EUR 230m minimum, equivalent to 60% of the current market capitalization. The one factor which could cause these expectations to fall through would be issues with financing, but given GTC's cash position of EUR 78m we are confident the Company can handle its current financial obligations on time. As for longer-term debt, after violating covenants on several loans, the Company has to negotiate extensions with the lenders. Moreover, in order to be able to finance unaided the two Warsaw malls, GTC will have to sell some of its properties if it wants to avoid a share issue. None of these efforts are beyond the Company's reach in our view. We maintain a buy rating for GTC with the price target lowered from PLN 7.0 to PLN 6.6.**

### Impairment losses

GTC announced in January that it had recognized about EUR 132m impairment losses against the profit for Q4 2014. The biggest value losses affected properties located in smaller cities in Romania, Croatia, and Bulgaria and a land property in Budapest, Hungary.

### Income-generating properties

GTC's portfolio of completed properties was worth EUR 1.32bn at the end of 2014, representing about 78% of the value of all properties in which the Company has interests. The yield on the finished properties was reported at 8.9%, and the average expected rental value was EUR 13.1/sqm, leaving virtually no room for any further impairment. 93% of the income-generating properties are

located in Poland and other CEE capitals, and their average occupancy ratio is 95%. 5% of the properties are shopping centers with 93% occupancy rates in Bulgaria which in 9M 2014 increased current NOI by 39% y/y. The four most problematic properties located in Romania and Croatia generate marginal NOI, but at EUR 13m their combined book value is equivalent to a little over 1% of the total value of all income-generating properties.

### Other properties

We estimate the book value of GTC's "other" properties (not including the Warsaw malls) at EUR 223m after Q4 impairment of an estimated EUR 60 or 17%. In our opinion, the value adjustments were driven by a desire by GTC to sell these properties as they do not have strategic significance.

### Liquidity

GTC had cash of EUR 78m at the end of 2014 which it considers enough to address on time all financial obligations for the next twelve months. As for new sources of financing, the Developer defines then as available cash, rental income, and asset divestments, which means it is not planning a share issue as a way of propping up liquidity. In our view the biggest risks to liquidity at the moment come from loans totaling EUR 72m, taken out to refinance shopping malls in Croatia, Bulgaria, and Romania, on which GTC violated the covenants. The lenders are entitled to call these loans within 6 to 12 months from breach, which they have not done so far as they negotiate new payment plans with GTC. We assume that these negotiations will end favorably for GTC and that the loan terms will be extended by several years, allowing the Company to use ca. EUR 57m of its own cash resources to build the Warsaw malls.

### Capital raise still not completely off the table

GTC has not completely abandoned plans to issue shares as a way of raising capital for new property investment in CEE. It will revisit the possibility after the publication of FY2014 results.

Robyg		Buy						
Analyst: Piotr Zybala		Current price:		PLN 2.16		Last rating		
		Target price:		PLN 2.95		2015-01-26		
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics
Revenue	402.9	485.9	20.6%	406.1	-16.4%	410.1	1.0%	Number of shares (m)
EBITDA	56.3	57.8	2.7%	61.9	7.0%	67.7	9.4%	MC (current price, PLNm)
EBITDA margin	14.0%	11.9%		15.2%		16.5%		EV (current price, PLNm)
EBIT	55.1	56.7	3.0%	60.1	5.8%	65.7	9.4%	Free float
Net profit	20.0	26.1	30.3%	33.3	27.8%	45.2	35.5%	
P/E	27.8	21.6		17.0		12.5		Price change: 1M
P/CE	26.2	20.7		16.1		12.0		Price change: 6M
P/BV	1.4	1.3		1.3		1.3		Price change: 12M
EV/EBITDA	15.0	13.4		12.8		11.0		Low (52 weeks)
Dyield (%)	5.6	3.7		3.7		4.6		High (52 weeks)

The successes that Robyg achieved last year found no reflection in its share price which today is trading at the same levels as last year. Robyg far exceeded our 2014 sales projection of ca. 1500 homes by selling 2100 units, thus reaffirming its position as a market leader. Going forward, we see even more buoyant outlook ahead of the Developer and we are confident it can reach the 2100-2300-unit sales target set for this year. As for earnings, we estimate the 2014 net profit at PLN 33m (P/E 17.0x), and in 2015 we anticipate bottom-line expansion to PLN 45m (12.5x P/E), followed by further growth to PLN 67m, i.e. double the profit posted in 2014 (8.4x 2016E P/E). We maintain a buy rating for ROB with the price target lowered 4% to PLN 2.95 after the adoption of more conservative earnings forecasts.

#### Forecast update

Robyg closed 1676 homes in 2014, 10% more than we had anticipated. Moreover, in Q2 2014 the Company recognized a PLN 11.1m valuation gain on an office building, far exceeding our PLN 3.7m estimate. To account for this, we have raised our 2014 net profit estimate by 30% to PLN 33.3m including just under PLN 12m generated in Q4. For 2015, we stand by our earnings forecasts which assume settlement of about 2200 homes resulting in a 35% increase to PLN 45m in the annual net profit. Our projections for 2016, however, underwent considerable downward adjustments, with the bottom-line forecast cut from PLN 78m to ca. PLN 67m, still implying impressive year-on-year growth of 49%.

#### Sales leader of 2014

Robyg sold 2118 flats in 2014 (+22% y/y), reasserting its position as the sales leader among WSE-listed developers. The sales target for 2015 is 2100-2300 units, and we believe it will be achieved provided the Company acquires new land and starts to develop it into new projects. Our own 2015 sales forecast is 2050 units.

#### Joint ventures

In 2014 Robyg purchased four land parcels in Warsaw with capacity for ca. 1700 homes, and it signed a preliminary agreement for a land lot for 500 homes in Gdańsk, and as a result it has maintained a relatively stable land bank. About 60% of the homes that will be built on the new land are 50-50 joint-venture projects which are expected to account for 44% of total 2015 sales, marking an increase from lower ratios of 41-42% in 2013-2014. The increasing share of joint ventures is one of the main reasons behind the downward revisions to our earnings projections for 2016 and subsequent years. Projects shared with partners reduce risks but on the other hand they also reduce revenue growth potential.

#### Expansion in Gdańsk

Gdańsk homes were the main driver of the strong sales growth enjoyed by Robyg last year, soaring 55-60% relative to 2013, with their share in total sales increased raised from 36% to 47% (with the other 53% sold in Warsaw). It is worth noting that the boosted Gdańsk sales were achieved on projects which constituted a continuation of existing residential estates. We estimate Robyg's share in the housing market of the Tricity (Gdańsk, Gdynia, Sopot) at 16% compared to 7% in Warsaw. According to market analysts, the time to sell in Gdańsk is currently the shortest of all major Polish cities at only 3.6 quarters compared to 4.2 quarters (the second-shortest time to sell) in Warsaw.

#### Dividends

Robyg's latest dividend policy (the Company has paid dividends regularly for the last four years) assumes payout ratios of 75-80% in 2015 and 2016. Based on this, in 2015 we expect 25% DPS growth to PLN 0.10 (with dividend yield at 4.6%) followed by a further increase to PLN 0.13 in 2016 (DYield'16=6.0%), and PLN 0.19 in 2017 (DYield'17=8.8%).

## Retail

CCC										Accumulate									
Analyst: Piotr Bogusz				Current price:		PLN 149.35				Last rating				2014-12-19					
				Target price:		PLN 158													
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics											
Revenue	1 317.5	1 643.1	24.7%	2 010.6	22.4%	2 537.2	26.2%	Number of shares (m)			38.4								
EBITDA	180.3	203.4	12.8%	317.6	56.1%	375.5	18.2%	MC (current price, PLNm)			5 735.0								
EBITDA margin	13.7%	12.4%		15.8%		14.8%		EV (current price, PLNm)			6 349.8								
EBIT	141.3	167.5	18.5%	278.3	66.1%	326.2	17.2%	Free float			63.0%								
Net profit	106.3	125.2	17.8%	328.6	162.4%	336.2	2.3%												
P/E	53.9	45.8		17.5		17.1		Price change: 1M			6.8%								
P/CE	39.5	35.6		15.6		14.9		Price change: 6M			35.2%								
P/BV	10.8	9.7		6.9		5.2		Price change: 12M			27.6%								
EV/EBITDA	32.7	29.1		20.0		16.7		Low (52 weeks)			103.5								
Dyld (%)	1.1	1.1		1.1		1.1		High (52 weeks)			151.7								

In the course of the past year, CCC demonstrated its ability grow profits while pushing ahead with international expansion. For the Company's Austrian and German business, we anticipate that as brand awareness increases and sales effectiveness improves the CCC stores there will break even in 2015 in the former case and in 2016 in the latter. Moreover, we expect continued profit growth in the Czech Republic, Hungary, Croatia, and Slovenia. CCC is projected to expand its net sales area at the robust pace of 22% in 2015 while maintaining same-store sales growth at a steady annual rate of 3.5%. Due primarily to the dollar's appreciation versus the zloty, the gross margin this year is likely to show a 1.3ppt contraction to 53.5%. We have a 2014 core net profit estimate for CCC of PLN 215m (+20% y/y) and for 2015 we anticipate net earnings of PLN 246m (+20%). The overall business acceleration is reflected in CCC's attractive PEG ratio (showing discounts of 3% and 69% to 2015-2016 peer averages) which makes the respective 5% and 13% discounts on 2015E P/E and EV/EBITDA multiples, undeserved in our view. We maintain an accumulate rating for CCC with the price target at PLN 158/share, reflecting the appreciation of USD vs. PLN and a reduction in the risk-free-rate to 3.5%.

### Improving international profits

CCC is planning to open 75,000 square meters of new sales area this year, of which 24% in Germany and 11% in Austria, the two markets which are set to be the main growth drivers in the years ahead. According to our calculations, the Austrian stores should break even by the end of the year (provided they improve sales per square meter by 16%), while the German stores will take longer to become profitable, reaching break even some time in 2016 (assuming 34% growth in sales per square meter). The stores in the Czech Republic, Hungary, Croatia, and Slovenia will make increasing contributions to profits in 2015.

### Gross margins remain fairly strong

We expect CCC to post 3.7ppt y/y gross margin expansion to 54.8% in 2014, marking a return to the high levels recorded in the past. In 2015, gross margin is set to decline by 1.3ppt to 53.5% in our view led by a stronger dollar and possible deeper seasonal price markdowns aimed at reducing the footwear inventory. Note that the dollar's impact on CCC is limited this year by the fact that the Company manufactures about half of its collections in Poland and thanks to USDPLN hedging.

### Reduced risk of inventory carryover

Because of unfavorable weather conditions discouraging shopping for autumn and winter footwear, CCC was left with a high inventory at the end of September at PLN 2930 per square meter. The Company was originally planning to hold the unsold merchandise over until the next winter season instead of having a big clearance but in the end it managed to make up for the slow third quarter in December when sales went up a whopping 42% compared to the same month the previous year. All in all, CCC generated revenue in excess of PLN 2 billion in 2014, in line with its guidance. As for inventory, we expect it decreased to PLN 2850 per square meter (revised from an earlier estimate of PLN 3000) by the end of last year, and by the end of June 2015 we anticipate it will go down further to PLN 2540.

### CCC delivers 2014 guidance

In spite of unseasonably warm autumn weather, CCC managed to deliver its 2014 revenue guidance of PLN 2 billion. With the bulk of the footwear sold at full price, the gross profit margin for the year will have decreased by 1.1ppt to 53.5%. As a result, assuming tight SG&A control, we believe after a Q4 core net profit of PLN 99.5m CCC will exceed by PLN 10m the full-year bottom-line profit target of PLN 200m.

LPP		Sell										
Analyst: Piotr Bogusz		Current price:		PLN 7716				Last rating		2015-01-26		
		Target price:		PLN 6400								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	3 223.8	4 116.3	27.7%	4 758.1	15.6%	5 448.6	14.5%	Number of shares (m)		1.8		
EBITDA	563.4	764.1	35.6%	773.4	1.2%	751.9	-2.8%	MC (current price, PLNm)		13 966.5		
EBITDA margin	17.5%	18.6%		16.3%		13.8%		EV (current price, PLNm)		14 416.9		
EBIT	454.4	615.9	35.5%	583.3	-5.3%	531.1	-9.0%	Free float		48.0%		
Net profit	353.1	430.9	22.0%	389.6	-9.6%	401.0	2.9%					
P/E	38.9	32.4		35.9		34.8		Price change: 1M		3.3%		
P/CE	29.7	24.1		24.1		22.5		Price change: 6M		-4.5%		
P/BV	11.3	9.3		8.3		7.3		Price change: 12M		-13.7%		
EV/EBITDA	24.4	18.5		18.6		19.2		Low (52 weeks)		7 100.0		
Dyild (%)	1.0	1.1		1.2		1.2		High (52 weeks)		10 100.0		

LPP is experiencing external downward pressure on profits from the sharp depreciation of the Russian ruble and the Ukrainian hryvnia, accompanied by a strengthening dollar and unfavorable weather. Worse still the Retailer has had to scale back its Russian expansion plans in the wake of the economic slump (crashing ruble, reduced investment in new retail spaces) and consequently in 2015 we anticipate a slowdown from 22% to 19% in the rate of expansion of its total sales area (129,000sqm in 2014 increasing to 139,500sqm in 2015). Moreover, because of deteriorating sales productivity at its stores abroad as well as at home, LPP may have a hard time liquidating the excess leftover inventory reported at the end of Q3 2014. For 2015, we anticipate 2ppt gross margin tightening to 56.5% at LPP due to more aggressive sales offers and the fact that the existing inventory was purchased at a higher USDPLN exchange rate. We are downgrading LPP from reduce to sell with the price target lowered to PLN 6400/share to reflect the appreciation in the USD vs. PLN and the downward revision in the expected 2015 gross margin contraction from 1.3 to 2ppts.

#### Ukraine and Russia put pressure on sales

The acceleration in the downturn on the ruble and the hryvnia observed in Q4 2014 will result in more downward pressure on LPP's earnings results in 2015, including on the gross margin affected by the inability of making sales prices keep pace with the falling ruble. At the same time, price hikes always affect the purchasing power of local shoppers, and this will be reflected in a worsened sales productivity in LPP stores in Russia and Ukraine.

#### Falling sales in Poland

LPP is forced to open new stores in locations with lower sales-generating potential in a saturated Polish market, and further its per-square-meter sales productivity suffers due to cannibalization effects, with the 2015-2016 annual contraction projected at 3%. Regardless, we expect LPP stores will continue to generate steady EBIT margins going forward thanks to revenue-based rental costs. Our 2014-2020 annual CAGR projection for LPP's sales area expansion is 9%.

#### Falling profits

LPP's gross margins are affected by a strong dollar (the Company does not hedge FX risks), downward pressure from Russia and Germany, and expected aggressive clearance sales aimed at reducing inventory. For 2015, we anticipate 2ppt margin contraction to 56.5%. At the same time, thanks to rent negotiations and reduced ruble and hryvnia costs, we expect a continued decline in SG&A expenses this year at a rate of 3.6% to PLN 266 per square meter. After all this, we project that LPP's EBIT margin will post a 2.9ppt decline to 9.4% in 2015, and rebound slightly to 10.1% in 2016.

#### Slowdown in sales area expansion

The economic slump in Russia and Ukraine has stemmed the rate at which LPP was planning to expand its sales areas there (in 2013 and 2014 Russia and Ukraine accounted for 31% and 28%, respectively, of new store additions). Germany can become an alternative growth market for the Company but its presence there is small at this point and so we would not expect an acceleration in store openings in Germany until 2016. Our projections as to annual growth in LPP's sales area assume deceleration from 22% in 2014 to 19% in 2015 and 16% in 2016.

## Other

Work Service		Buy										
Analyst: Paweł Szpigel		Current price:		PLN 18.11				Last rating		2015-01-26		
		Target price:		PLN 21.9								
(PLN m)	2012	2013	change	2014E	change	2015E	change	Key metrics				
Revenue	727.4	918.4	26.2%	1 777.1	93.5%	2 357.4	32.7%	Number of shares (m)		67.4		
EBITDA	43.3	52.8	21.9%	90.4	71.2%	124.9	38.2%	MC (current price, PLNm)		1 219.9		
EBITDA margin	6.0%	5.7%		5.1%		5.3%		EV (current price, PLNm)		1 365.8		
EBIT	39.1	48.0	22.8%	83.3	73.5%	112.4	35.0%	Free float		26.2%		
Net profit	20.4	26.5	30.0%	30.6	15.5%	48.5	58.8%					
P/E	54.7	42.1		39.9		25.1		Price change: 1M		3.5%		
P/CE	45.2	35.6		32.4		20.0		Price change: 6M		24.3%		
P/BV	9.1	4.7		3.2		2.6		Price change: 12M		46.0%		
EV/EBITDA	28.2	22.7		15.1		11.7		Low (52 weeks)		12.2		
Dyld (%)	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 decreases while the share of international sales increases, Work Service is set to improve its operating margin from an estimated 4.7% in 2014 to 6.1% in 2018. By moving beyond of Poland, the Company will also be able to shorten the cash conversion cycle and reduce exposure to regulatory risk. On the other hand, it faces downward pressure from a weakened ruble (due to a lack of hedging) and a higher share of minority shareholders in net profit. We are lowering our price target for WSE to PLN 21.9 with the investment rating maintained at buy.**

### International expansion continues

Work Service is planning to acquire a Romanian temp agency which, we believe, fits well within the Company's business model. 31 December 2013 marked the end of hiring restrictions applied to Bulgarians and Romanians by Austria, Belgium, France, Spain, the Netherlands, Luxembourg, Malta, Germany, and the UK, opening up a wealth of opportunities for companies like Work Service which is preparing a large-scale strategy for cross-border placements of Romanian workers in Germany and Austria. For valuation purposes we assumed that Work Service will acquire a 51% stake in the Romanian company for PLN 30m, i.e. at 7.5x EV/EBIT. Further, Work Service is

also negotiating the acquisition of the German company Königstein Beratungsgesellschaft für EDV-Dienstleistungen mbH, with the initial stake being taken over set at 51%. The acquisition is a step in the right direction which will reinforce Work Service's presence in Germany as an outsourcer of IT talent.

### Operating in a growth market

Work Service is maximizing the opportunities offered by increasing worldwide demand for personnel services by growing at twice the average market rate (with revenue up 26.2% in 2013 vs. 11% average). The CEE market for personnel services expands at a rate of over 10-11% a year. In 2012, its value was estimated at EUR 2.35 billion ("Temporary Staffing in CEE-5"). IC Consulting expects the market to expand at an average annual rate of 10.8% in the years 2013-2017, driven mainly a growing number of temporary workforce expected to increase at a rate of 6.7% a year on the back of stronger demand from call centers, the construction industry, and sales and marketing.

### German workforce demand

A survey of workforce deficit in nineteen German industries revealed that the sectors most in need of skilled employees include retail (34,700 vacancies), the metal industry (32.4k vacancies), energy and electrical engineering (30.6k vacancies), the auto industry (29k vacancies), medicine (28.8k vacancies), and logistics (27.0k vacancies). We believe Work Service can tap into this market with the help of another of its recent acquisitions, Work Express, which specializes in cross-border employee placements and has a large bank of temporary workers from the CEE region.

## Previous ratings for companies re-rated as of the date of this Publication:

**Agora**

rating	Reduce	Hold	Reduce	Hold
rating day	2014-05-07	2014-06-06	2014-08-27	2015-01-26
price on rating day	10.15	9.60	8.24	8.35
WIG on rating day	50873.54	52901.29	52781.56	51680.12

**Asseco Poland**

rating	Accumulate	Accumulate	Accumulate
rating day	2014-07-08	2015-01-13	2015-01-26
price on rating day	40.75	52.80	53.80
WIG on rating day	51286.46	51910.34	51680.12

**Budimex**

rating	Buy	Accumulate
rating day	2014-11-19	2015-01-26
price on rating day	132.00	153.25
WIG on rating day	53368.22	51680.12

**BZ WBK**

rating	Hold	Hold	Sell	Reduce
rating day	2014-05-07	2014-07-14	2014-09-08	2015-01-26
price on rating day	362.00	348.00	403.00	343.15
WIG on rating day	50873.54	51085.89	54412.52	51680.12

**CEZ**

rating	Reduce	Reduce	Sell	Reduce	Reduce
rating day	2014-05-07	2014-06-03	2014-09-08	2014-10-31	2015-01-26
price on rating day	91.00	88.15	95.40	90.20	88.30
WIG on rating day	50873.54	52230.73	54412.52	53492.00	51680.12

**Ciech**

rating	Accumulate	Hold	Hold	Hold
rating day	2014-07-07	2014-08-06	2014-09-29	2015-01-26
price on rating day	34.00	37.72	41.35	48.40
WIG on rating day	50995.56	50865.95	54574.21	51680.12

**Cyfrowy Polsat**

rating	Accumulate	Hold	Reduce	Reduce
rating day	2014-06-06	2014-12-05	2014-12-15	2015-01-26
price on rating day	22.10	24.14	25.00	22.90
WIG on rating day	52901.29	53346.86	52265.24	51680.12

**Dom Development**

rating	Buy	Buy	Buy
rating day	2014-05-07	2014-06-23	2015-01-26
price on rating day	44.50	46.00	46.70
WIG on rating day	50873.54	52923.26	51680.12

**Elektrobudowa**

rating	Buy	Buy
rating day	2014-05-20	2015-01-26
price on rating day	72.50	81.22
WIG on rating day	51070.22	51680.12

### Enea

rating	Accumulate	Accumulate	Hold	Accumulate
rating day	2014-06-03	2014-10-31	2014-12-05	2015-01-26
price on rating day	16.07	16.00	17.00	16.96
WIG on rating day	52230.73	53492.00	53346.86	51680.12

### Energa

rating	Hold	Hold	Hold
rating day	2014-06-03	2014-10-31	2015-01-26
price on rating day	18.85	24.66	23.30
WIG on rating day	52230.73	53492.00	51680.12

### Erste Bank

rating	Buy
rating day	2015-01-26
price on rating day	19.98
WIG on rating day	51680.12

### Famur

rating	Hold	Hold	Buy	Buy
rating day	2014-05-07	2014-07-23	2014-12-05	2015-01-26
price on rating day	4.46	3.66	3.16	3.28
WIG on rating day	50873.54	51667.60	53346.86	51680.12

### Getin Noble Bank

rating	Hold	Accumulate	Buy
rating day	2014-07-14	2014-12-01	2015-01-26
price on rating day	3.00	2.23	1.80
WIG on rating day	51085.89	53247.07	51680.12

### GTC

rating	Accumulate	Buy	Buy
rating day	2014-06-06	2014-10-22	2015-01-26
price on rating day	8.00	5.85	4.91
WIG on rating day	52901.29	53213.51	51680.12

### Handlowy

rating	Reduce	Hold	Sell	Reduce
rating day	2014-06-06	2014-07-14	2014-09-08	2015-01-26
price on rating day	121.30	108.00	118.00	108.80
WIG on rating day	52901.29	51085.89	54412.52	51680.12

### ING BSK

rating	Accumulate	Hold	Hold
rating day	2014-07-14	2014-10-07	2015-01-26
price on rating day	128.70	144.00	136.50
WIG on rating day	51085.89	53992.31	51680.12

### JSW

rating	Hold
rating day	2015-01-26
price on rating day	20.40
WIG on rating day	51680.12

**Kernel**

rating	Buy	Accumulate	Hold	Hold
rating day	2014-05-07	2014-06-06	2014-07-07	2015-01-26
price on rating day	27.05	30.84	32.15	32.48
WIG on rating day	50873.54	52901.29	50995.56	51680.12

**Kęty**

rating	Hold	Hold
rating day	2014-07-01	2015-01-26
price on rating day	226.95	280.00
WIG on rating day	51934.94	51680.12

**KGHM**

rating	Hold	Buy
rating day	2014-11-05	2015-01-26
price on rating day	127.25	108.25
WIG on rating day	53905.66	51680.12

**Kopex**

rating	Buy	Hold
rating day	2014-07-07	2015-01-26
price on rating day	10.75	10.82
WIG on rating day	50995.56	51680.12

**Kruk**

rating	Buy	Buy
rating day	2014-06-06	2015-01-26
price on rating day	95.49	113.00
WIG on rating day	52901.29	51680.12

**LPP**

rating	Reduce	Sell
rating day	2014-12-19	2015-01-26
price on rating day	7770.00	7716.00
WIG on rating day	51739.04	51680.12

**LW Bogdanka**

rating	Hold	Buy
rating day	2014-07-07	2015-01-26
price on rating day	116.00	99.00
WIG on rating day	50995.56	51680.12

**Millennium**

rating	Reduce	Accumulate	Hold	Accumulate
rating day	2014-07-07	2014-07-14	2014-10-07	2015-01-26
price on rating day	8.05	7.74	8.77	7.50
WIG on rating day	50995.56	51085.89	53992.31	51680.12

**Netia**

rating	Hold	Hold
rating day	2014-07-07	2015-01-26
price on rating day	5.27	5.70
WIG on rating day	50995.56	51680.12

### Orange Polska

rating	Reduce	Hold
rating day	2014-11-05	2015-01-26
price on rating day	9.98	8.20
WIG on rating day	53905.66	51680.12

### OTP Bank

rating	Accumulate
rating day	2015-01-26
price on rating day	3779.00
WIG on rating day	51680.12

### Pekao

rating	Hold	Reduce	Hold	Reduce	Reduce
rating day	2014-07-14	2014-09-08	2014-11-05	2014-12-05	2015-01-26
price on rating day	175.00	191.00	178.50	186.45	179.00
WIG on rating day	51085.89	54412.52	53905.66	53346.86	51680.12

### PKO BP

rating	Buy	Buy
rating day	2014-07-14	2015-01-26
price on rating day	38.20	33.00
WIG on rating day	51085.89	51680.12

### RBI

rating	Buy
rating day	2015-01-26
price on rating day	10.21
WIG on rating day	51680.12

### Robygn

rating	Buy	Buy
rating day	2014-06-23	2015-01-26
price on rating day	2.35	2.16
WIG on rating day	52923.26	51680.12

### Synthos

rating	Buy	Buy
rating day	2014-12-17	2015-01-26
price on rating day	3.90	4.07
WIG on rating day	50683.91	51680.12

### Tarczyński

rating	Hold	Buy	Buy	Buy
rating day	2014-06-04	2014-07-17	2014-12-03	2015-01-26
price on rating day	11.89	10.00	11.55	12.75
WIG on rating day	52326.40	51445.92	53773.45	51680.12

### Tauron

rating	Buy	Buy	Accumulate	Buy
rating day	2014-06-03	2014-10-31	2014-12-05	2015-01-26
price on rating day	5.40	5.17	5.27	5.01
WIG on rating day	52230.73	53492.00	53346.86	51680.12

**TVN**

<b>rating</b>	<b>Buy</b>	<b>Accumulate</b>
rating day	2014-09-11	2015-01-26
price on rating day	14.98	17.60
WIG on rating day	54558.48	51680.12

**Vistal**

<b>rating</b>	<b>Buy</b>	<b>Buy</b>
rating day	2014-10-15	2015-01-26
price on rating day	13.78	9.59
WIG on rating day	52823.62	51680.12

**Work Service**

<b>rating</b>	<b>Accumulate</b>	<b>Buy</b>	<b>Buy</b>
rating day	2014-09-08	2014-10-07	2015-01-26
price on rating day	17.08	18.70	18.11
WIG on rating day	54412.52	53992.31	51680.12

## 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

## Recommendations of Dom Maklerski mBanku:

A recommendation is valid for a period of 6-9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:

**BUY** – we expect that the rate of return from an investment will be at least 15%  
**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.

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**Economic profits** – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

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