26 November 2009

Update

BRE Bank Securities

Chemical Industry

Poland

Current price	**PLN 71.5**
Target price	**PLN 80.2**
Market cap	PLN 1366.7m
Free float	PLN 398.9m
Average daily trading (3M)	PLN 2.03m

Shareholder Structure

State Treasury	50.73%
Kompania Węglowa	9.90%
ING NN OFE	5.02%
Zbigniew Jakubas	5.16%
Others	29.19%

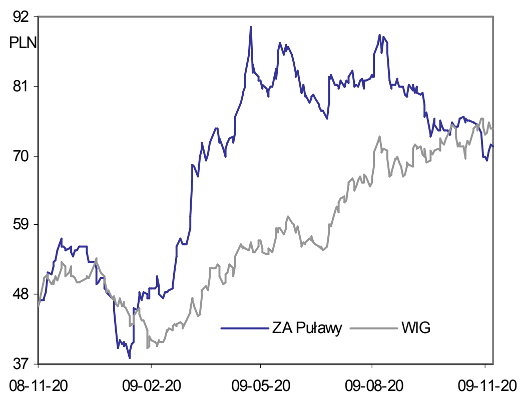
Sector Outlook

In the past few months, the situation in the fertilizer market has been stabilizing, and producers have been able to rebuild sales volumes after the downturn of late 2008. That said, there is little chance for a rapid rebound in fertilizer prices. The situation is better in the caprolactam market, where sales are driven by demand from China. Melamine sales and prices should also improve toward the end of the year.

Company Profile

ZAP is Poland's biggest producer of nitrogen fertilizers and an important exporter. In addition, the company produces melamine (7% share in global output capacity) and caprolactam (43% of Polish output).

ZA Puławy vs. WIG



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ZA Puławy

Accumulate

PULW.WA; ZAP.PW

(Upgraded)

ZAP Puts Worst Quarter Behind

The first quarter of fiscal 2009/2010 was the worst one for ZAP due to seasonal factors and one-time losses. We expect noticeable improvement in profits in the second quarter, supported by sales of Emission Reduction Units (ERU). Although an upward a shift in the fertilizer market is not likely to take place in the near future, even based on our conservative forecasts, ZAP is trading at a 10%-15% discount to its sector peers on the EV/EBITDA ratio (after ERU revenues which we estimate at PLN 8.9/share). Adding to this the expected big dividend payout, we are raising our investment rating on ZAP to accumulate, with a new price target of PLN 80.2 per share.

Picking up after weak Q109/10

ZAP's earnings results for Q1 of fiscal '09/10 missed our expectations and consensus estimates. An operating loss of PLN 47m was an effect of lost competitiveness in export markets (lower sales of UAN and ammonium nitrate, relatively high gas prices, stronger zloty), scheduled downtime on a caprolactam unit, and a one-time surge in payroll expenses stemming from a settlement with trade unions (PLN 6.5m). In the second quarter, EBIT should show quarter-on-quarter improvement thanks to seasonally stronger domestic sales of fertilizers, full capacity utilization on melamine and caprolactam plants, and an expected expansion in margins earned by the Chemicals business. Even though it is not likely that the company can break within just one quarter, a reduction in the EBIT loss should be enough to please investors. Q2 '09/10 results will be further boosted by the first revenue stream from sales of ERUs, which are expected to exceed PLN 50m this year. ERU sales will provide invaluable support to profits and cash flows amid a slumping market.

Dividends should be handsome

During a General Meeting on 16th December, ZAP's shareholders are going to vote on the Management Board's FY2008/09 dividend proposal of PLN 48.7m, or PLN 2.55 a share. However, we think that the company's balance sheet position (net cash at 30 September, including bank deposits and Treasury bills, exceeded PLN 471m, or PLN 24.6/share) and its expected privatization next year, mandate a payout of at least the whole of last year's profit (PLN 10/share, DY at 14%). The date of record is tentatively set for February 2nd, 2010, and payout is slated for February 17th. That the dividends could be higher than the Management Board suggests is implied by the addition by the State Treasury of an item to the GA agenda requiring a vote on a reserve capital appropriation.

(PLN m)	2008/09	2008/09	2009/10F	2010/11F	2011/12F
Revenue	2 503.5	2 396.8	2 028.4	2 391.1	2 848.6
EBITDA	432.8	407.2	139.0	200.9	407.4
EBITDA margin	*17.3%*	*17.0%*	*6.9%*	*8.4%*	*14.3%*
EBIT	358.7	338.3	67.9	101.2	282.4
Net profit	330.8	194.6	67.8	82.5	226.9
DPS	1.70	4.30	10.18	0.89	1.08
P/E	4.1	7.0	20.2	16.6	6.0
P/CE	3.4	5.2	9.8	7.5	3.9
P/BV	0.9	0.8	0.9	0.9	0.8
EV/EBITDA	2.0	1.9	8.7	6.9	3.1
DYield	2.4%	6.0%	14.2%	1.2%	1.5%

Q1 2009/2010: Short of Expectations

ZA Puławy reported weaker-than-expected earnings results for Q1 2009/10, even though our forecasts were much more conservative than market consensus. Sales missed our estimate by a whopping 20% due to dismal sales of UAN which were PLN 73m lower than forecasted (the slump was probably a consequence of a huge supply of UAN from the USA and other countries which incur lower costs of natural gas). But, since sales of UAN in the period were unprofitable anyway, regardless of their size, the Q1 09/10 EBIT was probably more negatively affected by PLN 29m lower-than-forecasted sales of ammonium sulfate and ammonium nitrate. The quarter's profitability was further affected by increased payroll expenses (PLN 58.3m reported vs. PLN 51.2m expected and PLN 49.2m posted in Q1 2009/2009). According to the company, this increase was an effect of a changed accounting approach and a one-time payout to employees (against which, incidentally, a provision had been recognized in the preceding quarter). After all this, ZAP's first-quarter EBIT loss was PLN 13m higher than expected at PLN 46.8m (EBITDA missed estimates by an even wider margin due to a switch to IFRS accounting in respect of depreciation and amortization). According to the new accounting policy, the EBIT figure factors in a PLN 13.5m gain generated from exchange rate hedges.

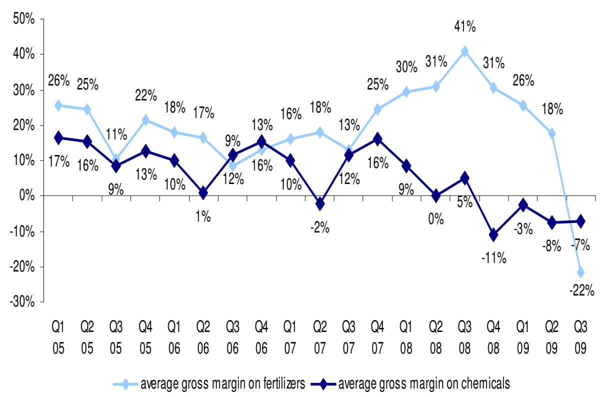
Actual vs. forecasted consolidated results

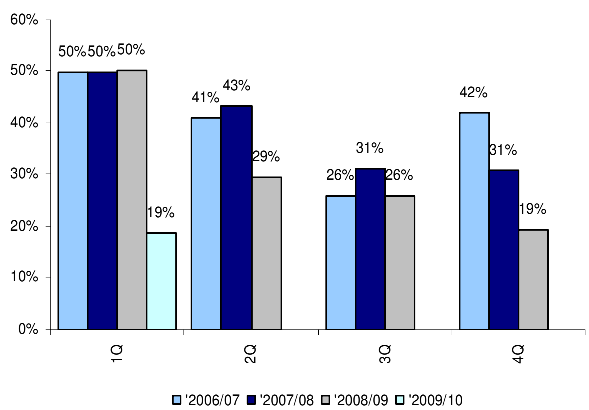
(PLN m)	Q1 09/10	Q1 08/09	Change	Q1 09/10F	Actuals vs. Forecasts	Consensus Estimates	Actuals vs. Consensus
Revenue	383.4	674.8	-43%	481.0	-20%	484.0	-20.8%
EBITDA	-30.0	181.3	-117%	-12.1	-	0.0	-
EBITDA margin	*-7.8%*	*26.9%*	-	*-2.5%*	-	*0.0%*	-
EBIT	-46.8	168.2	-	-33.8	-	-14.4	-
Pre-tax income	-39.7	185.9	-121%	-24.8	-	-	-
Net income	-31.0	150.1	-121%	-19.8	-	6.2	-

Source: ZAP, PAP, BRE Bank Securities

In spite of an EBITDA loss, ZAP generated positive cash flows of PLN 47.9m in Q1 09/10 by releasing PLN 106m cash from working capital. However, high capital expenses (PLN 156m vs. PLN 56m in the same period a year ago), incurred in line with the budget (the full-year CAPEX budget is PLN 405m), led to a shrinkage in net cash. The amount of ZAP's net debt is hard to determine because of changed presentation of short-term financial assets (deposits are booked in their full amount under "trade and other receivables"). Assuming no change in the amount of Q1 09/10 deposits relative to the preceding quarter (PLN 270.4m), and assuming that ZAP has T-bill holdings of PLN 59.4m, hedging payables of PLN 12.5m, and cash of PLN 141.3m, we estimate ZAP's cash base as of 30 September 2009 at PLN 457.7m, compared to PLN 548m three months earlier. In our view, this allows for a payout of the total of last year's PLN 194.6m profit as dividends, which would figure to PLN 10 per share.

Average gross margin by product, share of exports in sales





Source: ZAP, analysis by BRE Bank Securities

ZA Puławy presented its financials in a breakdown by business segment (Agro Division, Chemicals, Energy, and Other) for the first time in Q1 2009/2010, in line with the newly adopted IFRS reporting. Since this is the first such a presentation, measurable year-on-year comparisons are hard to make. Roughly speaking, however, the Fertilizer segment experienced a deterioration relative to the previous year, due to weaker and less profitable export sales. The year-on-year decline in Chemicals was not as bad, and probably stemmed from returns on melamine sales which contracted due to falling prices of melamine and flat prices of natural-gas in Poland. There was a surprising doubling of inter-segment revenues from energy sales (the surprise stems from the fact that energy prices increased by just several dozen percent relative to Q1 2008/2009), which ZAP explains with a different accounting approach applied to intercompany utility supplies (external energy purchases, which used to be handled by each plant for itself, are now coordinated centrally by the Energy segment, inclusive of transfer fees).

Actual vs. forecasted consolidated results by segment

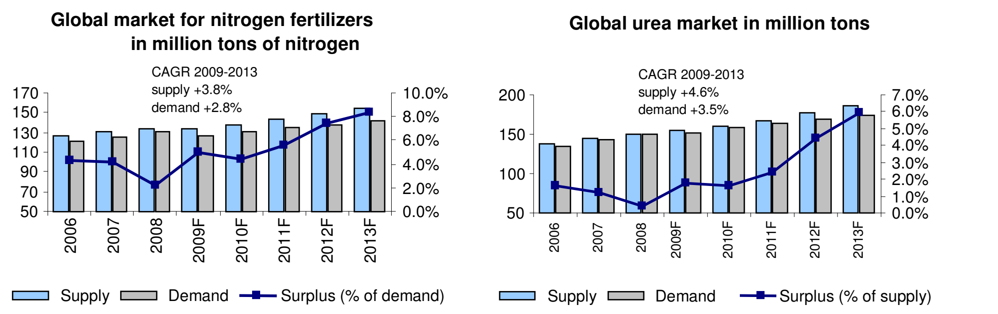
(PLN m)	Agro		Chemicals		Energy		Other		Eliminations	
	Q109/10	Q108/09	Q109/10	Q108/09	Q109/10	Q108/09	Q109/10	Q108/09	Q109/10	Q108/09
Revenue	287.2	596.6	243.4	365.8	337.3	142.0	46.3	50.8	-530.9	-480.4
External sales	178.7	442.4	190.4	208.7	4.0	4.0	10.3	19.6	0.0	0.0
Gross profit	-44.1	164.7	-8.2	54.9	33.6	14.8	-7.2	-10.7	26.4	2.1
Gross margin	-15.3%	27.6%	-3.3%	15.0%	9.9%	10.4%	-15.5%	-21.1%	-	-
EBITDA	-58.9	138.5	-11.4	52.0	34.2	16.0	-20.3	-27.3	26.4	2.1
Amortization and depreciation	5.2	2.8	7.7	7.2	1.7	1.4	2.0	1.8	0.0	0.0
EBIT	-64.1	135.7	-19.2	44.8	32.5	14.6	-22.4	-29.0	26.4	2.1

Source: Za Puławy

Fertilizer Market: Steady After the Fall

According to IFA, the demand for nitrogen fertilizers in 2009 should figure to 127m of nitrogen, which entails a 3.4% y/y decline. With consumption reduced, after the period of increasing tensions between supply and demand (2000-2007) the global output surplus surged considerably (6.6m tons vs. 3m tons a year ago), forcing manufacturers to cut capacity utilization from record-high levels of 95-97% to 85-90% on average. This coincided with the global economic crisis and the plunge in freight costs, which used to give an additional geographical premium to producers located close to the key markets. The industry's problems were further exacerbated by the construction of new plants (with capacity of ca. 10m tons, i.e. 7% of the global demand). Current analyses show that the market has already entered the phase of stabilization (decline in the manufacturer's inventories, increased purchases on the part of farmers), though we can hardly expect a rapid return to the boom seen in 2007-08. CAPEX schedules suggest that by 2013, the supply of nitrogen fertilizers will increase by 16%, while demand will only go up by 12%.This will further increase the global output surplus, and cause the capacity utilization rates to remain at the current levels.

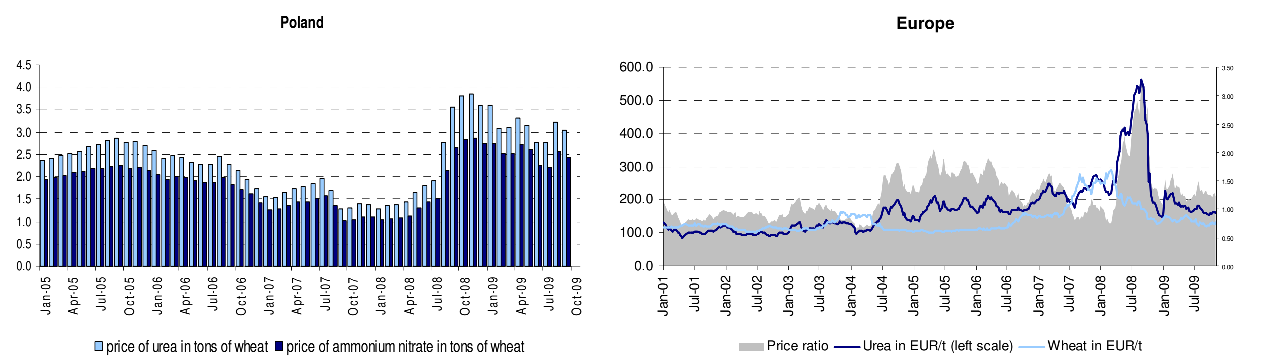
Global market for nitrogen fertilizers and urea



Source: IFA, analysis by BRE Bank Securities

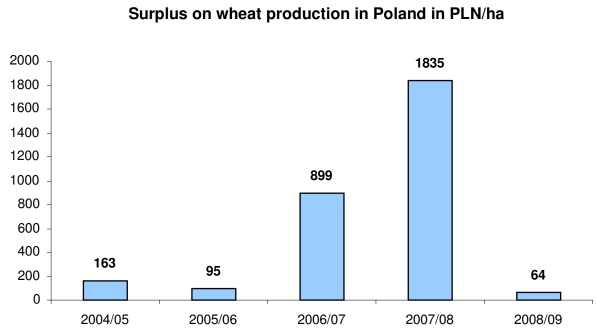
An important factor in the recent rebound in the market has been the improvement in the farmers' relative purchasing power, which declined dramatically towards the end of last year as grain prices plunged while the prices of agricultural materials remained high. At present, the ratio of the price of ammonium nitrate or urea to wheat in Europe is at a 10-year average level, which is more advantageous to the farmers than, say, the 2005-2009 average. In Poland, these adjustments are still ongoing; in fact, fertilizing costs had not returned to the 2005 level until only the most recent price cuts, which the manufacturers were forced to make due to the competition from imports. In addition to the decline in fertilizer prices, the Polish farming industry will be protected against a decline in per-hectare profits, which could come from the plunging grain prices, by the new wave of direct subsidies from the EU, which will provide it with nearly PLN 2.8bn more funds due to the higher EUR/PLN exchange rate.

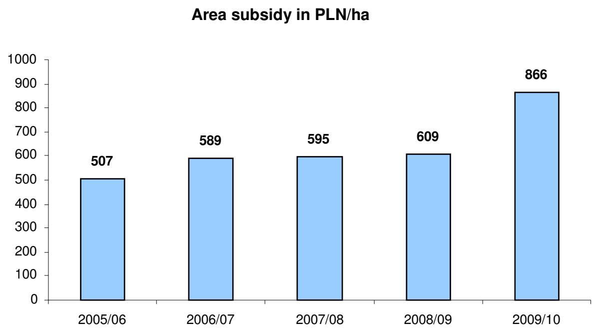
Price ratio of fertilizers to wheat in Poland (retail) and Europe



Source: Bloomberg, Institute of Agricultural and Food Economics, estimates by BRE Bank Securities

Surplus on grain production in Poland (excl. EU subsidies) and area subsidy

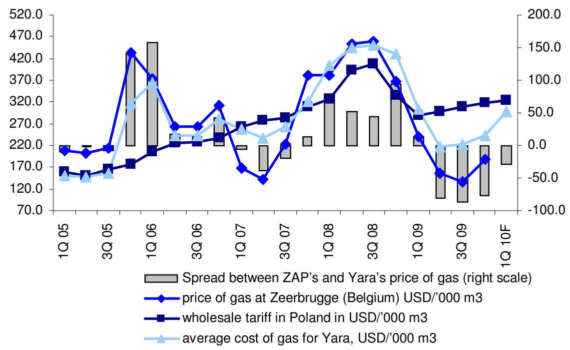


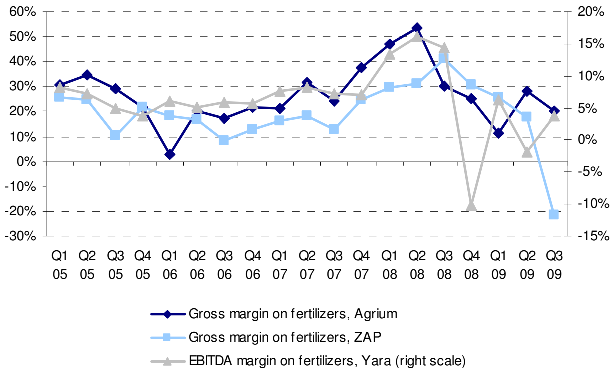


Source: Agency for Agricultural Restructuring and Modernization, estimates by BRE Bank Securities

A big problem for ZAP are gas tariffs in Poland, which are frequently out of synch with tendencies in the efficient markets. Through 2008, the system allowed the Company to generate an additional margin vs. its Western European competitors, but the situation was reversed in Q2 2009. With the considerable reductions in gas prices at the European exchanges, production costs plunged for such concerns as Yara, allowing them to cut prices. Meanwhile, the price of natural gas as paid by ZAP declined by a mere 7% in June, which, combined with the appreciating zloty and the mounting pressure from imports, led to a reduction in profitability (with a decline in gross margin on fertilizers from 26% in Q3'08/09 and 18% in Q4'08/09 to 10% in Q1'09/10). In the ensuing quarters, we can expect these relations to improve, due to the increase of natural gas prices in oil-linked contracts. We estimate that starting in Q2'09, ZAP's cost of natural gas will be the same as for Western European producers. However, this will have little impact on FY 2009/10 earnings, as it will take place after the spring fertilizing campaign.

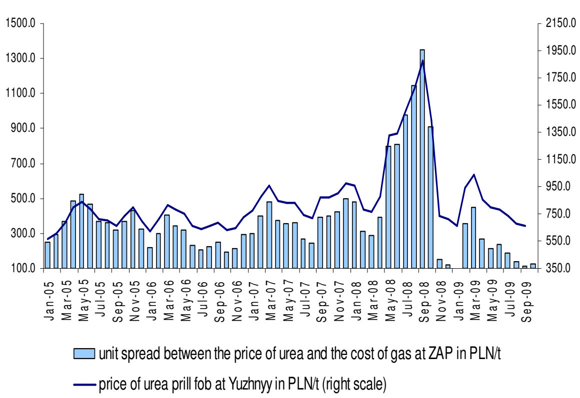
Average prices of gas paid by ZAP and Yara and at Zeerbrugge in USD/thousand cubic meters; profitability of the fertilizer business vs. competition (Agrium, Yara)

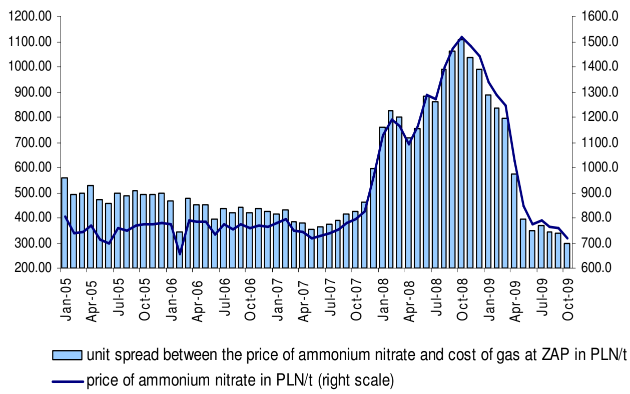




Source: Bloomberg, Yara, PGNiG, estimates by BRE Bank Securities

Spread between the price of urea and ammonium nitrate vs. price of gas paid by ZAP



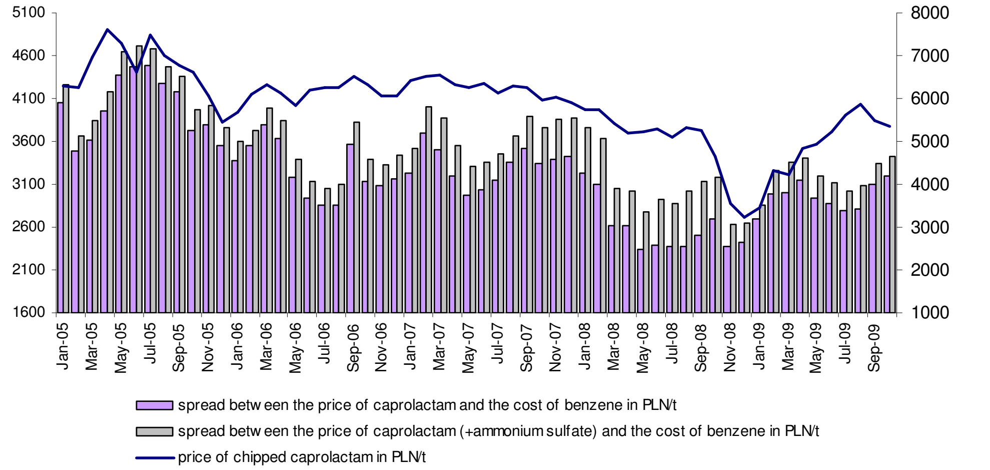


Source: Fertecon, ZAP, estimates by BRE Bank Securities

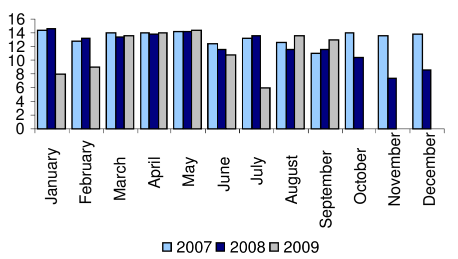
Caprolactam: Asian Demand Rises Appreciably, ZAP's Margin Improves

After the dramatic plunge in the final months of 2008 (when the industry's capacity utilization ratio fell to 50%), the market for caprolactam rebounded clearly in the first half of the year, mostly thanks to the clear increase in orders from Asia and the rebound in car manufacturing. Given the fact that several plants were shut down for good (including MCC's in Japan for 230,000 tons and Braskem's in Brasil for 62,000 tons), which reduced the global supply, margins should remain high even when benzene prices are at a higher level. ZAP is taking full advantage of this rebound, thanks to its ability to convert its entire output into chips and place it at the best markets. As a result, it was able to use its capacity at 100% in the second quarter, vs. the 75% average for its European peers. We expect that in the immediate future this tendency will persist as far as volumes are concerned (China has introduced antidumping duty on PA-6, which will strengthen demand in a market where ZAP's position is very solid), but any potential increase in the spread between the price and the petrochemical feedstock will be offset by the appreciating zloty and the fairly stable prices of ammonium sulfate, which, as a by-product, contributes to the Company's margin. Profitability will be boosted, on the other hand, by the expected reduction in electricity prices (a decline by ca. PLN 8-10m vs. H1'09 can be expected in H2'09). In addition, additional q/q earnings improvement in Q2'09/10 should stem from the lack of expenses on maintenance downtime, which took place in July.

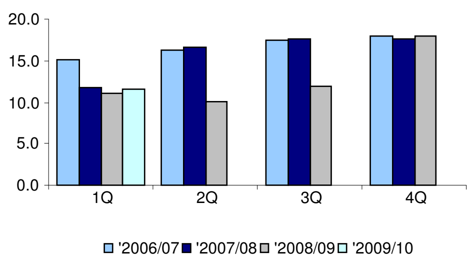
Price/cost spread on caprolactam in PLN/t, output sold in thousand tons vs. total domestic output



Caprolactam output (Poland)



Caprolactam output (ZAP)

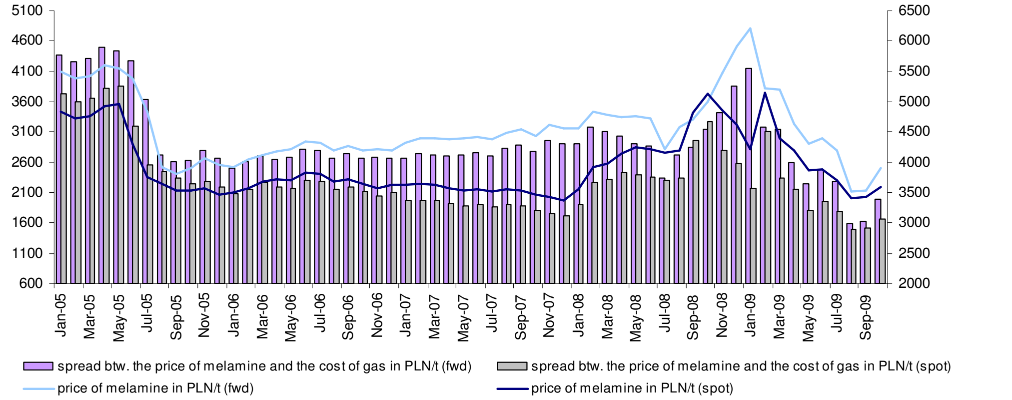


Source: Bloomberg, ICIS, GUS, estimates by BRE Bank Securities

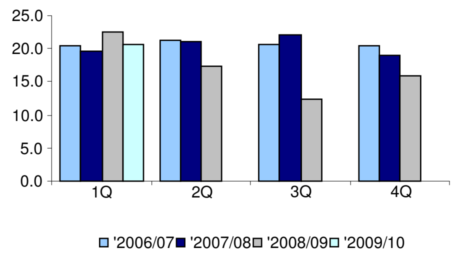
Melamine: Opportunity to Improve Volumes and Margins

In the past few quarters, the melamine market witnessed a dramatic plunge in demand due to the problems experienced by the wood processing industry. In consequence, output was reduced (European manufacturers are currently operating at 75-80% of their capacity) and prices were cut, by 40% YTD according to ICIS. A true profitability disaster was avoided thanks to the decline in the price of several feedstock materials (natural gas or urea, depending on the nature of the given plant's vertical integration). Unfortunately, in the case of ZAP, whose price of gas is determined by tariffs, the decline in revenues from melamine production was not correlated with a similar decline in the cost of gas (the chart below shows how the spread shrank). As a result, in H1'09 the company recorded a gross loss on melamine sales in H1'09 (what the Company says about its margin in the Chemicals segment points in this direction as well). The third quarter was even tougher in this respect due to further price cuts and the appreciation of the zloty. Already in Q4'10, however, and in early 2010, we should see an improvement, as the European manufacturers start to transfer the increase in gas prices onto customers, which, given the fact that gas tariffs in Poland have remained unchanged since April, will be reflected in a higher margin for ZAP (moreover, according to the Management, in Q4'09 the company has already increased its capacity utilization to 100%). Another factor of help will be the increase in demand, as harbingered by the positive signals coming from particle board manufacturers (already in Q2 a 12% q/q rebound in European consumption was observed, although it was by and large driven by the depletion of customer inventories). According to analyses by DSM Melamine, however, 2007 and 2008 levels will not be matched until 2011, as prior to that the market will be impacted by new plant launches planned for late 2009/early 2010 in Qatar (60,000 tons), China (50-100,000 tons) and Trinidad (60,000 tons), although the increase in supply may be partially offset by the closures of smaller, less competitive plants that are not vertically integrated and require external urea supplies.

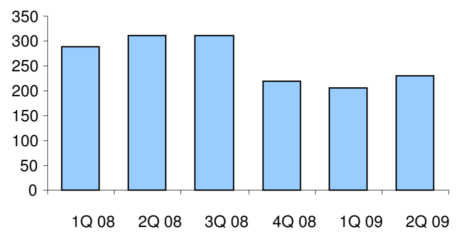
Price/cost spread on melamine, estimated volume of output sold in thousand tons



Melamine output at ZAP



Global demand for melamine in thousand tons



Source: Bloomberg, ICIS, DSM, ZAP, estimates by BRE Bank Securities

CAPEX and Subsidies

The Management promised to intensify investment in FY 2009/10, with spending in excess of PLN 400m. This will mark a considerable increase on the last two years, when CAPEX figured to PLN 107m (2007/08) and PLN 147m (2008/09), respectively. The key projects under preparation include the modernization of the oxygen-ammonia-urea line (increasing capacity in urea by 270,000 tons by 2011, with launch planned for September 2010) and a desulphurization installation in the CHP (adjustment to EU requirements in 2012). An important aspect of the CAPEX plans is the expected EU subsidy under the Infrastructure and Environment program, which could reach PLN 40m. Its key impact will be on cash flows (subsidies will be disbursed at the completion of the individual projects, and this is the schedule we take into account in our model). In the income statement, subsidies will be booked in other operating income in accordance with the period of depreciation of the investment they apply to (by way of example, in 2011/2012 we include ca. PLN 1m on this account). In the case of the expansion in urea capacity and the ensuing increase in ADBlue output (100,000 tons vs. the current 30,000 tons), the Company will be able to take advantage of a tax shield, as the project is located in a special economic zone. 50% of qualified outlays are tax-deductible through 2017 (this only applies to revenues generated within the zone), which we have factored into our model (we do assume, however, that only ca. 25% of the invested amount would be recuperated, i.e. PLN 50m, which would imply a PLN 260m gross profit on the new installations in 2013-2017). We ignore the costly projects that are currently in very early stages (coal gasification facility, a 1600MW power plant).

Income on Nitrous Oxide Emission Credits

Under Joint Implementation (a mechanism provided for by the Kyoto Protocol) with BASF, ZAP installed a nitrous oxide monitoring system and catalyzer on its nitric acid installations, which allowed it to cut N_2O emissions by ca. 85%. Given the emissions baseline currently in force, it will be able to generate free emission reduction units (ERU) and sell them in the market (some of them will go to BASF in exchange for the construction of the installation in question). According to the Management, in 2009/2010 the Company should sell ca. 1.3m ERU, which will bring gains of ca. PLN 53m on current market prices. Such amounts should keep coming in at least until 2012 (when the Kyoto Protocol expires, though the mechanisms in question may be kept in place). ZAP has already signed appropriate ERUPA agreements (ERU Purchase Agreement), which will be based on market prices (though a minimum price is guaranteed). In our model, we take into account gains on ERU in excess of PLN 200m in 2009-2012.

Earnings Forecast and Valuation

Based on our DCF model and relative valuation, we set the per-share price target on ZAP at PLN 80.2. On this basis, we rate the stock as accumulate.

	Weight	Price
Relative valuation	50%	81.8
DCF analysis	50%	66.3
	Price	74.0
	9M Target Price	**80.2**

DCF analysis

Model Assumptions

1. The model is based on the following assumptions for F/X rates and the prices of commodities and ZAP's products within the forecast horizon:

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
EUR/USD	1.40	1.33	1.32	1.30	1.30	1.30	1.30	1.30	1.30	1.30
EUR/PLN	4.10	3.83	3.58	3.50	3.50	3.50	3.50	3.50	3.50	3.50
USD/PLN	2.93	2.88	2.71	2.69	2.69	2.69	2.69	2.69	2.69	2.69
in EUR/t										
Melamine	944	1014	1225	1225	1225	1225	1225	1225	1225	1225
Caprolactam	1388	1519	1667	1693	1693	1693	1693	1693	1693	1693
Urea	174	221	277	283	283	283	283	283	283	283
Ammonium nitrate	193	246	311	315	315	315	315	315	315	315
UAN	113	143	181	190	190	190	190	190	190	190
Ammonium sulfate	64	81	102	104	104	104	104	104	104	104
Benzene (EUR/t)	678	769	917	943	943	943	943	943	943	943
Gas inc. transfer in PLN/'000 m3	993	1 004	1018	1 008	996	1 000	1 004	1 008	1 009	1 009

2. In our model, we take into account gains on nitrous oxide ERU in excess of PLN 200m in 2009-2012.
3. When calculating equity value, we take into account hedging liabilities which amounted to –PLN 33.1m at the end of 2008/2009.
4. We take into account positive cash flows from EU investment subsidies in the amount of PLN 40m.
5. In 2012-2018, we assume Ciech will benefit from the tax shield as described above thanks to its investment in the special economic zone (PLN 50m).
6. The depreciation and amortization expense projected for FY2018/19 is higher than CAPEX, which is unsustainable over the long term, prompting us to revise the D&A expense to PLN 118.8 million when calculating the terminal value.
7. When calculating FCF_{TV}, we based terminal value estimations on the sales growth rate and EBITDA margins projected for 2018/19.
8. We assume that FCF after FY2017 will grow at a rate of 0%. We also assume a risk-free rate of 6.2% (6.2% in the forecast years), and a beta of 1.0.
9. Cash flows are discounted as of 30 November 2009, and we use net debt at year-end 2008/2009.

DCF Valuation Model

(PLN m)	2009/10F	10/11F	11/12F	12/13F	13/14F	14/15F	15/16F	16/17F	17/18F	18/19F	2019+
Revenues	**2 028**	**2 391**	**2 849**	**2 856**	**2 953**	**2 859**	**2 895**	**2 909**	**2 922**	**2 937**	**2 952**
change	*-15.4%*	*17.9%*	*19.1%*	*0.3%*	*3.4%*	*-3.2%*	*1.3%*	*0.5%*	*0.5%*	*0,5%*	*0,5%*
EBITDA	**139.0**	**200.9**	**407.4**	**361.8**	**354.3**	**326.8**	**305.1**	**285.2**	**267.8**	**256,3**	**257,6**
EBITDA margin	*6.9%*	*8.4%*	*14.3%*	*12.7%*	*12.0%*	*11.4%*	*10.5%*	*9.8%*	*9.2%*	*8,7%*	*8,7%*
Amortization and depreciation	71.2	99.7	125.0	128.3	124.1	121.9	124.8	129.2	135.7	141,1	118,8
EBIT	**67.9**	**101.2**	**282.4**	**233.5**	**230.2**	**204.9**	**180.3**	**156.0**	**132.1**	**115,2**	**138,8**
EBIT margin	*3.3%*	*4.2%*	*9.9%*	*8.2%*	*7.8%*	*7.2%*	*6.2%*	*5.4%*	*4.5%*	*3,9%*	*4,7%*
Tax rate on EBIT	12.9	19.2	53.7	39.4	33.7	28.9	24.3	19.6	20.1	21,9	26,4
NOPLAT	**55.0**	**82.0**	**228.8**	**194.1**	**196.5**	**176.0**	**156.0**	**136.3**	**112.0**	**93,3**	**112,4**
CAPEX	-405.0	-284.5	-155.1	-107.7	-110.4	-113.1	-116.0	-118.9	-118.9	-118,9	-118,9
Working capital	57.6	-73.2	-87.9	-2.3	-18.9	18.8	-8.3	-3.5	-3.5	-3,6	-3,6
Equity investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0,0	0,0
EU subsidies	3.0	17.0	20.0	0.0	0.0	0.0	0.0	0.0	0.0	0,0	0,0
FCF	**-218.3**	**-159.0**	**130.8**	**212.5**	**191.3**	**203.6**	**156.6**	**143.2**	**125.3**	**112,0**	**108,8**
WACC	*11.2%*	*11.1%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11,2%*	*11,2%*
discount factor	*94.0%*	*84.6%*	*76.1%*	*68.4%*	*61.5%*	*55.3%*	*49.7%*	*44.7%*	*40.2%*	*36,2%*	*36,2%*
PV FCF	-205.1	-134.4	99.5	145.3	117.6	112.6	77.9	64.1	50.4	40,5	
WACC	***11.2%***	***11.1%***	***11.2%***	***11.2%***	***11.2%***	***11.2%***	***11.2%***	***11.2%***	***11.2%***	***11,2%***	***11,2%***
Cost of debt	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7,2%*	*7,2%*
Risk-free rate	*6.20%*	*6.20%*	*6.20%*	*6.20%*	*6.20%*	*6.20%*	*6.20%*	*6.20%*	*6.20%*	*6,20%*	*6,20%*
Risk premium	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1,0%*	*1,0%*
Effective tax rate	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19,0%*	*19,0%*
Net debt / EV	*0.0%*	*1.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0,0%*	*0,0%*
Cost of Equity	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11.2%*	*11,2%*	*11,2%*
Risk premium	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5,0%*	*5,0%*
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1,0	1,0

FCF growth after the forecast horizon	*0.0%*
Terminal value	971.4
Present value of the terminal value (PV TV)	351.4
Present value of FCF in the forecast horizon	368.3
Equity value (EV)	719.6
Net debt	-581.5
Options liabilities at year-end 2008/09	-33.2
Minority interests	0.0
Equity value	1 268.0
Number of shares (millions)	19.1
Equity value per share (PLN)	**66.3**
Cost of equity (9M)	*8.3%*
Target Price	**71.8**
EV/EBITDA('09/10) for the target price	5.9
P/E('09/10) for the target price	20.3
TV to EV	49%

Sensitivity analysis

	FCF growth in perpetuity				
	0.0%	**1.0%**	**2.0%**	**3.0%**	**4.0%**
WACC +1.0pp	70.2	71.8	73.8	76.2	79.1
WACC +0.5pp	71.0	72.8	74.9	77.6	80.9
WACC	71.8	73.8	76.2	79.1	82.9
WACC -0.5pp	72.8	74.9	77.6	80.9	85.2
WACC -1.0pp	73.8	76.2	79.1	82.9	87.9

Relative Valuation

We compared Ciech's P/E and EV/EBITDA multiples with the multiples of its peers estimated for FY2009 through FY2011. The peer group includes chemical companies from Western Europe and two leading Russian producers. We purposefully selected companies operating in radically different market environments so as to average the valuation of ZA Puławy. The comparable companies also differ in respect of competitive advantages. For Western European companies (DSM, Yara, Agrium), the edge lies chiefly in their multinational operations, organized logistics networks, and the proximity of target markets. On the other hand, Silvinit and Acron, with considerable technological and efficiency backlogs, rely on access to cheaper materials, and the group also includes the Romanian manufacturer of fertilizers and melamine Azomures. The profits on ERU we assume have been excluded from multiple-based valuation and valued separately (we estimate the value of discounted cash flows from this source at PLN 8.9 per share).

		P/E				EV/EBITDA			
	Price	**2008**	**2009F**	**2010F**	**2011F**	**2008**	**2009F**	**2010F**	**2011F**
Acron	31.71	2.8	12.2	7.8	7.2	2.6	8.2	6,0	5,1
Agrium	54.87	6.6	22.8	11.1	8.9	4.4	11.5	6,9	5,8
Azomures	0.30	3.3	5.7	8.0	10.2	-	3.4	4,1	4,6
DSM	33.41	12.8	27.1	22.7	17.9	6.9	11.0	9,2	8,2
K+S	42.59	7.4	61.2	19.2	12.5	4.8	17.2	9,3	7,0
Police	5.25	13.7	-1.6	44.4	10.2	3.0	-3.7	6,2	4,9
Silvinit	758.96	5.3	12.8	7.9	6.4	4.6	10.1	7,2	5,5
Yara	236.00	6.6	26.1	14.2	11.8	4.9	17.7	10,4	8,9
Maximum		13.7	61.2	44.4	17.9	6.9	17.7	10,4	8,9
Minimum		2.8	-1.6	7.8	6.4	2.6	-3.7	4,1	4,6
Median		**6.6**	**17.8**	**12.7**	**10.2**	**4.6**	**10.5**	**7,0**	**5,7**
ZA Puławy*	71.50	7.0	54.0	34.1	7.4	2.0	9.5	5,9	2,4
(premium / discount)		6.0%	203.0%	169.6%	-27.5%	-56.5%	-10.3%	-16,6%	-58,5%
Implied price									
Median		6.6	17.8	12.7	10.2	4.6	10.5	7,0	5,7
Multiple weight				50.0%				50.0%	
Year weight		0.0%	33.3%	33.3%	33.3%	0.0%	33.3%	33,3%	33,3%
Equity value per share (PLN)		**72.8**							
Gains on ERU per share		8.9							
Equity value per share (PLN)		**81.8**							

EV/EBITDA based on net debt at year-end 2008
**multiples for ZAP are estimated for net income and EBITDA adjusted for estimated gains on the sale of ERU*

Income Statement

(PLN m)	2006/07	2007/08	2008/09	2009/10F	2010/11F	2011/12F	2012/13F
Revenues	**2 205.3**	**2 503.5**	**2 396.8**	**2 028.4**	**2 391.1**	**2 848.6**	**2 856.3**
change	*8.6%*	*13.5%*	*-4.3%*	*-15.4%*	*17.9%*	*19.1%*	*0.3%*
Cost of sales	1 821.7	1 867.7	1 778.9	1 762.7	2 066.9	2 324.5	2 351.4
Gross profit	383.6	635.8	617.9	265.7	324.2	524.1	504.9
Gross profit margin	*17.4%*	*25.4%*	*25.8%*	*13.1%*	*13.6%*	*18.4%*	*17.7%*
Selling expenses	153.9	168.0	150.1	163.6	179.1	191.6	194.2
General and administrative expenses	70.7	82.8	97.0	80.6	88.2	94.4	95.7
Other net operating profit	-7.6	-26.3	-32.5	46.4	44.3	44.3	18.5
EBIT	**151.4**	**358.7**	**338.3**	**67.9**	**101.2**	**282.4**	**233.5**
change	*-3.5%*	*136.9%*	*-5.7%*	*-79.9%*	*49.1%*	*179.0%*	*-17.3%*
EBIT margin	*6.9%*	*14.3%*	*14.1%*	*3.3%*	*4.2%*	*9.9%*	*8.2%*
Profit on financing activity	7.0	42.6	-97.2	15.8	0.7	-2.2	3.9
Extraordinary gains/losses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax income	**158.5**	**401.4**	**241.2**	**83.7**	**101.9**	**280.2**	**237.4**
Tax	28.5	70.6	46.6	15.9	19.4	53.2	40.1
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income	**130.0**	**330.8**	**194.6**	**67.8**	**82.5**	**226.9**	**197.3**
change	*3.0%*	*154.5%*	*-41.2%*	*-65.2%*	*21.8%*	*174.9%*	*-13.1%*
margin	*5.9%*	*13.2%*	*8.1%*	*3.3%*	*3.5%*	*8.0%*	*6.9%*
Amortization and depreciation	99.9	74.0	68.9	71.2	99.7	125.0	128.3
EBITDA	**251.4**	**432.8**	**407.2**	**139.0**	**200.9**	**407.4**	**361.8**
change	*-8.4%*	*72.2%*	*-5.9%*	*-65.9%*	*44.5%*	*102.8%*	*-11.2%*
EBITDA margin	*11.4%*	*17.3%*	*17.0%*	*6.9%*	*8.4%*	*14.3%*	*12.7%*
Shares at year-end (millions)	19.1	19.1	19.1	19.1	19.1	19.1	19.1
EPS	6.8	17.3	10.2	3.5	4.3	11.9	10.3
CEPS	12.0	21.2	13.8	7.3	9.5	18.4	17.0
ROAE	*10.7%*	*23.7%*	*12.3%*	*4.3%*	*5.4%*	*13.5%*	*10.7%*
ROAA	*7.9%*	*18.2%*	*9.6%*	*3.4%*	*4.1%*	*10.2%*	*8.2%*

Balance Sheet

(PLN m)	2006/07	2007/08	2008/09	2009/10F	2010/11F	2011/12F	2012/13F
ASSETS	**1 665.5**	**1 967.9**	**2 081.8**	**1 925.2**	**2 117.5**	**2 346.4**	**2 489.3**
Fixed assets	**659.1**	**785.4**	**827.2**	**1 158.0**	**1 325.8**	**1 335.9**	**1 315.3**
Property, plant and equipment	620.4	662.4	764.6	1 094.6	1 262.8	1 274.5	1 255.6
Intangible assets	8.5	10.5	12.8	13.6	13.2	11.6	9.9
Long-term receivables	3.3	75.5	0.0	0.0	0.0	0.0	0.0
Other fixed assets	26.9	36.9	49.8	49.8	49.8	49.8	49.8
Current assets	**1 006.4**	**1 182.5**	**1 254.6**	**767.2**	**791.7**	**1 010.5**	**1 174.0**
Inventories	152.5	198.0	217.6	215.6	252.8	284.3	287.6
Short-term receivables	363.0	355.3	413.9	350.3	412.9	491.9	493.3
Prepayments	40.9	48.8	41.5	41.5	41.5	41.5	41.5
Cash and cash equivalents	450.0	580.3	581.6	159.8	84.4	192.7	351.6

(PLN m)	2006/07	2007/08	2008/09	2009/10F	2010/11F	2011/12F	2012/13F
LIABILITIES	**1 665.5**	**1 967.9**	**2 081.8**	**1 925.2**	**2 117.5**	**2 346.4**	**2 489.3**
EQUITY	**1 255.5**	**1 540.2**	**1 635.9**	**1 509.1**	**1 574.7**	**1 781.0**	**1 921.5**
Share capital	191.2	191.2	191.2	191.2	191.2	191.2	191.2
Other equity	1 064.3	1 349.0	1 444.8	1 317.9	1 383.5	1 589.8	1 730.4
Long-term liabilities	**60.6**	**0.0**	**0.3**	**0.3**	**55.9**	**55.9**	**55.9**
Loans	60.5	0.0	0.0	0.0	55.6	55.6	55.6
Other	0.1	0.0	0.3	0.3	0.3	0.3	0.3
Short-term liabilities	**349.5**	**427.6**	**445.5**	**415.8**	**487.0**	**509.5**	**511.9**
Loans	48.4	59.8	0.0	0.0	44.4	44.4	44.4
Trade creditors	160.2	178.0	162.6	154.6	181.3	203.8	206.2
Accruals	11.7	19.3	19.8	19.8	19.8	19.8	19.8
Other	129.2	170.6	263.1	241.4	241.4	241.4	241.4
Debt	108.9	59.8	0.1	0.0	100.0	100.0	100.0
Net debt	-341.1	-520.5	-581.5	-159.8	15.6	-92.7	-251.6
(Net debt / Equity)	*-27.2%*	*-33.8%*	*-35.5%*	*-10.6%*	*1.0%*	*-5.2%*	*-13.1%*
(Net debt / EBITDA)	-1.4	-1.2	-1.4	-1.1	0.1	-0.2	-0.7
BVPS	65.7	80.6	85.6	78.9	82.4	93.2	100.5

Cash Flows

(PLN m)	2006/07	2007/08	2008/09	2009/10F	2010/11F	2011/12F	2012/13F
Cash flows from operating activities	**156.4**	**336.0**	**320.1**	**159.0**	**108.4**	**266.3**	**319.4**
Net income	130.0	330.8	194.6	67.8	82.5	226.9	197.3
Amortization and depreciation	99.9	74.0	68.9	71.2	99.7	125.0	128.3
Working capital	-61.2	-78.7	35.0	57.6	-73.2	-87.9	-2.3
Other	-12.4	9.8	21.6	-37.5	-0.7	2.2	-3.9
Cash flows from investing activities	**103.0**	**-3.9**	**-448.5**	**-382.7**	**-260.7**	**-127.4**	**-93.3**
CAPEX	-86.9	-107.5	-147.2	-405.0	-284.5	-155.1	-107.7
Equity investments	-4.9	-11.6	-16.9	0.0	0.0	0.0	0.0
Other	194.8	115.2	-284.4	22.3	23.8	27.7	14.3
Cash flows from financing activities	**-102.6**	**-91.1**	**-159.7**	**-198.1**	**76.9**	**-30.5**	**-67.2**
Stock offering	0.0	0.5	0.0	0.0	0.0	0.0	0.0
Debt	-49.2	-45.3	-59.3	-0.1	100.0	0.0	0.0
Dividend (buy-back)	-38.2	-32.5	-82.2	-194.6	-17.0	-20.6	-56.7
Other	-15.2	-13.8	-18.2	-3.4	-6.1	-9.9	-10.5
Change in cash	**156.8**	**241.0**	**-288.1**	**-421.8**	**-75.4**	**108.3**	**158.9**
Cash at end of period	450.0	580.3	581.6	159.8	84.4	192.7	351.6
DPS (PLN)	2.00	1.70	4.30	10.18	0.89	1.08	2.97
FCF	74.9	176.0	248.4	-224.3	-176.1	111.2	211.7
(CAPEX / Sales)	*3.9%*	*4.3%*	*6.1%*	*20.0%*	*11.9%*	*5.4%*	*3.8%*

Market multiples

	2006/07	2007/08	2008/09	2009/10F	2010/11F	2011/12F	2012/13F
P/E	10.5	4.1	7.0	20.2	16.6	6.0	6.9
P/CE	5.9	3.4	5.2	9.8	7.5	3.9	4.2
P/BV	1.1	0.9	0.8	0.9	0.9	0.8	0.7
P/S	0.6	0.5	0.6	0.7	0.6	0.5	0.5
FCF/EV	*7.3%*	*20.8%*	*32.1%*	*-18.6%*	*-12.7%*	*8.7%*	*19.0%*
EV/EBITDA	4.1	2.0	1.9	8.7	6.9	3.1	3.1
EV/EBIT	6.8	2.4	2.3	17.8	13.7	4.5	4.8
EV/S	0.5	0.3	0.3	0.6	0.6	0.4	0.4
DYield	*2.8%*	*2.4%*	*6.0%*	*14.2%*	*1.2%*	*1.5%*	*4.2%*
Price (PLN)	**71.50**						
Shares at year-end (millions)	19.1	19.1	19.1	19.1	19.1	19.1	19.1
MC (PLN m)	1366.7	1366.7	1366.7	1366.7	1366.7	1366.7	1366.7
Equity attributable to minority shareholders (PLN m)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EV (PLN m)	1 025.6	846.2	773.7	1 207.0	1 382.3	1 274.0	1 115.1

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

Recommendations of BRE Bank Securities
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Previous ratings issued for ZA Puławy

Rating	Hold	Hold
Date issued	2009-04-02	2009-05-28
Price on rating day	70.00	80.40
WIG on rating day	24145.69	29775.36