

**Oil & Gas**

Poland

<b>Current price</b>	<b>PLN 31.94</b>
<b>Target price</b>	<b>PLN 26.60</b>
Market cap	PLN 4.148bn
Free float	PLN 1.286bn
Avg daily trading volume (3M)	PLN 12.19m

**Shareholder Structure**

State Treasury	63.97%
ING OFE	5.02%

Others	31.01%
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**Sector Outlook**

In the recent months, the environment has been unfavorable for the refining business, both in terms of margins and the Urals/Brent spread. There are signals, however, that this is changing. If the current revival in the global fuel market continues, the sentiment in the sector should improve.

**Company Profile**

Grupa Lotos is the second largest refining group in Poland, with 6m tons of annual capacity which it plans to increase to 10.5m tons in 2011. The company also runs the second largest chain of fuel stations in Poland (around 350), and holds a majority stake in Petrobalitc, which mines crude oil from the Baltic Sea shelf.

# Lotos

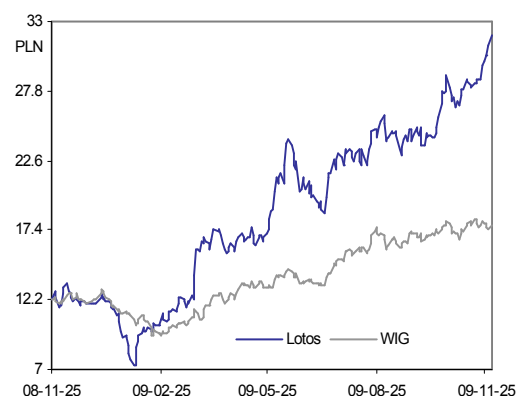
LTOS.WA; LTS.PW

## Reduce

(Downgraded)

### Big Premium to Rival PKN, Bigger Risk

Lotos's shares have soared 20% over the past month, outperforming the WIG20 (+3.4%), rival PKN Orlen (+2%), and the MSCI Energy benchmark (-0.5%). The rally has created a considerable premium in excess of the company's fair value. The premium to PKN Orlen is most pronounced on FY2010E EV/EBITDA multiples (12.3 for Lotos, 4.8 for PKN after adjustment for strategic reserves), but it is also marked in the sum-of-parts analysis presented on the next page. According to our calculations, investors value Lotos's oil-processing capacity (after completion of the 10+ upgrade program) as worth over 30 percent more than PKN's (based on per-ton throughput). As for our assessments of the value of PKN Orlen's other assets, we consider them to be conservative, in particular with respect to the Retail business (our assumed replacement value for each PKN and Lotos service station is PLN 3m – an amount which does not take into account the differences in the cash flows generated by each chain). We also think it appropriate to assess Lotos's value based on the current amount of net debt, which is expected to increase from the level recorded in Q309 after the company draws the remaining 25% of its 10+ credit line (we take full account of the effects of the 10+ upgrades). All these considerations have prompted a rating downgrade on Lotos from hold to reduce, at an unchanged price target (PLN 26.6), and downward revisions in our financial projections for the company. In our opinion, PKN Orlen is a much better bet amid current refinery fundamentals.

**Lotos vs. WIG****Kamil Kliszcz**

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(PLN m)	2007	2008	2009F	2010F	2011F
Revenue	13125.1	16294.7	14745.3	18048.2	23807.5
EBITDA	1019.9	169.2	767.9	777.0	1734.0
EBITDA margin	7.8%	1.0%	5.2%	4.3%	7.3%
EBIT	713.7	-145.8	468.5	439.5	943.9
Net profit	777.2	-453.9	728.2	392.1	765.6
DPS	0.36	0.00	0.00	0.00	0.00
P/E	4.7	-8.0	5.7	10.6	5.4
P/CE	3.4	-26.1	4.0	5.7	2.7
P/BV	0.6	0.7	0.6	0.6	0.5
EV/EBITDA	4.3	42.8	12.8	14.5	6.7
DYield	1.1%	0.0%	0.0%	0.0%	0.0%

**PKN Orlen v. Lotos – Market value comparison by business segment and assets**

(PLN m)	PKN ORLEN	LOTOS
Share price	31.10	31.94
Number of shares	427.7	129.9
MCAP	13 302	4 148
Net debt at 30 Sep. '09*	13 696	5 915
Minority interests	2 860	35
<b>EV</b>	<b>29 858</b>	<b>10 098</b>
<b>Polkomtel</b>	<b>3 424</b>	<b>0</b>
<b>Anwil (85%)</b>	<b>1 400</b>	<b>0</b>
<b>Service Stations</b>	<b>4 000</b>	<b>426</b>
number of own stations	1 336	142
value per station (PLN m)	3.0	3.0
FY09E EBITDA	1 217	62
segment EV/EBITDA	3.3	6.9
<b>Petrochemicals</b>	<b>3 435</b>	<b>-</b>
average FY08/10 EBITDA	687	-
EV/EBITDA	5.0	-
<b>Upstream</b>	<b>-</b>	<b>1 788</b>
<b>Strategic reserve</b>	<b>5 800</b>	<b>2 000</b>
<b>Refinery and other</b>	<b>11 799</b>	<b>5 884</b>
annual production	28.0	10.5
PLN / ton	421	560

\*Lotos's net debt as at 30 Sep. (PLN 4.9bn) has increased by a further PLN 1bn payable under debt taken out toward the 10+ program, whose full effects we factored in "annual production" above (Lotos had used 75% of the credit facility by 30 Sep. '09)

Source: Estimates by BRE Bank Securities



## Income Statement

(PLN m)	2006	2007	2008	2009F	2010F	2011F	2012F
<b>Revenue</b>	<b>12 798.1</b>	<b>13 125.1</b>	<b>16 294.7</b>	<b>14 745.3</b>	<b>18 048.2</b>	<b>23 807.5</b>	<b>25 669.8</b>
<i>change</i>	32.7%	2.6%	24.1%	-9.5%	22.4%	31.9%	7.8%
<b>EBIT</b>	<b>798.3</b>	<b>713.7</b>	<b>-145.8</b>	<b>468.5</b>	<b>439.5</b>	<b>943.9</b>	<b>1 626.1</b>
Refinery	627.0	617.0	-339.0	394.0	306.2	817.3	1 092.0
including LIFO	-133.0	393.3	-612.1	467.5	17.2	3.7	242.1
Upstream	201.0	134.0	194.0	95.5	134.7	119.8	507.1
Retail	-37.0	-50.0	-14.0	22.1	22.2	23.9	29.5
Other	7.3	12.7	13.2	-43.0	-23.6	-17.0	-2.5
<b>EBIT (LIFO accounting)</b>	<b>931.3</b>	<b>320.4</b>	<b>466.3</b>	<b>1.0</b>	<b>422.3</b>	<b>940.2</b>	<b>1 384.0</b>
<b>EBIT</b>	<b>798.3</b>	<b>713.7</b>	<b>-145.8</b>	<b>468.5</b>	<b>439.5</b>	<b>943.9</b>	<b>1 626.1</b>
<i>change</i>	-22.8%	-10.6%	-120.4%	-421.3%	-6.2%	114.8%	72.3%
<i>EBIT margin</i>	6.2%	5.4%	-0.9%	3.2%	2.4%	4.0%	6.3%
Finance gains/losses	91.7	268.6	-384.4	453.4	45.2	1.8	-218.4
Extraordinary gains/losses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	25.8	22.3	26.0	0.0	0.0	0.0	0.0
<b>Pre-tax income</b>	<b>915.9</b>	<b>1 004.5</b>	<b>-504.2</b>	<b>921.9</b>	<b>484.7</b>	<b>945.7</b>	<b>1 407.7</b>
Tax	181.2	190.3	-114.3	184.4	92.1	179.7	267.5
Minority interests	54.7	37.0	64.0	9.3	0.5	0.5	2.0
<b>Net income</b>	<b>679.9</b>	<b>777.2</b>	<b>-453.9</b>	<b>728.2</b>	<b>392.1</b>	<b>765.6</b>	<b>1 138.3</b>
<i>change</i>	-22.7%	14.3%	-158.4%	-260.4%	-46.2%	95.3%	48.7%
<i>margin</i>	5.3%	5.9%	-2.8%	4.9%	2.2%	3.2%	4.4%
Amortization & depreciation	297.4	306.2	315.0	299.4	337.5	790.1	892.1
<b>EBITDA</b>	<b>1 095.7</b>	<b>1 019.9</b>	<b>169.2</b>	<b>767.9</b>	<b>777.0</b>	<b>1 734.0</b>	<b>2 518.2</b>
<i>change</i>	-15.6%	-6.9%	-83.4%	353.9%	1.2%	123.2%	45.2%
<i>EBITDA margin</i>	8.6%	7.8%	1.0%	5.2%	4.3%	7.3%	9.8%
Shares at year-end (millions)	113.7	113.7	113.7	129.9	129.9	129.9	129.9
EPS	6.0	6.8	-4.0	5.6	3.0	5.9	8.8
CEPS	8.6	9.5	-1.2	7.9	5.6	12.0	15.6
ROAE	14.1%	14.2%	-8.1%	12.2%	5.9%	10.5%	13.9%
ROAA	9.2%	8.9%	-4.1%	5.1%	2.2%	3.8%	5.1%



## Balance Sheet

(PLN m)	2006	2007	2008	2009F	2010F	2011F	2012F
<b>ASSETS</b>	<b>7 763.5</b>	<b>9 720.4</b>	<b>12 202.0</b>	<b>16 268.2</b>	<b>18 817.6</b>	<b>21 216.1</b>	<b>23 248.3</b>
<b>Fixed assets</b>	<b>3 781.8</b>	<b>4 508.1</b>	<b>7 093.8</b>	<b>10 109.6</b>	<b>11 540.9</b>	<b>12 390.0</b>	<b>12 706.2</b>
Property, plant and equipment	3 484.9	4 253.0	6 733.3	9 604.9	10 961.0	11 838.3	12 169.9
Intangible assets	55.9	65.0	55.9	200.0	275.3	247.1	231.7
Goodwill	67.1	58.2	45.6	45.6	45.6	45.6	45.6
Long-term investment	111.9	73.5	104.9	104.9	104.9	104.9	104.9
Other fixed assets	62.2	58.4	154.1	154.1	154.1	154.1	154.1
<b>Current assets</b>	<b>3 981.7</b>	<b>5 212.3</b>	<b>5 108.2</b>	<b>6 158.6</b>	<b>7 276.6</b>	<b>8 826.1</b>	<b>10 542.1</b>
Inventories	1 707.4	2 589.3	2 447.2	3 139.7	3 667.4	4 187.4	5 570.5
Short-term receivables	1 276.5	1 542.5	1 564.9	1 990.6	2 436.5	3 214.0	3 465.4
Other current assets	225.4	155.5	383.3	383.3	383.3	383.3	383.3
Cash and cash equivalents	772.4	925.0	712.8	645.0	789.5	1 041.4	1 122.9

(PLN m)	2006	2007	2008	2009F	2010F	2011F	2012F
<b>LIABILITIES</b>	<b>7 763.5</b>	<b>9 720.4</b>	<b>12 202.0</b>	<b>16 268.2</b>	<b>18 817.6</b>	<b>21 216.1</b>	<b>23 248.3</b>
<b>Equity</b>	<b>5 095.5</b>	<b>5 816.2</b>	<b>5 404.1</b>	<b>6 489.3</b>	<b>6 881.4</b>	<b>7 646.9</b>	<b>8 785.2</b>
Share capital	113.7	113.7	113.7	129.9	129.9	129.9	129.9
Other equity	4 981.8	5 702.5	5 290.4	6 359.4	6 751.5	7 517.1	8 655.4
<b>Minority interests</b>	<b>306.4</b>	<b>334.7</b>	<b>395.9</b>	<b>48.3</b>	<b>48.8</b>	<b>49.3</b>	<b>51.2</b>
<b>Long-term liabilities</b>	<b>719.6</b>	<b>1 215.6</b>	<b>3 700.5</b>	<b>5 744.4</b>	<b>7 139.9</b>	<b>7 608.5</b>	<b>8 076.9</b>
Loans	330.7	842.9	3 412.2	5 456.2	6 851.7	7 320.2	7 788.7
Other	388.9	372.7	288.3	288.3	288.3	288.3	288.3
<b>Short-term liabilities</b>	<b>1 642.0</b>	<b>2 353.8</b>	<b>2 701.4</b>	<b>3 986.2</b>	<b>4 747.5</b>	<b>5 911.4</b>	<b>6 334.9</b>
Loans	173.5	517.2	507.4	811.3	1 018.8	1 088.4	1 158.1
Trade creditors	1 385.1	1 757.5	1 894.5	2 875.3	3 429.2	4 523.4	4 877.3
Other	83.4	79.2	299.6	299.6	299.6	299.6	299.6
Debt	504.2	1 360.1	3 919.6	6 267.4	7 870.4	8 408.7	8 946.8
Net debt	-268.2	435.1	3 206.8	5 622.4	7 080.9	7 367.2	7 823.8
(Net debt / Equity)	-5.3%	7.5%	59.3%	86.6%	102.9%	96.3%	89.1%
(Net debt / EBITDA)	-0.2	0.4	19.0	7.3	9.1	4.2	3.1
<b>BVPS</b>	<b>44.8</b>	<b>51.2</b>	<b>47.5</b>	<b>50.0</b>	<b>53.0</b>	<b>58.9</b>	<b>67.6</b>



## Cash Flows

(PLN m)	2006	2007	2008	2009F	2010F	2011F	2012F
<b>Cash flows from operating activities</b>	<b>654.4</b>	<b>157.8</b>	<b>311.7</b>	<b>666.1</b>	<b>265.2</b>	<b>1 351.1</b>	<b>970.0</b>
Net income	679.9	777.2	-453.9	728.2	392.1	765.6	1 138.3
Amortization & depreciation	297.4	306.2	315.0	299.4	337.5	790.1	892.1
Working capital	-288.5	-882.9	197.4	-137.4	-419.7	-203.3	-1 280.7
Other	-34.3	-42.7	253.1	-224.1	-44.7	-1.3	220.3
<b>Cash flows from investing activities</b>	<b>-721.5</b>	<b>-816.4</b>	<b>-2 417.1</b>	<b>-2 926.1</b>	<b>-1 579.7</b>	<b>-1 305.9</b>	<b>-1 073.2</b>
CAPEX	-688.6	-1 050.3	-2 478.5	-3 315.1	-1 768.9	-1 639.2	-1 208.3
Capital investments	-48.3	0.0	0.0	0.0	0.0	0.0	0.0
Other	15.4	233.8	61.4	389.0	189.2	333.3	135.1
<b>Cash flows from financing activities</b>	<b>-78.2</b>	<b>513.1</b>	<b>1 963.1</b>	<b>2 192.2</b>	<b>1 459.0</b>	<b>206.7</b>	<b>184.6</b>
Stock offering	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt	-50.5	556.6	2 266.3	2 347.8	1 603.0	538.3	538.1
Dividend / buy-back	0.0	-40.9	0.0	0.0	0.0	0.0	0.0
Other	-27.7	-34.1	-303.2	-155.6	-144.0	-331.5	-353.5
<b>Change in cash</b>	<b>-143.6</b>	<b>-147.1</b>	<b>-138.8</b>	<b>-67.8</b>	<b>144.5</b>	<b>251.9</b>	<b>81.5</b>
Cash at end of period	772.4	925.0	712.8	645.0	789.5	1 041.4	1 122.9
DPS (PLN)	0.00	0.36	0.00	0.00	0.00	0.00	0.00
FCF	-111.0	-1 103.6	-1 997.6	-2 869.0	-1 503.7	-288.1	-238.2
(CAPEX / Sales)	5.4%	8.0%	15.2%	22.5%	9.8%	6.9%	4.7%

## Market multiples

	2006	2007	2008	2009F	2010F	2011F	2012F
P/E	5.3	4.7	-8.0	5.7	10.6	5.4	3.6
P/CE	3.7	3.4	-26.1	4.0	5.7	2.7	2.0
P/BV	0.7	0.6	0.7	0.6	0.6	0.5	0.5
P/S	0.3	0.3	0.2	0.3	0.2	0.2	0.0
FCF/EV	-3.0%	-25.1%	-27.6%	-29.2%	-13.3%	-2.5%	-2.0%
EV/EBITDA	3.3	4.3	42.8	12.8	14.5	6.7	4.8
EV/EBIT	4.6	6.2	-49.6	21.0	25.7	12.3	7.4
EV/S	0.3	0.3	0.4	0.7	0.6	0.5	0.5
DYield	0.0%	1.1%	0.0%	0.0%	0.0%	0.0%	0.0%
<b>Price (PLN)</b>	<b>31.94</b>						
Shares at year-end (millions)	113.7	113.7	113.7	129.9	129.9	129.9	129.9
MC (PLN m)	3631.6	3631.6	3631.6	4148.2	4148.2	4148.2	4148.2
Equity attributable to minority shareholders (PLN m)	306.4	334.7	395.9	48.3	48.8	49.3	51.2
EV (PLN m)	3 669.8	4 401.4	7 234.3	9 818.8	11 277.9	11 564.6	12 023.2



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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**

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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**Previous ratings issued for Lotos**

Rating	Buy	Buy	Accumulate	Accumulate	Hold	Hold
<b>Date issued</b>	2009-03-09	2009-05-28	2009-09-04	2009-09-22	2009-11-04	2009-11-06
<b>Price on rating day</b>	11.44	18.25	24.18	24.05	26.70	27.92
<b>WIG on rating day</b>	22948.51	29775.36	36009.43	36680.84	37391.24	38863.29