

20 May 2011

Update



Construction

Poland

2012F P/E	9.6
2012F EV/EBITDA	5.8
WIG Budownictwo*	4 227.92

*Construction Sector Index

Construction

When Others Panic, Overweight

The WIG Budownictwo index has fallen some 22.5% since the beginning of the year. In the same period, WIG has risen by 1.8%. The decline in the construction industry index was a consequence of a double blow of bad news: expectations of a contraction in margins in 2011 and a reduction in spending on public construction projects. The market stopped to discount future big contracts. We believe this has been an overreaction, which could be called panic in the case of selected companies. In our opinion, it is the high time to overweight the industry, because:

1. In Q1 2011, the prices of steel and cement were on the rise, and the companies were creating their budgets for 2011. This might mean that the negative impact of contract budget revisions and provisions will be much more limited in the following quarters.
2. Earnings will start to improve in the segment in Q2/Q3 2011, beginning with small companies, thanks to the considerable y/y growth in their order backlogs.
3. Bigger companies will not start to improve their earnings until H2 2012. However, we expect that as the earnings of the smaller players improve, sentiment towards the industry will change, leading to higher expectations and a lower discount on account of the risk attached to the forecasts for the leading companies.
4. Assuming that margins will improve to ca. 3% in H2 2012, many companies are very cheap (P/E < 10).
5. A 3% EBIT margin is the benchmark for many markets, including many less attractive ones. The only negative exceptions are Germany and Japan. Competition from new foreign entrants has been abating.
6. For specialist companies (chemical and gas and oil engineering, power plant construction), the benchmark EBIT margin is around 5% or more.
7. The construction market in Poland will not break down after Euro 2012 soccer championship and the conclusion of the 2007-2013 Infrastructure and Environment Program.
8. Quite possibly, already in July we will hear the first reports on the European Commission's work on the new support program for infrastructural investment in CEE and SEE countries in 2014-2020.
9. In building construction, demand for housing and commercial, office and industrial facilities will more than offset the decline in demand on the part of the public sector.
10. Some big power plant construction contracts will be awarded soon (contracts worth PLN 11-28bn in 2011).
11. The only segment where spending will clearly fall, which will not be offset in any way, will be road construction.
12. Company revenues will be stable in 2012-2013. The long-term perspective remains very attractive (per capita construction output is over three times higher in Germany than in Poland).
13. At the current valuations, Polish companies are attractive acquisition targets.

	9MTP	Rating
Budimex	99.0	Hold
Erbud	37.6	Buy
Mostostal Warszawa	54.5	Buy
PBG	167.9	Buy
Polimex Mostostal	3.41	Accumulate
Trakcja Polska	3.5	Buy
Unibep	9.9	Buy
ZUE	13.2	Accumulate

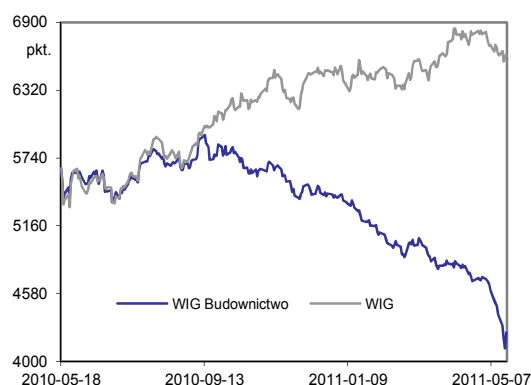
	9MTP	Upside/ downside*
Budimex	99.0	-1.0%
Erbud	37.6	26.6%
Mostostal Warszawa	54.5	60.3%
PBG	167.9	18.2%
Polimex Mostostal	3.41	10.4%
Trakcja Polska	3.5	29.2%
Unibep	9.9	50.9%
ZUE	13.2	13.6%

* closing prices as of 19.05.2011

Sector Outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. This major drop is not warranted by the companies' fundamentals. Many of them are very cheap relative to their long-term earnings potential. We recommend overweighting the sector. Companies perceived as defensive have the least potential for growth.

WIG Budownictwo vs. WIG



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Spółka	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
ZUE	12.2	11.6	11.3	7.0	5.9	5.1

Selection – As Important As Allocation

Like during the 2008/2009 financial panic, the stocks most likely to generate the highest returns today are the most risky ones. During the financial crisis, the magnitude of risk was determined by debt. Now, the main concerns in the case of the construction sector include earnings, order backlogs, contract fines and provisions, and negative cash flows. We ranked the construction companies in our coverage universe by their attractiveness as investments:

- 1) Mostostal Warszawa (low valuation relative to strong 2012 earnings prospects, growing order backlog).
- 2) Unibep (potential for strong earnings in 2012, small exposure to public-sector orders).
- 3) Erbud (low valuation, small exposure to public-sector orders).
- 4) PBG (a chance to resume negotiations with OHL, valued lower than western engineering companies).
- 5) Trakcja Polska (stock price is down without any fundamental reasons).
- 6) Rafako (positioned to benefit from power-plant orders).
- 7) ZUE (a drop in share price, leader in tram line infrastructure).
- 8) Polimex Mostostal (positioned to benefit from power-plant orders, an early-cycle company).

Outside of our coverage universe, our top picks in the construction sector are Mostostal Zabrze, Prochem, Energoinstal, Hydrobudowa Polska, Mostostal Plock, Elektrotim, and Bipromet).

Our least favorite builder is Budimex in whose case investors are more inclined to react to what is being said by the Management than what actually happens (BDX shares fell after Mirbud's guidance announcement, but stayed in place after the announcement of the actual good results). The following table shows the valuation multiples of selected construction stocks.

Construction company valuations

Company	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Elektrobudowa	15.2	13.5	11.8	9.3	8.1	7.0
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Rafako	15.0	13.8	10.7	8.5	7.8	5.7
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
ZUE	12.2	11.6	11.3	7.0	5.9	5.1

Source: BRE Bank Securities

YTD performance

The WIG Budownictwo index has fallen 21.3% since the beginning of the year, making the construction sector the biggest underperformer of the year so far. The sector was hardly a growth leader in the previous years – in H1 2010, building companies were valued based on record 2009 earnings and traded at multiples typical of growth industries. Today, their valuations discount an expected industry slowdown and earnings deterioration. We would look at the depreciated values of selected companies as attractive investment opportunities.

YTD performance of construction stocks

	2010 year-end Current price		Change	Price at 31 March	Current price	Change
Budimex	99.5	100.0	0.5%	102.5	100.0	-2.4%
PBG	212.6	142.0	-33.2%	188.0	142.0	-24.5%
Polimex Mostostal	4.0	3.1	-22.8%	3.5	3.1	-12.2%
Mostostal Warszawa	61.0	34.0	-44.3%	45.6	34.0	-25.4%
Pol-Aqua	17.7	17.4	-2.0%	17.5	17.4	-0.9%
Mostostal Zabrze	2.8	2.6	-7.5%	2.7	2.6	-4.8%
Erbud	52.0	29.7	-42.9%	39.5	29.7	-24.9%
Mirbud	4.4	4.0	-9.2%	4.6	4.0	-13.2%
Unibep	9.8	6.6	-33.1%	7.8	6.6	-15.7%
Rafako	13.4	10.4	-22.4%	11.0	10.4	-5.5%
Elektrobudowa	167.0	156.9	-6.0%	154.0	156.9	1.9%
Hydrobudowa Polska	3.1	2.2	-30.8%	2.4	2.2	-8.5%
Trakcja Polska	4.1	2.7	-33.9%	3.5	2.7	-22.1%
ZUE	13.3	11.6	-12.3%	13.9	11.6	-16.4%
Mostostal Plock	44.8	37.8	-15.7%	37.0	37.8	2.0%
Remak	58.2	51.2	-12.1%	50.3	51.2	1.7%
Energomontaż Południe	3.7	4.0	6.7%	4.0	4.0	-0.2%
Prochem	25.8	26.3	1.9%	23.9	26.3	9.7%
Bipromet	6.0	7.3	21.8%	6.2	7.3	17.9%
Energoinstal	9.0	8.5	-4.7%	8.6	8.5	-0.7%
Projprzem	10.8	12.5	15.4%	11.4	12.5	9.2%
Mostostal Export	1.3	1.1	-11.2%	1.3	1.1	-11.2%
Elektrotim	13.2	11.1	-16.2%	13.4	11.1	-17.2%
ABM Solid	15.1	10.2	-32.6%	14.0	10.2	-27.5%
Awbud	2.4	1.5	-36.7%	2.2	1.5	-30.6%
Enap	1.5	1.3	-14.2%	1.4	1.3	-5.9%
Energopol	9.7	8.9	-8.4%	9.4	8.9	-4.8%
Budopol	1.4	1.3	-6.3%	1.3	1.3	1.5%
Combined			-12.2%			-5.7%
WIG Budownictwo	5 395	4 248	-21.3%	4 861	4 248	-12.6%
WIG	47 491	48 748	2.6%	48 731	48 748	0.0%
WIG 20	2 743	2 821	2.9%	2 817	2 821	0.2%
mWIG 40	2 805	2 902	3.5%	2 912	2 902	-0.3%
sWIG 80	12 220	12 400	1.5%	12 733	12 400	-2.6%

Source: BRE Bank Securities

Q1 2011 earnings results

Smaller and more specialized builders reported better first-quarter results than large general contractors. The general trend was consistent with our predictions, however, the profit deterioration experienced by some of the larger players was much more severe than we had expected. Moreover, some of the smaller firms generated weaker-than-expected results due to temporary order shortages and seasonal effects, but their backlogs for the following quarters are larger than last year. These companies include Trakcja Polska, Remak, Projprzem, Elektrotim, and Bipromet.

Among larger and more liquid companies, good Q1 2011 results were reported by Budimex and Mostostal Zabrze. PBG generated good but in-line results, while the disappointing showings made by Mostostal Warszawa, Polimex Mostostal, and Erbud were more than offset in their stock prices.

Q1 2011 earnings results

Company	Results	Results vs. consensus estimates	Y/Y comparison
Budimex	good	in line	flat
Polimex Mostostal	weak	weaker	weaker
PBG	good	in line	flat
Hydrobudowa Polska	weak	-	weaker
Mostostal Warszawa	weak	weaker	weaker
Mostostal Zabrze	good	-	better
Erbud	weak	weaker	weaker
Unibep	decent	better	weaker
Rafako	good	in line	flat
Elektrobudowa	weak	weaker	weaker
Trakcja Polska	weak	in line	weaker
Pol-Aqua	weak	-	flat
Mirbud	good	-	better
ABM Solid	weak	-	weaker
Awbud	weak	-	weaker
ZUE	weak	weaker	better
Energoinstal	good	-	better
Mostostal Plock	weak	-	weaker
Remak	decent	-	weaker
Energomontaż Południe	decent	-	better
Prochem	weak	-	weaker
Projprzem	weak	-	better
Elektrotim	weak	-	better
Mostostal Export	weak	-	flat
Energopol Południe	weak	-	flat
Tesgas	good	-	weaker
Budopol	good	-	better
Bipromet	weak	-	flat
Resbud	weak	-	flat

Source: BRE Bank Securities

Cash flows were weak for a reason

Weak operating cash flows were a recurring theme of the Q1 2011 earnings season. Low OCF is typical for the first quarter, when construction firms spend the contract advances and fees received in the fourth quarter.

This year, the seasonal trends were combined with payment bottlenecks on the part of the government in a reversal from the previous two years when the national road authority (GDDKiA) was not able to efficiently spend its budget and therefore made advance payments to contractors. Payment cycles in the private sector have also become extended in an investor's market, while subcontractor and supplier payment deadlines remain short.

Weak cash flow = paper profit?

There may be one more explanation for the weak first-quarter cash flows, namely, recognition of unrealistically high contract profits prior to completion. Prolonged differences between profits and cash flows increase the risk of losses in the future. The problem is that there is no way of assessing what portion of the negative cash flows can be attributed to unrealistic profit estimations, and which part is an effect of payment cycle trends in the construction industry.

A case-by-case analysis of the companies in our coverage reveals that, historically, Polimex Mostostal, Hydrobudowa, and PBG have been quite aggressive when estimating the profitability of their contracts, while Budimex, Rafako, and Mostostal Warszawa have been more conservative.

Improving situation in private sector construction

There is increasing demand for construction services from private investors. Housing has been on the rise since 2010, and a rebound is expected to occur in commercial real-estate development (offices, shopping centers) and industrial construction (factories, warehouses) after two years of stagnation. The improving momentum in these two sectors is supported by decreasing vacancy ratios, strong demand for shopping centers in areas where such establishments are few, and high capacity utilization rates and strong earnings in the manufacturing industry.

Outlook for public investment

There is concern that public authorities and local governments will reduce expenditure in the coming years. Public expenditure is constrained by the ratio of debt to GDP which is nearing the constitutional 55% threshold. Consistently with the government's 2011-2015 road building plans, the cutbacks apply mostly to expenses on road development. In turn, allocations to railroad infrastructure are set to increase to PLN 7 billion in 2012 (from PLN 4.2bn), and although we have some doubt whether the increase will be quite as big, we are sure that railroad developers can expect more business next year.

Local governments, mainly in major cities, are also heavily in debt and will therefore be forced to cut back on cultural and leisure services such as museums and water parks to be able to fund more vital projects like public transportation infrastructure. The lower government demand for building construction services will be compensated by higher demand from the private sector.

Parliamentary election

There is a consensus that government spending will be restrained even more after this year's parliamentary elections. We think the reverse is true, and that the incumbent government is purposely holding back orders and contract payments to prevent budget cuts and tax hikes as a strategy to win the election. Combined with the advancing privatization, all these measures are designed to prevent the deficit situation from blowing up before the election after which the situation should start improving.

Outlook for the construction industry

The table below outlines our outlook for the construction industry in a breakdown by sector. We expect a rebound in private construction and power engineering, and a downturn in public construction. Note also our estimations pertaining to the shares that the different industry sectors are expected to have in the total construction output:

- road construction accounted for 27.6% of the 2010 construction output, and its share is expected to increase to 34% in 2011;
- decreasing government expenditure on road development will result in flat construction output growth in 2012 and 2013;
- in building construction, the value of private sector orders is twice the value of public orders.

The following forecasts are a reiteration of the forecasts first presented in our 2011 Investment Strategy in January.

Construction forecast

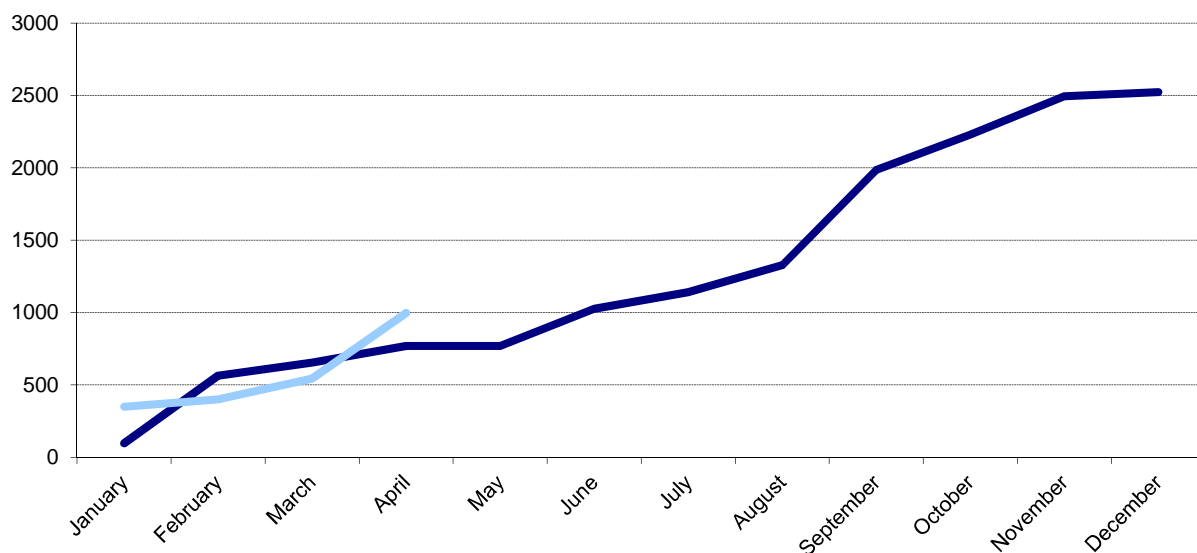
	Share in total output (2010F)	Y/Y growth		
		2011F	2012F	2013F
Total construction	100.0%	18.0%	-0.7%	-0.2%
Building construction	46.9%	-0.2%	7.2%	6.4%
- housing	15.3%	7.0%	10.0%	7.0%
- commercial real estate	10.6%	13.7%	9.9%	6.9%
- industrial construction	6.9%	10.0%	10.0%	7.0%
- public construction	12.1%	-27.9%	-4.5%	3.7%
- other	2.0%	2.6%	8.7%	6.3%
Infrastructure and other construction	53.1%	34.0%	-5.9%	-5.1%
- road construction and engineering	27.6%	45.9%	-17.1%	-34.3%
- railroad construction	1.9%	166.0%	6.0%	6.0%
- power plant and chemical plant construction	20.3%	10.0%	10.0%	30.7%
- other	3.3%	3.7%	3.7%	3.7%

Source: BRE Bank Securities

Building the order book

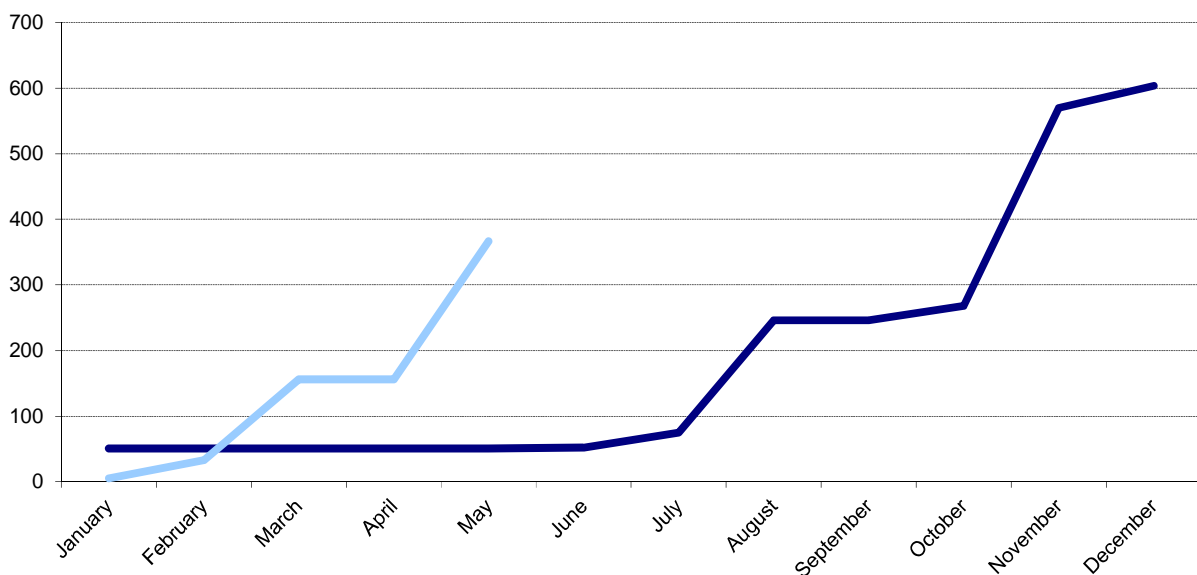
The fluctuating pace of backlog growth reported by different infrastructure builders should not be interpreted as a sign of a future revenue downturn. For example, Mostostal Warszawa has captured contracts worth considerably more than in the same period a year ago, and its 2012 backlog is estimated at PLN 1bn compared to PLN 790m last year. Similarly, the tramline infrastructure developer ZUE has a 2012 backlog of PLN 350m. The diagrams below illustrate last year's and this year's YTD backlog growth for both companies.

Mostostal Warszawa's backlog growth (PLN m)



Source: Mostostal Warszawa, BRE Bank Securities

ZUE's backlog growth (PLN m)



Source: ZUE, BRE Bank Securities

“Light” and “heavy” road-building companies

Road construction is the only sector of the building industry set for a slowdown in the coming years. Because of limited ability to move workforce resources from road to building construction, the cutbacks in road expenditure are going to have varying degrees of impact on different companies. Construction companies can be grouped into two categories depending on the organization of their road divisions:

1) Light organizations

Polimex Mostostal's road-building arm “Z-10” in Katowice employs about 400 people. Fewer than 200 of the workforce are permanent employees, ensuring that the temporary workers do not weigh down on revenues in the event of an order shortage. Z-10 is equipped to generate annual revenues of PLN 400-500m, but is currently working towards achieving a turnover of about PLN 1 billion thanks to strong demand. A similar organizing principle is followed by Mostostal Warszawa (300-400 employees) and PBG (350-400).

2) Heavy organizations

Budimex employs approximately 1800 road workers generating annual revenues of PLN 3bn, indicating that the ratio of workforce to output is about twice that seen in “light” organizations. The most extreme example of a heavy organization is Tiltr, the company which is about to merge with railroad builder Trakcja Polska and which employs about 2500 people and generates PLN 1.4bn in annual revenues.

Heavy organizations have done better in the period from 2007 through 2011 thanks to their self-sufficiency. In 2012 and beyond, however, light organizations have a better chance of succeeding. This means that Tiltr has to capture an adequately high volume of contracts for delivery in 2012 and 2013 if it is not to weigh down on the earnings of Trakcja Polska.

Power plant tenders

Contractor selection by major Polish power plants is going as expected. Bidders vying to build power generation facilities in Opole and Stalowa Wola have received requests for quotations, while the tender procedures in Jaworzno, Kozienice, Turów, and Włocławek are at the earlier stage of technical specifications.

The probability that Enea will carry out its project in Kozienice has increased since EdF's failed acquisition attempt. Other likely projects include a planned power plant in Siekierki which is being sold by Vattenfall together with some other heat and power assets.

As for other capacity upgrade plans of the Polish power industry, a trend has emerged recently to replaced coal-fired generation with gas-fired units which require less involvement from local subcontractors but at the same time take shorter to build. In short, more gas-fired power plant projects means that the order boom for local subcontractors will start earlier and be more intense, however, it will last a shorter time.

Selected power-plant tenders

Location	Fuel	Investor	MW	Value (PLN bn)	Status	Contract awards expected
Opole	hard coal	PGE	1600-1800	10	Awaiting price quotes The project has been put up for sale and will probably go to Hitachi	H2 2011
Siekierki	hard coal	-	480	2.8		2011/2012
Stalowa Wola	natural gas	Tauron, PGNiG	400-430	1.3	Awaiting technical specifications	H2 2011
Jaworzno	hard coal	Tauron	800-910	5	Tech specs have been received	2011/2012
Kozienice	hard coal	Enea	900-1000	5.6	Tech specs have been received	2011/2012
Turów	lignite	PGE	430-450	2.1	Awaiting technical specifications*	2011/2012
Włocławek	natural gas	PKN Orlen	400-500	1.4	Tech specs have been received	2011/2012
Total				28.2		

Source: BRE Bank Securities; *an appeal procedure has been filed

Earnings cycle

Construction in Poland, particularly public construction, is a cyclical business. For successful contract bidders, there is a waiting period as long as nine months between the time the contract budget is calculated and the time the contract is signed. During that time, depending on trends in building costs, the margins achievable on the contract can either shrink or widen.

Most Polish firms are currently working on contracts captured amid intense market competition and high costs of commodities and building materials, which means that they cannot look forward to high margins. Fortunately, there is no additional pressure from rising salaries.

Once the low-margin contracts are completed, for the most part in Q2 2012, the earnings results of major Polish builders are set to start recovering in H2 2012. Smaller subcontractors like Remak, Energoinstal, Mostostal Zabrze, Trakcja Polska, and Elektrotim, should feel the pickup much earlier, about halfway into 2011.

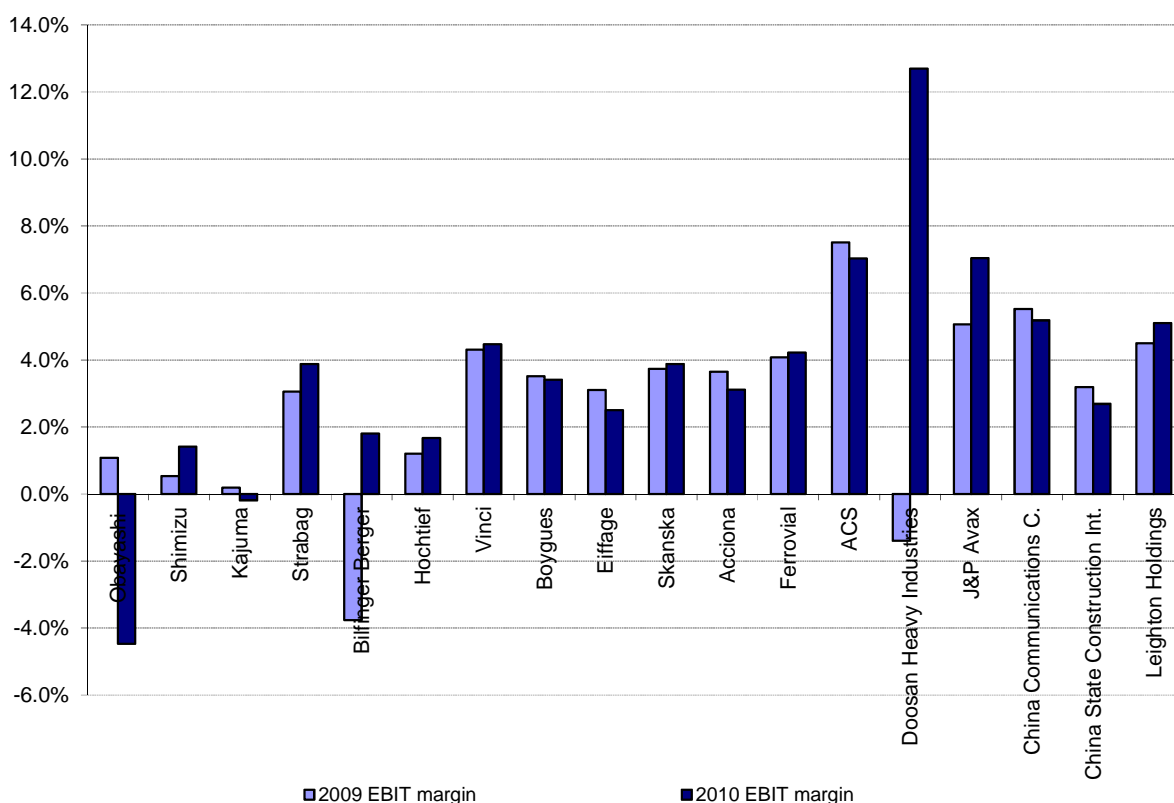
EBIT margins can return to 3%

Investors do not seem to believe that construction firms can go back to generating 3% EBIT margins. Meanwhile, 3% is a level achieved by most companies in Europe, including in

- Spain, where many firms own interests in Polish companies,
- France, which is a highly competitive market,
- Baltic countries where the construction industry was severely impacted by the financial crisis.

EBIT margins well below 3% are reported by construction companies in Germany and Japan which are faced with stagnant demand and fierce competition.

2009 and 2010 EBIT margins achieved by construction companies across the world



Source: Companies, BRE Bank Securities

Polish company valuations show lack of belief in 3% EBIT margins

At current levels, the share prices of some general construction companies like Mostostal Warszawa, Erbud, and Unibep, discount future EBIT margins below 3%. Higher margins are priced in some other stocks, as investors take into account, for instance, the extensive in-house resources and capacity of Polimex Mostostal, or the highly specialized services provided by PBG, Elektrobudowa, or Rafako. Foreign engineering companies generate EBIT margins much higher than 3%.

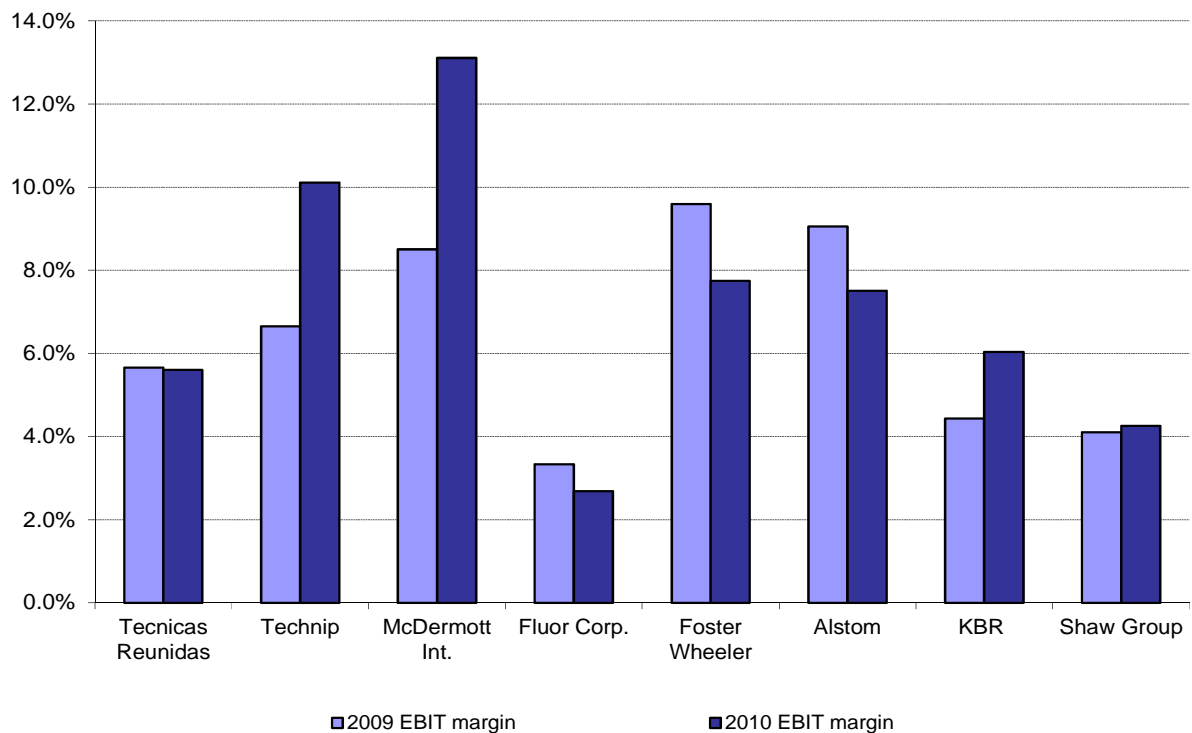
Moreover, international builders are valued at multiples characteristic of growth stories (2011E P/E ~ 13.4, EV/EBITDA ~ 8.5). Assuming that local builders do not disappoint with their earnings performance going forward, they display substantial discounts in some cases compared to their foreign peers.

If we assume a return to 3% EBIT margins for companies like Mostostal Warszawa, Unibep, or Erbud, we can say that these stocks offer upside potentials going into tens of percent.

Valuation multiples for selected international construction companies

Company	2010 P/E	2011F P/E	2012F P/E	2010 EV/EBITDA	2011F EV/EBITDA	2012F EV/EBITDA	EV/S *
Obayashi	-	15.0	14.4	-	-	15.2	13.8
Shimizu	-	22.6	19.5	-	14.6	11.6	10.3
Kajuma	24.4	15.9	14.6	24.4	80.5	14.1	11.5
Strabag	14.0	13.0	12.6	14.0	3.3	3.1	3.1
Bilfinger Berger	12.3	11.6	12.0	12.3	8.4	7.6	7.2
Hochtief	17.9	24.1	11.4	17.9	5.2	6.0	4.1
Vinci	14.3	12.7	11.8	14.3	7.5	6.7	6.4
Boygues	11.0	10.2	9.0	11.0	4.8	4.4	4.2
Eiffage	18.0	13.4	11.1	18.0	9.7	8.8	8.2
Skanska	13.9	9.8	13.4	13.9	7.8	6.0	7.9
Acciona	34.0	24.6	19.7	34.0	10.5	8.7	7.9
Ferrovial	52.0	99.8	46.0	52.0	11.5	12.0	11.1
ACS	12.1	11.3	11.1	12.1	12.7	12.1	11.6
Doosan Heavy Industries	27.2	13.6	9.8	27.2	15.1	11.5	9.2
J&P Avax	5.9	7.4	8.4	5.9	6.8	7.1	8.1
China Communications C.	10.1	7.9	7.0	10.1	7.3	5.9	5.1
China State Construction Int.	27.2	19.7	14.8	27.2	26.6	19.8	14.0
Leighton Holdings	14.0	-	13.1	14.0	5.7	9.1	4.6
Median	14.1	13.2	12.0	14.1	8.5	8.7	7.9

Source: BRE Bank Securities, Bloomberg

EBIT margins achieved by international engineering companies


Source: BRE Bank Securities, Bloomberg

Valuation multiples for international engineering companies

Company	2010 P/E	2011F P/E	2012F P/E	2010 EV/EBITDA	2011F EV/EBITDA	2012F EV/EBITDA
Tecnicas Reunidas	17.2	14.2	12.6	10.6	9.2	8.3
Technip	20.5	18.1	15.1	9.1	7.9	6.7
McDermott Int.	16.0	15.8	12.3	9.3	9.0	7.4
Fluor Corp.	31.5	20.5	17.2	10.5	8.3	7.1
Foster Wheeler	17.9	22.3	14.8	8.9	10.3	7.2
Alstom	11.1	14.4	12.7	7.5	8.4	7.5
KBR	18.0	15.4	13.8	7.6	7.2	6.5
Shaw Group	17.8	22.8	14.3	7.0	8.5	6.1
JGC	23.5	21.5	12.4	9.4	6.1	5.4
Chiyoda	94.1	43.0	25.2	27.4	5.0	7.1
Linde	18.9	16.1	14.3	9.3	8.3	7.6
Median	18.0	18.1	14.3	9.3	8.3	7.1

Source: Companies, BRE Bank Securities

Construction to triple in the next 30 years?

Overall construction is expected to remain flat in Poland over the next three years due to falling road expenditure. Local growth will be seen in selected sectors of the industry. In the long term, however, we expect the industry will follow an upward momentum in line with GDP growth.

Construction output in Poland and other European countries

Country	Construction output (EUR bn)	Population	Per-capita construction output
Austria	28.4	8 356 707	3 398.5
Germany	251.1	81 757 600	3 071.3
Poland	36.8	38 192 000	963.6
Czech Republic	20.1	10 674 947	1 882.9
Hungary	9.9	9 979 000	992.1
Slovakia	5.5	5 429 763	1 012.9
Switzerland	37.5	7 866 500	4 767.1
Russia	101.9	142 905 200	713.1

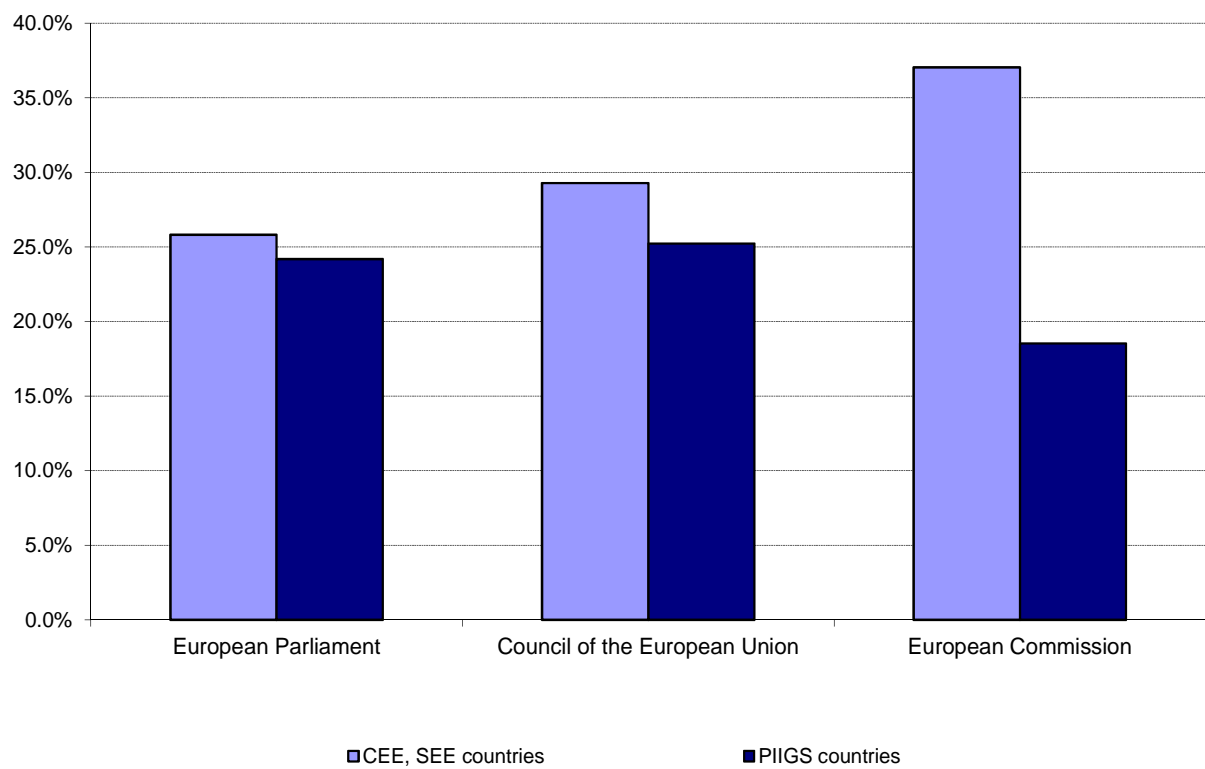
Source: Strabag, BRE Bank Securities

EU funding

Some worry that the EU's 2007-2013 Infrastructure and Environment Operational Program (IEOP) has been the first and last program designed to support local infrastructure investment because of the financial troubles of the so-called PIIGS countries. We disagree. The political influence of new EU Member States from the CEE and SEE regions is comparable to that of the PIIGS countries. Further, the EU's environmental policy and CO2 emission reduction objectives entail high costs for the less affluent CEE and SEE economies which rely heavily on power-intensive manufacturing.

In what is essentially pure speculation, we would venture a guess that EU members will reach a compromise as regards provision of continued support on a scale comparable to IEOP in return for emission reduction commitments – otherwise, CEE and SEE countries may start to question the economic viability of their EU membership.

Final decisions about the future of the European Cohesion Fund and Regional Development Fund (used to finance the 2007-2013 IEOP) will be made toward the end of 2012, but the discussion and first signals about the fate of these funds can be expected in July 2011.

CEE/SEE and PIIGS representation in UE institutions

Source: BRE Bank Securities

20 May 2011

Update


Construction

Poland

Budimex

Hold

BMEX.WA; BDX PW

(Upgraded)

Current price	PLN 100.0
Target price	PLN 99.0
Market cap	PLN 2.55bn
Free float	PLN 0.90bn
Avg daily trading volume (3M)	PLN 3.55m

Shareholder Structure

Ferrovial Agroman	59.06%
OFE PZU	5.66%

Others	35.28%
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Sector Outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. This major drop is not warranted by the companies' fundamentals. Many of them are very cheap relative to their long-term earnings potential. We recommend overweighting the sector. Companies perceived as defensive have the least potential for growth.

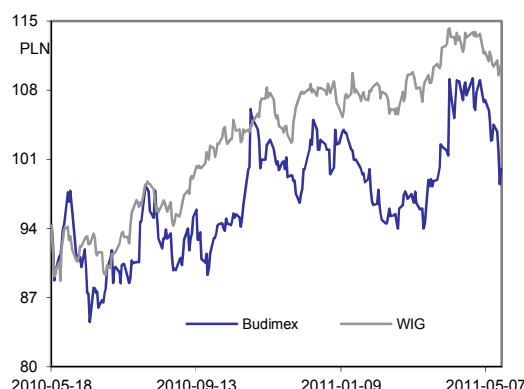
Company Profile

Budimex provides construction services, specializing in road construction and building construction (homes, offices, retail space and public utility buildings). It is a general contractor in large infrastructural, public utility and other projects.

Important Dates

30.08.11 - H1 2011 report
14.11.11 - Q3 2011 report

Budimex vs. WIG



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Not a Good Time for Defensive Companies

Despite its strong earnings for Q1'11, the price of the Budimex stock has fallen, but less so than for other construction companies. The most important issue for valuation is how much cash Budimex has, and what its room for maneuver with regard to releasing provisions is. Payment backlogs have arisen on the part of public-sector customers, but subcontractors have to be paid on time. The General Directorate for National Roads and Motorways (GDDKiA) now pays late rather than early, the way it used to. We attribute this situation to Poland's high debt and tight budget. Already in Q2 and Q3 2011 we will see the impact of these developments on Budimex's balance sheet. At the moment, it shows very high cash levels, but also very low receivables. Its shape is of great importance for future dividend payments as well. The 2011 dividend yield is exceptionally attractive at 9.1%, but a question remains whether such high payments will recur in the future. We believe that given the Company's high dividends for 2010, the stock's downside potential has been exhausted. Risks stemming from Budimex's high dependence on the road construction segment, and from the fact that its earnings are determined by the provisions it releases, have been priced in already. At the same time, Budimex is seen as the industry's most defensive company. If sentiment to the industry improves, the stock might gain less than its peers. We are upgrading Budimex to hold.

Why is Budimex bidding so low for road construction projects?

Budimex has acquired (and continues to acquire) very many road construction contracts, because its Management frets about the possible plunge in the value of contracts in the market. Budimex is not a small company: it has some 1,800 employees in road construction, with revenues of up to PLN 3bn. For comparison, Mostostal Warszawa employs ca. 400 people, and generates revenues of ca. PLN 1bn. Budimex relies on its own resources to a greater extent; therefore, if its order backlog collapses, it may find it more difficult to reduce operating expenses.

Earnings will be determined by released provisions

We estimate that approximately one-third of Budimex's revenues in 2011 will come from contracts covered with provisions. Due to provisioning, such contracts carry zero margins. Our forecasts assume that earnings will be strong, but this means provisions have to be released. We are unable to make a precise estimate of when and in what amount this will be happening.

Budimex will shrink

In the following years, Budimex's revenues will be shrinking due to its very high exposure to the road construction segment. We do not note such risk in the case of Mostostal Warszawa, which actively participates in contracts for power-plant construction, and has lower exposure to road construction.

(PLN m)	2009	2010	2011F	2012F	2013F
Revenue	3 289.9	4 430.3	4 865.0	4 718.9	4 134.0
EBITDA	221.7	352.6	284.5	307.6	231.6
EBITDA margin	6.7%	8.0%	5.8%	6.5%	5.6%
EBIT	200.5	331.4	262.9	285.5	209.1
Net profit	173.7	267.4	223.4	234.6	174.1
P/E	14.7	9.5	11.4	10.9	14.7
P/CE	13.1	8.8	10.4	9.9	13.0
P/BV	4.4	3.8	3.8	3.2	3.0
EV/EBITDA	7.7	2.0	7.7	7.6	9.8
DYield	5.8%	6.8%	9.1%	4.4%	4.6%

Valuation

Using DCF analysis and relative valuation, we set the price target for Budimex at PLN 99.0 per share. The target implies 0.3% downside potential from current levels, prompting a hold rating.

Valuation Summary

	Value per share	Weight
DCF Valuation	92.6	75%
Relative Valuation	88.0	25%
Average	91.5	
9M cost of equity	8.2%	
Target Price	99.0	

Source: BRE Bank Securities

Relative Valuation

The relative valuation of Budimex consists in a comparison of its forward 2011-2013 P/E and EV/EBITDA ratios with the multiples of its peers. Assessed based on forward multiples, Budimex is trading at a 32.8% premium to the construction sector. The premium is the highest in 2013 (which has a 20% weight in the valuation) when we do not expect Budimex's earnings to be supported by deferred income or provision reversals. Note also that the EV/EBITDA estimates for Budimex are impacted by expectations of future cash erosion.

Relative valuation based on recurring earnings multiples

	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Elektrobudowa	13.2	11.8	10.3	8.3	7.1	6.0
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
ZUE	12.2	11.6	11.3	7.0	5.9	5.1
Median	12.7	10.7	8.3	7.3	5.7	5.2
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Premium (discount)	-10.2%	1.8%	76.9%	4.7%	33.3%	90.5%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

Source: BRE Bank Securities

DCF Valuation

DCF model assumptions:

- Growth rate after FY2020 = 3%.
- Risk-free rate is 6.1% (10Y T-bond yield).
- Segmental revenue and margin growth as discussed above.
- The working capital of the construction business will converge to a neutral balance (with receivables slightly higher than payables).
- Land inventories expected to decrease with time to average market levels.
- Advance payments from homebuyers to positively influence working capital.
- Budimex will pay out 50% of future profits as dividends to shareholders
- Half of contract provisions will be expensed, and half will be reversed
- The target EBIT margin for the construction business is 3%.



DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Sales revenue	4 865.0	4 718.9	4 134.0	4 297.5	4 467.9	4 645.5	4 826.0	5 006.7	5 176.9	5 340.0	
Change	53.9%	-3.0%	-12.4%	4.0%	4.0%	4.0%	3.9%	3.7%	3.4%	3.2%	
EBITDA	284.5	307.6	231.6	214.2	221.6	229.3	237.1	244.8	252.2	259.3	
EBITDA margin	5.8%	6.5%	5.6%	5.0%	5.0%	4.9%	4.9%	4.9%	4.9%	4.9%	
D&A expenses	21.6	22.1	22.5	23.0	23.4	23.9	24.4	24.6	24.9	24.9	
EBIT	262.9	285.5	209.1	191.3	198.2	205.4	212.7	220.1	227.3	234.4	
EBITDA margin	5.4%	6.1%	5.1%	4.5%	4.4%	4.4%	4.4%	4.4%	4.4%	4.4%	
EBIT tax	49.9	54.2	39.7	36.3	37.7	39.0	40.4	41.8	43.2	44.5	
NOPLAT	212.9	231.3	169.4	154.9	160.5	166.4	172.3	178.3	184.1	189.8	
CAPEX	-23.8	-24.3	-24.8	-25.3	-25.8	-26.3	-26.8	-25.9	-26.1	-24.9	
Working capital	-1453.3	-260.1	-8.4	64.2	61.2	54.3	61.3	53.7	9.8	-4.0	
FCF	-1242.5	-31.0	158.7	216.8	219.4	218.2	231.2	230.8	192.7	185.8	191.4
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Discount factor	94.0%	84.6%	76.2%	68.6%	61.7%	55.6%	50.0%	45.0%	40.5%	36.6%	
PV FCF	-1 168.5	-26.2	120.9	148.7	135.4	121.2	115.6	103.9	78.1	68.1	
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Cost of debt	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	6.8%	
Risk-free rate	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.6%	
Credit risk premium	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
Cost of equity	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	
FCF growth after the forecast horizon	3.0%										
Terminal value	2518.0										
Present value of terminal value (PV TV)	922.4										
Present value of FCF in the forecast horizon	-302.9										
Equity value	619.5										
Net debt	1745.3										
Dividend	0.0										
Minority interests	0.1										
Equity value	364.7										
Number of shares (millions)	25.5										
Equity value per share (PLN)	92.6										
Cost of equity (9M)	8.2%										
Target Price	100.2										
EV/EBITDA ('10) for the target price	2.0										
P/E ('10) for the target price	9.6										
TV to EV	149%										

Sensitivity Analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0pp	95.4	97.6	100.2	103.2	106.6
WACC -0.5pp	95.4	97.6	100.2	103.2	106.6
WACC	95.4	97.6	100.2	103.2	106.6
WACC +0.5pp	95.4	97.6	100.2	103.2	106.6
WACC +1.0pp	95.4	97.6	100.2	103.2	106.6



Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Sales revenue	3 075.9	3 274.3	3 289.9	4 430.3	4 865.0	4 718.9	4 134.0
Change	1.1%	6.4%	0.5%	-3.9%	53.9%	-3.0%	-12.4%
COGS	2 927.7	2 885.8	2 877.2	3 946.0	4 440.9	4 267.7	3 779.0
Gross profit	148.3	388.4	412.6	484.3	424.1	451.2	355.0
Gross margin	4.8%	11.9%	12.5%	10.9%	8.7%	9.6%	8.6%
Selling expenses	-26.2	-30.2	-22.8	-23.5	-25.8	-26.6	-23.4
General and administrative expenses	-114.6	-135.5	-129.4	-123.3	-129.4	-133.3	-117.3
Other net operating expenses	-21.1	-25.9	-56.3	-12.9	-6.0	-5.8	-5.1
Profit/loss on derivative instruments	41.7	-88.9	-3.7	6.7	0.0	0.0	0.0
EBIT	28.0	107.9	200.5	331.4	262.9	285.5	209.1
Change	182.2%	285.0%	85.7%	65.3%	-20.7%	10.7%	-31.0%
EBITDA margin	0.9%	3.3%	6.1%	7.5%	5.4%	6.1%	5.1%
Financial activity	-16.1	14.9	22.0	3.5	12.9	4.1	5.9
Other	1.6	2.9	1.7	-3.1	0.0	0.0	0.0
Pre-tax profit	13.6	125.8	224.2	331.8	275.8	289.6	215.0
Tax	-0.5	32.1	50.5	64.3	52.4	55.0	40.8
Minority interests							
Net profit	14.1	93.7	173.7	267.4	223.4	234.6	174.1
change	255.3%	563.3%	85.3%	54.0%	-16.5%	5.0%	-25.8%
margin	0.46%	2.86%	5.28%	6.04%	4.59%	4.97%	4.21%
D&A expenses	23.6	22.2	21.2	21.2	21.6	22.1	22.5
EBITDA	51.7	130.2	221.7	352.6	284.5	307.6	231.6
Change	66.0%	152.0%	70.3%	59.0%	-19.3%	8.1%	-24.7%
EBITDA margin	1.7%	4.0%	6.7%	8.0%	5.8%	6.5%	5.6%
Shares at year-end (millions)	25.5	25.5	25.5	25.5	25.5	25.5	25.5
EPS	0.6	3.7	6.8	10.5	8.7	9.2	6.8
CEPS	1.5	4.5	7.6	11.3	9.6	10.1	7.7
ROAE	2.7%	17.1%	30.3%	42.2%	33.0%	32.0%	21.2%
ROAA	0.6%	3.3%	5.2%	7.2%	6.3%	7.7%	5.9%



Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	2 344.3	3 286.1	3 339.6	4 067.2	3 058.4	3 004.9	2 848.7
Fixed assets	475.6	462.9	517.9	632.9	635.0	637.2	639.5
Property, plant and equipment	97.1	118.5	99.8	106.6	108.8	111.0	113.2
Goodwill	103.6	94.3	93.9	89.3	89.3	89.3	89.3
Deferred tax assets	97.6	167.0	241.5	357.3	357.3	357.3	357.3
Other	177.3	83.2	82.7	79.6	79.6	79.6	79.6
Current assets	1 868.7	2 823.2	2 821.7	3 434.4	2 423.3	2 367.6	2 209.2
Inventories	533.3	1 219.8	1 128.6	991.4	1 054.7	991.3	900.5
Accounts receivable	758.3	771.6	528.3	557.2	946.8	993.9	880.0
Cash and cash equivalents	509.2	726.0	1 130.4	1 862.4	398.5	359.1	405.3
Other	68.0	105.8	34.4	23.4	23.4	23.4	23.4
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	2 344.3	3 286.1	3 339.6	4 067.2	3 058.4	3 004.9	2 848.7
Equity	536.2	561.7	586.2	680.4	672.0	794.9	851.7
Minority interests	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Long-term liabilities	312.9	433.6	418.0	255.0	255.0	355.0	355.0
Loans	171.0	254.7	230.2	13.2	13.2	113.2	113.2
Reserves	48.5	81.8	78.8	102.1	102.1	102.1	102.1
Performance bonds	89.8	93.3	105.1	135.5	135.5	135.5	135.5
Other	3.6	3.8	3.9	4.2	4.2	4.2	4.2
Short-term liabilities	1 495.1	2 290.8	2 335.4	3 131.9	2 131.4	1 855.0	1 642.1
Loans	106.2	136.4	62.9	17.5	17.5	17.5	17.5
Accruals	1 133.6	1 375.3	1 514.2	1 794.4	1 014.2	960.4	865.5
Trade creditors	216.0	192.0	546.9	1 034.2	814.0	591.4	473.3
- provisions for contract losses	42.4	51.7	241.1	476.3	192.7	51.2	0.0
Other	-3.1	535.5	211.4	285.7	285.7	285.7	285.7
Debt	277.2	391.1	293.2	30.7	30.7	130.7	130.7
Net debt	-232.0	-334.9	-837.2	-1 831.7*	-367.8	-228.4	-274.6
(Net debt / Equity)	-43.3%	-59.6%	-142.8%	-269.2%	-54.7%	-28.7%	-32.2%
(Net debt / EBITDA)	-4.5	-2.6	-3.8	-5.2	-1.3	-0.7	-1.2
BVPS	21.0	22.0	23.0	26.7	26.3	31.1	33.4

* PLN 1745m before accounts payable to consortium partners



Cash Flows

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Operating cash flows	-15.2	173.0	1 036.0	1 191.1	-1 221.2	-7.5	182.4
Pre-tax income	13.6	125.8	224.2	331.8	275.8	289.6	215.0
D&A expenses	23.6	22.2	21.2	21.2	21.6	22.1	22.5
Working capital	-40.0	-159.2	602.2	433.2	-1 311.5	-189.3	17.2
Provisions for contract losses	42.4	51.7	241.1	476.3	-141.8	-70.8	-25.6
Taxes paid	-20.5	-39.7	-101.0	-101.2	-52.4	-55.0	-40.8
Derivatives valuations	-41.7	88.9	3.7	-10.5	0.0	0.0	0.0
Other	7.4	83.3	44.7	40.3	-12.9	-4.1	-5.9
Cash flows from investing activities	19.1	-64.2	-376.2	-5.2	-23.8	-24.3	-24.8
CAPEX	-5.3	5.5	0.2	-12.7	-23.8	-24.3	-24.8
Equity investment	1.6	-88.4	-307.3	5.1	0.0	0.0	0.0
Derivatives valuations	28.0	16.3	-71.6	0.0	0.0	0.0	0.0
Long-term loans receivable	-6.5	0.0	0.0	0.0	0.0	0.0	0.0
Other	1.2	2.4	2.4	2.4	0.0	0.0	0.0
Cash flows from financing activities	16.0	90.0	-253.6	-454.8	-218.9	-7.6	-111.4
Stock issue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt	28.8	99.2	-97.3	-262.3	0.0	100.0	0.0
Dividend (buy-back)	0.0	0.0	-149.1	-173.6	-231.8	-111.7	-117.3
Other	-12.8	-9.2	-7.3	-18.9	12.9	4.1	5.9
Change in cash	20.0	198.8	406.2	731.2	-1 463.9	-39.4	46.2
Cash at period-end	524.3	725.2	1 130.3	1 861.5	398.5	359.1	405.3
DPS (PLN)	0.0	0.0	5.8	6.8	9.1	4.4	4.6
FCF	-10.2	80.9	84.3	1 243.8	-1 242.5	-31.0	158.7
(CAPEX / Sales)	0.2%	-0.2%	0.0%	0.3%	0.5%	0.5%	0.6%

Market multiples

	2007	2008	2009	2010	2011F	2012F	2013F
P/E	180.7	27.2	14.7	9.5	11.4	10.9	14.7
P/CE	67.7	22.0	13.1	8.8	10.4	9.9	13.0
P/BV	4.8	4.5	4.4	3.8	3.8	3.2	3.0
P/S	0.8	0.8	0.8	0.6	0.5	0.5	0.6
FCF/EV	-0.4%	3.6%	4.9%	172.4%	-56.9%	-1.3%	7.0%
EV/EBITDA	44.9	17.0	7.7	2.0	7.7	7.6	9.8
EV/EBIT	82.8	20.5	8.6	2.2	8.3	8.1	10.9
EV/S	0.8	0.7	0.5	0.2	0.4	0.5	0.6
DYield	0.0%	0.0%	5.8%	6.8%	9.1%	4.4%	4.6%
Price (PLN)	100.0						
Shares at year-end (millions)	25.5	25.5	25.5	25.5	25.5	25.5	25.5
MC (PLN m)	2 553.0	2 553.0	2 553.0	2 553.0	2 553.0	2 553.0	2 553.0
Equity attributable to minority shareholders (PLN m)	0.1	0.0	0.0	0.0	0.0	0.0	0.0
EV (PLN m)	2 321.1	2 218.1	1 715.8	721.3	2 185.2	2 324.6	2 278.4

20 May 2011

Update



Construction

Poland

Erbud

ERBA.WA, ERB PW

Buy

(Upgraded)

Current price **PLN 29.7**
Target price **PLN 37.6**

Market cap PLN 0.36bn

Free float PLN 0.10bn

Avg. daily trading volume PLN 0.44m

Shareholder Structure

Wolff & Muller	32.95%
Juladal Investment Limited	21.91%
ING OFE	6.24%
Dariusz Grzeszczak	5.95%
AVIVA OFE BZ WBK	7.36%
Others	25.59%

Sector Outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. This major drop is not warranted by the companies' fundamentals. Many of them are very cheap relative to their long-term earnings potential. We recommend overweighting the sector. Companies perceived as defensive have the least potential for growth.

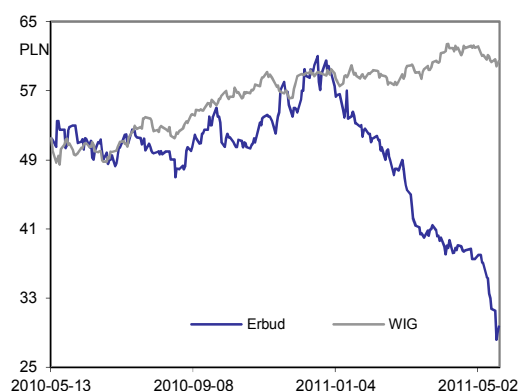
Company Profile

Erbud is a general contractor specializing in housing, retail, office and industrial building projects. It has also bought two local road construction companies, thereby diversifying its business into segments independent of the economic climate.

Important Dates

30.08 - H1 2011 report
14.11 - Q3 2011 report

Erbud vs. WIG



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Worth a Try?

In Q1'11 Erbud disappointed once again, creating high provisions that had a negative impact on earnings. Interestingly, the culprit was once again the Wrocław branch (one of the Company's seven branches). It was subsequently audited and its manager was hired. We hope such problems will not return in the future. Erbud has never before recorded such a high loss on a contract. The situation is gradually improving at subsidiaries and road construction is no longer generating losses. The order backlog for exports has expanded considerably, which should have a positive impact on earnings in the upcoming quarters. We believe that at its current price, Erbud remains an interesting exposure to a scenario of EBIT margins returning to the European average of ca. 3%. If this indeed happens, which we conservatively do not expect until 2013, the Company's multiples figure to 7.5 for P/E and 4.5 for EV/EBITDA. It is also worth noting that Erbud's current price is comparable to its valuation at the time of the financial crisis, when the outlook for its order backlog was very uncertain. Moreover, the investors' reaction to the Company's Q1 earnings was a reflection of the general sentiment to the industry. Had it been better, the provision in question would have been dismissed as a one-off. Due to the considerable reduction in the price of the stock, we are upgrading our rating to buy, with a lower target price (PLN 37.6 per share vs. PLN 42.6 per share).

Provision for Silesia shopping mall

In Q1 2011, Erbud created PLN 15.6m worth of provisions for the contract for the construction of the Silesia shopping mall. Of this amount, PLN 9.6m are certain losses, whereas the remaining PLN 6m could be partially released. We do not assume this in our forecasts.

Exposure to the private sector may pay off

As a building constructor, Erbud specializes in contracts for private investors. It builds residential estates, shopping malls and office buildings. This exposure may prove advantageous, because the private sector will record the fastest growth in 2011. The Company's recent announcement that it might win contracts worth PLN 200-300m might reflect precisely this trend.

Private sector contracts are less exposed to inflation

The lag between bid calculation and its award is shorter in the case of contracts for private investors. As a result, exposure to the risk of an increase in expenses is more limited. Quite possibly, contract budget revisions, like those carried out in Q1'11 to take account of inflation, will not be necessary in the future.

(PLN m)	2009	2010	2011F	2012F	2013F
Revenue	954.6	1 108.1	1 281.5	1 338.8	1 373.0
EBITDA	68.3	33.0	24.8	59.8	67.6
EBITDA margin	7.2%	3.0%	1.9%	4.5%	4.9%
EBIT	60.5	24.9	16.6	51.5	59.2
Net income	41.7	15.2	15.4	43.1	49.8
P/E	9.0	24.6	24.3	8.7	7.5
P/CE	7.5	16.0	15.8	7.3	6.4
P/BV	1.6	1.5	1.4	1.2	1.1
EV/EBITDA	3.5	7.9	13.3	5.5	4.5
DYield	0.4%	1.7%	0.8%	0.8%	2.3%

Q1 2011 Results

Erbud reported weak first-quarter profits which were depressed by PLN 15.6m provision charges related to a shopping-center contract. The reported gross margin was a negative 0.8%, and the adjusted margin would have been 4.8%, much less than our 8% estimate. General expenses of PLN 12.3m were lower than our PLN 14m forecast. One positive aspect of Erbud's first-quarter announcement was the promise that the company is about to add PLN 200-300m-worth of new contracts to its backlog.

Reported vs. forecasted Q1 2011 results

(PLN m)	Q1 2011	Q1 2011F	Difference	Consensus	Difference	Q1 2010	change
Revenue	276.0	222.9	23.8%	223.7	23.4%	184.4	49.7%
Gross profit	-2.3	17.8	-	-	-	20.7	-
%	-0.8%	8.0%	-	-	-	11.2%	-
EBIT	-14.5	4.2	-	4.2	-	7.9	-
%	-5.2%	1.9%	-	-	-	4.3%	-
Pre-tax profit	-15.4	4.7	-	-	-	6.0	-
Net profit	-14.2	3.8	-	3.4	-	4.6	-
%	-5.2%	1.7%	-	-	-	2.5%	-

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

An analysis by business segment shows the dismal performance reported by General Contracting (which booked the PLN 15.6m provisions on its accounts and which includes revenues from power engineering). The segment of Exports was negatively impacted by the weak results of Erbud International; the German subsidiary GWI generated PLN 10.3m revenue and a 4.5% EBIT margin. Road Construction reported a solid improvement relative to Q4 2010. The Real-Estate business generated a negative gross profit suggesting that Erbud sold flats in old projects at a loss.

Reported Q1 results by business segment

Segment	Revenue	Gross profit	Margin	EBIT	Margin
Domestic General Construction	227.9	-3.5	-1.5%	-11.7	-5.2%
Exports	19.9	-0.8	-3.9%	-2.1	-10.8%
Road Construction	17.8	2.5	13.9%	0.7	4.2%
Real Estate Development	7.7	-0.4	-4.6%	-1.1	-14.8%
Steel Frames	2.8	-0.2	-6.5%	-0.2	-6.5%
Total	276.0	-2.3	-0.8%	-14.5	-5.2%

Source: Erbud, BRE Bank Securities

Erbud reported an other operating income of PLN 0.1m and other net financial expenses of PLN 1.0m in Q1 2011. Tax was a negative PLN 1.1m. Minority interests amounted to PLN -0.2m. The operating cash flow was a negative PLN 124.3m.

Erbud's total order backlog stands at PLN 1.26bn (marking a 16% year-on-year increase), of which PLN 0.99bn-worth of contracts are scheduled for completion in 2011. The company is about to capture PLN 200-300m new contracts soon, and the combined value of all of its outstanding contract bids is PLN 4.23bn.

Valuation

Using DCF analysis and relative valuation, we set the price target for ERB stock at PLN 37.6 per share. The target represents a 29.7% upside from the current market price, prompting a buy rating.

Valuation Summary

	Value per share	Weight
DCF Valuation	37.2	75%
Relative Valuation	27.4	25%
Average	34.7	
9M cost of equity	8.3%	
Value per share	37.6	

Source: BRE Bank Securities

Relative Valuation

The peer group for Erbud comprises large construction companies listed on the WSE. Erbud is trading at a 21.3% premium to the average of comparable P/E and EV/EBITDA multiples forecasted for 2011 through 2013. The main source of the premium is a weak 2011 earnings outlook affected by the PLN 15.6m provision charges recognized in Q1. Erbud's forecasted 2012 and 2013 multiples show discounts to peer averages.

Erbud's 2012 results will be positively impacted by an expected revaluation of a commercial property in progress (PLN 5.6m), a factor absent in case of peers earnings.

Similarly to residential developers, Erbud's EV/EBITDA ratio is inflated relative to peer multiples due to the fact that its debt related to the housing business is counted twice: once in COGS and the second time in EV.

Relative Valuation

	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2013F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Elektrobudowa	13.2	11.8	10.3	8.3	7.1	6.0
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Rafako	12.9	11.8	9.1	6.9	6.2	4.5
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
ZUE	12.2	11.6	11.3	7.0	5.9	5.1
Median	12.2	10.9	9.1	7.0	5.9	5.2
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Premium (discount)	98.4%	-20.4%	-17.8%	90.0%	-7.9%	-14.5%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

Source: BRE Bank Securities

DCF Valuation

DCF model assumptions:

- Growth rate after FY2017 = 3%.
- Risk-free rate is 6.1% (10Y T-bond yield).
- Receivables turnover cycles longer than payables turnover cycles.
- Inventory in the property development segment amounts to 4 years of output.
- Erbud's EBIT margins on general contracting will be comparable to sector averages.
- Erbud will commence a commercial real estate project in Poznań in 2012.



DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Revenue	1 281.5	1 338.8	1 373.0	1 443.7	1 509.9	1 575.4	1 639.8	1 702.8	1 763.4	1 821.4	
change	15.6%	4.5%	2.6%	5.1%	4.6%	4.3%	4.1%	3.8%	3.6%	3.3%	
EBITDA	24.8	59.8	67.6	65.1	67.4	69.8	72.3	74.7	77.0	79.2	
EBITDA margin	1.9%	4.5%	4.9%	4.5%	4.5%	4.4%	4.4%	4.4%	4.4%	4.3%	
Depreciation	8.2	8.3	8.4	8.5	8.6	8.7	8.8	8.9	9.0	9.0	
EBIT	16.6	51.5	59.2	56.6	58.8	61.1	63.5	65.8	68.0	70.2	
EBIT margin	1.3%	3.8%	4.3%	3.9%	3.9%	3.9%	3.9%	3.9%	3.9%	3.9%	
Tax on EBIT	3.2	9.8	11.2	10.7	11.2	11.6	12.1	12.5	12.9	13.3	
Property valuations		-5.6	-9.8	-1.9	-1.8	-1.9	-2.0	-2.0	-2.1	-2.1	
NOPLAT	13.5	36.2	38.2	43.9	45.8	47.6	49.4	51.2	53.0	54.7	
CAPEX	-8.6	-27.9	-28.0	-8.9	-9.0	-9.1	-9.3	-9.4	-9.5	-9.0	
Working capital	-80.1	-12.2	13.3	-6.7	-6.0	-6.0	-6.0	-6.0	-5.9	-6.0	
Capital investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	-67.0	4.3	31.9	36.8	39.4	41.2	43.0	44.8	46.6	48.8	50.2
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
discount factor	93.2%	83.9%	75.5%	68.0%	61.2%	55.1%	49.6%	44.6%	40.2%	36.3%	
PV FCF	-62.5	3.6	24.1	25.0	24.1	22.7	21.3	20.0	18.7	17.7	
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Cost of debt	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	6.8%	
Risk-free rate	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.6%	
Credit risk premium	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
Cost of equity	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	
FCF growth after the forecast horizon	3.0%										
Terminal value	660.7										
Present value of terminal value (PV TV)	239.9										
Present value of FCF in the forecast horizon	114.8										
Enterprise value	354.7										
Net debt	-115.0										
Minority interests	2.4										
Enterprise value (EV)	467.3										
Number of shares	12.6										
Value per share (PLN)	37.2										
9M cost of equity	8.3%										
Equity value	39.5										
EV/EBITDA ('11) for the target price	9.5										
P/E ('11) for the target price	32.3										
TV to EV	68%										

Sensitivity Analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0pp	37.4	38.6	40.0	41.5	43.3
WACC -0.5pp	37.2	38.4	39.7	41.3	43.0
WACC	36.9	38.1	39.5	41.0	42.8
WACC +0.5pp	36.7	37.9	39.2	40.8	42.5
WACC +1.0pp	36.5	37.7	39.0	40.5	42.2



Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Revenue	663.1	1 046.1	954.6	1 108.1	1 281.5	1 338.8	1 373.0
<i>change</i>	55.6%	57.8%	-8.8%	16.1%	15.6%	4.5%	2.6%
COGS	606.7	943.7	836.5	1 020.8	1 207.7	1 232.2	1 260.2
Gross profit	56.4	102.5	118.1	87.3	73.8	106.5	112.8
<i>gross profit margin</i>	8.5%	9.8%	12.4%	7.9%	5.8%	8.0%	8.2%
Selling expenses	-0.4	-1.3	-1.4	-2.2	-2.3	-2.5	-2.6
G&A expenses	-22.2	-36.4	-48.6	-50.6	-52.9	-56.1	-58.6
Property valuations						5.6	9.8
Other net operating income/expenses	-1.0	-3.9	-7.6	-9.5	-2.0	-2.1	-2.1
EBIT	32.8	60.8	60.5	24.9	16.6	51.5	59.2
<i>change</i>	29.3%	85.4%	-0.5%	-58.8%	-33.2%	209.5%	15.0%
<i>EBIT margin</i>	4.9%	5.8%	6.3%	2.2%	1.3%	3.8%	4.3%
Financial income/expenses	6.5	-46.5	-4.2	-1.8	2.5	1.9	2.4
Extraordinary income/expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax profit	39.2	14.3	56.3	23.2	19.1	53.4	61.6
Tax	7.4	3.8	13.7	8.1	3.6	10.1	11.7
Other	0.0	1.2	0.9	-0.2	0.1	0.1	0.1
Net income	31.8	9.3	41.7	15.2	15.4	43.1	49.8
<i>change</i>	57.6%	-70.8%	348.7%	-63.5%	1.1%	180.4%	15.5%
<i>margin</i>	4.8%	0.9%	4.4%	1.4%	1.2%	3.2%	3.6%
D&A expenses	1.8	6.3	7.8	8.1	8.2	8.3	8.4
EBITDA	34.6	67.1	68.3	33.0	24.8	59.8	67.6
<i>change</i>	30.1%	93.8%	1.8%	-51.7%	-24.8%	140.8%	13.1%
<i>EBITDA margin</i>	5.2%	6.4%	7.2%	3.0%	1.9%	4.5%	4.9%
Shares at year-end (millions)	12.6	12.6	12.6	12.6	12.6	12.6	12.6
EPS	2.5	0.7	3.3	1.2	1.2	3.4	4.0
CEPS	2.7	1.2	3.9	1.9	1.9	4.1	4.6
ROAE	27.3%	4.7%	19.1%	6.3%	6.0%	15.3%	15.5%
ROAA	9.9%	1.6%	6.6%	2.4%	2.4%	6.6%	7.1%



Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	491.2	647.9	608.2	646.3	630.1	676.4	724.6
Fixed assets	46.0	99.7	93.0	107.0	107.4	132.5	161.9
Intangible assets	0.4	0.3	0.3	0.4	0.4	0.4	0.4
Goodwill	1.5	19.7	20.1	20.1	20.1	20.1	20.1
Property, plant and equipment	16.7	37.2	35.9	33.6	34.0	34.4	34.8
Investment properties	12.0	11.8	8.4	5.9	5.9	30.6	59.6
Long-term investment	1.5	1.5	6.6	24.7	24.7	24.7	24.7
Other	14.0	29.2	21.6	22.3	22.3	22.3	22.3
Current assets	445.2	548.3	515.3	539.4	522.8	543.8	562.6
Inventories	118.6	144.6	99.5	95.0	104.5	107.0	110.0
Receivables	101.0	217.3	187.2	168.6	245.8	256.7	244.5
Construction contracts, prepayments	42.5	70.5	52.9	119.4	122.8	127.5	130.3
Cash and cash equivalents	128.4	115.6	172.5	153.7	47.0	49.8	75.0
Other	54.8	0.3	3.1	2.7	2.7	2.7	2.7
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	491.2	647.9	608.2	646.3	630.1	676.4	724.6
Equity	192.5	201.4	235.5	248.6	260.9	300.9	342.1
Minority interests	17.5	19.8	2.9	3.0	3.1	3.2	3.4
Long-term liabilities	44.5	90.2	40.9	48.9	43.1	43.1	43.1
Loans	20.9	61.6	4.3	5.8	0.0	0.0	0.0
Provisions and other	23.7	28.6	36.6	43.1	43.1	43.1	43.1
Current liabilities	236.7	336.5	328.9	345.9	323.0	329.1	336.0
Loans	19.9	22.4	29.7	32.9	0.0	0.0	0.0
Trade creditors	119.0	155.7	192.4	188.0	198.5	202.6	207.2
Construction contracts, prepayments	92.9	109.7	83.9	113.2	112.7	114.7	117.0
Provisions and other	4.9	48.7	22.9	11.8	11.8	11.8	11.8
Debt	40.8	84.0	34.0	38.7	0.0	0.0	0.0
Net debt	-87.6	-31.6	-138.5	-115.0	-47.0	-49.8	-75.0
(Net debt / Equity)	-45.5%	-15.7%	-58.8%	-46.3%	-18.0%	-16.5%	-21.9%
(Net debt / EBITDA)	-2.5	-0.5	-2.0	-3.5	-1.9	-0.8	-1.1
BVPS	15.3	16.0	18.7	19.8	20.8	23.9	27.2



Cash Flows

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Cash flows from operating activities	36.2	-52.5	153.3	24.2	-58.9	31.9	59.4
Net income	31.8	9.3	41.7	15.2	15.4	43.1	49.8
D&A expenses	1.8	6.3	7.8	8.1	8.2	8.3	8.4
Working capital	13.5	-97.8	106.0	40.4	-80.1	-12.2	13.3
Property valuations						-5.6	-9.8
Other	-11.0	29.7	-2.1	-39.5	-2.4	-1.7	-2.3
Cash flows from investing activities	-74.8	6.1	-29.2	-28.4	-8.6	-27.9	-28.0
CAPEX	-2.9	35.8	-3.2	-4.1	-8.6	-27.9	-28.0
Equity investment	-77.1	-40.0	0.0	0.0	0.0	0.0	0.0
Other	5.3	10.4	-26.1	-24.3	0.0	0.0	0.0
Cash flows from financing activities	137.9	34.0	-67.1	-14.6	-39.2	-1.2	-6.2
Stock issue	120.7	0.0	0.0	0.6	0.0	0.0	0.0
Debt	18.9	160.8	86.2	62.0	-38.7	0.0	0.0
Dividend (buy-back)	0.0	0.0	-1.5	-6.3	-3.0	-3.1	-8.6
Other	-1.7	-126.8	-151.8	-71.0	2.5	1.9	2.4
Change in cash	99.2	-12.4	57.0	-18.8	-106.7	2.8	25.2
Cash at period-end	128.4	115.6	172.5	153.7	47.0	49.8	75.0
DPS (PLN)	0.0	0.0	0.1	0.5	0.2	0.2	0.7
FCF	-38.2	-92.3	157.8	73.3	-67.0	4.3	31.9
(CAPEX / Sales)	0.4%	-3.4%	0.3%	0.4%	0.7%	2.1%	2.0%

Market multiples

	2007	2008	2009	2010	2011F	2012F	2013F
P/E	11.7	40.2	9.0	24.6	24.3	8.7	7.5
P/CE	11.1	23.9	7.5	16.0	15.8	7.3	6.4
P/BV	1.9	1.9	1.6	1.5	1.4	1.2	1.1
P/S	0.6	0.4	0.4	0.3	0.3	0.3	0.3
FCF/EV	-12.6%	-25.5%	66.4%	28.0%	-20.3%	1.3%	10.6%
EV/EBITDA	8.8	5.4	3.5	7.9	13.3	5.5	4.5
EV/EBIT	9.3	6.0	3.9	10.5	19.8	6.3	5.1
EV/S	0.5	0.3	0.2	0.24	0.26	0.24	0.22
DYield	0.0%	0.0%	0.4%	1.7%	0.8%	0.8%	2.3%
Price (PLN)	29.7						
Shares at year-end (millions)	12.6	12.6	12.6	12.6	12.6	12.6	12.6
MC (PLN m)	373.4	373.4	373.4	373.4	373.4	373.4	373.4
Equity attributable to minority shareholders (PLN m)	17.5	19.8	2.9	3.0	3.1	3.2	3.4
EV (PLN m)	303.3	361.6	237.7	261.3	329.4	326.8	301.7

20 May 2011

Update



Construction

Poland

Current price	PLN 34.00
Target price	PLN 54.50
Market cap	PLN 0.68bn
Free float	PLN 0.20bn
Avg daily trading volume (3M)	PLN 0.57m

Shareholder Structure

Acciona	50.09%
OFE PZU Złota Jesień	14.90%
AVIVA OFE Aviva BZ WBK	9.00%

Others 26.01%

Sector Outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. This major drop is not warranted by the companies' fundamentals. Many of them are very cheap relative to their long-term earnings potential. We recommend overweighting the sector. Companies perceived as defensive have the least potential for growth.

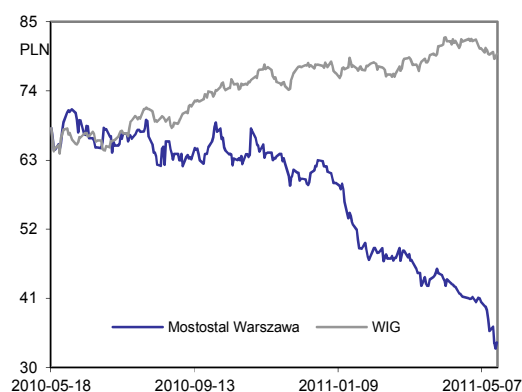
Company Profile

Mostostal Warszawa is one of Poland's largest construction firms. It acts as general contractor for buildings, industrial facilities, and infrastructure projects, as well as chemical and power plants, and environmental-protection systems.

Important dates

31.08 - H1 2011 report
14.11 - Q3 2011 report

MSW vs. WIG



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Mostostal Warszawa Buy

MOWA.WA; MSW PW

(Reiterated)

Cheapest Constructor in the Market?

We believe Mostostal Warszawa is the cheapest construction company listed on the WSE and one of the cheapest ones in the region. At EV/S = 0.17, it is cheaper than Japanese, German or Austrian companies (i.e. companies from markets where margins are low and competition intensive). Its market cap less net cash is just PLN 475m, even though it is one of Poland's biggest diversified holdings. In addition, for quite a while it has not been very optimistic in its assessment of the outlook for 2011. This has proved to be a correct diagnosis, not just for Mostostal. Long-term growth opportunities remain very good. We do not believe MSW's business is going to shrink in the upcoming years. We estimate that it has already accumulated orders exceeding PLN 1bn for 2012 (vs. PLN 0.8bn one year ago). Beginning with 2013, its earnings will start to be positively affected by major power-plant construction contracts. The Company bids for all interesting projects (hydro-engineering, incineration plants, power engineering). It remains cautious in the road construction segment, as unfortunately this is the area in which competition is the most intense. We are conservatively lowering our financial projections (discounting, inter alia, the risk of penalties at Bogdanka). We are reiterating a buy rating with a target price of PLN 54.5 per share (vs. PLN 59.9 per share previously).

Mostostal Warszawa is ready for 2012

We estimate the Company's order backlog for 2012 at PLN 712m for building construction (vs. PLN 407m one year ago), PLN 130m for industrial engineering (vs. PLN 23m) and PLN 152m for road construction (vs. PLN 346m). Mostostal should still be able to fill its 2012 road construction pipeline, as long as it is able to grab a few of the PLN 10-11bn contracts which are still expected to be awarded. The Company's road construction segment employs 400 people, including some temporary workers. A reduction in revenues from PLN 1bn to PLN 0.5-0.6bn will not have a negative impact on margins.

Success of the Opole bid could reverse investor sentiment

In a consortium with Rafako and Polimex Mostostal, MSW is planning to submit a bid for the construction of a new power-generation unit at the Opole power plant (ca. PLN 10bn, with deadline on 30 June). Thus, the long-awaited date is getting nearer and nearer.

Potential dispute with Bogdanka

Bogdanka is claiming that MSW has been late in its work on the expansion of the coal processing plant (PLN 186.8m). It is possible that penalties will be assessed, which we have taken into account by making our earnings estimates for 2011 conservative. We believe penalties for the delay are possible, but we do not expect that Mostostal will have to pay Bogdanka compensation for lost profits (penalties tend to be capped at 10% of contract value).

(PLN m)	2009	2010	2011F	2012F	2013F
Revenues	2 712,1	2 615,7	2 773,3	2 683,1	3 127,8
EBITDA	209,1	114,0	75,4	108,4	152,9
EBITDA margin	7,7%	4,4%	2,7%	4,0%	4,9%
EBIT	181,2	77,9	38,3	70,4	113,9
Net income	117,3	60,9	35,5	60,4	92,8
P/E	5,8	11,2	19,1	11,3	7,3
P/CE	4,7	7,0	9,4	6,9	5,2
P/BV	1,4	1,3	1,3	1,2	1,0
EV/EBITDA	2,0	4,3	6,3	4,2	2,7
DYield	0,9%	5,3%	1,6%	1,6%	2,7%

Q1 2011 Results

The first-quarter results of Mostostal Warszawa (MSW) fell short of forecasts. The gross margin came in at just 2.2% (we forecasted 4.4%) due to the weak profitability of the parent company (which posted a margin of 0.3%, far off our 3.5% estimate) following downward revisions to contract budgets. Without PLN 7.8m reversals of contract provisions, the standalone bottom line would have been a loss.

Reported vs. forecasted Q1 2011 results

(PLN m)	Q1 2011	Q1 2011F	Difference	Consensus	Difference	Q1 2010	change
Revenue	549.3	528.0	4.0%	555.0	-1.0%	528.2	4.0%
Gross profit	11.8	23.4	-49.6%	-	-	45.7	-74.1%
%	2.2%	4.4%	-	-	-	8.6%	-
EBIT	0.0	4.7	-	5.7	-	22.8	-
%	0.0%	0.9%	-	-	-	4.3%	-
Pre-tax profit	4.0	5.9	-31.3%	-	-	27.3	-85.2%
Net profit	0.6	3.1	-79.6%	5.0	-87.1%	18.6	-96.6%
%	0.1%	0.6%	-	-	-	3.5%	-

Source: Mostostal Warszawa, F – forecasts by BRE Bank Securities; Consensus estimates by PAP

The Q1 2011 profits of all MSW companies except Mostostal Płock exceeded expectations, but this was not enough to offset the sales loss reported on a consolidated level. One positive aspect of Q1 2011 were lower-than-expected SG&A expenses (PLN 18.7m vs. PLN 23.3m).

Reported vs. forecasted Q1 2011 results by MSW company

(PLN m)	Mostostal Warszawa (standalone)	Remak	Mostostal Płock	Other companies
Actuals				
Revenue	381.3	34.0	25.0	109.0
Gross profit	1.0	3.8	-0.4	7.5
Margin	0.3%	11.1%	-1.7%	6.9%
Our Forecast				
Revenue	380.0	27.0	16.0	105.0
Gross profit	13.3	2.6	1.3	6.3
Margin	3.5%	9.5%	8.0%	6.0%

Source: Mostostal Warszawa, BRE Bank Securities

Other net operating expenses of PLN 6.9m exceeded our PLN 4.5m estimate owing mainly to asset divestments by Mostostal Płock. Other net financial income amounted to PLN 4.1m (we expected PLN 1.2m). The effective tax rate was 34%, and minority interests were PLN 2.0m. MSW generated a negative operating cash flow of a whopping PLN 262.3m in Q1 2011, second only to Polimex's, but this seems a natural dip from the unusual Q4 2010 high.

Valuation

Using DCF analysis and relative valuation, we set the price target for MSW stock at PLN 54.5 per share. The target implies a 60.2% upside potential from current levels, prompting a buy rating.

Valuation Summary

	Value per share	Weight
DCF Valuation	54.8	75%
Relative Valuation	37.1	25%
Average	50.4	
9M cost of equity	8.2%	
Target Price	54.5	

Source: BRE Bank Securities

Relative Valuation

Compared to a peer group of publicly-traded general construction firms, Mostostal Warszawa is trading at an 8.8% discount to the average of P/E and EV/EBITDA multiples forecasted for 2011 through 2013. The discount is low due to the company's relatively high P/E multiple and high cash levels. For EV/EBITDA alone, MSW's discount is 31.6%.

Relative Valuation

	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Elektrobudowa	15.2	13.5	11.8	9.3	8.1	7.0
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Rafako	12.9	11.8	9.1	6.9	6.2	4.5
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
ZUE	12.2	11.6	11.3	7.0	5.9	5.1
Median	12.2	10.8	9.1	7.7	5.9	5.2
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
Premium (discount)	56.3%	3.8%	-19.7%	-17.9%	-29.9%	-48.5%
Multiple weight	15.0%	20.0%	15.0%	15.0%	20.0%	15.0%

Source: BRE Bank Securities

DCF Valuation

DCF model assumptions:

- Growth rate after FY2017 = 3%.
- Risk-free rate is 6.1% (10Y T-bond yield).
- Receivables turnover cycles will be longer.



DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Revenue	2 773.3	2 683.1	3 127.8	3 274.1	3 426.1	3 583.8	3 742.3	3 897.0	4 037.1	4 166.8	
change	6.0%	-3.3%	16.6%	4.7%	4.6%	4.6%	4.4%	4.1%	3.6%	3.2%	
EBITDA	75.4	108.4	152.9	159.3	166.0	170.6	174.0	179.4	184.1	188.5	
EBITDA margin	2.7%	4.0%	4.9%	4.9%	4.8%	4.8%	4.6%	4.6%	4.6%	4.5%	
Depreciation	37.1	38.0	39.0	40.0	41.1	42.2	42.2	42.2	42.2	42.2	
EBIT	38.3	70.4	113.9	119.3	124.9	128.5	131.9	137.2	142.0	146.4	
EBIT margin	1.4%	2.6%	3.6%	3.6%	3.6%	3.6%	3.5%	3.5%	3.5%	3.5%	
Tax on EBIT	7.3	13.4	21.6	22.7	23.7	24.4	25.1	26.1	27.0	27.8	
NOPLAT	31.0	57.0	92.3	96.6	101.2	104.1	106.8	111.1	115.0	118.5	
CAPEX	-44.5	-45.6	-46.8	-48.1	-49.3	-50.6	-47.2	-46.4	-46.4	-42.2	
Working capital	-3.3	-17.8	-26.9	-6.3	-6.6	-6.2	-6.1	-6.6	-5.9	-5.5	
FCF	20.3	31.6	57.5	82.3	86.4	89.5	95.6	100.3	104.8	113.1	116.4
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
discount factor	94.0%	84.6%	76.2%	68.6%	61.7%	55.6%	50.0%	45.0%	40.5%	36.6%	
PV FCF	19.1	26.7	43.8	56.4	53.3	49.7	47.8	45.2	42.5	41.4	
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Cost of debt	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	6.8%	
Risk-free rate	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.6%	
Credit risk premium	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
Cost of equity	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	
FCF growth after the forecast horizon		3.0%									
Terminal value		1 532.2									
Present value of terminal value (PV TV)		561.3									
Present value of FCF in the forecast horizon		426.0									
Equity value		987.2									
Net debt		-261.1									
Dividends paid		0.0									
Minority interests		153.0									
Equity value		1 095.4									
Number of shares (millions)		20.0									
Value per share (PLN)		54.8									
9M cost of equity		8.2%									
Target Price		59.3									
EV/EBITDA for the target price		7.4									
P/E for the target price		19.5									
TV to EV		51%									

Sensitivity Analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0pp	59.3	61.5	64.1	67.1	70.7
WACC -0.5pp	57.3	59.3	61.5	64.1	67.1
WACC	55.5	57.3	59.3	61.5	64.1
WACC +0.5pp	54.0	55.5	57.3	59.3	61.5
WACC +1.0pp	52.6	54.0	55.5	57.3	59.3



Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Revenue	1 928.4	2 211.3	2 712.1	2 615.7	2 773.3	2 683.1	3 127.8
change	62.3%	14.7%	22.7%	-3.6%	6.0%	-3.3%	16.6%
COGS	1 822.2	1 994.0	2 399.9	2 454.0	2 625.5	2 512.2	2 897.2
Gross profit	106.2	217.3	312.2	161.7	147.8	170.9	230.7
gross margin	5.5%	9.8%	11.5%	6.2%	5.3%	6.4%	7.4%
Selling expenses	-0.8	-1.1	-2.2	-1.5	-1.6	-1.5	-1.6
General and administrative expenses	-59.2	-74.8	-89.9	-92.4	-97.9	-94.7	-110.5
Other net operating income/expenses	12.7	-19.5	-38.9	10.0	-10.0	-4.2	-4.8
EBIT	58.9	121.9	181.2	77.9	38.3	70.4	113.9
change	178.0%	107.0%	48.7%	-57.0%	-50.9%	83.9%	61.8%
EBIT margin	3.1%	5.5%	6.7%	3.0%	1.4%	2.6%	3.6%
Financial activity	1.3	1.0	-5.1	9.3	12.6	13.5	15.1
Equity in income of associates	2.2	-3.3	-6.7	-2.8	-1.5	0.0	0.0
Pre-tax profit	62.3	119.5	169.5	84.4	49.3	83.9	129.0
Tax	-3.7	-27.2	-43.5	-20.1	-9.4	-15.9	-24.5
Minority interests	5.7	11.2	8.7	3.4	4.4	7.6	11.6
Net profit	52.9	81.1	117.3	60.9	35.5	60.4	92.8
change	211.7%	53.2%	44.6%	-48.1%	-41.7%	70.0%	53.7%
margin	2.7%	3.7%	4.3%	2.3%	1.3%	2.3%	3.0%
Depreciation	19.6	22.8	27.9	36.1	37.1	38.0	39.0
EBITDA	78.5	144.6	209.1	114.0	75.4	108.4	152.9
change	93.2%	84.3%	44.6%	-45.5%	-33.9%	43.9%	41.0%
EBITDA margin	4.1%	6.5%	7.7%	4.4%	2.7%	4.0%	4.9%
Shares at year-end (millions)	20.0	20.0	20.0	20.0	20.0	20.0	20.0
EPS	2.6	4.1	5.9	3.0	1.8	3.0	4.6
CEPS	3.6	5.2	7.3	4.9	3.6	4.9	6.6
ROAE	20.8%	26.1%	28.6%	12.2%	6.7%	10.7%	14.8%
ROAA	6.0%	7.1%	8.4%	3.9%	2.1%	3.6%	5.3%



Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	1 009.0	1 275.8	1 504.9	1 638.4	1 684.8	1 663.5	1 857.4
Fixed assets	184.2	246.4	361.8	362.2	369.6	377.2	385.0
Intangible assets	1.2	2.2	1.6	6.6	6.6	6.6	6.6
Investments in associates	4.2	1.0	5.7	3.5	3.5	3.5	3.5
Property, plant and equipment	150.7	188.1	285.0	284.7	292.1	299.7	307.6
Long-term investment	1.3	0.9	1.0	1.0	1.0	1.0	1.0
Other	26.8	54.3	68.5	66.5	66.5	66.5	66.5
Current assets	824.8	1 029.4	1 143.1	1 276.2	1 315.1	1 286.2	1 472.3
Inventories	54.6	41.3	35.7	53.6	57.4	54.9	63.3
Receivables	332.0	516.3	490.0	559.0	562.3	521.9	608.4
Short-term prepayments	147.3	162.0	187.0	301.0	319.1	308.7	359.9
Cash and cash equivalents	287.7	309.3	429.2	352.4	366.2	390.5	430.5
Other	3.2	0.5	1.2	10.2	10.2	10.2	10.2
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	1 009.0	1 275.8	1 504.9	1 638.4	1 684.8	1 663.5	1 857.4
Equity	284.9	337.7	482.5	515.9	540.4	590.1	664.9
Minority interests	59.5	65.3	73.7	70.1	70.1	70.1	70.1
Long-term liabilities	34.4	46.0	74.5	68.2	68.2	68.2	68.2
Loans, financial leases	16.5	29.0	60.1	52.9	52.9	52.9	52.9
Provisions and other	17.9	17.0	14.4	15.3	15.3	15.3	15.3
Short-term liabilities	630.2	826.8	874.3	984.3	1 006.1	935.1	1 054.3
Loans	29.3	30.1	30.4	38.4	38.4	38.4	38.4
Trade creditors	311.7	338.5	368.5	390.0	417.2	399.2	460.4
Long-term accruals	217.3	283.6	311.6	437.0	431.6	378.6	436.6
Other	71.9	174.5	163.7	119.0	119.0	119.0	119.0
Debt	45.8	59.1	90.6	91.3	91.3	91.3	91.3
Net debt	-241.9	-250.2	-338.6	-261.1	-274.9	-299.2	-339.2
(Net debt / Equity)	-84.9%	-74.1%	-70.2%	-50.6%	-50.9%	-50.7%	-51.0%
(Net debt / EBITDA)	-3.1	-1.7	-1.6	-2.3	-3.6	-2.8	-2.2
BVPS	14.2	16.9	24.1	25.8	27.0	29.5	33.2

**Cash Flows**

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Cash flows from operating activities	101.7	66.9	213.8	14.2	56.7	67.1	89.9
Net profit	52.9	81.1	117.3	60.9	35.5	60.4	92.8
Depreciation	19.6	22.8	27.9	36.1	37.1	38.0	39.0
Working capital	-57.9	20.2	24.8	-33.8	-9.9	-10.3	-10.4
Other	87.1	-57.2	43.8	-49.1	-6.0	-21.0	-31.6
Cash flows from investing activities	28.9	-25.7	-69.5	-29.2	-44.5	-45.6	-46.8
CAPEX	28.3	-22.3	-66.8	-32.4	-44.5	-45.6	-46.8
Capital investment	0.0	-4.5	-3.5	-0.3	0.0	-0.3	0.0
Other	0.5	1.2	0.8	3.4	0.0	0.3	0.0
Cash flows from financing activities	-13.5	-19.7	-24.4	-61.7	1.6	2.8	-3.1
Stock issue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt	-9.1	-10.4	-14.8	-22.2	0.0	0.0	0.0
Dividend (buy-back)	-0.9	-5.2	-6.2	-35.7	-11.0	-10.7	-18.1
Other	-3.5	-0.1	-0.1	0.0	0.0	0.0	0.0
Change in cash	117.1	21.5	119.9	-76.8	13.8	24.3	40.0
Cash at period-end	287.7	309.3	429.2	352.4	366.2	390.5	430.5
DPS (PLN)	0.0	0.3	0.3	1.8	0.6	0.5	0.9
FCF	68.3	11.6	137.8	16.6	20.3	31.6	57.5
(CAPEX / Sales)	-1.5%	1.0%	2.5%	1.2%	1.6%	1.7%	1.5%

Market multiples

	2007	2008	2009	2010	2011F	2012F	2013F
P/E	12.8	8.4	5.8	11.2	19.1	11.3	7.3
P/CE	9.4	6.5	4.7	7.0	9.4	6.9	5.2
P/BV	2.4	2.0	1.4	1.3	1.3	1.2	1.0
P/S	0.4	0.3	0.3	0.3	0.2	0.3	0.2
FCF/EV	13.7%	2.3%	33.2%	3.4%	4.3%	7.0%	14.0%
EV/EBITDA	6.3	3.4	2.0	4.3	6.3	4.2	2.7
EV/EBIT	8.5	4.1	2.3	6.3	12.4	6.4	3.6
EV/S	0.3	0.2	0.2	0.19	0.17	0.17	0.13
DYield	0.1%	0.8%	0.9%	5.3%	1.6%	1.6%	2.7%
Price (PLN)	34.0						
Shares at year-end (millions)	20.0	20.0	20.0	20.0	20.0	20.0	20.0
MC (PLN m)	680.0	680.0	680.0	680.0	680.0	680.0	680.0
Equity attributable to minority shareholders (PLN m)	59.5	65.3	73.7	70.1	70.1	70.1	70.1
EV (PLN m)	497.6	495.1	415.1	488.9	475.1	450.8	410.9

20 May 2011

Update



Construction

Poland

PBG

PBGG.WA; PBG PW

Buy

(Upgraded)

Current price	PLN 142.0
Target price	PLN 167.9
Market cap	PLN 2.03bn
Free float	PLN 0.76bn
Average daily trading (3M)	PLN 12.09m

Shareholder Structure

Jerzy Wiśniewski	26.13%
Pionier Pekao IM	24.27%
ING Nationale-Nederlanden Polska OFE	9.58%

Others	40.02%
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Industry Outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. The sharp declines that some construction stocks have suffered have no basis in the fundamentals. In spite of an overall bearish sector outlook, we see some good investment opportunities among Polish construction firms. The companies that are considered the safest offer the least upside potential.

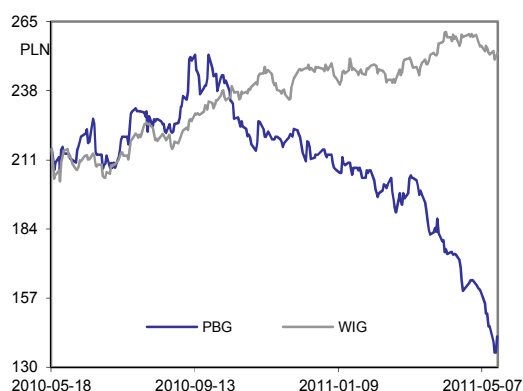
Company Profile

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

Important Dates

31 August 2011 - H1 2011 report
14 November 2011 - Q3 2011 report

PBG vs. WIG



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Committed to OHL

For the first time in history, PBG's price-to-earnings ratio is less than 10, making the company's shares much cheaper than during the financial crisis. OHL has put on hold the acquisition of Hydrobudowa and other PBG operations because of a low share price. The Spaniards cannot afford making a purchase at a price greater than the book value and having to make goodwill impairment charges. In our opinion, investors may have overestimated the risks facing the construction sector. We do not agree that the industry faces a slowdown after 2012, as we think it will benefit from continued EU funding between 2014 and 2020. Many construction companies are trading at cheap prices compared to their long-term earnings prospects, and we expect a rebound on these stocks, including Hydrobudowa. Our expectations are supported by PBG's changing strategy with respect to its subsidiary which, to date, has been operating as PBG's weaker partner or subcontractor tasked with performing less profitable contracts. Given PBG's determination to make the deal with OHL, we think it will start helping Hydrobudowa to report strong earnings and cash flows by handing over some of the more lucrative contracts such as the potential order for LNG storage tanks (which has a value of PLN 200m but can potentially increase to PLN 500m). Once the deal is sealed, PBG will be able to continue pursuing its strategy of growth through public-private contracts, exports, power-plant engineering, and acquisitions. We are upgrading PBG to buy with a price target of PLN 167.9 a share.

Can PBG become an international engineering corporation?

PBG's long-term objective is to become an international engineering corporation catering to the gas and oil industry. We believe the company is determined to pursue that objective through the deal and future partnership with OHL.

We assume the OHL will go through

Our financial forecasts for PBG are based on the assumption that the OHL deal will be sealed in Q2 2011. We have lowered our expectations with respect to future margins, assuming that PBG will hand some of its high-margin contracts over to Hydrobudowa.

Self-fulfilling prophecy

We believe PBG's efforts aimed at increasing Hydrobudowa's attractiveness will help lift the latter's stock price. If investors gain confidence in PBG's strategy, this will give Hydrobudowa potential for upside which should convince OHL to go ahead with the acquisition.

(PLN m)	2009	2010	2011F	2012F	2013F
Revenues	2 578.0	2 740.3	2 396.1	2 002.1	2 414.2
EBITDA	333.6	319.4	292.3	266.8	278.5
EBITDA margin	12.9%	11.7%	12.2%	13.3%	11.5%
EBIT	286.5	272.7	239.5	216.2	212.7
Net income	210.6	224.3	197.5	192.9	190.5
P/E	9.6	9.0	10.3	10.5	10.7
P/CE	7.9	7.5	8.1	8.3	7.9
P/BV	1.5	1.3	1.2	1.1	1.0
EV/EBITDA	8.2	8.4	6.0	5.9	5.8
DYield	0.0%	1.0%	2.8%	2.4%	2.4%

Q1 2011 Results

On lower-than-expected revenue, PBG achieved a higher gross margin of 11.6% (we expected 10.7%). General expenses were lower than expected (PLN 34.6m) at PLN 26.9m, resulting in a stronger sales profit. All in all PBG's Q1 figures were higher than estimated, but we have a neutral view on the quarter's performance (low Q1 2010 base, relatively low gross margin compared to our full-year forecast of 14%, profitability in gas & oil engineering at 18.5%, cash flows at a negative PLN 195.0m). Relative to the consensus forecast, the reported EBIT can hardly be seen as a positive surprise. At the bottom line, the earnings may have been affected by one-offs.

PBG's first-quarter earnings vs. our forecasts, PAP consensus

(PLN m)	Q1 2011	Q1 2011F	Difference	Consensus (PAP)	Difference	Q1 2010	Change
Revenues	477.6	521.1	-8.3%	514.8	-7.2%	469.0	1.8%
Gross profit	55.3	55.8	-0.9%	-	-	48.7	13.6%
%	11.6%	10.7%	-	-	-	10.4%	-
EBIT	33.5	31.0	8.0%	33.6	-0.4%	23.9	39.9%
%	7.0%	6.0%	-	-	-	5.1%	-
Pre-tax profit	30.3	22.1	37.2%	-	-	22.8	33.0%
Net profit	24.1	16.5	45.8%	20.8	15.8%	17.8	35.5%
%	5.0%	3.2%	-	4.0%	-	3.8%	-

Source: PBG, BRE Bank Securities, PAP

Other operating income fell short of expectations (PLN 5.1m vs. PLN 9.8m), resulting in an EBIT which was only 8% higher than our estimate and in line with consensus. Financing income amounted to PLN 8.9m (we expected PLN 3.1m) thanks to a sale by Hydrobudowa 9 of a real-estate project for PLN 4m. Minority interests amounted to PLN 1.4m (we expected PLN 0.2m).

The large negative cash flow was probably "owed" to Aprivia (which spent contract advances). The consolidated cash flow was PLN -195m, PBG's standalone cash flow was PLN -55.6m, and Hydrobudowa's cash flow was PLN -23m.

Q1 2011 results by segment

(PLN m)	Revenues	Gross profit	Pct. margin
Gas & Oil Engineering	144.9	26.8	18.5%
Hydroengineering	71.1	15.2	21.4%
General Construction	134.0	10.1	7.6%
Road Construction	123.1	1.9	1.5%
Other	4.5	1.3	29.0%
Total	477.6	55.3	11.6%

Source: PBG, BRE Bank Securities

As for Hydrobudowa, its lower-than-forecasted gross margin (5.9% reported vs. 6.7% estimated) was more than offset by lower SG&A expenses (PLN 10.8m vs. PLN 15.1m). A sales profit of PLN 5.6m topped our PLN 3.5m estimate. Other operating income amounted to PLN 2.7m (we expected PLN 4.2m), and other financing income was PLN 1.8m (we expected PLN 3.1m expenses). Summing up, we have a positive view on Hydrobudowa's Q1 2011 results, especially the strong gross profit.

Hydrobudowa's first-quarter earnings vs. our forecasts, PAP consensus

(PLN m)	Q1 2011	Q1 2011F	Difference	Q1 2010	Change
Revenues	277.2	280.0	-1.0%	322.7	-14.1%
Gross profit	16.4	18.6	-11.7%	24.9	-34.1%
%	5.9%	6.7%	-	7.7%	--
EBIT	8.3	7.7	7.2%	11.6	-28.7%
%	3.0%	2.8%	-	3.6%	—
Pre-tax profit	10.1	4.6	118.0%	11.4	-11.5%
Net profit	8.8	3.8	133.0%	8.9	-1.6%
%	3.2%	1.3%	-	2.8%	-

Source: Hydrobudowa Polska, BRE Bank Securities

Q1 2011 results of Hydrobudowa Polska by segment

(PLN m)	Revenues	Gross profit	Pct. margin
Gas & Oil Engineering	2.7	0.0	-0.2%
Hydroengineering	59.4	9.3	15.6%
General Construction	117.5	3.0	2.6%
Road Construction	86.1	4.1	4.7%
Other	11.6	0.1	0.8%
Total	277.2	16.4	5.9%

Source: Hydrobudowa Polska, BRE Bank Securities

Valuation

Our valuation of PBG is based on two methods, relative valuation and the DCF model. Our target price is PLN 167.9 per share, i.e. 18.2% more than the current market price. We recommend buying the stock.

	Value per share	Weight
DCF Valuation	157.0	75%
Relative Valuation	149.5	25%
Average	155.1	
9M cost of equity	8.2%	
Target Price	167.9	

Relative Valuation

The peer group for PBG comprises Polish construction companies. On P/E and EV/EBITDA multiples for 2011-2013, PBG is trading at a 1.5% discount to peers. Major discounts appear for 2011-based multiples.

PBG vs. construction peers

	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Elektrobudowa	13.2	11.8	10.3	8.3	7.1	6.0
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Rafako	12.9	11.8	9.1	6.9	6.2	4.5
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
ZUE	12.2	11.6	11.3	7.0	5.9	5.1
Median	12.9	10.9	8.8	7.7	5.9	5.1
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Premium (discount)	-20.1%	-3.3%	21.6%	-21.5%	1.1%	13.3%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

DCF Valuation

Valuation assumptions

- Risk-free rate is 6.1% (10Y T-bond yield);
- FCF growth rate after FY2017 = 3%.
- PBG will sell a 51% stake in Hydrobudowa and a 50% stake in Aprivia to OHL.
- Hydrobudowa's earnings will be consolidated through Q2 2011.
- Starting in Q3 2011, PBG will consolidate 50% of Aprivia's earnings under the proportional Method.
- The loan to Strateg Capital will be converted into shares in the company (PLN 108.6m), with full consolidation beginning with 2011.
- We discount growth in power-plant engineering, road construction and real-estate development.
- Cash flows will be strong thanks to: non-consolidation of Hydrobudowa beginning in Q3 2011 (which will balance receivables and payables; our valuation takes into account net debt before the sale of the stake in Hydrobudowa), a decline in short- and long-term loans.
- PBG's stakes in Energomontaż (25%) and Hydrobudowa (12.05% following the transaction with OHL) are factored in at market value.
- Loans granted to related and unrelated companies decline to zero in 2012.



DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Revenue	2 396.1	2 002.1	2 414.2	2 841.8	2 983.1	3 112.4	3 242.2	3 368.6	3 485.9	3 596.1	
Change	-12.6%	-16.4%	20.6%	17.7%	5.0%	4.3%	4.2%	3.9%	3.5%	3.2%	
EBITDA	292.3	266.8	278.5	313.0	332.5	338.3	343.7	348.5	358.1	366.8	
EBITDA margin	12.2%	13.3%	11.5%	11.0%	11.1%	10.9%	10.6%	10.3%	10.3%	10.2%	
D&A expenses	52.8	50.5	65.8	75.2	75.6	76.1	76.5	76.9	77.4	77.4	
EBIT	239.5	216.2	212.7	237.8	256.8	262.2	267.1	271.5	280.7	289.4	
EBIT margin	10.0%	10.8%	8.8%	8.4%	8.6%	8.4%	8.2%	8.1%	8.1%	8.0%	
Tax on EBIT	45.5	41.1	40.4	45.2	48.8	49.8	50.8	51.6	53.3	55.0	
NOPLAT	194.0	175.1	172.3	192.6	208.0	212.4	216.4	219.9	227.3	234.4	
CAPEX	-129.5	-172.5	-227.0	-157.9	-79.4	-79.9	-80.3	-80.8	-81.3	-77.4	
Working capital	290.8	176.5	8.1	-88.7	-31.8	-24.1	-24.0	-23.2	-23.4	-22.0	
Other	566.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Property valuation	-12.0	-35.0	-35.9	-20.8	-19.8	-20.4	-21.1	-21.7	-22.3	-23.0	
FCF	962.7	194.7	-16.8	0.3	152.6	164.0	167.5	171.2	177.7	189.4	195.1
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Discount factor	94.0%	84.6%	76.2%	68.6%	61.7%	55.6%	50.0%	45.0%	40.5%	36.6%	
PV FCF	905.4	164.8	-12.8	0.2	94.2	91.1	83.7	77.1	72.0	69.4	
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Cost of debt	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	6.8%	
Risk-free rate	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.6%	
Credit risk premium	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
Cost of equity	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	
FCF growth after the forecast horizon	3.0%										
Terminal value (TV)	2 566.8										
Present value of terminal value (PV TV)	940.3										
Present value of FCF in the forecast horizon	1 545.1										
Present value of FCF	2 485.4										
Net debt	585.0										
Other investment properties	197.2										
Minority interests	6.0										
25% stake in Energomontaż	99.5										
12.05% stake in Hydrobudowa	53.3										
Equity value	2 244.4										
Number of shares (millions)	14.3										
Equity value per share (PLN)	157.0										
9-month cost of equity	8.2%										
Target Price	169.9										
EV/EBITDA ('10) for the target price	9.7										
P/E for the target price	10.8										
TV to EV	38%										

Sensitivity analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0pp	161.7	165.9	170.6	176.1	182.3
WACC -0.5pp	161.3	165.4	170.2	175.6	181.8
WACC	160.9	165.2	169.9	175.3	181.3
WACC +0.5pp	160.4	164.6	169.3	174.6	180.8
WACC +1.0pp	160.0	164.2	168.8	174.2	180.3



Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Revenue	1 376.8	2 089.3	2 578.0	2 740.3	2 396.1	2 002.1	2 414.2
Change	104.2%	51.8%	23.4%	6.3%	-12.6%	-16.4%	20.6%
COGS	1 191.7	1 751.2	2 185.9	2 393.1	2 070.6	1 739.1	2 138.7
Gross profit	185.0	338.1	392.1	347.2	325.5	263.0	275.4
gross profit margin	13.4%	16.2%	15.2%	12.7%	13.6%	13.1%	11.4%
Selling expenses	-0.4	0.0	0.0	-0.1	-0.5	-0.4	-0.5
G&A expenses	-79.6	-106.8	-109.8	-109.1	-93.4	-78.1	-94.2
Valuation of commercial properties				24.2	12.0	35.0	35.9
Other net operating income/expenses	4.3	-7.8	4.1	10.4	-4.0	-3.3	-4.0
EBIT	109.4	223.4	286.5	272.7	239.5	216.2	212.7
Change	52.0%	104.3%	28.2%	-4.8%	-12.2%	-9.7%	-1.6%
EBIT margin	7.9%	10.7%	11.1%	10.0%	10.0%	10.8%	8.8%
Financial income/expenses	34.7	-9.9	-23.9	-5.1	10.4	22.5	23.1
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax profit	144.1	213.5	262.6	267.6	249.9	238.7	235.8
Tax	-26.7	-25.8	-40.6	-49.1	-47.5	-45.4	-44.8
Minority interests	-15.4	-29.7	-11.4	5.8	-4.9	-0.5	-0.5
Net profit	102.1	158.0	210.6	224.3	197.5	192.9	190.5
Change	95.6%	54.9%	33.3%	6.5%	-11.9%	-2.4%	-1.2%
margin	7.4%	7.6%	8.2%	8.2%	8.2%	9.6%	7.9%
D&A expenses	28.8	47.1	47.1	46.7	52.8	50.5	65.8
EBITDA	138.2	270.6	333.6	319.4	292.3	266.8	278.5
Change	56.1%	95.8%	23.3%	-4.3%	-8.5%	-8.8%	4.4%
EBITDA margin	10.0%	12.9%	12.9%	11.7%	12.2%	13.3%	11.5%
Shares at year-end (millions)	13.4	13.4	14.3	14.3	14.3	14.3	14.3
EPS	7.6	11.8	14.7	15.7	13.8	13.5	13.3
CEPS	9.7	15.3	18.0	19.0	17.5	17.0	17.9
ROAE	18.3%	18.0%	17.5%	15.0%	11.8%	10.6%	9.7%
ROAA	6.1%	6.1%	6.1%	5.1%	5.2%	6.6%	6.2%



Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	2 289.3	2 857.0	4 008.3	4 755.0	2 894.0	2 915.4	3 206.0
Fixed assets	717.9	909.3	1 011.5	1 599.1	1 121.2	1 233.3	1 430.5
Intangible assets	13.3	14.6	33.0	41.6	34.3	34.3	34.3
Goodwill	267.4	333.1	319.0	346.9	98.7	98.7	98.7
Property, plant and equipment	307.0	411.5	368.3	665.4	524.7	527.2	530.5
Investment properties	34.2	41.6	154.1	369.5	357.2	511.7	705.5
Other financial assets	63.4	57.2	115.0	114.8	45.3	0.4	0.4
Other	32.6	51.4	22.2	60.9	60.9	60.9	60.9
Current assets	1 571.3	1 947.6	2 996.8	3 155.8	1 772.9	1 682.1	1 775.5
Inventories	40.1	69.3	233.7	293.5	308.0	311.0	314.5
Receivables	602.6	725.1	1 135.8	1 335.0	919.0	767.9	892.9
Construction contract receivables	445.2	777.8	725.6	393.6	65.6	54.9	66.1
Short-term prepayments	14.7	21.1	24.2	54.6	54.6	54.6	54.6
Cash and cash equivalents	410.3	289.7	660.3	863.8	330.2	493.7	447.3
Other financial assets	58.4	64.7	217.3	215.4	95.4	0.0	0.0
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	2 289.3	2 857.0	4 008.3	4 755.0	2 894.0	2 915.4	3 206.0
Equity	748.0	1 010.9	1 395.3	1 605.2	1 746.6	1 890.1	2 032.4
Minority interests	34.6	103.7	228.2	226.3	231.2	231.7	232.2
Long-term liabilities	330.0	364.8	561.8	985.6	71.6	71.6	71.6
Loans, finance leases	258.6	323.1	493.1	914.0	0.0	0.0	0.0
Provisions and other	71.4	41.7	68.7	71.6	71.6	71.6	71.6
Current liabilities	1 176.7	1 377.7	1 823.1	1 937.9	844.6	722.0	869.8
Loans	466.7	717.8	641.8	534.7	0.0	0.0	0.0
Trade creditors	543.2	538.0	1 046.2	1 234.8	709.1	595.6	732.4
Construction contract payables	19.6	15.4	60.5	89.6	56.7	47.6	58.6
Other	147.2	106.4	74.6	78.8	78.8	78.8	78.8
Debt	725.2	1 040.9	1 134.9	1 448.7	0.0	0.0	0.0
Net debt	314.9	751.2	474.6	585.0	-330.2	-493.7	-447.3
(Net debt / Equity)	42.1%	74.3%	34.0%	36.4%	-18.9%	-26.1%	-22.0%
(Net debt / EBITDA)	2.3	2.8	1.4	1.8	-1.1	-1.9	-1.6
BVPS	55.7	75.3	97.6	112.3	122.2	132.2	142.2

Cash Flows

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Cash flows from operating activities	-117.6	-255.2	306.5	433.6	523.7	362.9	205.8
Net profit	102.1	158.0	210.6	224.3	197.5	192.9	190.5
D&A expenses	28.8	47.1	47.1	46.7	52.8	50.5	65.8
Working capital	-177.7	-469.2	121.0	215.9	290.8	176.5	8.1
Other	-70.7	8.8	-72.2	-53.3	-17.5	-57.0	-58.5
Cash flows from investing activities	-179.0	-191.7	-352.0	-530.0	437.1	-172.5	-227.0
CAPEX *	-131.8	-191.9	-151.0	-390.1	-129.5	-172.5	-227.0
Equity investment	-41.7	19.7	14.5	-104.6	566.6	0.0	0.0
Other	-5.5	-19.6	-215.5	-35.2	0.0	0.0	0.0
Cash flows from financing activities	655.5	325.1	416.9	144.9	-1 494.4	-26.9	-25.2
Stock issue	333.1	292.3	181.8	-0.3	0.0	0.0	0.0
Debt	342.2	74.0	278.5	226.9	-1 448.7	0.0	0.0
Dividend (buy-back)	-1.9	0.0	0.0	-20.0	-56.1	-49.4	-48.2
Other	-17.9	-0.4	-1.2	0.0	0.0	0.0	0.0
Change in cash	358.9	-121.9	371.4	48.5	-533.6	163.5	-46.4
Cash at period-end	410.3	289.7	660.3	863.8	330.2	493.7	447.3
DPS (PLN)	0.1	0.0	0.0	1.4	3.9	3.5	3.4
FCF	-207.7	-473.6	249.2	-200.4	962.7	194.7	-16.8
(CAPEX / Sales)	9.6%	9.2%	5.9%	14.2%	5.4%	8.6%	9.4%

Market multiples

	2007	2008	2009	2010	2011F	2012F	2013F
P/E	18.7	12.1	9.6	9.0	10.3	10.5	10.7
P/CE	14.6	9.3	7.9	7.5	8.1	8.3	7.9
P/BV	2.5	1.9	1.5	1.3	1.2	1.1	1.0
P/S	1.4	0.9	0.8	0.7	0.8	1.0	0.8
FCF/EV	-9.2%	-17.1%	9.1%	-7.5%	54.6%	12.3%	-1.0%
EV/EBITDA	16.3	10.2	8.2	8.4	6.0	5.9	5.8
EV/EBIT	20.6	12.4	9.5	9.9	7.4	7.3	7.6
EV/S	1.6	1.3	1.1	1.0	0.7	0.8	0.7
DYield	0.1%	0.0%	0.0%	1.0%	2.8%	2.4%	2.4%
Price (PLN)	142.0						
Shares at year-end (millions)	13.4	13.4	14.3	14.3	14.3	14.3	14.3
MC (PLN m)	1 907.1	1 907.1	2 029.9	2 029.9	2 029.9	2 029.9	2 029.9
Equity attributable to minority shareholders (PLN m)	34.6	103.7	228.2	226.3	231.2	231.7	232.2
EV (PLN m)	2 253.6	2 770.2	2 721.6	2 699.7	1 772.3	1 578.3	1 616.2

* This item includes CAPEX at PBG, Strateg Capital (in 2011, the construction of a stationary plant will be concluded), outlays on property development projects in the commercial segment.

20 May 2011

Update


Construction
Poland

Current price	PLN 3.09
Target price	PLN 3.41
Market cap	PLN 1.61bn
Free float	PLN 1.00bn
Avg daily trading volume (3M)	PLN 8.80m

Shareholder Structure

Pionier Pekao IM	10.00%
AVIVA OFE BZ Aviva WBK	9.95%
ING OFE	7.75%
OFE PZU	7.68%
Polimex-Cekop Development	2.52%
Others	62.00%

Sector Outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. The sharp declines that some construction stocks have suffered have no basis in the fundamentals. In spite of an overall bearish sector outlook, we see some good investment opportunities among Polish construction firms. The companies that are considered the safest offer the least upside potential.

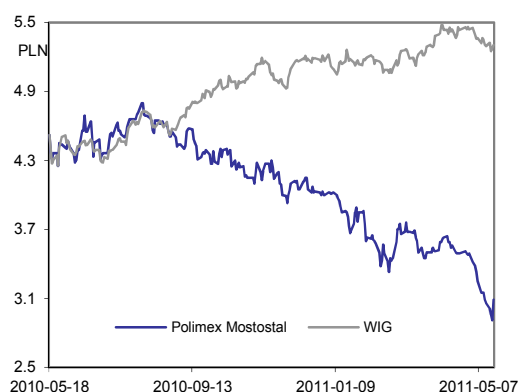
Company Profile

Polimex manufactures galvanized-steel products, steel components, and boilers for the power industry, and offers construction services to the manufacturing, chemical, power, road, and railroad industries as well as developing properties.

Important dates

31.08 - H1 2011 report
10.11 - Q3 2011 report

PXM vs. WIG



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Polimex Mostostal Accumulate

MOSD.WA; PXM PW

(Reiterated)

Power To Grow

Polimex's Q1 2011 results disappointed somewhat, with a relatively low gross margin and weak profits from steel structures. We expect improvement going forward, particularly in power engineering, chemical plant engineering, and steel structures, all of which are poised to benefit from the capacity-expansion plans of the Polish power industry. Power-plant contract tenders are going according to plan, and we expect the first PLN 10bn award to be made to the winning general contractor in H2 2011. The failed privatization of Enea means that the utility is more likely to build the planned coal-fired power plant in Kozenice. Further, we predict that the buyer of Vattenfall's Warsaw-based heat supplier will hire Polimex and Hitachi to build a new combined-cycle unit in Siekierki (the contract is worth an estimated PLN 2.8bn). Finally, Tauron decided to replace some of its coal-fired projects with steam and gas power plants which require less work and no boilers, but which are easier to develop and therefore take less time to finish, providing contractors and subcontractors with opportunities to grow earnings more rapidly and sooner, though over a shorter time span. We are reiterating an accumulate rating on PXM, with the price target lowered from PLN 4.03 to PLN 3.41 per share to reflect our conservative assessment of the risks facing the road construction industry.

Improving steel business

Polimex produces steadily growing volumes of steel structures which, however, generate tight margins at the moment (the Q1 2011 gross margin was just 9.1%). The reasons are two-fold: low-margin contracts captured in 2010 (with margins depressed by high steel prices), and a temporary shortage of chemical pipeline orders at subsidiary Energopol Sochaczew. We predict that the margins earned on steel structures will increase to 13% in Q2 2011 and further to 16.5% in the following quarters.

2011 order backlog

Polimex has accumulated a 2011 order backlog of an estimated PLN 3.9m, which is less than we predicted and which prompted downward revisions in our revenue forecasts for the company. The 2012 backlog is PLN 2.7bn, and we think it will continue to grow to a level which will ensure fulfillment of our revenue forecast.

Road risks

Polimex recognized a gross margin of 9.5% from road contracts in Q1 2011, which was much more than what we had expected. This suggests to us that the company may be overly optimistic when predicting margins achievable on long-term contracts, prompting downward revisions in our own forecasts and a reiterated accumulate rating in spite of the recent drop in share price.

(PLN m)	2009	2010	2011F	2012F	2013F
Revenue	4 836.7	4 160.9	4 719.9	4 846.2	5 253.8
EBITDA	343.6	300.4	279.2	312.5	364.2
EBITDA margin	7.1%	7.2%	5.9%	6.4%	6.9%
EBIT	264.9	212.7	169.2	202.0	252.6
Net income	156.4	109.7	110.3	148.6	206.4
P/E	9.2	13.1	14.6	10.8	7.8
P/CE	6.1	7.3	7.3	6.2	5.1
P/BV	1.2	1.0	1.0	0.9	0.8
EV/EBITDA	6.0	7.0	7.7	6.6	5.2
DYield	0.3%	1.3%	0.0%	0.0%	0.0%

Valuation

We have valued the Polimex Mostostal stock using the DCF model and relative valuation. Our 9M Target Price is PLN 3.41 per share. The target implies a 10.4% upside potential from current levels, prompting an accumulate rating.

Valuation

	Value per share	Weight
DCF Valuation	3.24	75%
Relative Valuation	2.89	25%
Average	3.15	
9M cost of equity	8.2%	
Target Price	3.41	

Source: BRE Bank Securities

Relative Valuation

Compared to a peer group of large publicly-traded construction firms, PXM is trading at a 4.9% premium to peers on the average of estimated 2011-2013 P/E and EV/EBITDA multiples, owed partly to SEE tax credits expected to be claimed in 2011 through 2013.

Relative Valuation

	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Elektrobudowa	13.2	11.8	10.3	8.3	7.1	6.0
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Rafako	12.9	11.8	9.1	6.9	6.2	4.5
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
ZUE	12.2	11.6	11.3	7.0	5.9	5.1
Median	12.2	10.9	9.1	7.0	5.9	5.1
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Premium (discount)	19.3%	-0.3%	-14.4%	10.1%	12.3%	2.2%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

Source: BRE Bank Securities

DCF Valuation

Valuation assumptions

- Risk-free rate is 6.1% (10Y T-bond yield).
- FCF growth rate after FY2017 = 3%.
- Credit risk premium is 2% in 2009-2017.
- We treat the valuation of land for development as a value-increasing factor.
- We adjust the number of shares for treasury shares held by Polimex-Cekop Development.
- We assume longer days in receivables.



DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020P	2020+
Revenues	4 719.9	4 846.2	5 253.8	5 682.4	5 988.3	6 303.1	6 607.7	6 902.8	7 175.2	7 441.9	
Change	13.4%	2.7%	8.4%	8.2%	5.4%	5.3%	4.8%	4.5%	3.9%	3.7%	
EBITDA	279.2	312.5	364.2	390.9	408.0	425.4	442.0	457.7	471.3	484.4	
EBITDA margin	5.9%	6.4%	6.9%	6.9%	6.8%	6.7%	6.7%	6.6%	6.6%	6.5%	
D&A expenses	110.0	110.5	111.6	112.7	113.8	114.8	115.9	116.7	117.0	117.0	
EBIT	169.2	202.0	252.6	278.2	294.3	310.6	326.1	341.0	354.3	367.4	
EBIT margin	3.6%	4.2%	4.8%	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%	
Tax on EBIT	6.8	8.1	10.1	11.1	55.9	59.0	62.0	64.8	67.3	69.8	
NOPLAT	162.5	193.9	242.5	267.1	238.4	251.6	264.2	276.2	287.0	297.6	
CAPEX	-110.0	-110.5	-121.6	-122.7	-123.8	-124.8	-125.9	-126.7	-122.0	-117.0	
Working capital	-151.8	-62.4	-38.0	-72.8	-41.9	-41.2	-38.9	-37.5	-32.9	-33.1	
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	10.7	131.6	194.5	184.2	186.4	200.4	215.3	228.7	249.1	264.5	272.5
WACC	10.2%	10.4%	10.7%	10.9%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Discount factor	94.5%	85.6%	77.4%	69.7%	62.8%	56.5%	50.9%	45.8%	41.2%	37.3%	
PV FCF	10.1	112.6	150.4	128.5	117.0	113.2	109.5	104.7	102.6	98.5	

WACC	10.2%	10.4%	10.7%	10.9%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%
Cost of debt	8.1%	8.1%	8.1%	8.1%	8.1%	8.1%	8.1%	8.1%	8.1%	7.6%
Risk-free rate	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.6%
Credit risk premium	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Effective tax rate	4.0%	4.0%	4.0%	4.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Net debt / EV	26%	22%	14%	5%	0%	0%	0%	0%	0%	0%
Cost of equity	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0

FCF growth after the forecast horizon	3.0%	Sensitivity analysis				
Terminal value (TV)	3 585.3	FCF growth in perpetuity				
Present value of terminal value (PV TV)	1 335.6		2.0%	2.5%	3.0%	3.5%
Present value of FCF in the forecast horizon	1 047.2					4.0%
Enterprise value (EV)	2 382.8	WACC -1.0pp	3.95	4.23	4.56	4.95
Net debt	482.9	WACC -0.5pp	3.51	3.72	3.95	4.23
Property valuation *	25.0	WACC	3.17	3.33	3.51	3.72
Minority interests	232.3	WACC +0.5pp	2.90	3.03	3.17	3.33
Equity value	1 692.6	WACC +1.0pp	2.68	2.79	2.90	3.03
Number of shares (millions **)	521.7					3.17
Equity value per share (PLN)	3.24					
9M cost of equity	8.2%					
Target Price	3.51					

EV/EBITDA ('10) for the target price	6.7
P/E for the target price	14.8
TV to EV	56%

* Valuation of land for development.

** Number of shares adjusted for stock issue on account of merger.



Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Revenues	3 720.5	4 301.7	4 836.7	4 160.9	4 719.9	4 846.2	5 253.8
Change	49.8%	15.6%	12.4%	-14.0%	13.4%	2.7%	8.4%
COGS	3 398.3	3 870.7	4 326.9	3 723.4	4 302.2	4 393.3	4 734.1
Gross profit	322.2	431.0	509.8	437.6	417.7	453.0	519.7
gross profit margin	8.7%	10.0%	10.5%	10.5%	8.9%	9.3%	9.9%
Selling expenses	-28.3	-32.3	-26.8	-30.3	-30.3	-30.6	-32.6
G&A expenses	-137.1	-185.3	-213.2	-210.4	-210.4	-212.5	-226.2
Other net operating income/expenses	3.6	14.7	-4.9	15.9	-7.7	-7.8	-8.3
		77.1					
EBIT	160.4	228.1	264.9	212.7	169.2	202.0	252.6
Change	62.8%	42.2%	16.1%	-19.7%	-20.4%	19.4%	25.0%
EBIT margin	4.3%	5.3%	5.5%	5.1%	3.6%	4.2%	4.8%
Financial income/expenses	-15.4	-72.1	-55.5	-56.8	-51.3	-43.3	-32.2
Share in profits/losses of associates	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other	4.4	2.8	6.2	-0.7	-0.5	-0.6	-0.8
Pre-tax profit	149.4	158.9	215.6	155.2	117.3	158.1	219.6
Tax	32.7	18.5	40.3	35.9	4.7	6.3	8.8
Minority interests	16.6	20.3	18.9	9.6	2.3	3.2	4.4
Net profit	100.1	120.1	156.4	109.7	110.3	148.6	206.4
Change	59.9%	20.0%	30.2%	-29.9%	0.6%	34.7%	38.9%
margin	2.7%	2.8%	3.2%	2.6%	2.3%	3.1%	3.9%
D&A expenses	45.0	70.4	78.6	87.7	110.0	110.5	111.6
EBITDA	205.4	298.5	343.6	300.4	279.2	312.5	364.2
Change	58.4%	45.3%	15.1%	-12.6%	-7.1%	11.9%	16.5%
EBITDA margin	5.5%	6.9%	7.1%	7.2%	5.9%	6.4%	6.9%
Shares at year-end (millions)	463.6	463.6	463.6	463.6	521.7	521.7	521.7
EPS	0.2	0.3	0.3	0.2	0.2	0.3	0.4
CEPS	0.3	0.4	0.5	0.4	0.4	0.5	0.6
ROAE	15.0%	11.8%	13.6%	8.1%	7.3%	9.1%	11.4%
ROAA	4.5%	3.9%	4.3%	2.8%	2.8%	3.9%	5.2%



Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	2 801.4	3 438.6	3 827.7	3 923.5	3 833.6	3 863.6	4 035.1
Fixed assets	983.2	1 381.7	1 685.3	1 712.2	1 712.2	1 712.2	1 722.2
Intangible assets	437.6	509.4	517.7	512.2	512.2	512.2	512.2
Property, plant and equipment	426.4	710.8	947.9	1 027.9	1 027.9	1 027.9	1 037.9
Long-term investment	80.9	76.5	107.8	92.7	92.7	92.7	92.7
Other	38.3	84.9	111.9	79.3	79.3	79.3	79.3
Current assets	1 818.2	2 056.9	2 142.4	2 211.3	2 121.4	2 151.3	2 312.8
Inventories	348.9	395.1	350.9	432.9	360.2	407.8	465.5
Receivables	1 289.6	1 347.5	1 328.0	1 382.9	1 604.8	1 647.7	1 733.8
Short-term prepayments	9.8	11.2	9.9	10.1	10.1	10.1	10.1
Cash and cash equivalents	169.9	303.1	453.6	385.4	146.3	85.7	103.4
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	2 801.4	3 438.6	3 827.7	3 923.5	3 833.6	3 863.6	4 035.1
Equity	983.0	1 053.9	1 242.7	1 449.0	1 559.3	1 707.9	1 914.3
Minority interests	102.6	114.9	140.8	9.7	12.0	15.2	19.6
Long-term liabilities	461.5	634.5	817.7	756.9	756.9	756.9	661.9
Loans, finance leases	329.9	435.9	603.4	551.6	551.6	551.6	456.6
Provisions	92.6	101.1	104.1	118.4	118.4	118.4	118.4
Other	39.0	97.5	110.3	86.9	86.9	86.9	86.9
Current liabilities	1 254.4	1 635.3	1 626.5	1 708.0	1 505.4	1 383.6	1 439.3
Loans	229.4	317.5	154.6	316.7	116.7	-33.3	-83.3
Trade creditors	897.7	1 240.4	1 414.1	1 336.3	1 333.7	1 361.9	1 467.6
Long-term accruals	127.2	77.4	57.8	54.9	54.9	54.9	54.9
Debt	559.3	753.4	758.0	868.3	668.3	518.3	373.3
Net debt	389.4	450.4	304.5	482.9	522.0	432.6	269.9
(Net debt / Equity)	39.6%	42.7%	24.5%	33.3%	33.5%	25.3%	14.1%
(Net debt / EBITDA)	1.9	1.5	0.9	1.6	1.9	1.4	0.7
BVPS	2.1	2.3	2.7	3.1	3.0	3.3	3.7



Cash Flows

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Cash flows from operating activities	-203.8	355.5	544.4	37.2	122.2	243.2	316.6
Net profit	100.1	120.1	156.4	109.7	110.3	148.6	206.4
D&A expenses	45.0	70.4	78.6	87.7	110.0	110.5	111.6
Working capital	-463.0	193.1	280.0	-222.1	-151.8	-62.4	-38.0
Other	114.1	-28.1	29.4	62.0	53.7	46.5	36.6
Cash flows from investing activities	-97.1	-303.4	-349.1	-128.3	-110.0	-110.5	-121.6
CAPEX	-143.7	-323.9	-352.1	-136.5	-110.0	-110.5	-121.6
Equity investment	46.9	0.0	0.0	6.7	0.0	0.0	0.0
Other	-0.2	20.5	3.1	1.4	0.0	0.0	0.0
Cash flows from financing activities	257.7	100.1	-53.3	27.4	-251.3	-193.3	-177.2
Stock issue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt	109.6	152.6	-44.9	110.1	-200.0	-150.0	-145.0
Dividend (buy-back)	-8.5	-4.6	-4.6	-18.1	0.0	0.0	0.0
Other	156.7	-47.9	-3.7	-64.5	-51.3	-43.3	-32.2
Change in cash	-43.1	152.2	142.1	-63.6	-239.1	-60.6	17.7
Cash at period-end	143.1	295.2	437.4	373.8	134.7	74.1	91.8
DPS (PLN)	0.02	0.01	0.01	0.04	0.00	0.00	0.00
FCF	-442.8	172.6	196.2	-104.2	10.7	131.6	194.5
(CAPEX / Sales)	2.6%	7.5%	7.3%	3.1%	2.3%	2.3%	2.3%

Market multiples

	2007	2008	2009	2010	2011F	2012F	2013F
P/E	14.3	11.9	9.2	13.1	14.6	10.8	7.8
P/CE	9.9	7.5	6.1	7.3	7.3	6.2	5.1
P/BV	1.5	1.4	1.2	1.0	1.0	0.9	0.8
P/S	0.4	0.3	0.3	0.3	0.3	0.3	0.3
FCF/EV	-23.0%	8.6%	9.5%	-4.9%	0.5%	6.4%	10.2%
EV/EBITDA	9.4	6.7	6.0	7.0	7.7	6.6	5.2
EV/EBIT	12.0	8.8	7.8	9.9	12.7	10.2	7.5
EV/S	0.5	0.5	0.4	0.5	0.5	0.4	0.4
DYield	0.6%	0.3%	0.3%	1.3%	0.0%	0.0%	0.0%
Price (PLN)	3.09						
Shares at year-end (millions) *	463.6	463.6	521.7	521.7	521.7	521.7	521.7
MC (PLN m)	1 432.5	1 432.5	1 612.1	1 612.1	1 612.1	1 612.1	1 612.1
Equity attributable to minority shareholders (PLN m)	102.6	114.9	140.8	9.7	12.0	15.2	19.6
EV (PLN m)	1 924.5	1 997.7	2 057.3	2 104.6	2 146.1	2 059.9	1 901.5

- We adjust the number of shares for treasury shares held by Polimex-Cekop Development and for maximum dilution possible under the incentive scheme.

20 May 2011

Update



Construction

Poland

Current price	PLN 2.71
Target price	PLN 3.50
Market cap	PLN 0.63bn
Free float	PLN 0.20bn
Average daily trading (3M)	PLN 0.76m

Shareholder Structure post merger

Comsa Emte	29.0%
Invalda	17.2%
Tiltra Group Management	10.6%
NDX Energija (VP Group)	6.2%
ING OFE	5.4%
Others	31.6%

Sector Outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. The sharp declines that some construction stocks have suffered have no basis in the fundamentals. In spite of an overall bearish sector outlook, we see some good investment opportunities among Polish construction firms. The companies that are considered the safest offer the least upside potential.

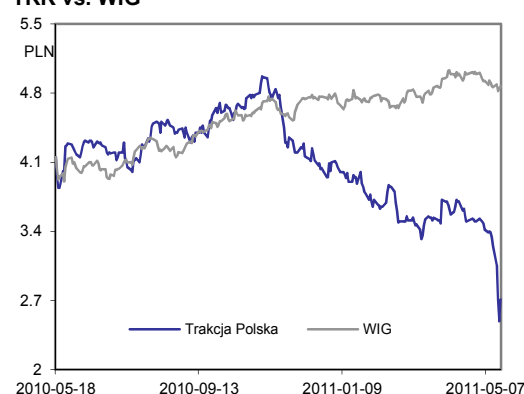
Company Profile

Trakcja Polska's core lines of business and railroad and street track development: including surfacing, track laying and maintenance, electrical work, engineering, rail automation and installation of phone lines. In addition, the company offers road-development and building-construction services, and is a property developer. In the years ahead, Trakcja Polska plans to diversify into wind-farm development.

Important dates

31.08 - H1 2011 report
10.11 - Q3 2011 report

TRK vs. WIG



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Trakcja Polska Buy

TRKC.WA; TRK PW

(Upgraded)

Trakcja Takes Undeserved Beating

We cannot see any basis in fundamentals for the recent 30% plunge in Trakcja's share price. The company reported core first-quarter earnings in line with expectations. As for the outlook for the rest of the year, Tiltra has not captured many new orders recently, but its 2011 order book is worth an estimated PLN 850m. Added to this is the PLN 300m revenue expected from the asphalt-mix manufacturer Poldim (which has a 30% market share) and PLN 150m from Lithuanian contracts. All told, Trakcja is currently only PLN 150m short of delivering our full-year revenue estimate of PLN 1.44bn. The uncertainty surrounding the 2012 earnings outlook is not as severe as some seem to think. Tiltra's 2012/2013 order backlog (ex. Q1 2012) has a value of PLN 114m so far, and the overall annual revenue forecast includes Poldim's PLN 300m and an estimated PLN 300m expected to be generated in Lithuania. To meet our 2012 PLN 1.3bn revenue forecast, Trakcja needs to secure a further PLN 750-800m-worth of business, which should be no problem given that it is currently competing for contracts totaling PLN 10-11bn. Even based on our lowered conservative earnings forecasts, TRK is trading at a FY2011E P/E of 8.7, prompting an upgrade to buy with the price target lowered from PLN 3.7 to PLN 3.50.

How is business in Lithuania?

Business in Lithuania is going well. The stock price of Invalda, the company which is set to acquire a 17.2% stake in the merged Trakcja-Tiltra, has risen 1.6% since the April merger. During the same time, the price of Lithuanian builder Panevezio Statybos Trestas, listed on Nasdaq OMX, appreciated 0.3%, indicating that Lithuania is a safe high-margin market characterized by low competition. Our favorite member of the Tiltra Group is Kauno Tiltai.

Tiltra's prospects in Poland

Tiltra's subsidiary road builder PEUIM has strong growth prospects as a company located in the north-eastern region of Poland which has an underdeveloped expressway infrastructure. In turn, Poldim's prospects are limited by a better developed motorway network in south-eastern Poland, but the company can offset any slowdown in the road construction business with asphalt sales.

Trakcja is undervalued

Trakcja Polska is trading at an all-round discount to the construction sector which we find excessive even taking into account the slowdown faced by road developers and the risks entailed in the Tiltra merger.

(PLN m)	2009	2010	2011F	2012F	2013F
Revenues	711.6	484.8	2 259.2	2 520.6	2 425.9
EBITDA	86.8	53.0	173.4	173.4	157.3
EBITDA margin	12.2%	10.9%	7.7%	6.9%	6.5%
EBIT	76.7	42.4	127.7	127.7	111.6
Net income	71.6	36.4	72.6	79.3	71.7
P/E	6.1	11.9	8.7	7.9	8.8
P/CE	5.3	9.2	5.3	5.0	5.4
P/BV	1.2	1.1	0.8	0.7	0.7
EV/EBITDA	3.1	5.9	6.2	5.4	5.4
DYield	3.7%	0.0%	0.0%	0.0%	0.0%

Q1 2011 Results

Trakcja Polska reported higher-than-expected EBIT and net profit figures for Q1 2011, achieved mainly thanks to high operating income which came in at PLN 1.1m (we forecasted PLN 0.75m expenses). The gross margin missed our 8.6% mark at 5.5%. This was partly offset by lower SG&A expenses (PLN 6.4m reported vs. PLN 7.0m forecasted), but a low gross margin bodes ill for future contract profits. In short, Trakcja's Q1 2011 results were as weak as we had predicted. We expect the company to experience improvement in Q2 2011 thanks to higher revenues and the consolidation of Tiltra.

Reported vs. forecasted Q1 2011 results

(PLN m)	Q1 2011	Q1 2011F	Difference	Consensus (PAP)	Difference	Q1 2010	Change
Revenues	78.1	66.9	16.8%	68.6	13.9%	50.3	55.3%
Gross profit	4.3	5.8	-25.3%	-	-	9.8	-56.0%
%	5.5%	8.6%	-	-	-	19.4%	-
EBIT	-0.9	-2.0	-	-1.2	-	4.5	-
%	-1.2%	-3.0%	-	-	-	8.9%	-
Pre-tax profit	-0.4	-1.4	-	-	-	5.6	-
Net profit	-0.4	-1.1	-	-0.1	-	3.6	-
%	-0.5%	-1.7%	-	-	-	7.2%	-

Source: BRE Bank Securities

Valuation

We have valued the Trakcja Polska stock using the DCF model and relative valuation. Our 9M Target Price is PLN 3.50 per share, which is 29.2% higher than the current price, prompting a buy rating.

Valuation

	Value per share	Weight
DCF Valuation	3.14	75%
Relative Valuation	3.47	25%
Average	3.22	
9M cost of equity	8.6%	
Target Price	3.50	

Source: BRE Bank Securities

Relative Valuation

The peer group for Trakcja Polska comprises large construction companies listed on the WSE. TRK is trading at a 14.4% discount to the average of P/E and EV/EBIDTA multiples forecasted for 2010 through 2012. The source of the premium are high EV/EBITDA multiples, stemming from high net debt. Note that Trakcja's profits in 2011 and 2012 will be significantly influenced by real-estate operations which are currently valued at 2012F P/E = 5 – 9.

Relative Valuation

	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Elektrobudowa	13.2	11.8	10.3	8.3	7.1	6.0
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Rafako	12.9	11.8	9.1	6.9	6.2	4.5
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
ZUE	12.2	11.6	11.3	7.0	5.9	5.1
Median	12.9	10.9	9.1	7.7	5.9	5.1
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Premium (discount)	-32.6%	-27.1%	-3.9%	-19.9%	-8.8%	5.8%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

Source: BRE Bank Securities

DCF Valuation

DCF model assumptions:

- Growth rate after FY2017 = 3%.
- Risk-free rate is 6.1% (10Y T-bond yield).
- DCF model relies on pro-forma earnings data for the merged company for FY2010.
- Tiltra Group is fully consolidated starting in 2011.
- Equal turnover ratios for accounts receivable and payable (Trakcja Polska's advance payments vs. Tiltra's surplus of receivables over payables).
- The model does not factor in the difference between the book value and the market value of the land in Wrocław.
- Beta = 1.1, reflecting the high debt of the merged company.



DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Revenue	2 259.2	2 520.6	2 425.9	2 505.2	2 595.1	2 688.3	2 782.3	2 876.9	2 971.9	3 067.0	
Change	366.0%	11.6%	-3.8%	3.3%	3.6%	3.6%	3.5%	3.4%	3.3%	3.2%	
EBITDA	173.4	173.4	157.3	159.5	163.6	167.8	172.0	176.3	180.6	184.9	
EBITDA margin	7.7%	6.9%	6.5%	6.4%	6.3%	6.2%	6.2%	6.1%	6.1%	6.0%	
D&A expenses	45.7	45.7	45.7	45.7	45.7	45.7	45.7	45.7	45.7	45.7	
EBIT	127.7	127.7	111.6	113.8	117.8	122.1	126.3	130.6	134.9	139.2	
EBIT margin	5.7%	5.1%	4.6%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	
Tax on EBIT	24.3	24.3	21.2	21.6	22.4	23.2	24.0	24.8	25.6	26.4	
NOPLAT	103.4	103.4	90.4	92.2	95.5	98.9	102.3	105.8	109.2	112.7	
CAPEX	-823.5	-45.7	-45.7	-45.7	-45.7	-45.7	-45.7	-45.7	-45.7	-45.7	
Working capital	-5.9	48.9	16.9	11.9	-3.8	-3.9	-4.0	-4.0	-4.0	-4.0	
Stock issue	328.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	-351.9	152.4	107.3	104.1	91.7	94.9	98.3	101.8	105.2	108.7	112.0
WACC	9.3%	9.7%	10.1%	10.6%	11.2%	11.6%	11.6%	11.6%	11.6%	11.1%	
Discount factor	95.0%	86.5%	78.6%	71.0%	63.9%	57.3%	51.3%	46.0%	41.2%	37.1%	
PV FCF	-334.2	131.9	84.3	74.0	58.6	54.4	50.5	46.8	43.4	40.3	
WACC	9.3%	9.7%	10.1%	10.6%	11.2%	11.6%	11.6%	11.6%	11.6%	11.1%	
Cost of debt	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	6.8%	
Risk-free rate	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.6%	
Credit risk premium	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	41%	33%	26%	17%	8%	0%	0%	0%	0%	0%	
Cost of equity	11.6%	11.6%	11.6%	11.6%	11.6%	11.6%	11.6%	11.6%	11.6%	11.1%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	1.10	
FCF growth after the forecast horizon	3.0%										
Terminal value (TV)	1 391.0										
Present value of terminal value (PV TV)	516.0										
Present value of FCF in the forecast horizon	249.8										
Present value of FCF	765.8										
Net debt*	92.1										
Interests in Eco-Wind Construction	60.2										
Minority interests	4.6										
Equity value	729.3										
Number of shares (millions)	232.1										
Equity value per share (PLN)	3.14										
9M cost of equity	8.6%										
Target Price	3.41										
EV/EBITDA ('10) for the target price	7.5										
P/E for the target price	21.7										
TV to EV	71%										

Sensitivity analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0pp	3.41	3.58	3.78	4.00	4.27
WACC -0.5pp	3.26	3.41	3.58	3.78	4.00
WACC	3.13	3.26	3.41	3.58	3.78
WACC +0.5pp	3.01	3.13	3.26	3.41	3.58
WACC +1.0pp	2.90	3.01	3.13	3.26	3.41

* Combined total for Trakcja Polska and Tiltra Group as at year-end 2010



Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Revenue	646.8	794.6	711.6	484.8	2 259.2	2 520.6	2 425.9
Change	78.1%	22.9%	-10.4%	-31.9%	366.0%	11.6%	-3.8%
COGS	592.9	719.5	603.6	415.3	2 038.1	2 295.0	2 220.1
Gross profit	53.9	75.1	108.0	69.5	221.1	225.7	205.9
gross profit margin	8.3%	9.4%	15.2%	14.3%	9.8%	9.0%	8.5%
Selling expenses	-2.0	-2.7	-2.3	-2.4	-8.6	-9.0	-8.6
G&A expenses	-18.1	-19.2	-27.2	-24.3	-79.8	-83.4	-80.3
Other net operating income/expenses	-4.2	-0.2	-1.8	-0.3	-5.0	-5.6	-5.4
EBIT	29.6	53.0	76.7	42.4	127.7	127.7	111.6
Change	145.1%	79.3%	44.6%	-44.6%	200.8%	0.0%	-12.6%
EBIT margin	4.6%	6.7%	10.8%	8.8%	5.7%	5.1%	4.6%
Financial income/expenses	7.2	15.0	11.3	3.1	-37.5	-29.2	-22.5
Share in profits/losses of associates	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax profit	36.8	68.0	87.9	45.6	90.2	98.5	89.1
Tax	-7.1	-12.3	-17.1	-9.1	-17.1	-18.7	-16.9
Minority interests	1.2	1.0	-0.8	0.0	0.5	0.4	0.4
Net profit	28.5	54.7	71.6	36.4	72.6	79.3	71.7
Change	165.7%	92.2%	30.9%	-49.1%	99.4%	9.2%	-9.5%
margin	4.4%	6.9%	10.1%	7.5%	3.2%	3.1%	3.0%
D&A expenses	6.1	7.9	10.1	10.6	45.7	45.7	45.7
EBITDA	35.6	60.9	86.8	53.0	173.4	173.4	157.3
Change	112.4%	71.0%	42.4%	-38.9%	227.1%	0.0%	-9.3%
EBITDA margin	5.5%	7.7%	12.2%	10.9%	7.7%	6.9%	6.5%
Shares at year-end (millions)	130.1	160.1	160.1	160.1	232.1	232.1	232.1
EPS	0.2	0.3	0.4	0.2	0.3	0.3	0.3
CEPS	0.3	0.4	0.5	0.3	0.5	0.5	0.5
ROAE	21.4%	23.9%	21.0%	9.4%	12.0%	9.4%	7.8%
ROAA	6.5%	8.7%	10.6%	6.0%	5.6%	4.0%	3.6%



Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	496.4	754.2	602.2	618.3	1 967.8	2 010.2	1 984.1
Fixed assets	133.2	139.3	213.0	225.4	1 101.2	1 101.2	1 101.2
Intangible assets	4.0	0.0	1.1	0.0	0.0	0.0	0.0
Investments in associates	49.1	54.0	54.0	56.4	591.8	591.8	591.8
Property, plant and equipment	44.6	52.1	98.6	94.5	435.4	435.4	435.4
Long-term investment	14.2	0.2	0.3	15.7	15.7	15.7	15.7
Other	21.4	33.0	59.0	58.8	58.3	58.3	58.3
Current assets	363.2	614.8	389.2	392.9	866.6	908.9	882.9
Inventories	83.1	84.5	75.5	102.2	154.4	107.2	94.1
Receivables	134.3	160.1	83.2	112.9	526.1	587.0	564.9
Short-term prepayments	2.3	3.3	1.7	3.1	3.1	3.1	3.1
Cash and cash equivalents	141.1	367.0	228.7	174.7	182.9	211.6	220.7
Other	2.3	0.0	0.0	0.0	0.0	0.0	0.0
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	496.4	754.2	602.2	618.3	1 967.8	2 010.2	1 984.1
Equity	145.5	311.6	369.4	406.8	807.7	887.0	958.7
Minority interests	4.4	5.4	7.5	0.0	0.5	0.9	1.4
Long-term liabilities	63.6	59.1	61.0	63.3	451.7	451.7	451.7
Loans, finance leases	45.8	33.3	43.1	40.6	429.0	429.0	429.0
Provisions and other	17.8	18.1	17.9	22.7	22.7	22.7	22.7
Derivatives	0.0	7.7	0.0	0.0	0.0	0.0	0.0
Current liabilities	283.0	378.0	164.2	148.2	707.9	670.5	572.3
Loans	24.7	11.6	15.2	15.3	191.8	91.8	11.8
Trade creditors	222.2	299.9	118.9	113.8	497.0	559.6	541.3
Derivatives	0.0	26.7	6.7	0.5	0.5	0.5	0.5
Other	36.1	39.9	23.4	18.6	18.6	18.6	18.6
Debt	70.5	44.9	58.3	55.9	620.8	520.8	440.8
Net debt	-70.6	-322.1	-170.4	-118.8	437.9	309.2	220.1
(Net debt / Equity)	-48.6%	-103.4%	-46.1%	-29.2%	54.2%	34.9%	23.0%
(Net debt / EBITDA)	-2.0	-5.3	-2.0	-2.2	2.5	1.8	1.4
BVPS	1.1	1.9	2.3	2.5	3.5	3.8	4.1

**Cash Flows**

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Cash flows from operating activities	44.0	141.9	-38.9	-23.5	150.4	203.6	157.3
Net profit	28.5	54.7	71.6	36.4	72.6	79.3	71.7
D&A expenses	6.1	7.9	10.1	10.6	45.7	45.7	45.7
Working capital	-4.7	50.4	-92.2	-94.1	0.4	49.1	16.1
Other	14.2	28.9	-28.4	23.6	31.7	29.5	23.7
Cash flows from investing activities	-89.0	-51.5	-86.1	-50.5	-823.5	-45.7	-45.7
CAPEX	-21.8	-14.8	-59.4	-8.9	-823.5	-45.7	-45.7
Equity investment	-67.2	-36.7	-26.7	-41.6	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash flows from financing activities	47.9	81.6	-2.5	-5.0	588.4	-129.2	-102.5
Stock issue	0.0	111.5	1.7	0.0	328.3	0.0	0.0
Debt	52.7	-25.6	15.1	-3.5	297.5	-100.0	-80.0
Dividend (buy-back)	-3.3	0.0	-16.0	0.0	0.0	0.0	0.0
Other	-1.5	0.0	0.0	0.0	0.0	0.0	0.0
Change in cash	2.9	172.1	-127.5	-79.0	-84.8	28.7	9.1
Cash at period-end	141.1	313.2	204.1	138.1	146.4	175.0	184.2
DPS (PLN)	0.0	0.0	0.1	0.0	0.0	0.0	0.0
FCF	-65.1	11.2	-114.8	-64.4	-351.9	152.4	107.3
(CAPEX / Sales)	3.4%	1.9%	8.3%	1.8%	36.5%	1.8%	1.9%

Market multiples

	2007	2008	2009	2010	2011F	2012F	2013F
P/E	12.4	7.9	6.1	11.9	8.7	7.9	8.8
P/CE	10.2	6.9	5.3	9.2	5.3	5.0	5.4
P/BV	2.4	1.4	1.2	1.1	0.8	0.7	0.7
P/S	0.5	0.5	0.6	0.9	0.3	0.2	0.3
FCF/EV	-22.7%	9.5%	-42.4%	-20.4%	-33.0%	16.2%	12.6%
EV/EBITDA	8.0	1.9	3.1	5.9	6.2	5.4	5.4
EV/EBIT	9.7	2.2	3.5	7.4	8.4	7.4	7.6
EV/S	0.4	0.1	0.4	0.6	0.5	0.4	0.4
DYield	0.9%	0.0%	3.7%	0.0%	0.0%	0.0%	0.0%
Price (PLN)	2.71						
Shares at year-end (millions)	130.1	160.1	160.1	160.1	232.1	232.1	232.1
MC (PLN m)	352.6	433.9	433.9	433.9	629.0	629.0	629.0
Equity attributable to minority shareholders (PLN m)	4.4	5.4	7.5	0.0	0.5	0.9	1.4
EV (PLN m)	286.3	117.2	271.0	315.1	1 067.4	939.1	850.4

20 May 2011

Update



Construction

Poland

Unibep

UNBE.WA; UNI PW

Buy

(Reiterated)

Current price **PLN 6.56**
Target price **PLN 9.90**

Market cap PLN 0.22bn

Free float PLN 0.06bn

Avg daily trading volume (3M) PLN 0.16m

Shareholder Structure

Zofia Mikołuszczo	27.06%
Zofia Iwona Stajkowska	17.68%
Beata Maria Skowrońska	17.97%
AVIVA OFE BZWBK	9.97%
Others	27.32%

Sector Outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. The sharp declines that some construction stocks have suffered have no basis in the fundamentals. In spite of an overall bearish sector outlook, we see some good investment opportunities among Polish construction firms. The companies that are considered the safest offer the least upside potential.

Company Profile

Unibep is a general contractor specializing in building construction and operating in Poland (mostly the Mazowsze and Podlasie voivodships) and Russia. It is also involved in road construction, real estate development and it manufactures prefabricated homes.

Important Dates

31.08 - H1 2011 report
14.11 - Q3 2011 report

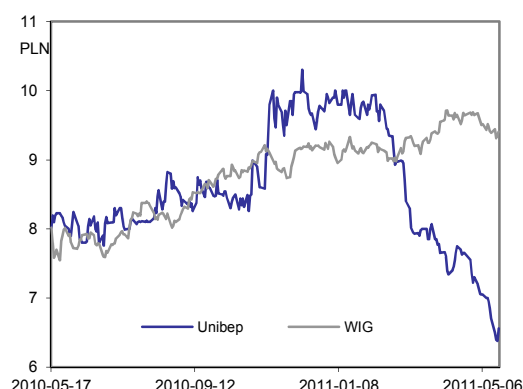
PLN 40m Bottom Line Coming Next Year

Since the year began, the Unibep stock has fallen by over 30%, which is not warranted by the Company's fundamentals, but rather reflects concerns about the situation of the construction sector. Compared to the industry as a whole, Unibep does not seem to be at risk of earnings erosion. We note a number of arguments in its favor: 1) the Company specializes in construction work for privately-owned clients (which means it does not have to run in public tendering procedures); 2) Unibep has launched the construction of several major housing estates for property developers, and it is likely to receive orders for further stages of these projects, at higher margins; 3) Unibep's exposure to the risky road construction segment is limited; 4) in its export markets, competition is limited and it has been able to obtain contracts under a cost plus margin formula (e.g. the Petersburg contract); 5) the Company is not big, and if it gets new orders, for example in Russia, its revenues could surge; 6) the property development business is sensibly managed: the *Grzybowska 81* office building in Warsaw will be erected in an attractive location, and home sales are going well in the case of *Point House*, a big residential estate (73 out of 236 units sold, construction is scheduled for completion in late 2011 or early 2012; 7) no other construction company can possibly attain an FY12 P/E as low as Unibep (5.4). This low value is a consequence of the fact that 2012 is going to show a combined impact of *Point House* sales, property revaluations and the expected improvement in earnings in the construction business. We reiterate our buy rating for Unibep.

Major earnings boost coming from property development

Unibep's earnings after 2011 will be strongly boosted by the property development business, in both the residential segment, whose effect will be observed in 2012, and the commercial segment. Commercial projects will bring property revaluation gains (leading to a lower P/E) and higher debt (negative impact on the EV/EBITDA ratio). We estimate that Unibep's P/E multiple without the commercial projects would figure to 8.6 for 2012 and 7.3 for 2013. These are still very attractive values.

UNI vs. WIG



Opportunities across the eastern border

In the construction business, Unibep's growth strategy focuses on Eastern European markets, which are bigger and more difficult, but less competitive. Some project in those markets are priced under the cost plus fee formula, which is not possible in the highly competitive Polish market. The entire business model relies on KUKE's willingness to guarantee construction contracts abroad, but there seems to be no risk that this will change in the future. We believe it is possible for Unibep to win new major contracts in the Eastern markets.

(PLN m)	2009	2010	2011F	2012F	2013F
Revenues	392.7	657.9	780.6	870.9	918.4
EBITDA	31.4	35.7	33.3	63.7	66.8
EBITDA margin	8.0%	5.4%	4.3%	7.3%	7.3%
EBIT	26.6	29.8	26.8	57.0	60.1
Net profit	17.8	22.7	19.5	40.9	42.2
P/E	12.5	9.8	11.4	5.4	5.3
P/CE	9.9	7.8	8.6	4.7	4.5
P/BV	2.0	1.6	1.4	1.1	0.9
EV/EBITDA	7.2	7.0	9.0	5.3	5.1
DYield	1.5%	1.5%	0.0%	0.0%	0.0%

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Q1 2011 Results

Unibep's Q1 2011 results came slightly ahead of expectations. The gross margin missed our 6.7% estimate at 6.3%, depressed by the road construction segment which experienced a seasonal revenue slowdown and booked a PLN 2.2m gross sales loss (we expected a PLN 1.2m loss). Other segments achieved higher-than-forecasted gross margins: 6.3% in general construction (vs. 6.0% expected), and 6.4% in manufacturing (vs. 1.0% expected). SG&A expenses were lower than predicted (PLN 6.0m) at PLN 5.4m.

Reported vs. forecasted Q1 2011 results

(PLN m)	Q1 2011	Q1 2011F	Difference	Q1 2010	Change
Revenues	139.9	122.1	14.6%	121.7	14.9%
Gross profit	8.8	8.2	7.6%	11.1	-20.8%
%	6.3%	6.7%	-	9.1%	-
EBIT	3.6	2.0	78.6%	6.3	-43.4%
%	2.6%	1.6%	-	5.2%	-
Pre-tax profit	2.9	2.0	49.6%	5.2	-43.2%
Net profit	2.2	1.6	35.5%	3.9	-44.1%
%	1.5%	1.3%	-	3.2%	-

Source: Unibep, forecasts by BRE Bank Securities

Other net operating income amounted to PLN 0.2m (we expected PLN 0.1m expenses). Other net financing expenses were PLN 0.7m (we expected a zero balance). The effective tax rate was 27%, and operating cash flows were seasonally weak at a negative PLN 22.6m. The Q1 2011 results show deterioration relative to the same period a year ago when Unibep achieved record margins on lucrative contracts captured in 2008.

Reported vs. forecasted Q1 results by business segment

(PLN m)	Q1 2011			Q1 2011F		
	Revenue	Gross profit	Pct. margin	Revenue	Gross profit	Pct. margin
General Construction (Poland and abroad)	125.3	7.9	6.3%	106.2	6.3	6.0%
Road Construction	1.2	-2.2	-176.9%	0.7	-1.2	-177.8%
Manufacturing	4.5	0.3	6.4%	5.3	0.1	1.0%
Housing sales	9.0	2.7	30.3%	10.0	3.0	30.0%
Total	139.9	8.8	6.3%	122.1	8.2	6.7%

Source: Unibep, forecasts by BRE Bank Securities

In the following quarters of 2011, Unibep's earnings will gradually improve. Second-quarter earnings might deteriorate vs. Q2 2010, but this will be a consequence of:

- The very high and non-recurrent construction margins in Q2 2010;
- Considerable number of homes delivered last year (homes will not be delivered to buyers in the *Osiedle Santorini* project until late 2011 or early 2012).

Order Backlog

Unibep has accumulated a 2011 order backlog of PLN 660m. This figure excludes the property development segment. The value of pre-sold homes that will be delivered to buyers in 2011 can be estimated at slightly under PLN 20m.

We do not expect the order pipeline in domestic general construction and road construction to expand greatly later in the year, but we do see such an opportunity for general contracting orders in the eastern markets. At the moment, KUKE is considering extending a guarantee for the contract to construct the Vnukovo hotel in Moscow. The value of the contract is some EUR 83m, and it could be launched as soon as in three months. The order backlog could also expand significantly through the signing of other contracts in these markets.

Unibep's order backlog for 2011 and the following years

(PLN m)	2011	2012	2013-2014
Domestic General Construction	401	120	
General Construction (Exports)	156	130	56
Manufacturing	69	15	
Road Construction	31	11	
Total	657	276	56

Source: Unibep, forecasts by BRE Bank Securities

Current Situation and Outlook by Segment

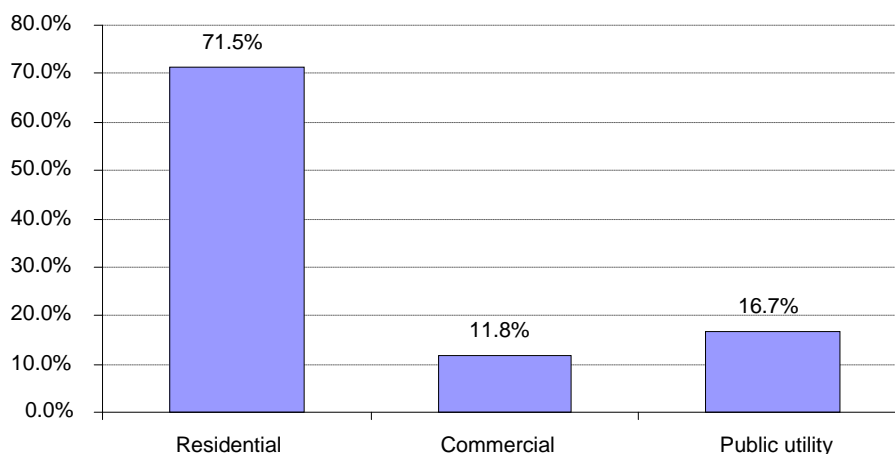
General contracting in Poland

Unibep's order backlog is dominated by housing contracts

Among Unibep's general contracting orders for 2011 in Poland, housing construction contracts predominate. They will account for 70% of the revenues in the segment this year. The fact that most of Unibep's customers are privately owned entities is an advantage, because it means that the Company does not have to make aggressively priced bids for public contracts. Unibep already has a big order backlog for 2011 and is not interested in acquiring new orders at any cost.

In 2010, Unibep won a new office building construction contract from GTC. The commercial construction segment will be reviving in 2011, and we expect a considerable increase in the intensity of construction work.

Domestic general contracting orders by type of building (percent)



Source: Unibep, forecasts by BRE Bank Securities

Lublin stadium tendering procedure declared null and void

One exception to Unibep's policy of not making aggressively priced bids was its bid for the construction of the Lublin municipal stadium, which was much lower than the competitor's offers (PLN 83.1m vs. PLN 111.6m for the second-lowest bid). The discrepancy between bids can be partially attributed to the fact that the contract is a "design and build" one. In our opinion, Unibep's objective was to gain references that it could subsequently use in export markets. The procedure has been declared null and void for procedural reasons. From our point of view, this is good news (reduction in risk).

Overview of bids for Lublin municipal stadium

(PLN m)	Gross bid	Net bid	Difference
Unibep, SPAK Studio Projektowe	101.4	83.1	
Budimex	136.2	111.6	34.3%
KPBP Budus	141.0	115.5	39.0%
ABM Solid, PBK PeBeKa	159.4	130.7	57.2%
Warbud, Baugesellschaft Walter Hellmich	162.9	133.5	60.6%
Mostostal Warszawa, Tamex	177.3	145.3	74.8%
Interbud-Lublin, Alstal-Budownictwo, Masters	183.3	150.3	80.8%
Hydrobudowa Polska, PBG	189.7	155.5	87.0%
Mostostal Puławy	193.0	158.2	90.3%
Investor's budget	155.0	127.0	

Source: BRE Bank Securities, the city of Lublin

General contracting in Eastern Europe

Unibep is currently working on two major projects on the other side of Poland's eastern border. One is a contract for the construction of a hotel and office center in Sankt Petersburg, which is priced on a "cost plus fee" basis, i.e. Unibep's margin is fixed and does not depend on the cost of subcontracting services. Under this formula, this seems to be a very safe contract.

The contract for the construction of Victoria Hotel in Minks, Belarus, is based on a fixed price. It encompasses design work on the part of Unibep, which means that the Company's exposure to the risk of a change in the price of subcontracting services and construction materials is longer than usual. On the other hand, the margin on the contract could be positively affected by the increasingly strong depreciation of the BYR vs. the EUR.

A conditional agreement for the construction of Hotel Vnukovo on Moscow was signed towards the end of 2009. The likelihood that the contract will materialize is now on the rise. The investor has succeeded in securing bank financing (the loan agreement has been signed). We are now awaiting KUKU guarantees for the contract. After this condition, and a number of less important ones, have been met, construction work could begin. We estimate Unibep's chances of working on this contract at 80%, but we conservatively ignore it in our forecasts.

Overview of Unibep's major export contracts

Contract	Value (m)	Currency	Timeline	Pricing formula	Status	Factored into our forecasts?
Hotel and office center in Sankt Petersburg	65.9	EUR	2010-2011	"Cost + fee"	Underway, financing and KUKU guarantees secured	Yes
Hotel Victoria, Minsk	40.5	EUR	2011-2013	Fixed price*	Underway, financing and KUKU guarantees secured	Yes
Hotel Vnukovo, Moscow	83	EUR	2011-2013	Fixed price**	We are awaiting KUKU guarantees for the contract	No

Source: BRE Bank Securities S.A., Unibep; *the contract encompasses design and construction work; **the contract encompasses building completion tasks.

We do not preclude further major contracts in the eastern markets, which are now the major growth direction for the Company. Polish companies are not very active on the other side of Poland's eastern border, to a certain extent due to who their shareholders are. As a result, competition from Polish companies is low.

Unibep is using a very interesting business model in the east, which is almost entirely based on KUKU's willingness to provide insurance for export contracts. The services of Polish construction companies are more expensive than those of their local competitors. The advantage of Unibep's model is that it offers the investors access to cheaper financing (guarantees from KUKU, which is backed by the Polish State Treasury).

Road Construction

In road construction, Unibep focuses on the local markets of north-eastern Poland. In 2010, it was unable to win any major road contracts, and we can hardly expect a significant increase in the segment's revenues in 2011.

Due to the strong and aggressive competition, Unibep is fairly cautious in its plans to expand the road construction business. In our opinion, the Company should be better able to use its potential in the future given the current expressway construction plans for north-eastern Poland.

Manufacturing

Within its manufacturing segment, Unibep was able to build a sizable order pipeline for 2011, amounting to PLN 69m. This means that the fixed costs of the factory of prefabricate homes will be covered to a greater extent in 2011 than in 2010, when the segment generated a loss. Note, however, that this loss was caused by external factors (a flood-related loss on an uninsured contract, plus, the plant was had barely began operating). The objective for 2011 is for the segment to break even.

We remain conservative in our forecasts for the segment. We assume that in the long term, the segment will generate margins approaching those on the general contracting business in Poland. One risk factor is the possible increase in the price of wood, but we do not believe it will be of material importance (the manufacturing phase comes at an early stage of contract work).

Until now, Unibep's manufacturing activities have been restricted to Scandinavian markets. In 2011, Unibep will work on its first domestic contract (a hotel to be built in the modular technology). Economy modular hotel networks can be found in Western Europe, and the concept is coming to Poland. The advantage of Unibep's technology is its ability to perform the requisite work quickly (several months instead of 1.5 years), as well as the option of dismantling the building and moving it elsewhere. Construction costs are comparable to those incurred in the traditional technology.

Housing Sales

We estimate that at the end of 2010, Unibep had 62 homes in old, completed property-development projects (7710 square meters of usable floor area). Approximately 30% of this total is in the high-margin *Osiedle Santorini* project. In addition, Unibep is working on one big property development project, *Point House*, scheduled for completion in December 2011. Our forecasts assume that Unibep will not be able to deliver the first homes from this project to buyers in 2011. Instead, we expect revenue to start coming in Q1 2012. We estimate the revenues from this project at PLN 125m, with a gross margin of ca. 28%.

In Q2 2011, Unibep will launch a small project called *Praga Square* in right-bank Warsaw. It will comprise just 11 units. As the land was purchased at a high cost, we do not expect a high margin here. Originally, Unibep's goal was to build a model residential building from wooden prefabricates. However, due to the nature of the project that Unibep bought and problems encountered in its attempts to perform the requisite work in the new technology, the Company chose to go for the traditional technology after all.

In addition, Unibep owns land in the Warsaw district of Białoleka. Its area is nearly 20 thousand square meters, and it could fit up to 8.9 thousand square meters of usable floor area. Thus, the project will have low residential density, which should appeal to buyers. The location is comparable to that of Dom Development's *Osiedle Derby*. At the moment, Unibep is attempting to obtain a building permit. Two buildings within the project will be built from wooden modules manufactured in Unibep's factory.

Unibep's residential property development projects

Project	Scheduled completion date	Square meters UFA	Average price per m ²	No. of homes	Gross margin
Osada Brzeziny	Completed	2 730	4 254	28	3%
Osiedle Polnych Maków	Completed	1 980	4 727	36	3%
Osiedle Santorini, E1-E3	Completed	2 100	6 700	355	30%
Gardenia	Completed	900	4 500	6	3%
Point House	H1 2012	16 000	7 800	236	28%
Praga Square	Q4 2012	900	7 500	11	16%
Berensona	H2 2013	8 961	5 770	168	19%

Source: Unibep, forecasts by BRE Bank Securities

Forecasts for Unibep's residential projects

Project	Revenues			Gross profit		
	2011F	2012F	2013F	2011F	2012F	2013F
Osada Brzeziny	10.5	1.2		0.3	0.0	
Osiedle Polnych Maków	8.4	0.9		0.3	0.0	
Osiedle Santorini, E1-E3	14.1	0.0		4.2	0.0	
Gardenia	4.1			0.1		
Point House		87.4	37.4		24.2	10.4
Praga Square		2.0	4.7		0.3	0.8
Berensona			51.7			9.8
Total	37.0	91.5	93.9	4.9	24.6	20.9

Source: Unibep, forecasts by BRE Bank Securities

Forecasted inventories

Project	2011F	2012F	2013F
Osada Brzeziny	1.1	-	-
Osiedle Polnych Maków	0.9	-	-
Osiedle Santorini, E1-E3	0.0	-	-
Gardenia	0.0	-	-
Point House	72.2	27.1	-
Praga Square	2.3	4.0	-
Berensona	11.2	29.3	-
New project	-	24.3	77.6
Total: residential inventories	87.7	84.6	77.6
Total: construction inventories	48.2	50.2	52.4
Total	135.9	134.8	130.0

Source: Unibep, forecasts by BRE Bank Securities

Commercial space rental

Grzybowska 81 office project

The purchase of *Grzybowska 81* from Pekaes in late 2010 marked Unibep's entry into the commercial segment. We like the *Grzybowska 81* project. It is located in close proximity of a new business center that is being erected on Towarowa street, near a new metro station. We estimate Unibep's margin on the project at 27.8%. By the end of 2010, Unibep spent just ca. PLN 5m on stakes in property development projects, which we attribute to the *Grzybowska 81* project in full.

One risk that affects the project is the fact that a considerable number of other projects will be built in close proximity. Thus, LC Corp will build an office building on an adjacent lot (31.5k square meter of rental space), and Ghelamco is planning to build an office building in the neighborhood (*Spire*).

With the strong potential competition on the part of other developers, we are conservative in our estimates of the likely rental rates. We expect EUR 16.5/m², i.e. just EUR 1.5/m² more than the rental rates prevailing in Mokotów, i.e. a much less attractive location, and EUR 3.5-5.5/m² less than in downtown Warsaw. We assume that at the early stage of the project, Unibep will finance construction work with own cash, loans and possibly bonds, regardless of how much of the space it rents out. Construction work has begun already. Unibep should be able to get bank financing once approximately 30% of the space has been rented out.

Kutno Shopping Mall

Unibep also acquired a shopping mall project in Kutno. It will be a single-storied facility, in which 60% of the total area will be taken by a supermarket and a home-improvement store, which makes it a "second-generation" shopping center (rather than a "third-generation" mall. Given that Kutno has 46.7k inhabitants, this approach seems to make sense. At the moment, the city does not have any modern retail facilities.

Due to the strong dependence on major retail networks, which will get 60% of the total rented area, we do not expect a strong margin on the project; we estimate it at 15.9%. We have factored the project into our forecasts. Construction is scheduled to begin in late 2011, but our conservative estimate is early 2012. There is a valid zoning plan for the project, but no building permit yet.

It is possible that the project or a part of it will be sold to another company or financial investor, but we ignore this possibility in our forecasts. The Kutno project will not begin until the major renters have been signed.

Land investment in Radom

For several million zloty, Unibep purchased a 24% stake in an SPV which owns 29.26 hectares of land in Radom. The land could house residential buildings, single-family homes or multi-family units. However, commercial facilities are a possibility as well. Neither Unibep nor its partners are planning to use the land for construction; the idea is to re-sell some of the land to investors at a later time. We have not factored the potential gains on such a sale into our forecasts.

Unibep's commercial property development projects

Project	Location	Start date	Completion date	Rental area (m ²)	Rent (EUR/m ²)
Grzybowska 81	Warszawa, ul. Grzybowska	Q2 2011	Q4 2012	9 950	16.5
Shopping mall	Kutno (near Łódź)	Q1 2012	Q3 2013	18 000	8.5

Source: Unibep, forecasts by BRE Bank Securities

Forecasts for Unibep's commercial projects

(PLN m)	Yield			NOI		Valuation			
	2011F	2012F	2013F	2013F	2014F	2011F	2012F	2013F	2014F
Grzybowska 81	7.5%	7.2%	7.0%	5.8	7.9	51.2	106.7	109.8	113.1
Shopping mall	9.0%	8.5%	8.0%	1.8	7.2	18.0	40.3	89.5	92.2
Total				7.6	15.1	69.2	147.0	199.3	205.2

Source: Unibep, forecasts by BRE Bank Securities

Forecasts for Unibep's commercial projects

(PLN m)	CAPEX/year					Valuation gains				Developer's margin
	2010	2011F	2012F	2013F	2014F	2011F	2012F	2013F	2014F	
Grzybowska 81	5.0	34.6	39.6	0.0	0.0	11.6	15.9	3.0	3.3	27.8%
Shopping mall	0.0	18.0	19.7	37.7	0.0	0.0	2.6	11.6	2.7	15.9%
Total	5.0	52.6	59.3	37.7	0.0	11.6	18.5	14.6	6.0	22.4%

Source: Unibep, forecasts by BRE Bank Securities

Forecasted earnings, order backlog

Forecasted earnings

	2011F	2012F	2013F	2014F
Domestic General Construction				
Revenues	441.1	463.2	486.3	510.6
Gross profit	23.4	28.3	32.1	33.7
Pct. margin	5.3%	6.1%	6.6%	6.6%
Road Construction				
Revenues	67.5	69.5	71.6	73.8
Gross profit	3.4	4.5	4.7	4.9
Pct. margin	5.0%	6.5%	6.6%	6.6%
General Construction (Exports)				
Revenues	160.0	168.0	176.4	185.2
Gross profit	8.8	9.2	9.7	10.2
Pct. margin	5.5%	5.5%	5.5%	5.5%
Manufacturing				
Revenues	75.0	78.8	82.7	86.8
Gross profit	4.5	5.1	5.5	5.7
Pct. margin	6.0%	6.5%	6.6%	6.6%
Housing sales				
Revenues	37.0	91.5	93.9	97.1
Gross profit	4.9	24.6	20.9	20.4
Pct. margin	13.3%	26.9%	22.3%	21.0%
Commercial space rentals				
Revenues	0.0	0.0	7.6	15.1
Gross profit	0.0	0.0	7.6	15.1
Pct. margin	-	-	100.0%	100.0%
Total				
Revenues	780.6	870.9	918.4	968.6
Gross profit	45.0	71.7	80.5	89.9
Pct. margin	5.8%	8.2%	8.8%	9.3%

Source: BRE Bank Securities

Valuation

We have valued the Unibep stock using the DCF model and relative valuation. Our 9M Target Price is PLN 9.9 per share, which is 50.8% higher than the current price, prompting a buy rating.

Valuation

	Value per share	Weight
DCF Valuation	9.3	75%
Relative Valuation	8.4	25%
Average	9.1	
9M cost of equity	8.8%	
Target Price	9.9	

Source: BRE Bank Securities

Relative Valuation

Compared to a peer group of large publicly-traded construction firms, Unibep is trading at a 14.7% discount to the average of P/E and EV/EBITDA multiples forecasted for 2011 through 2013. The scale of this discount increases when multiples for 2011 are omitted from the comparison.

Relative Valuation

	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Elektrobudowa	13.2	11.8	10.3	8.3	7.1	6.0
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Rafako	12.9	11.8	9.1	6.9	6.2	4.5
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
ZUE	12.2	11.6	11.3	7.0	5.9	5.1
Median	12.9	10.9	9.1	7.0	5.9	5.2
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
Premium (discount)	-11.2%	-50.0%	-42.2%	28.2%	-10.9%	-2.2%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

Source: BRE Bank Securities

DCF Valuation

DCF model assumptions:

- Growth rate after FY2017 = 3%.
- Risk-free rate is 6.1% (10Y T-bond yield).
- Real estate development business will continue.
- Beta = 1.15 (reflecting the increase in risk due to the Company's rising debt).
- Credit risk premium = 3%.
- Revenues and margins in the individual segments are as presented above.
- Property development projects as described above.



DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Revenues	780.6	870.9	918.4	968.2	1 012.9	1 059.7	1 107.0	1 153.8	1 196.0	1 234.8	
Change	18.7%	11.6%	5.5%	5.4%	4.6%	4.6%	4.5%	4.2%	3.7%	3.2%	
EBITDA	33.3	63.7	66.8	65.8	68.0	70.3	72.7	75.1	77.3	79.5	
EBITDA margin	4.3%	7.3%	7.3%	6.8%	6.7%	6.6%	6.6%	6.5%	6.5%	6.4%	
D&A expenses	6.5	6.6	6.7	6.8	6.9	7.0	7.0	7.1	7.1	7.1	
EBIT	26.8	57.0	60.1	59.0	61.1	63.4	65.7	68.0	70.2	72.4	
EBIT margin	3.4%	6.6%	6.5%	6.1%	6.0%	6.0%	5.9%	5.9%	5.9%	5.9%	
Property valuation	-11.6	-18.5	-14.6	-6.0	-6.2	-6.3	-6.5	-6.7	-6.9	-7.1	
Adjusted EBIT	15.2	38.6	45.5	53.0	55.0	57.0	59.1	61.3	63.3	65.3	
Tax on EBIT	2.9	7.3	8.6	10.1	10.4	10.8	11.2	11.6	12.0	12.4	
NOPLAT	12.3	31.2	36.8	42.9	44.5	46.2	47.9	49.6	51.3	52.9	
CAPEX	-60.1	-66.9	-45.4	-7.5	-7.6	-7.7	-7.7	-7.4	-7.5	-7.1	
Working capital	-3.9	7.0	6.5	-0.8	-1.7	-2.1	-0.9	-1.0	-0.4	-0.2	
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	-45.1	-22.0	4.6	41.4	42.2	43.4	46.3	48.3	50.5	52.7	54.3
WACC	10.7%	10.3%	10.3%	10.6%	11.1%	11.7%	11.9%	11.9%	11.9%	11.4%	
Discount factor	94.2%	85.4%	77.5%	70.0%	63.1%	56.5%	50.5%	45.1%	40.4%	36.2%	
PV FCF	-42.5	-18.8	3.6	29.0	26.6	24.5	23.4	21.8	20.4	19.1	
WACC	10.7%	10.3%	10.3%	10.6%	11.1%	11.7%	11.9%	11.9%	11.9%	11.4%	
Cost of debt	9.1%	9.1%	9.1%	9.1%	9.1%	9.1%	9.1%	9.1%	9.1%	8.6%	
Risk-free rate	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.6%	
Credit risk premium	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	26%	34%	35%	28%	18%	4%	0%	0%	0%	0%	
Cost of equity	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%	11.4%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	1.15	
FCF growth after the forecast horizon	3.0%										
Terminal value (TV)	650.1										
Present value of terminal value (PV TV)	235.6										
Present value of FCF in the forecast horizon	107.0										
Present value of FCF	342.7										
Net debt	25.7										
Book value of land	0.0										
Equity value	316.9										
Number of shares (millions)	33.9										
Equity value per share (PLN)	9.3										
9M cost of equity	8.8%										
Target Price	10.2										
EV/EBITDA ('10) for the target price	10.8										
P/E for the target price	14.0										
TV to EV	74%										

Sensitivity analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0pp	10.2	10.7	11.3	11.9	12.7
WACC -0.5pp	9.7	10.2	10.7	11.3	11.9
WACC	9.3	9.7	10.2	10.7	11.3
WACC +0.5pp	8.9	9.3	9.7	10.2	10.7
WACC +1.0pp	8.6	8.9	9.3	9.7	10.2



Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Revenues	407.5	503.9	392.7	657.9	780.6	870.9	918.4
Change	98.6%	23.7%	-22.1%	67.5%	18.7%	11.6%	5.5%
COGS	378.7	448.3	349.7	604.3	735.6	799.2	838.0
Gross profit	28.8	55.6	43.0	53.5	45.0	71.7	80.5
gross profit margin	7.1%	11.0%	11.0%	8.1%	5.8%	8.2%	8.8%
Selling expenses	0.0	0.0	-2.7	-3.3	-3.9	-4.4	-4.6
G&A expenses	-10.9	-18.1	-16.2	-20.1	-23.8	-26.6	-28.0
Valuation of commercial properties					11.6	18.5	14.6
Other net operating income/expenses	-2.1	-5.7	2.5	-0.4	-2.0	-2.2	-2.4
EBIT	15.8	31.8	26.6	29.8	26.8	57.0	60.1
Change	349.9%	101.3%	-16.1%	11.7%	-9.9%	112.7%	5.4%
EBIT margin	3.9%	6.3%	6.8%	4.5%	3.4%	6.6%	6.5%
Financial income/expenses	-0.7	4.7	-1.9	-0.3	-2.5	-6.2	-7.6
Extraordinary income/expenses	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 profit	15.1	36.4	24.8	29.4	24.3	50.9	52.5
Tax	3.4	8.8	7.0	6.8	4.9	10.0	10.3
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net profit	11.7	27.6	17.8	22.7	19.5	40.9	42.2
Change	448.0%	135.3%	-35.6%	27.5%	-14.1%	109.9%	3.2%
margin	2.9%	5.5%	4.5%	3.4%	2.5%	4.7%	4.6%
D&A expenses	1.0	1.7	4.7	5.9	6.5	6.6	6.7
EBITDA	16.7	33.4	31.4	35.7	33.3	63.7	66.8
Change	299.7%	99.6%	-6.1%	13.8%	-6.6%	91.0%	5.0%
EBITDA margin	4.1%	6.6%	8.0%	5.4%	4.3%	7.3%	7.3%
Shares at year-end (millions)	27.2	33.9	33.9	33.9	33.9	33.9	33.9
EPS	0.4	0.8	0.5	0.7	0.6	1.2	1.2
CEPS	0.5	0.9	0.7	0.8	0.8	1.4	1.4
ROAE	107.6%	46.2%	16.7%	18.1%	13.0%	22.7%	19.1%
ROAA	11.0%	13.2%	6.5%	7.0%	4.5%	7.5%	6.7%



Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	145.7	271.9	275.7	376.5	491.2	599.2	667.7
Fixed assets	23.9	41.9	72.6	91.3	162.7	242.3	296.1
Property, plant and equipment	9.1	8.8	49.1	58.2	59.2	60.2	61.2
Investment properties	0.0	0.0	0.0	5.0	69.2	147.0	199.3
Other	14.8	33.1	23.5	28.0	34.2	35.1	35.6
Current assets	121.8	230.1	203.1	285.3	328.5	356.9	371.7
Inventories	20.7	102.5	100.9	99.2	135.9	134.8	130.0
Receivables	55.0	49.7	55.0	116.0	133.3	149.9	158.6
Short-term prepayments	1.7	1.6	2.2	3.9	3.0	3.3	3.5
Cash and cash equivalents	24.5	62.4	18.1	28.8	29.2	40.8	51.0
Other	19.9	13.9	26.8	37.3	27.1	28.0	28.5
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	145.7	271.9	275.7	376.5	491.2	599.2	667.7
Equity	16.5	103.1	110.3	139.9	159.3	200.2	242.4
Minority interest	0.0	0.0	0.0	0.5	0.5	0.5	0.5
Long-term liabilities	13.4	16.5	27.5	61.4	111.3	161.3	176.4
Loans	2.6	0.4	8.3	32.4	82.4	132.4	147.4
Provisions	10.8	16.1	19.2	28.9	28.9	28.9	28.9
Current liabilities	115.7	152.3	137.8	174.8	220.0	237.1	248.5
Loans	8.1	13.4	12.1	22.1	22.1	22.1	22.1
Trade creditors	84.0	78.9	71.1	103.1	136.9	152.7	161.0
Construction contracts	9.6	4.8	13.2	7.4	7.4	0.0	0.0
Provisions and other	14.1	55.2	41.5	42.1	53.5	62.3	65.3
Debt	10.7	13.8	20.4	54.6	104.6	154.6	169.6
Net debt	-13.8	-48.6	2.3	25.7	75.3	113.7	118.6
(Net debt / Equity)	-83.5%	-47.1%	2.1%	18.4%	47.3%	56.8%	48.9%
(Net debt / EBITDA)	-0.8	-1.5	0.1	0.7	2.3	1.8	1.8
BVPS	0.6	3.0	3.3	4.1	4.7	5.9	7.1



Cash Flows

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Cash flows from operating activities	20.9	0.0	-26.4	25.7	13.0	42.1	48.2
Net profit	11.7	27.6	17.8	22.7	19.5	40.9	42.2
D&A expenses	1.0	1.7	4.7	5.9	6.5	6.6	6.7
Working capital	0.8	-54.6	-29.1	-1.5	0.3	7.3	6.4
Other	7.4	25.3	-19.9	-1.3	-13.2	-12.7	-7.2
Cash flows from investing activities	-4.2	-13.7	-16.7	-6.3	-60.1	-66.9	-45.4
CAPEX	-4.3	-16.0	-2.1	-7.6	-7.5	-7.6	-7.7
Equity investment	0.0	-1.0	-14.5	-10.2	0.0	0.0	0.0
Commercial building construction					-52.6	-59.3	-37.7
Other	0.1	3.3	0.0	11.4	0.0	0.0	0.0
Cash flows from financing activities	4.7	48.6	2.1	-8.6	47.5	36.4	7.4
Stock issue	0.0	58.1	0.0	0.0	0.0	0.0	0.0
Debt	6.5	-8.7	12.2	-0.4	50.0	42.6	15.0
Dividend (buy-back)	-0.4	0.0	-3.4	-3.4	0.0	0.0	0.0
Other	-1.4	-0.8	-6.6	-4.8	-2.5	-6.2	-7.6
Change in cash	21.5	34.8	-41.0	10.8	0.4	11.6	10.2
Cash at period-end	24.5	62.4	18.1	28.8	29.2	40.8	51.0
DPS (PLN)	0.0	0.0	0.1	0.1	0.0	0.0	0.0
FCF	9.3	-15.7	-33.3	28.7	-45.1	-22.1	4.4
(CAPEX / Sales)	1.1%	3.2%	0.5%	1.2%	1.0%	0.9%	0.8%

Market multiples

	2007	2008	2009	2010	2011F	2012F	2013F
2012F P/E	15.2	8.1	12.5	9.8	11.4	5.4	5.3
P/CE	14.0	7.6	9.9	7.8	8.6	4.7	4.5
P/BV	10.8	2.2	2.0	1.6	1.4	1.1	0.9
P/S	0.4	0.4	0.6	0.3	0.3	0.3	0.2
FCF/EV	5.1%	-9.0%	-14.8%	11.5%	-15.1%	-6.5%	1.4%
EV/EBITDA	10.9	5.2	7.2	7.0	9.0	5.3	5.1
EV/EBIT	11.5	5.5	8.4	8.4	11.1	5.9	5.7
EV/S	0.4	0.3	0.6	0.4	0.4	0.4	0.4
DYield	0.2%	0.0%	1.5%	1.5%	0.0%	0.0%	0.0%
Price (PLN)	6.56						
Shares at year-end (millions)	27.2	33.9	33.9	33.9	33.9	33.9	33.9
MC (PLN m)	178.6	222.6	222.6	222.6	222.6	222.6	222.6
Equity attributable to minority shareholders (PLN m)	0.0	0.0	0.0	0.5	0.5	0.5	0.5
EV (PLN m)	181.8	174.0	224.9	248.8	298.4	336.7	341.4

20 May 2011

Update



Construction

Poland

Current price	PLN 11.6
Target price	PLN 13.2
Market cap	PLN 255.6m
Free float	PLN 56.6m
Avg. daily trading volume (3M)	PLN 0.08m

Shareholder structure

Wiesław Nowak	72.73%
PKO BP Bankowy PTE	5.12%
Others	22.15%

Sector outlook

The WIG Budownictwo index has fallen over 20% since the beginning of the year. The sharp declines that some construction stocks have suffered have no basis in the fundamentals. In spite of an overall bearish sector outlook, we see some good investment opportunities among Polish construction firms. The companies that are considered the safest offer the least upside potential.

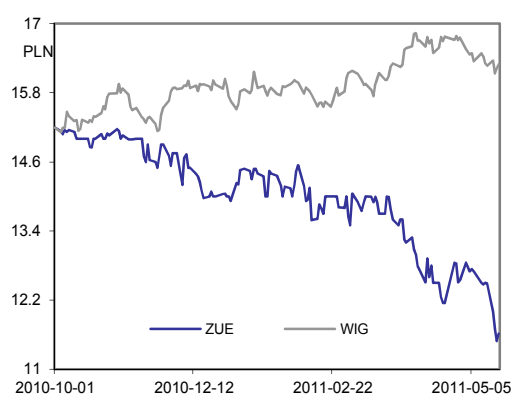
Company profile

ZUE is the Polish leader in tramline construction, with a market share approaching 35%. The company was in charge of the biggest and most difficult projects in Poland. In early 2010, it took over PRK Kraków, which added momentum to its efforts to enter the railroad construction segment. The company also provides urban infrastructure maintenance services (trackage,

Important dates

31.08 - H1 2011 report
14.11 - Q3 2011 report

ZUE vs. WIG



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ZUE

ZUEP.WA; ZUE PW

Accumulate

(Downgraded)

Tighter Margins On A Hefty Backlog

ZUE has a history of high margins and strong earnings growth. In the period from 2006 to 2008, when competition in tramline development was low, its EBIT margins exceeded 10%. Today, however, competition is getting increasingly intense as major players from the construction industry are seeking to diversify revenue sources in light of decreasing government expenses on road infrastructure. As a result, we expect ZUE's EBIT margin to contract to 5.9% in 2011 (rising to 6.5% in 2012). Otherwise, however, the company's growth prospects as the leader of rail-based urban transit systems remain strong. ZUE has built a massive order book with a 2011 value over PLN 500m and a 2012 value of PLN 300-350m which may soon increase by as much as PLN 75m with the addition of a new contract for a tram depot in Poznań. Such a large backlog guarantees revenue growth in the next two years. Any cuts in local infrastructure budgets which may occur in the near future will not influence contractor profits until 2013. We reduced our margin forecasts for ZUE, and we are downgrading the company's stock from buy to accumulate with the price target lowered from PLN 19.3 to PLN 13.2.

Large order backlog

ZUE's hefty PLN 900m order backlog includes PLN 500m-worth of contracts scheduled for completion in 2011 and PLN 300-350m-worth for delivery in 2012. The company is about to sign a new PLN 210.5m contract for a tram depot which it will share with a consortium partner.

Government expenses

Poland's heavily indebted local governments may be forced to make cutbacks in the coming years. In our opinion, the areas that will be most affected by reduced spending will be arts and leisure facilities like museums and waterparks rather than public transportation infrastructure. Any negative impacts on the profits of companies like ZUE will not materialize until 2013.

Most successful contract bidder

ZUE has won most of the tram line contract tenders held in recent years. Such successful contract acquisition is a winning long-term strategy, but in the short term it gives rise to margin risks.

2011 outlook

We expect ZUE to go back in the black after H1 2011 (the fourth quarter will be the one that will most influence 2011 earnings). Cash flows in the second and third quarters will be deep in the negative territory because of high initial expenses on new tram-line assignments (payment cycles have lengthened in the industry).

(PLN m)	2009	2010	2011F	2012F	2013F
Revenue	199.9	392.4	530.0	572.4	589.6
EBITDA	18.7	32.4	39.8	43.7	43.7
EBITDA margin	9.4%	8.2%	7.5%	7.6%	7.4%
EBIT	16.8	25.6	31.5	32.8	32.6
Net profit	8.6	16.8	20.9	22.1	22.6
P/E	21.5	15.2	12.2	11.6	11.3
P/CE	17.6	10.9	8.8	7.7	7.6
P/BV	3.6	1.6	1.5	1.3	1.2
EV/EBITDA	13.0	8.6	7.0	5.9	5.1
DYield	0.0%	0.6%	0.0%	0.0%	0.0%



Q1 2011 Results

Q1 2011: Y/Y improvement, reduced loss

ZUE's Q1 2011 showed a year-on-year improvement reflected in a reduced net loss. On an in-line revenue, the gross margin fell short of expectations at just 0.3% (we forecasted 10%). Combined with slightly higher-than-forecasted SG&A expenses (PLN 4.0m reported vs. PLN 3.7m expected), this led to EBIT and net losses. The weak gross margin was due to low contract profitability and fixed costs. For comparison, in 2010, the gross margin expanded from a negative 4.9% in Q1 to a positive 10% in Q4. ZUE does not have a history of publicly-available first-quarter earnings.

Q1 2011 results vs. forecasts

(PLN m)	Q1 2011	Q1 2011F	Difference	Q1 2010	Change
Revenues	46.0	46.8	-1.7%	28.8	59.7%
Gross profit	0.2	4.7	-96.6%	-1.4	-
%	0.3%	10.0%	-	-4.9%	-
EBIT	-3.3	0.7	-	-5.2	-
%	-7.3%	1.6%	-	-17.9%	-
Pre-tax profit	-3.6	-0.2	-	-5.5	-
Net profit	-2.7	0.0	-	-4.1	-
%	-5.8%	0.1%	-	-14.2%	-

Source: ZUE, F – forecasts by BRE Bank Securities

One positive aspect of these results was a positive operating cash flow in the amount of PLN 17m; we did not expect positive cash operating cash flow until Q2 2011. Other net operating income amounted to PLN 0.55m (we expected PLN 0.1m expenses). Other net financing expenses amounted to PLN 0.3m (we expected PLN 0.9m) The effective tax rate was 18% and minority interests were PLN -0.2m.

Valuation

Based on DCF analysis and relative valuation, we set the nine-month price target on ZUE at PLN 13.2 per share (+11.1%) DCF valuation suggests a 9-month target price of PLN 13.4 per share, and relative valuation, PLN 12.9 per share.

	Value per share	Weight
DCF Valuation	12.3	75%
Relative Valuation	11.9	25%
Average	12.2	
9M cost of equity	8.2%	
Target Price	13.2	

Relative Valuation

Peer group composition

In a peer group of medium and large publicly-traded construction firms, of which Trakcja Polska is the closest match. ZUE is trading at a premium of 3.0% to the industry.

Relative Valuation

	2011F P/E	2012F P/E	2013F P/E	201F EV/EBITDA	2012F EV/EBITDA	2013F EV/EBITDA
Budimex	11.4	10.9	14.7	7.7	7.6	9.8
Erbud	24.3	8.7	7.5	13.3	5.5	4.5
Elektrobudowa	13.2	11.8	10.3	8.3	7.1	6.0
Mostostal Warszawa	19.1	11.3	7.3	6.3	4.2	2.7
PBG	10.3	10.5	10.7	6.0	5.9	5.8
Polimex Mostostal	14.6	10.8	7.8	7.7	6.6	5.2
Rafako	12.9	11.8	9.1	6.9	6.2	4.5
Trakcja Polska	8.7	7.9	8.8	6.2	5.4	5.4
Unibep	11.4	5.4	5.3	9.0	5.3	5.1
Median	12.9	10.8	8.8	7.7	5.9	5.2
ZUE	12.2	11.6	11.3	7.0	5.9	5.1
Premium (discount)	-4.8%	6.5%	28.9%	-9.1%	-1.1%	-2.2%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

Source: BRE Bank Securities

DCF Valuation

DCF Model Assumptions

- Growth rate after FY2017 = 3%.
- Risk-free rate is 6.1% (10Y T-bond yield).
- Our valuation does not take into account properties earmarked for restructuring (the sales process is not progressing, our valuations of other companies ignore non-operating assets).
- CAPEX in line with the Management's 2010-2011 earnings guidance, and higher than D&A charges in 2012-2019.
- Longer payment turnovers in 2011-2012, on a par with the situation as of the end of 2010, following which receivables turnover will approach payables turnover.
- EBIT margin eventually declines to 5% (2% premium over general constructors).
- We value the 15% minority stake in PRK Kraków at the price implied by the price at which ZUE bought its 85% stake.



DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Revenues	530.0	572.4	589.6	607.3	625.5	644.2	663.6	683.5	704.0	725.1	
Change	35.1%	8.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	
EBITDA	39.8	43.7	43.7	43.6	43.5	44.0	45.1	46.2	47.4	48.4	
EBITDA margin	7.5%	7.6%	7.4%	7.2%	7.0%	6.8%	6.8%	6.8%	6.7%	6.7%	
D&A expenses	8.3	10.9	11.1	11.2	11.4	11.6	11.7	11.8	11.9	11.9	
EBIT	31.5	32.8	32.6	32.4	32.1	32.4	33.4	34.4	35.5	36.5	
EBIT margin	5.9%	5.7%	5.5%	5.3%	5.1%	5.0%	5.0%	5.0%	5.0%	5.0%	
Tax on EBIT	6.0	6.2	6.2	6.2	6.1	6.2	6.3	6.5	6.7	6.9	
NOPLAT	25.5	26.6	26.4	26.2	26.0	26.3	27.1	27.9	28.7	29.6	
CAPEX	-25.3	-12.0	-12.2	-12.4	-12.5	-12.7	-12.9	-12.4	-12.5	-11.9	
Working capital	-2.5	2.0	14.3	7.0	7.4	-1.2	-1.5	-1.5	-1.6	-1.6	
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	6.0	27.5	39.7	32.1	32.3	24.0	24.4	25.8	26.6	28.0	28.8
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Discount factor	94.0%	84.6%	76.2%	68.6%	61.7%	55.6%	50.0%	45.0%	40.5%	36.6%	
PV FCF	5.7	23.3	30.2	22.0	19.9	13.3	12.2	11.6	10.8	10.3	
WACC	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Cost of debt	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	7.3%	6.8%	
Risk-free rate	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%	5.6%	
Credit risk premium	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
Cost of equity	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	10.6%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	
FCF growth after the forecast horizon	3.0%										
Terminal value (TV)	379.2										
Present value of terminal value (PV TV)	138.9										
Present value of FCF in the forecast horizon	159.3										
Present value of FCF	298.2										
Net debt	13.0										
Minority interests	-13.8										
Equity value	271.4										
Number of shares (millions)	22.0										
Equity value per share (PLN)	12.3										
9M cost of equity	8.2%										
Target Price	13.4										
EV/EBITDA ('11) for the target price	6.8										
P/E for the target price	13.0										
TV to EV	51%										

Sensitivity analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0pp	12.3	12.8	13.4	14.0	14.8
WACC -0.5pp	11.9	12.3	12.8	13.4	14.0
WACC	11.5	11.9	12.3	12.8	13.4
WACC +0.5pp	11.2	11.5	11.9	12.3	12.8
WACC +1.0pp	10.9	11.2	11.5	11.9	12.3



Income Statement

(PLN m)	2007	2008	2009 *	2010F	2011F	2012F	2013F
Revenues	198.9	250.6	199.9	392.4	530.0	572.4	589.6
<i>Change</i>	138.8%	26.0%	-20.2%	9.0%	35.1%	8.0%	3.0%
COGS	163.0	199.5	174.4	352.4	482.3	522.0	538.9
Gross profit	35.9	51.1	25.5	40.0	47.7	50.4	50.7
<i>gross profit margin</i>	18.0%	20.4%	12.8%	10.2%	9.0%	8.8%	8.6%
G&A expenses	-5.1	-6.0	-8.9	-14.8	-15.2	-16.5	-16.9
Other net operating income/expenses	0.1	0.2	0.2	0.4	-1.0	-1.1	-1.1
EBIT	30.8	45.2	16.8	25.6	31.5	32.8	32.6
<i>Change</i>	266.0%	46.8%	-62.9%	52.7%	22.8%	4.4%	-0.6%
<i>EBIT margin</i>	15.5%	18.1%	8.4%	6.5%	5.9%	5.7%	5.5%
Financial income/expenses	1.5	-29.1	-5.9	-4.5	-3.2	-2.9	-2.0
Pre-tax profit	32.4	16.1	10.9	21.1	28.2	30.0	30.7
Tax	-6.3	-3.3	-2.2	-4.0	-5.4	-5.7	-5.8
Minority interests	0.0	0.0	0.0	0.4	2.0	2.1	2.2
Net profit	26.1	12.8	8.6	16.8	20.9	22.1	22.6
<i>Change</i>	287.1%	-50.9%	-32.5%	94.6%	24.2%	6.0%	2.2%
<i>margin</i>	13.1%	5.1%	4.3%	4.3%	3.9%	3.9%	3.8%
D&A expenses	0.9	1.3	1.9	6.7	8.3	10.9	11.1
EBITDA	31.8	46.5	18.7	32.4	39.8	43.7	43.7
<i>Change</i>	198.6%	46.5%	-59.8%	73.0%	22.9%	10.0%	-0.1%
<i>EBITDA margin</i>	16.0%	18.6%	9.4%	8.2%	7.5%	7.6%	7.4%
Shares at year-end (millions)	16.0	16.0	16.0	22.0	22.0	22.0	22.0
EPS	1.6	0.8	0.5	0.8	0.9	1.0	1.0
CEPS	1.7	0.9	0.7	1.1	1.3	1.5	1.5
ROAE	95.1%	30.9%	18.3%	27.9%	12.7%	12.0%	11.1%
ROAA	23.3%	10.4%	5.6%	5.8%	4.6%	4.3%	4.1%

* ZUE data



Balance Sheet

(PLN m)	2007	2008	2009 *	2010F	2011F	2012F	2013F
ASSETS	102.9	143.6	162.2	419.0	495.3	534.3	564.0
Fixed assets	27.6	43.8	111.4	134.5	151.5	152.6	153.7
Property, plant and equipment, intangible assets	17.4	17.9	21.2	57.9	74.9	76.0	77.1
Goodwill	0.0	0.0	0.0	31.2	31.2	31.2	31.2
Intangible assets	1.3	2.2	2.4	17.9	17.9	17.9	17.9
Long-term investment	0.0	0.0	78.3	0.0	0.0	0.0	0.0
Investment properties	0.0	0.0	0.0	6.1	6.1	6.1	6.1
Construction contract deposits	5.9	15.5	3.4	3.0	3.0	3.0	3.0
Other	3.1	8.3	6.1	18.5	18.5	18.5	18.5
Current assets	75.3	99.8	50.8	284.5	343.7	381.7	410.3
Inventories	2.9	4.5	1.8	5.5	7.3	7.9	8.1
Receivables	54.7	47.2	17.9	219.8	275.9	290.1	282.7
Construction contract deposits	2.4	3.9	0.8	1.1	1.1	1.1	1.1
Cash and cash equivalents	13.7	43.3	22.2	53.7	55.1	78.2	114.0
Other	1.5	0.9	8.1	4.4	4.4	4.4	4.4
(PLN m)	2007	2008	2009 *	2010F	2011F	2012F	2013F
EQUITY AND LIABILITIES	102.9	143.6	162.2	419.0	495.3	534.3	564.0
Equity	40.0	42.8	51.5	155.1	174.0	194.0	214.4
Minority interest	0.0	0.0	0.0	8.5	10.5	12.7	14.9
Long-term liabilities	8.7	33.7	78.1	44.8	44.8	44.8	44.8
Loans, leasing	2.9	1.7	70.3	10.3	10.3	10.3	10.3
Construction contract deposits	2.4	8.0	2.1	2.1	2.1	2.1	2.1
Employee benefits	0.1	0.1	0.1	2.9	2.9	2.9	2.9
Provisions and other	3.4	24.0	5.6	29.5	29.5	29.5	29.5
Current liabilities	54.1	67.1	32.6	210.5	265.9	282.7	289.9
Loans, leasing	1.5	1.7	9.2	56.4	56.4	56.4	56.4
Trade creditors and other	52.1	53.7	19.2	149.4	204.8	221.7	228.8
Other financial liabilities	0.0	9.5	3.3	0.3	0.3	0.3	0.3
Construction contract deposits	0.2	1.9	0.3	1.8	1.8	1.8	1.8
Other	0.4	0.2	0.6	2.6	2.6	2.6	2.6
Debt	4.4	3.5	79.5	66.7	66.7	66.7	66.7
Net debt	-9.4	-39.8	57.3	13.0	11.6	-11.5	-47.4
(Net debt / Equity)	-23.4%	-93.0%	111.3%	8.4%	6.7%	-5.9%	-22.1%
(Net debt / EBITDA)	-0.3	-0.9	3.1	0.4	0.3	-0.3	-1.1
BVPS	2.5	2.7	3.2	7.1	7.9	8.8	9.7

* ZUE data

**Cash Flows**

(PLN m)	2007	2008	2009 *	2010F	2011F	2012F	2013F
Cash flows from operating activities	17.5	42.3	17.6	-42.1	29.9	37.9	50.0
Pre-tax profit	32.4	16.1	10.9	21.1	28.2	30.0	30.7
D&A expenses	0.9	1.3	1.9	6.7	8.3	10.9	11.1
Derivative valuation	0.0	28.1	5.9	-0.4	0.0	0.0	0.0
Working capital	-10.4	3.9	9.5	-83.1	-2.5	2.0	14.3
Taxes paid	-2.7	-8.0	-12.7	8.3	-5.4	-5.7	-5.8
Other	-2.7	0.9	2.1	5.2	1.2	0.7	-0.2
Cash flows from investing activities	-2.5	-0.7	-111.5	13.2	-25.3	-12.0	-12.2
CAPEX	-4.4	-1.7	-81.2	-4.7	-25.3	-12.0	-12.2
Equity investment	0.0	0.0	-30.7	-2.9	0.0	0.0	0.0
Other	1.9	1.0	0.4	20.8	0.0	0.0	0.0
Cash flows from financing activities	-3.8	-12.1	72.8	60.4	-3.2	-2.9	-2.0
Stock issue	0.0	0.0	0.0	86.2	0.0	0.0	0.0
Debt	-1.9	-1.8	73.5	-17.9	0.0	0.0	0.0
Dividend (buy-back)	-1.7	-10.0	0.0	-1.5	0.0	0.0	0.0
Other	-0.2	-0.3	-0.7	-6.3	-3.2	-2.9	-2.0
Change in cash	11.2	29.5	-21.1	31.5	1.4	23.1	35.9
Cash at period-end	13.7	43.3	22.2	53.7	55.1	78.2	114.0
DPS (PLN)	0.1	0.6	0.0	0.1	0.0	0.0	0.0
FCF	11.0	39.9	21.8	-60.8	6.0	27.5	39.7
(CAPEX / Sales)	2.2%	0.7%	40.6%	1.2%	4.8%	2.1%	2.1%

Market multiples

	2007	2008	2009 *	2010F	2011F	2012F	2013F
P/E	7.1	14.5	21.5	15.2	12.2	11.6	11.3
P/CE	6.9	13.2	17.6	10.9	8.8	7.7	7.6
P/BV	4.6	4.3	3.6	1.6	1.5	1.3	1.2
P/S	0.9	0.7	0.9	0.7	0.5	0.4	0.4
FCF/EV	6.2%	27.3%	9.0%	-21.9%	2.2%	10.7%	17.8%
EV/EBITDA	5.6	3.1	13.0	8.6	7.0	5.9	5.1
EV/EBIT	5.7	3.2	14.5	10.8	8.8	7.8	6.8
EV/S	0.9	0.6	1.2	0.7	0.5	0.4	0.4
DYield	0.9%	5.4%	0.0%	0.6%	0.0%	0.0%	0.0%
Price	11.6						
Shares at year-end (millions)	16.0	16.0	16.0	22.0	22.0	22.0	22.0
MC (PLN m)	185.9	185.9	185.9	255.6	255.6	255.6	255.6
Equity attributable to minority shareholders (PLN m)	0.0	0.0	0.0	8.5	10.5	12.7	14.9
EV (PLN m)	176.6	146.1	243.2	277.2	277.7	256.8	223.2

* ZUE data



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List of abbreviations and ratios contained in the report:

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

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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%
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**Previous ratings issued for Budimex**

Rating	Reduce	Reduce	Reduce	Hold	Reduce
Date issued	2010-09-03	2010-09-13	2011-01-17	2011-03-28	2011-05-06
Price on rating day	91.30	95.10	103.20	98.80	106.80
WIG on rating day	42704.39	43671.28	47258.66	48626.25	49266.97

Previous ratings issued Erbud

Rating	Hold	Hold	Hold	Buy	Accumulate
Date issued	2010-11-05	2011-01-19	2011-03-02	2011-04-05	2011-04-29
Price on rating day	53.80	54.55	47.90	39.00	37.51
WIG on rating day	47066.40	48371.02	47141.05	49592.98	50219.70

Previous ratings issued Mostostal Warszawa

Rating	Hold	Accumulate	Buy	Buy
Date issued	2010-09-16	2010-12-03	2011-02-04	2011-02-11
Price on rating day	64.80	60.50	47.66	48.20
WIG on rating day	44249.33	46481.15	47559.15	47242.10

Previous ratings issued PBG

Rating	Sell	Reduce	Hold
Date issued	2010-10-05	2010-11-05	2011-03-28
Price on rating day	243.00	226.00	181.80
WIG on rating day	45542.07	47066.40	48626.25

Previous ratings issued Polimex Mostostal

Rating	Hold	Hold	Accumulate	Buy	Accumulate
Date issued	2010-09-03	2010-11-15	2011-01-18	2011-02-23	2011-03-03
Price on rating day	4.44	4.27	3.86	3.33	3.71
WIG on rating day	42704.39	47493.93	47457.37	46548.27	47326.35

Previous ratings issued Trakcja Polska

Rating	Hold
Date issued	2011-02-22
Price on rating day	3.80
WIG on rating day	46761.71

Previous ratings issued Unibep

Rating	Accumulate	Hold	Buy
Date issued	2010-09-14	2010-12-03	2011-04-05
Price on rating day	8.38	9.94	7.66
WIG on rating day	44223.72	46481.15	49592.98

Previous ratings issued ZUE

Rating	Buy
Date issued	2010-11-24
Price on rating day	14.50
WIG on rating day	45730.96