



19 March 2007

# PBG

Reuters: **PBGG.WA** Bloomberg: **PBG PW** Exchange: **WSE** Ticker: **PBGG**

## Acquisition of Hydrobudowa 9, upgrade to Buy

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### Upgrade to Buy on acquisition of Hydrobudowa 9

We have upgraded our rating for PBG from Hold to Buy and increased our price target to PLN400 from PLN300.

### The largest Hydrobudowa acquired

On March 17 the EGM of Hydrobudowa 9, PBG's largest competitor in Polish hydro engineering industry unanimously approved sales of company shares to PBG. PBG said it will pay around PLN80m for 100% stake in Hydrobudowa 9. PBG also said that it will grant a PLN30m loan to Hydrobudowa 9, in order to improve its financial liquidity.

### Making another milestone

By acquisition of Hydrobudowa 9, PBG will decisively strengthen its business position in hydro engineering industry, as so far Hydrobudowa 9 has been its greatest competitor in this field in Poland. The size of Hydrobudowa 9 is encouraging: with its 1000 workers the company generated roughly PLN300m revenues in 2006 and PBG estimates more than PLN300m in 2007. Although profitability is low (expected loss in 2006 due to portfolio of "bad" contracts signed in 2002-2003), PBG expects Hydrobudowa 9 to show bottom line in green already this year, while 5% net margin in 2008 is achievable. This would make acquisition very cheap, at 2008E P/E at 3.2!. PBG will start consolidation of Hydrobudowa 9 from 2Q07.

### Target price increased to PLN400 with a Buy rating. Risks remain contained

We have changed our forecasts for PBG due to inclusion of projected Hydrobudowa 9 performance in 2007 and 2008. We have hiked our 2007 revenue forecast by 20% to PLN1,439bn, EBIT by 8% to PLN135m and net profit by 18% to PLN113m. We have also improved our long-term margin assumptions for PBG in the long run, as we believe that acquisition of the strongest competitor will grant PBG with stronger negotiation power. Our new DCF price target was hiked by 33% to PLN400 thus we change our rating to Buy from Hold. The major risk for PBG is slowdown of EU funding flow to Poland (currently more than 50% of group's sales).

#### Forecasts and ratios

Year End Dec 31	2005A	2006A	2007E	2008E	2009E
Revenue (PLN)	409	672	1,439	2,129	2,659
EBITDA (PLNm)	51	91	170	277	384
EBITA (PLN)	33	74	135	238	343
Net Income (PLNm)	28	59	113	196	292
EPS (PLN)	2.31	4.89	8.42	14.61	21.71
P/E (DB EPS) (x)	25.5	34.1	40.0	23.1	15.5
EV/EBITDA (x)	21.7	29.0	32.3	21.5	15.9

Source: Deutsche Bank estimates, company data

### Deutsche Bank AG/London

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### Rating Upgrade

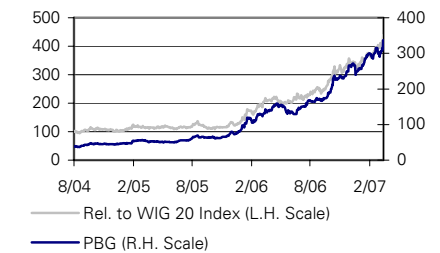
#### Buy

Price at 16 Mar 2007 (PLN)	337.00
Price Target (PLN)	400.00
52-week range (PLN)	337.00 - 129.50

#### Key changes

Rating	Hold to Buy	↑
Target Price	300.00 to 400.00	↑ 33.3%

#### Price/price relative



Performance (%)	1m	3m	12m
Absolute	12.3	26.7	135.7
WIG 20 Index	-1.8	-2.8	17.0

#### Stock data

Market Cap (PLNm)	4,525.9
Market Cap (US\$m)	1,547.2
Free float (%)	56
WIG 20 Index	3,314.7

#### Key indicators (FY1)

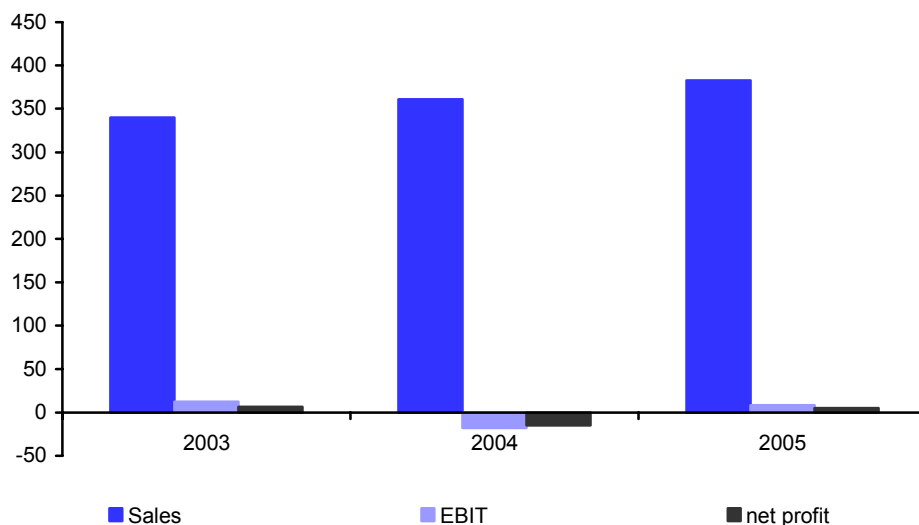
ROE (%)	19.1
ROA (%)	7.9
Net debt/equity (x)	118.0
Book value/share (PLN)	60.7
Price/book (x)	5.5
Net interest cover (x)	-
EBIT margin (%)	9.4

# Hydrobudowa 9

With more than PLN300m annual sales Hydrobudowa 9 is one of the largest Polish construction companies operating in hydro engineering sector. The company specializes in construction of sewer system objects, water treatment facilities, water mains and a range of other engineering works. The company has implemented modern technologies of renovation of underground installations and channel construction in “micro tunnel” technology. Hydrobudowa 9 also delivers bridge and road construction services, and highly specialized deep ground works. To support its sales, Hydrobudowa has created the engineering division, which constructs specialized hydro engineering facilities (pumps, aggregates etc).

According to PBG the company suffered however from portfolio of “bad” contracts which were signed in 2002-2003 period, due to weakening of euro vs. zloty (some of the deals were euro denominated on the revenue side). Therefore we might expect some loss at 2000-end, however it should have not impact on PBG financial performance, as PBG will start to consolidate Hydrobudowa 9 from 2Q07. Also, we believe that Hydrobudowa 9 performance was reflected already in the price to be paid by PBG (implying price/sales ratio at 0.26, compared to 1.5-2.0 for the construction sector on WSE).

**Figure 1: Hydrobudowa 9 past performance (PLNm)**



Source: Deutsche Bank

# Forecast change and DCF model

## Forecast changes

We have increased our forecasts for PBG due to consolidation of Hydrobudowa 9, and expected future improvement of margins of the acquired company. We also increased slightly our long-term margins for PBG, as we believe that getting control over its largest hydro engineering competitor will improve bidding power of PBG. Our 2007 and 2008 bottom line estimates were hiked by 18% and 16% respectively.

**Figure 2: PBG forecast changes table (PLNm)**

	2007E			2008E		
	previous	current	change	previous	current	change
Revenues	1199	1,439	20%	1754	2,129	21%
EBIT	125	135	8%	212	238	12%
net profit	96	113	18%	169	196	16%

Source: Deutsche Bank

## DCF model

Our new DCF model shows PLN400 as a new price target for PBG. We use a 5-year forecast period, 5.5% equity risk premium, variable risk free rates based on Polish Treasury bond yields, 0.76 beta ratio and a 3% growth rate of terminal value. We have set our new 12-month price target for PBG at PLN400 and changed our rating from Hold to Buy.

**Figure 3: PBG DCF model (PLNm)**

	2007E	2008E	2009E	2010E	beyond 2010
free cash flow	9.0	171.3	254.2	313.6	348.6
risk free rate (%)	4.55	4.78	4.93	5.00	5.21
equity risk premium (%)	5.50	5.50	5.50	5.50	5.50
Beta	0.76	0.76	0.76	0.76	0.76
cost of equity (%)	8.7	9.0	9.1	9.2	9.4
debt premium (%)	2.0	2.0	2.0	2.0	2.0
cost of debt (%)	6.5	6.8	6.9	7.0	7.2
effective tax rate (%)	19.00	19.00	19.00	19.00	19.00
effective cost of debt (%)	5.3	5.5	5.6	5.7	5.8
debt to debt plus equity ratio (%)	58.5	60.7	60.0	57.2	54.5
WACC (%)	6.7	6.8	7.0	7.2	7.5
terminal value growth rate					3%
discount factor	93.7%	87.7%	81.9%	76.5%	71.2%
PV of free cash flow	8.4	150.2	208.3	239.8	3995.2
total:					4601.9
net debt					173.2
net DCF value					4428.7
per share (PLN)					368
cost of equity					8.7%
<b>12 month price target (PLN)</b>					<b>400</b>

Source: Deutsche Bank

# Appendix 1

## Important Disclosures

Additional information available upon request

### Disclosure checklist

Company	Ticker	Recent price*	Disclosure
PBG	PBGG.WA	337.00 (PLN) 16 Mar 07	6

\*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

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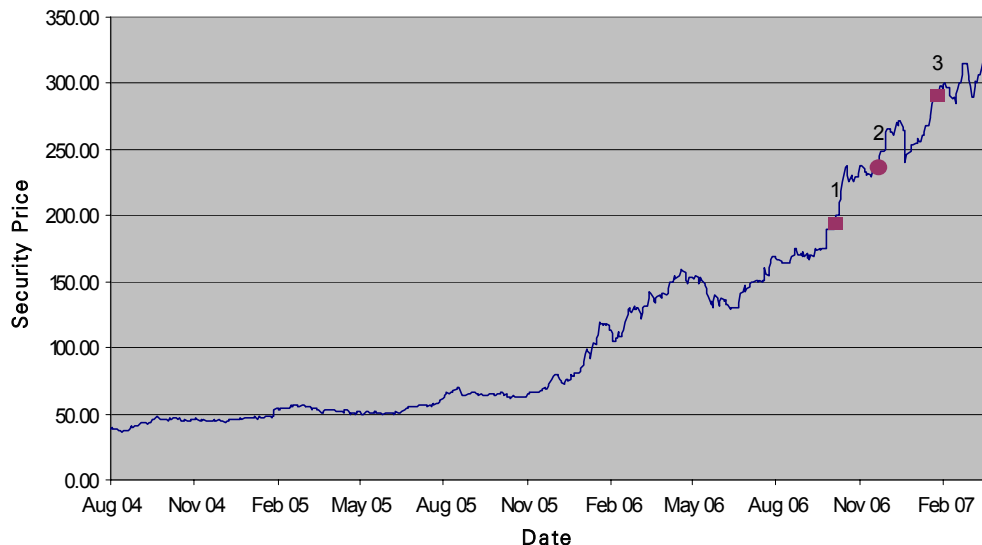
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**Historical recommendations and target price: PBG (PBG.WA)**

(as of 16/03/2007)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

\*New Recommendation Structure as of September 9, 2002

1.	5/10/2006:	Buy, Target Price Change PLN250.00	3.	24/1/2007:	Hold, Target Price Change PLN300.00
2.	21/11/2006:	Downgrade to Hold, PLN250.00			

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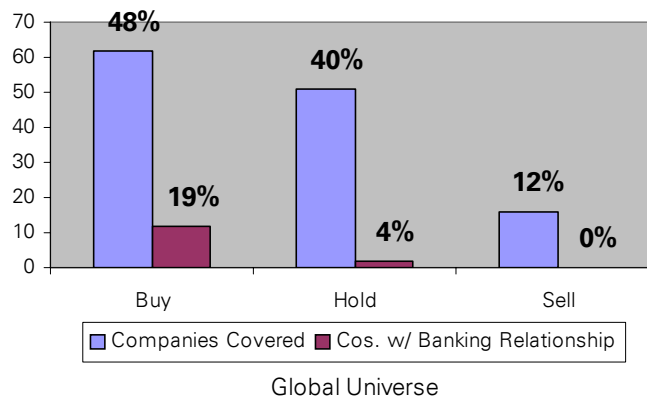
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