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# Polish construction

## Soft landing ahead?

**Tomasz Krukowski, CFA**

 Research Analyst  
 (48) 22 579 8732  
 tomasz.krukowski@db.com

**Buy PBG and Pol-Aqua, Sell Polimex, Hold Budimex**

We are initiating coverage of PBG, Pol-Aqua, Polimex and Budimex with the following recommendations/target prices: PBG Buy/PLN 275, Pol-Aqua Buy/PLN 60, Polimex Sell/PLN 5.0 and Budimex Hold/PLN 85. Polish construction is unlikely to be totally immune to the economic slowdown, but EU-financed infrastructure investments should act as a safety buffer and provide a soft landing. We expect aggregate 3-year net profit CAGR of 39% and believe that Polish construction average multiples (2009E P/E ratio of 16.9.x) are again becoming attractive.

**EU-financed infrastructure to hold back the slowdown?**

With YTD output increasing by 16.3% YoY, Polish construction appears to show no signs of a slowdown as of now. However, we do expect some slowdown to come, driven by the residential, public and industrial segments. Infrastructure, for the development of which the EU has earmarked EUR 21.5bn in 2007-2013, should be a safety buffer and provide a soft landing.

**We expect 3-year net profit CAGR of 39%**

Companies' backlogs, which have exceeded 2007 aggregate revenues by 68%, appear to secure medium-term earnings, but past experience tells us that the earnings of construction companies tend to lag behind the economic downturn, while in the mid-run, the risk of receivable write-downs is rising. We expect aggregate 3-year net profit CAGR of 39%, with 108% for Budimex, 38% for Pol-Aqua, 36% for PBG and only 23% for Polimex. The decreasing momentum should be visible in all four companies.

**Buy exposure to infrastructure, Sell residential, industrial and exports**

In the expected challenging environment, we recommend buying companies with a high exposure to EU-financed projects (PBG, Pol-Aqua with infrastructure shares in 2008E revenues of 68% and 34%, respectively) and avoid exposure to residential, industrial and exports. We find that Polimex (Sell) is highly exposed to industrial and exports. We see Budimex's high infrastructure exposure as counterbalanced by the significant scale of its operations in residential and public segments.

**Valuation multiples; having de-rated by 70%, we again deem them attractive**

We derive all our target prices from DCF models: PBG – PLN 275 (Buy), Pol-Aqua – PLN 60 (Buy), Polimex – PLN 5.0 (Sell) and Budimex – PLN 85 (Hold). We present a peer comparison for illustrative purposes and note that despite the over 70% ratios derating since May 2007, our Polish construction universe trades at double-digit premiums to both Western European and emerging market peers. We argue that earnings growth rates (39% aggregate 3-year net profit CAGR) justify P/E ratios of 20.5x for 2008E and 16.9x for 2009E. We see delays in the launch of new infrastructure projects as a major macro risk to our somewhat positive scenario. Company specific risks to our calls include higher-than-provisioned-for losses on old contracts in acquired entities for PBG, delays in invoicing for Pol-Aqua and a higher-than-expected utilization rate in new manufacturing planned in 2010 for Polimex. (See company pages for individual company valuation and risks.)

**Deutsche Bank AG/London**

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**Initiation of Coverage**
**Top picks**

|                              |     |
|------------------------------|-----|
| PBG (PBGG.WA), PLN242.00     | Buy |
| POL-AQUA (PQAA.WA), PLN50.10 | Buy |

**Companies featured**

| PBG (PBGG.WA), PLN242.00            | Buy         |       |       |
|-------------------------------------|-------------|-------|-------|
| 2007A                               | 2008E       | 2009E |       |
| DB EPS (PLN)                        | 7.60        | 11.23 | 14.53 |
| P/E (x)                             | 46.2        | 21.6  | 16.7  |
| EV/EBITA (x)                        | 45.1        | 15.3  | 11.1  |
| <b>Budimex (BMEX.WA), PLN82.40</b>  | <b>Hold</b> |       |       |
| 2007A                               | 2008E       | 2009E |       |
| DB EPS (PLN)                        | 0.59        | 3.36  | 4.15  |
| P/E (x)                             | 169.1       | 24.6  | 19.9  |
| EV/EBITA (x)                        | 75.8        | 14.3  | 10.6  |
| <b>Polimex (MOSD.WA), PLN5.45</b>   | <b>Sell</b> |       |       |
| 2007A                               | 2008E       | 2009E |       |
| DB EPS (PLN)                        | 0.21        | 0.28  | 0.31  |
| P/E (x)                             | 44.7        | 19.8  | 17.3  |
| EV/EBITA (x)                        | 30.5        | 13.6  | 12.1  |
| <b>POL-AQUA (PQAA.WA), PLN50.10</b> | <b>Buy</b>  |       |       |
| 2007A                               | 2008E       | 2009E |       |
| DB EPS (PLN)                        | 2.10        | 3.19  | 4.06  |
| P/E (x)                             | 36.3        | 15.7  | 12.3  |
| EV/EBITA (x)                        | 33.5        | 13.8  | 9.8   |

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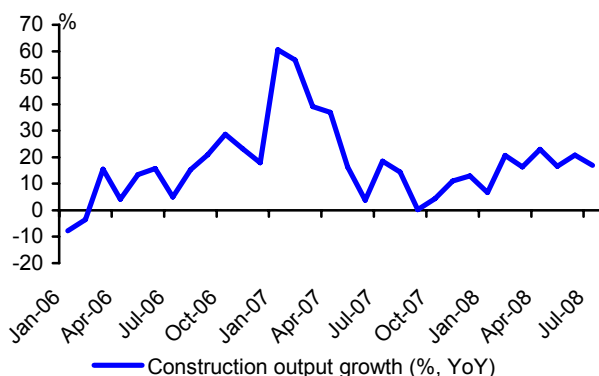
# Polish construction outlook

## Almost no signs of slowdown as of now...

**Although Polish construction output increased by 16.3% YoY and companies' backlogs are very strong...**

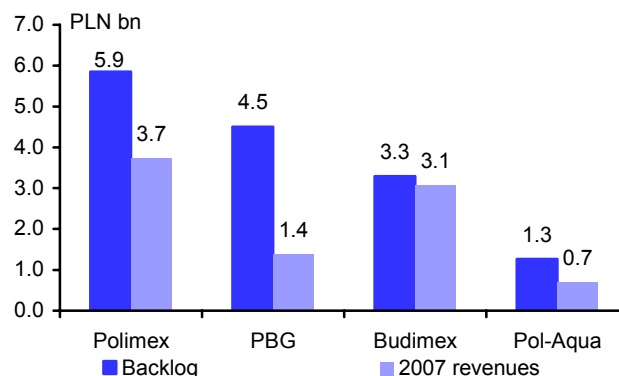
While the words "slowdown" and "downturn" have dominated headlines in the economic world recently, Polish construction appears to be an isolated island in that respect. Polish construction output increased by 16.9% YoY in July 2008 and by 16.3% YoY year to date. The construction business climate indexes continue to indicate a positive sentiment among industry players. The aggregate current backlog of the four largest WSE-listed construction companies exceeds the aggregate 2007 revenues by 68% (we acknowledge that part of the expansion is due to M&A).

**Figure 1: Polish construction output increased by 16.3% YTD**



Source: CSO

**Figure 2: Companies' current backlogs significantly exceed 2007 revenues**



Source: Company data

## ...but general downturn should also impact construction

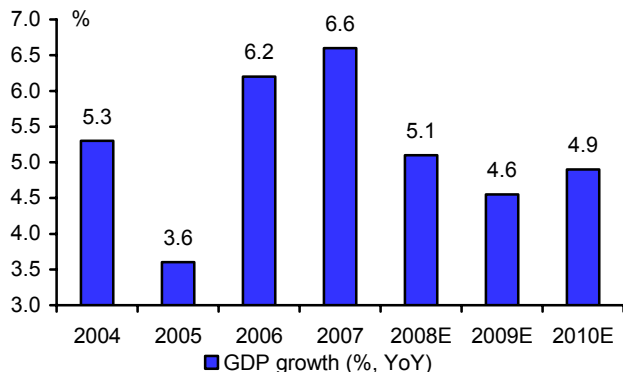
**...we expect some slowdown, driven by industrial, public and residential segments**

However, we do not believe that construction can be totally isolated from and immune to a slowdown in the surrounding economic activity. In recent years, Polish construction has showed a high correlation with fixed investment, though we expect the latter to decelerate from 17.6% in 2007 to 12.4% in 2008E and further to 10.0% in 2009E. Looking from a bottom-up perspective at the construction market we note that:

- In the industrial segment, many manufacturing companies are currently struggling with 1) significant sales growth deceleration (or even sales declines), and 2) margin pressure due to zloty appreciation against the euro, and have already declared cuts in capex, especially versus spending in previous years.
- In the public segment, rise in construction prices in recent years have made the budgets of many projects unrealistically low, leading to the cancellation or postponement of the project. The most noteworthy example of that is the cancellation of the EUR 1.9bn tender for the construction of the underground in Warsaw.
- In the residential development segment, recent data point to pre-sales declines in Poland's six largest metropolis (by 28% YoY in 2Q 2008) coupled with a surge in number of offered projects (by 108% YoY as of June 2008). As such, we expect developers to freeze launching construction of new projects and a contraction in residential development activity in 2009-2010.

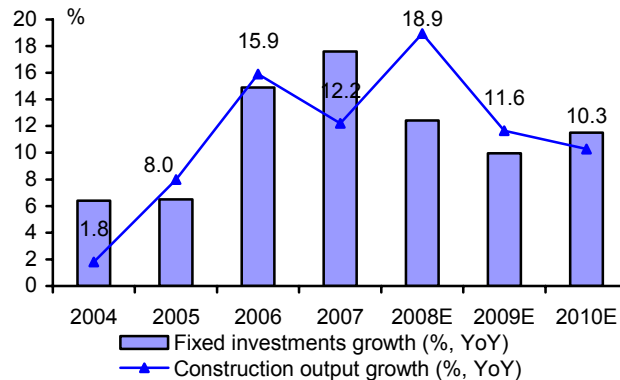
Against this backdrop, we expect growth in Polish construction output to decelerate from 18.9% in full year 2008E to 11.6% in 2009E and 10.3% in 2010E.

**Figure 3: Poland's GDP growth to decelerate to below 5% in 2009-2010...**



Source: Deutsche Bank

**Figure 4: ...with decelerating fixed investments undercutting construction activity**



Source: Deutsche Bank

### EU-financed infrastructure spending a safety buffer?

**Infrastructure to be the major driving force...**

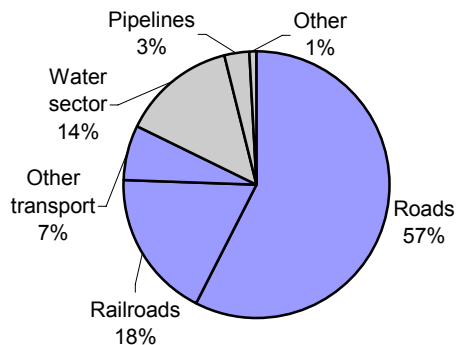
Note that, despite the general economic slowdown, we expect construction to be relatively robust, with growth rates in double digit territory in 2008E, 2009E and 2010E. In light of the expected deceleration in the industrial, public and residential segments, we expect infrastructure to be the major driving force.

**...underpinned by EUR 21.5bn EU financing**

The case for the Polish infrastructure development is made not just by the poor quality of existing infrastructure, but also because the European Union is financing the bulk of development costs. Under the approved EU budget for 2007-2013, Poland is to receive a total consideration of EUR 67.3bn in cohesion and structural funds, of which as much as EUR 26.2bn is planned to be spent on various construction work. The infrastructure segment (mainly roads and railroads), with EU allocation amounting to EUR 21.5bn, is set to be the major beneficiary.

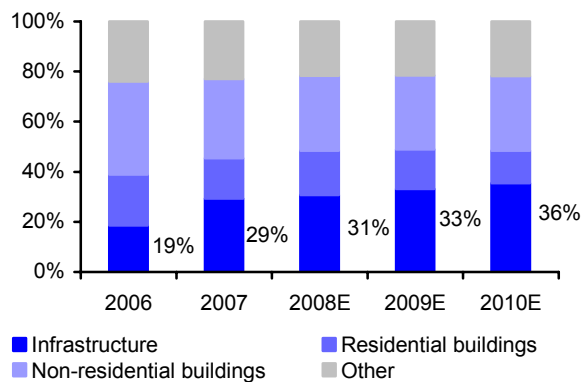
We expect the infrastructure construction market to grow at a CAGR of 21% between 2007 and 2010 and offset the expected slowdown in other market segments. In 2010 we expect infrastructure to account for 36% of the total Polish construction market, up from the 29% recorded in 2007.

**Figure 5: EU allocated EUR 26.2bn for Polish construction in 2007 - 2013, mainly for infrastructure...**



Source: Ministry of Regional Development

**Figure 6: ...which we expect to drive the market (structure of Polish construction market)**



Source: Deutsche Bank estimates

**Delays in new project as the major risk to our soft landing scenario...**

The major risk to our still optimistic scenario for Polish construction (3-year CAGR of 13.6%) is a delay in the launch of EU-financed infrastructure projects. Recent reports in the Polish press suggest that such a scenario is likely given that Polish construction/project management law is not fully compliant with EU regulation. Failure on that front could result in the EU's refusing to finance specific infrastructure projects.

**...but we note that the value of contracts signed in road construction YTD has already exceeded the total for 2007**

Although we do not ignore that risk, we point out that utilization of the EU money is a priority for Poland's government. We note that as of June 2008, Poland had utilized 89% of funds that were allocated by the EU for 2004-2006 (with the effective deadline for spending at the end of 2008). We note that YTD the value of contracts signed in road construction has reached PLN 6.9bn (tenders for an additional PLN 2.9bn have been completed with the respective contracts to be signed shortly), already exceeding the figure for full year 2007 of PLN 6.2bn. We also note that construction of some motorway sections is being financed by companies which are not related to the state, which have been granted concession to operate them following construction.

**Figure 7: Road construction contracts signed in 2007 and YTD 2008 (PLNm)**

| Contract type          | 2007         | YTD 2008     |
|------------------------|--------------|--------------|
| Motor- and expressways | 4,383        | 4,595        |
| Localways              | 964          | 948          |
| Bypasses               | 684          | 807          |
| Other                  | 218          | 577          |
| <b>TOTAL</b>           | <b>6,249</b> | <b>6,926</b> |

Source: General Directorate for National Roads and Motorways

**What do sector trends imply for earnings?**

**Medium-term earnings appear immune to a slowdown**

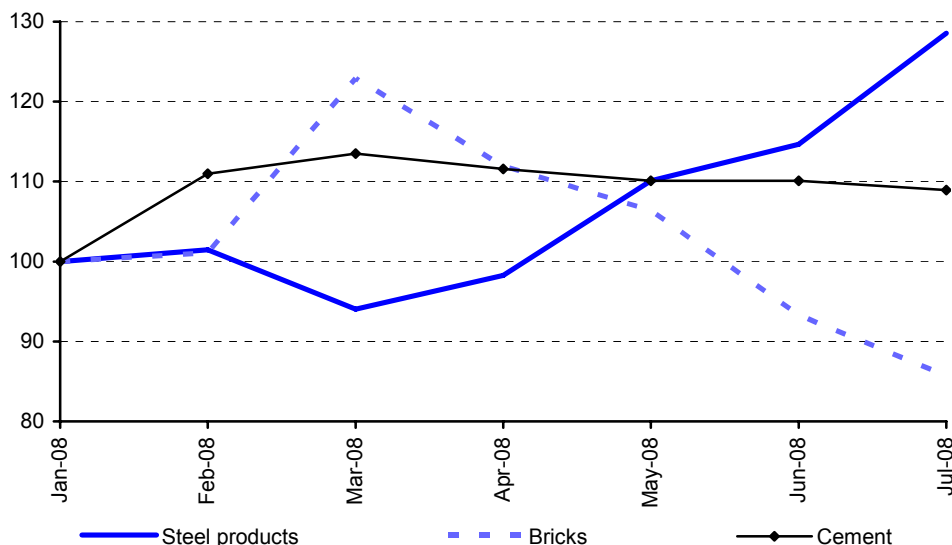
Although a slowdown usually implies sales and margin contractions for corporates, construction companies appear to be different in that respect, at least in the medium run (i.e. in 2008 and 2009).

**Solid backlogs appear to secure medium-term earnings...**

- While we expect construction market growth to decelerate in 2009, we forecast the aggregate revenues of the four companies in our universe (PBG, Polimex, Budimex, Pol-Aqua) to increase by 26% in 2008E and 18% in 2009E, with the visibility of those forecasts being relatively high, given the aggregate backlog exceeding reported revenues 2007 by 68%.

- On the gross margins front, we note that 1) construction companies have had relatively high pricing power recently, suggesting the current backlog is good quality, and 2) we view the recent trend of slight declines in building material prices (especially bricks and cement) as margin supportive.

**Figure 8: Building material prices (rebased to 100)**



Source: PBS

**...but watch out for receivables write-down risk...**

#### **Risks: watch out for receivables write-downs**

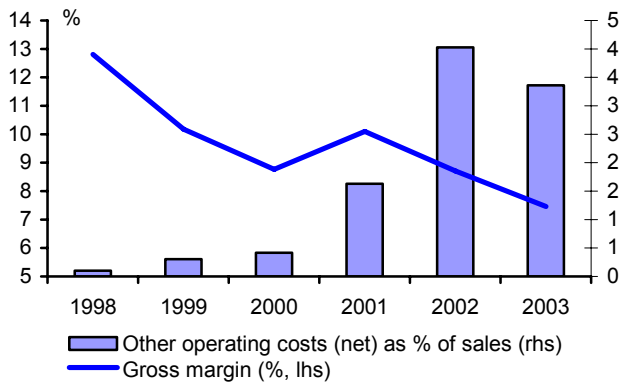
Liquidity dysfunction among corporates, a consequence of the economic slowdown, usually leads to an increased trade receivables collection period (as a mild consequence) or receivables write-downs (as a more severe one). Analyzing specific segments of the construction market, we believe there is a major risk of receivables write-downs in residential construction. This is because residential development in Poland has been predominantly financed by prepayments of the clients and a deceleration of pre-sales is likely to have a negative effect on the liquidity of residential property developers. Although we do not have detailed data on this, debt collection agencies cited in the Polish press report an increase of more than 40% in debt collection orders from the construction sector (source: *Gazeta Prawna*, 25 July 2008)

**...and note that in construction earnings tend to lag behind a general slowdown**

#### **Examples from the past – construction companies' earnings lag behind the slowdown**

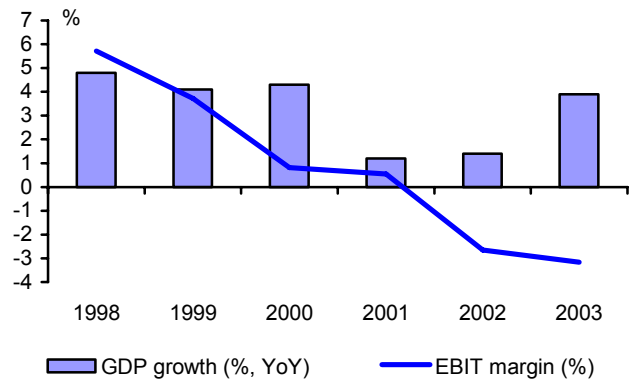
Lessons from the past appear to support our view that the reaction of construction companies to economic slowdown is a lagged one, with the major short-term risk being receivables write-downs. We looked at 2001 and 2002 (during which time Poland's GDP growth slowed to 1.2% and 1.4%, respectively and the construction market was in a recession) and aggregated the earnings of three sizeable companies at that time (Budimex, Mostostal Warszawa and Mostostal Zabrze). Our analysis shows that the companies did not see any deterioration on the gross margin front in either 2001 or 2002, which we attribute to the effect of a good quality backlog signed in more prosperous times. However, receivable write-downs, booked in the other operating costs line, more than doubled, pushing down the EBIT margin.

**Figure 9: Gross margin showed resistance to the economic slowdown in 2001-2002, but receivable write-downs surged...**



Source: Company data, Deutsche Bank estimates

**Figure 10: ...pushing EBIT margin into the red (charts below based on aggregate data for Budimex, Mostostal Warszawa and Mostostal Zabrze)**



Source: CSO, Company data, Deutsche Bank estimates

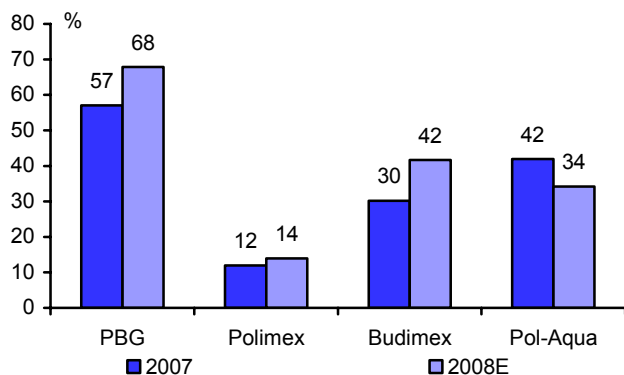
## How to play the more challenging environment

**Buy exposure to infrastructure, Sell exposure to residential, industrials and exports**

Our analysis suggests that:

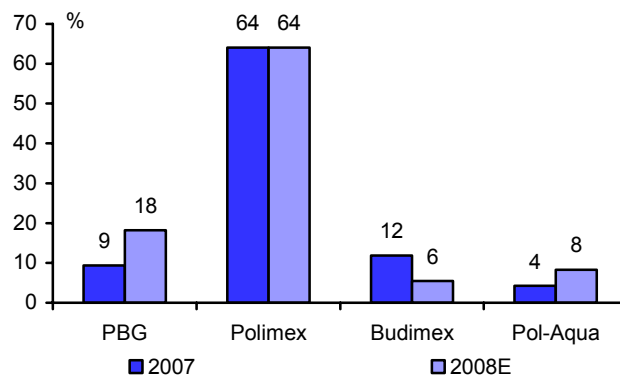
- The companies with the highest exposure to the infrastructure sector (including EU-financed projects in environmental construction) appear to be those best positioned to benefit from the expected market developments. This is not only because we expect continued robust growth in infrastructure, but also because there is almost no risk of not being paid for the work undertaken (state or local government budgets pay for this). We place PBG and Budimex, with 2008E expected share of infrastructure works in total sales of 68% and 42%, respectively, in this group.
- Companies with high exposure to Western European markets and to the industrial segment appear to be the most susceptible to the expected market slowdown. In that group we highlight Polimex with 33% of sales from exports in 2008E (mainly steel structure products) and 64% of sales to industrial clients (power generation, chemicals, oil & gas).
- Companies with high exposure to the residential segment appear to face the highest risk of receivables collection problems. Pol-Aqua and Budimex fall into this category, with 2008E expected share of residential construction in total revenues at 17% and -20%, respectively. We note, however, that roughly half of Budimex's sales in residential construction are intra-group, to Budimex's 50%-owned residential development subsidiary.

**Figure 11: Infrastructure as % of revenues**



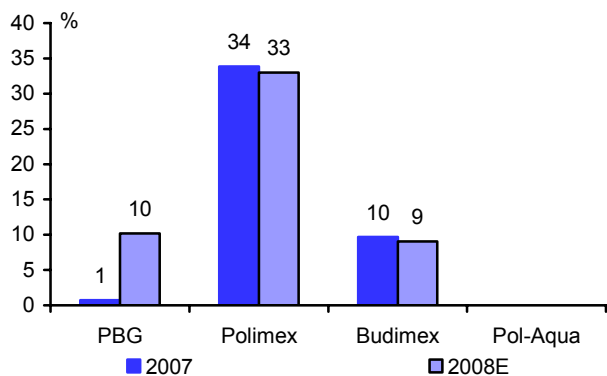
Source: Company data, Deutsche Bank estimates

**Figure 12: Industrial construction as % of revenues**



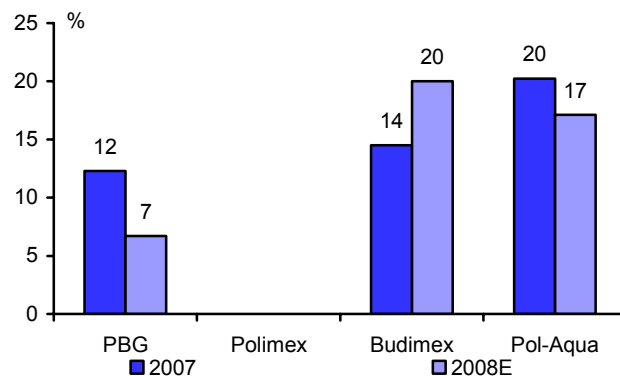
Source: Company data, Deutsche Bank estimates

**Figure 13: Exports as % of revenues**



Source: Company data, Deutsche Bank estimates

**Figure 14: Residential construction as % of revenues**



Source: Company data, Deutsche Bank estimates

### Earnings forecasts

**We forecast 3-year CAGR of 20% for aggregate sales...**

Based on the expected macro development and company-specific issues, we expect the aggregate revenues of Budimex, PBG, Polimex and Pol-Aqua to increase at a 3-year CAGR of 20%, with momentum declining from 26% in 2008E to 15% in 2010E. PBG and Pol-Aqua are our leaders in top line expansion with the former benefiting from mega-projects in oil and gas, the latter from recently conducted M&A.

**...and 39% for aggregate net profit**

At the net profit level, we expect a 3-year aggregate CAGR of 39% for aggregate earnings. Budimex is the leader here (CAGR of 108%) but note 2007's low base and the finally materialising earnings recovery story. PBG and Pol-Aqua boast very sound 3-year net profit CAGRs of 36% and 38%, respectively. Polimex is the laggard (we expect 3-year EPS CAGR of only 23%) as we believe the company will be the most affected by the expected slowdown in construction activity. For a detailed discussion of our earnings forecasts for each company, please see the respective company sections of this report.

**Figure 15: Earnings forecasts for Budimex, PBG, Polimex, Pol-Aqua**

| PLNm              | 2007         | 2008E         | %, YoY    | 2009E         | %, YoY    | 2020E         | %, YoY    | 3-year CAGR, % |
|-------------------|--------------|---------------|-----------|---------------|-----------|---------------|-----------|----------------|
| <b>Sales</b>      |              |               |           |               |           |               |           |                |
| Budimex           | 3,076        | 3,302         | 7         | 3,953         | 20        | 4,573         | 16        | 14             |
| PBG               | 1,377        | 1,963         | 43        | 2,376         | 21        | 2,750         | 16        | 26             |
| Polimex           | 3,720        | 4,681         | 26        | 5,329         | 14        | 6,138         | 15        | 18             |
| Pol-Aqua          | 706          | 1,262         | 79        | 1,579         | 25        | 1,773         | 12        | 36             |
| <b>Total</b>      | <b>8,880</b> | <b>11,207</b> | <b>26</b> | <b>13,237</b> | <b>18</b> | <b>15,235</b> | <b>15</b> | <b>20</b>      |
| <b>EBIT</b>       |              |               |           |               |           |               |           |                |
| Budimex           | 28           | 110           | 294       | 132           | 20        | 165           | 25        | 80             |
| PBG               | 109          | 209           | 91        | 281           | 35        | 359           | 28        | 49             |
| Polimex           | 160          | 238           | 48        | 273           | 15        | 321           | 17        | 26             |
| Pol-Aqua          | 60           | 100           | 67        | 137           | 36        | 158           | 16        | 38             |
| <b>Total</b>      | <b>358</b>   | <b>658</b>    | <b>84</b> | <b>823</b>    | <b>25</b> | <b>1,002</b>  | <b>22</b> | <b>41</b>      |
| <b>Net profit</b> |              |               |           |               |           |               |           |                |
| Budimex           | 15           | 86            | 469       | 106           | 24        | 136           | 28        | 108            |
| PBG               | 102          | 151           | 48        | 195           | 29        | 259           | 33        | 36             |
| Polimex           | 100          | 133           | 33        | 152           | 14        | 188           | 23        | 23             |
| Pol-Aqua          | 50           | 88            | 75        | 112           | 27        | 131           | 18        | 38             |
| <b>Total</b>      | <b>267</b>   | <b>457</b>    | <b>71</b> | <b>565</b>    | <b>23</b> | <b>714</b>    | <b>26</b> | <b>39</b>      |

Source: Company data, Deutsche Bank estimates

## Valuation and recommendations

### Sector has experience a multiple de-rating of over 70% since the peak in May 2008...

Construction sector has been on the downward trend since May 2007, when euphoria related to granting Poland the EURO 2012 soccer championships pushed prices to peak levels. Our construction sector index (unweighted price index including Budimex, PBG, Polimex and Pol-Aqua) has declined by 47% since May 2008. The average 12-month prospective P/E has slumped by 72% from 59.3x to 16.5x currently. We note that, during this period of falling prices, the companies have mostly delivered on earnings expectations and the 2008-2009 outlook has not deteriorated.

**The sector average 12-month prospective P/E slumped from 59.3x in May to 16.5x currently.**

**Figure 16: Construction sector index\* and 12-month prospective P/E at major turning points**



Source: Deutsche Bank

\*NOTE: unweighted price index of including Budimex, PBG, Polimex and Pol-Aqua, rebased to 100

**Polish construction stocks are trading at double digit premiums to their peers...**

**...but still at a premium to international peers**

Our Polish construction sector universe (including Budimex, PBG, Polimex and Pol-Aqua) is currently trading at average 2008E and 2009E P/E ratios of 20.5x and 16.9x, respectively. Those multiples, despite the severe de-rating, continue to imply significant premiums to Western European peers (95% and 59%) as well as some premiums to Emerging Markets companies (16% and 33%).

**Figure 17: Polish construction sector: Domestic peer comparison**

| Company                                                 | Ticker  | Price       |       | P/E (x)     |             |             | EV/EBITDA (x) |            |            |
|---------------------------------------------------------|---------|-------------|-------|-------------|-------------|-------------|---------------|------------|------------|
|                                                         |         | PLN, 19 Aug | US\$m | 2008E       | 2009E       | 2010E       | 2008E         | 2009E      | 2010E      |
| Budimex                                                 | BMEX.WA | 82.0        | 926   | 24.4        | 19.8        | 15.4        | 11.7          | 8.9        | 6.2        |
| PBG                                                     | PBGG.WA | 231.0       | 1,372 | 20.6        | 15.9        | 12.0        | 12.6          | 9.4        | 7.2        |
| Polimex                                                 | MOSD.WA | 5.6         | 1,200 | 20.3        | 17.8        | 14.5        | 11.0          | 9.4        | 7.9        |
| Pol-Aqua                                                | PQAA.WA | 50.8        | 617   | 15.9        | 12.5        | 10.6        | 10.5          | 7.7        | 6.3        |
| <b>Median</b>                                           |         |             |       | <b>20.5</b> | <b>16.9</b> | <b>13.2</b> | <b>11.4</b>   | <b>9.2</b> | <b>6.8</b> |
| <i>Premium/(Discount) to Western European peers (%)</i> |         |             |       | 95          | 59          | 69          | 83            | 61         | 25         |
| <i>Premium/(Discount) to Emerging Markets peers (%)</i> |         |             |       | 16          | 33          | 28          | 22            | 39         | 33         |

Source: Deutsche Bank estimates

**...which we deem justified by superior growth rates**

Are those premiums justified? We believe that, largely, they are. Firstly, the Western European construction market is recording negative output growth in 2008, while Poland's is expanding at a double digit rate. Secondly, the medium- and long-term outlook of the Polish construction market is well underpinned by the EU-financed infrastructure investments. We also note that companies operating in markets with booming infrastructure investments (e.g. China, India) enjoy similar multiples to the Polish market. On the other hand, we note that in bear market times there is a reluctance to pay high multiples even for high growth stories, a major downside valuation risk to Polish construction, in our view.

**Figure 18: Construction sector: International peer comparison (priced as of 19 August)**

| Company                       | Ticker    | Country      | Curr. | Price<br>(local) | MCAP<br>(US\$m) | Recc. | P/E (x)     |             |             | EV/EBITDA (%) |            |            |
|-------------------------------|-----------|--------------|-------|------------------|-----------------|-------|-------------|-------------|-------------|---------------|------------|------------|
|                               |           |              |       |                  |                 |       | 2008E       | 2009E       | 2010E       | 2008E         | 2009E      | 2010E      |
| <b>Western European peers</b> |           |              |       |                  |                 |       |             |             |             |               |            |            |
| ACCIONA                       | ANA.MC    | Spain        | EUR   | 128.9            | 12,300          | Buy   | 15.4        | 11.6        | NA          | 6.2           | 5.4        | NA         |
| ACS                           | ACS.MC    | Spain        | EUR   | 30.4             | 14,793          | Buy   | 8.7         | 7.9         | 7.8         | 7.3           | 6.9        | 6.7        |
| BAUER AG                      | B5AG.DE   | Germany      | EUR   | 54.9             | 1,441           | Buy   | 9.5         | 8.2         | 7.6         | 5.3           | 4.5        | 3.8        |
| BILFINGER BERGER              | GBFG.DE   | Germany      | EUR   | 44.7             | 2,406           | Buy   | 11.2        | 8.4         | 7.8         | 4.6           | 3.6        | 3.4        |
| FCC                           | FCC.MC    | Spain        | EUR   | 33.0             | 6,208           | Hold  | 10.5        | 10.3        | 9.3         | 6.2           | 6.1        | 5.8        |
| FERROVIAL                     | FER.MC    | Spain        | EUR   | 33.4             | 6,875           | Buy   | NM          | 377.1       | NA          | 11.0          | 10.7       | NM         |
| HOCHTIEF                      | HOTG.DE   | Germany      | EUR   | 49.5             | 5,140           | Hold  | 19.7        | 11.0        | 9.8         | 6.2           | 4.0        | 3.4        |
| STRABAG                       | STRV.VI   | Austria      | EUR   | 41.8             | 7,039           | Hold  | 17.9        | 14.5        | 13.2        | 6.8           | 5.9        | 5.4        |
| TERNA S.A.                    | TERr.AT   | Greece       | EUR   | 6.6              | 449             | Buy   | 8.8         | 15.4        | 10.3        | 5.1           | 7.2        | 5.8        |
| YIT CORPORATION               | YTY1V.HE  | Finland      | EUR   | 10.7             | 2,090           | Buy   | 6.4         | 5.0         | 4.6         | 5.6           | 4.6        | 4.1        |
| VINCI                         | SGEF.PA   | France       | EUR   | 36.9             | 28,394          | Buy   | 12.2        | 11.3        | 0.0         | 7.0           | 6.5        | NM         |
| EIFFAGE                       | FOUG.PA   | France       | EUR   | 43.0             | 6,045           | Hold  | 10.5        | 10.5        | 9.8         | 7.5           | 7.4        | 7.1        |
| NCC                           | NCCb.ST   | Sweden       | SEK   | 83.5             | 1,401           | Hold  | 6.4         | 8.4         | NA          | 4.3           | 5.1        | NA         |
| SKANSKA                       | SKAb.ST   | Sweden       | SEK   | 81.3             | 5,274           | Buy   | 9.1         | 10.7        | 0.0         | 3.7           | 4.0        | NM         |
| <b>Median</b>                 |           |              |       |                  |                 |       | <b>10.5</b> | <b>10.6</b> | <b>7.8</b>  | <b>6.2</b>    | <b>5.7</b> | <b>5.4</b> |
| <b>Emerging Markets peers</b> |           |              |       |                  |                 |       |             |             |             |               |            |            |
| DAEWOO E&C                    | 047040.KS | Korea        | KRW   | 13,600.0         | 4,171           | Hold  | 15.2        | 12.7        | 10.2        | 7.5           | 6.3        | 5.0        |
| GS E&C                        | 006360.KS | Korea        | KRW   | 111,000.0        | 5,322           | Buy   | 11.9        | 11.1        | 8.8         | 7.5           | 5.6        | 3.8        |
| HYUNDAI DEV. CO.              | 012630.KS | Korea        | KRW   | 46,450.0         | 3,380           | Buy   | 17.7        | 8.0         | NA          | 9.6           | 3.4        | NA         |
| IVRCL INFRA                   | IVRC.BO   | India        | INR   | 318.1            | 975             | Sell  | 20.2        | 17.8        | 14.0        | 12.8          | 10.1       | 8.6        |
| LANCO                         | LAIN.BO   | India        | INR   | 303.7            | 1,534           | Sell  | 18.9        | 14.3        | 10.4        | 22.5          | 17.0       | 15.0       |
| SAMSUNG ENGINEERING           | 028050.KS | Korea        | KRW   | 70,800.0         | 2,672           | Buy   | 15.8        | 12.4        | 10.2        | 10.6          | 6.8        | 5.1        |
| WBHO                          | WBOJ.J    | South Africa | ZAR   | 128.0            | 881             | Buy   | 15.8        | 11.9        | 10.3        | 7.6           | 5.4        | 4.3        |
| CHINA RAILWAY CONSTRUCTION    | 1186.HK   | China        | HKD   | 11.2             | 17,595          | Buy   | 29.9        | 18.1        | 13.5        | 9.3           | 6.6        | 5.0        |
| CHINA RAILWAY GROUP           | 0390.HK   | China        | HKD   | 5.4              | 15,515          | Buy   | 32.8        | 19.1        | 14.6        | 9.1           | 6.6        | 5.4        |
| <b>Median</b>                 |           |              |       |                  |                 |       | <b>17.7</b> | <b>12.7</b> | <b>10.3</b> | <b>9.3</b>    | <b>6.6</b> | <b>5.1</b> |
| <b>MEAN TOTAL</b>             |           |              |       |                  |                 |       | <b>13.7</b> | <b>11.3</b> | <b>9.8</b>  | <b>7.3</b>    | <b>6.1</b> | <b>5.1</b> |

Source: Deutsche Bank estimates

**Target prices based on DCF; two Buys, one Sell, one Hold**

**We used DCF to derive target prices**

We use a 5-year DCF model to derive 12-month target prices for Budimex, PBG, Polimex and Pol-Aqua. Detailed assumptions of our valuation models are discussed in the respective company sections of this report.

**Figure 19: Polish construction: target prices and recommendations**

| Ticker   | 12M TP<br>(PLN) | Price<br>(PLN, 19 Aug) | Total return<br>(%) | Recommendation |
|----------|-----------------|------------------------|---------------------|----------------|
|          |                 |                        |                     |                |
| PBG      | PBGG.WA         | 275                    | 231.0               | 19 BUY         |
| Polimex  | MOSD.WA         | 5                      | 5.6                 | -11 SELL       |
| Pol-Aqua | PQAA.WA         | 60                     | 50.8                | 18 BUY         |

Source: Deutsche Bank

**Buy PBG with TP of PLN 275**

PBG is our top pick within the Polish construction universe. Our 12-month target price of PLN 275 is 19% above the 19 August share price. In our view, the company is the best exposed in Poland to the inflow of EU funds and planned mega projects in oil and gas. PBG's current backlog already covers over 70% of our sales forecast through 2010. The stock is trading at a 2008E P/E ratio of 20.6x versus expected three-year EPS CAGR of 36%.

**Buy Pol-Aqua with TP of  
PLN 60**

Our alternative Buy is Pol-Aqua with a 12-month target price of PLN 60 (18% above the 19 August share price). Our positive stance is based on 1) the company's high exposure to the civil engineering market that is booming due to EU financing, 2) M&A-driven expansion into other construction markets (general, roads, building materials), and 3) an inexpensive valuation – we expect 18% total return potential on a 12-month horizon and the stock is trading at a 2008E P/E of 15.9x vs. our expected three-year EPS CAGR of 38%.

**Sell Polimex with TP of PLN  
5.0**

We recommend Selling Polimex (12-month target price of PLN 5.0, 11% below the 19 August share price). We view the company as being the most exposed, in our Polish construction universe, to the expected slowdown, as a result of its high reliance on exports and on industrial clients. We expect Polimex's earnings growth to decelerate from 33% in 2008E to 14% in 2009E. Our forecast of three-year EPS CAGR of 23%, the lowest in our construction universe, does not appear to be reflected in Polimex's valuation: 2008E P/E of 20.3x is in line with the sector averages.

**Hold Budimex with TP of  
PLN 85**

We initiate coverage of Budimex with a Hold recommendation and a 12-month target price of PLN 85 (4% above the 19 August share price). We believe Budimex's ongoing earnings recovery is priced in; we forecast 2008E net profit at PLN 86m, up 469% YoY (already reported 1H 2008 net profit accounts for 50% of our FY estimate). The stock is trading at 2008E and 2009E P/E ratios of 24.4x and 19.8x, implying a premium of 19% and 17%, respectively, to sector averages.

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**Emerging Europe** Poland  
**Building and Construction** Construction

22 August 2008

**PBG**Reuters: **PBGG.WA** Bloomberg: **PBG PW**

# Backlog already full while new mega projects are coming

## Initiating with Buy and 12-month target price of PLN 275

We are initiating coverage of PBG with a Buy rating and 12-month target price of PLN 275. In our view, the company is best exposed within the sector in Poland for the inflow of EU funds as well as planned mega projects in oil and gas. PBG's current backlog already covers over 70% of our sales forecast through 2010. The stock is trading at 2008E P/E ratio of 20.6x versus expected 3-year EPS CAGR of 36%. PBG is one of our top picks within Polish construction universe. We see significant total shareholder return: Buy.

## Backlog of PLN 4.5bn already covers over 70% of our sales forecast until 2010

PBG, with leading position in Poland's environmental and hydro construction, looks well placed to benefit from the EU-financed boom. We expect the new wave of tenders to kick off in 4Q, and PBG, with orders of nearly PLN 2bn in that market segment, is well positioned to cherry-pick the highest margin contracts. Additionally, the signing of a PLN 1.4bn contract in oil & gas has increased the company's total backlog to over PLN 4.5bn. In addition, we believe PBG could be the frontrunner to win PLN 1.1bn tender for an underground gas storage project, which should be completed in October.

## We expect 3-year EPS CAGR of 36%

We forecast PBG to report 48% and 29% net profit growth in 2008E and 2009E to PLN 151m and PLN 195m, respectively. Completion of old contracts in the environmental division and the increased share of high-value-added oil and gas engineering should drive margins expansion.

## DCF-based target price of PLN 275

Our 12-month target price of PLN 275 is based on DCF model. PBG is trading at 2008E P/E and EV/EBITDA of 20.6x and 12.6x, respectively, broadly in line with sector averages. We believe the stock deserves a premium reflecting seemingly higher earnings visibility and stability. We see delays in launching new EU-financed projects as a major macro risk, while the potential of higher losses than have been provisioned for on old contracts in acquired entities is a major company specific risk.

### Forecasts and ratios

| Year End Dec 31   | 2007A | 2008E        | 2009E | 2010E |
|-------------------|-------|--------------|-------|-------|
| Revenue (PLNm)    | 1,377 | <b>1,962</b> | 2,376 | 2,750 |
| EBITDA (PLNm)     | 138   | <b>242</b>   | 315   | 394   |
| EBITA (PLNm)      | 109   | <b>209</b>   | 281   | 359   |
| Net Income (PLNm) | 102   | <b>151</b>   | 195   | 259   |
| EPS (PLN)         | 7.60  | <b>11.23</b> | 14.53 | 19.31 |
| P/E (DB EPS) (x)  | 46.2  | <b>20.6</b>  | 15.9  | 12.0  |
| EV/EBITDA (x)     | 35.7  | <b>12.6</b>  | 9.4   | 7.2   |
| Yield (%)         | 0.0   | <b>0.0</b>   | 0.0   | 0.0   |

Source: Deutsche Bank estimates, company data

**Buy**

|                            |                        |
|----------------------------|------------------------|
| Price at 19 Aug 2008 (PLN) | <b>231.00</b>          |
| Price Target (PLN)         | <b>275.00</b>          |
| 52-week range (PLN)        | <b>399.00 - 203.50</b> |

### Price/price relative



| Performance (%) | 1m   | 3m    | 12m   |
|-----------------|------|-------|-------|
| Absolute        | 12.2 | -22.7 | -28.4 |
| WIG 20 Index    | -0.9 | -13.3 | -24.0 |

### Stock data

|                    |                |
|--------------------|----------------|
| Market Cap (PLNm)  | <b>3,102.3</b> |
| Market Cap (US\$m) | <b>1,394.2</b> |
| Free float (%)     | <b>67</b>      |
| WIG 20 Index       | <b>2,554.7</b> |

### Key indicators (FY1)

|                        |             |
|------------------------|-------------|
| ROE (%)                | <b>15.5</b> |
| Book value/share (PLN) | <b>88.8</b> |
| Price/book (x)         | <b>2.6</b>  |
| Net interest cover (x) | <b>14.2</b> |
| EBIT margin (%)        | <b>10.6</b> |

Model updated:04 February 2008

**Running the numbers****Emerging Europe****Poland****Construction****PBG**

Reuters: PBGG.WA

Bloomberg: PBG PW

**Buy**

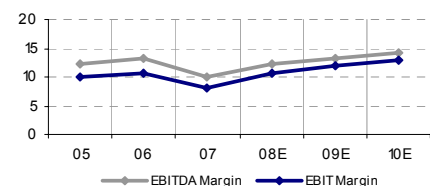
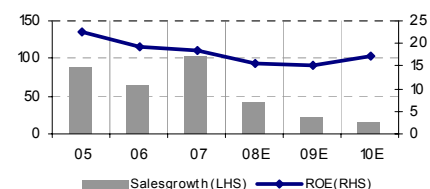
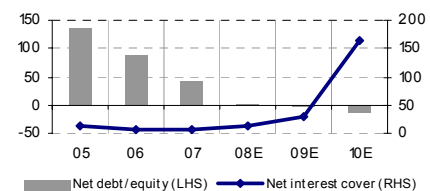
Price (19 Aug 08) PLN 231.00

Target price PLN 275.00

52-week Range PLN 203.50 - 399.00

Market Cap (m) PLNm 3,102  
USDm 1,394**Company Profile**

PBG is a construction company with a leading position in Poland in 1) oil & gas engineering (extraction, transmission and storage facilities), 2) environmental construction (water and sewage systems) and 3) hydro-construction (dams, storage reservoirs). PBG is also entering civil infrastructure segment (mainly roads). High specialization as well as focus on value added engineering works make PBG on of the highest-margin player within Polish construction universe. PBG is also very well exposed to benefit from the inflow of EU cohesion and structural funds to Poland.

**Price Performance****Margin Trends****Growth & Profitability****Solvency**

Tomasz Krukowski, CFA

+48 22 579-8732

tomasz.krukowski@db.com

Fiscal year end 31-Dec

|                             | 2005 | 2006  | 2007  | 2008E | 2009E | 2010E |
|-----------------------------|------|-------|-------|-------|-------|-------|
| <b>Financial Summary</b>    |      |       |       |       |       |       |
| DB EPS (PLN)                | 3.43 | 4.34  | 7.60  | 11.23 | 14.53 | 19.31 |
| Reported EPS (PLN)          | 3.43 | 4.34  | 7.60  | 11.23 | 14.53 | 19.31 |
| DPS (PLN)                   | 0.00 | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  |
| BVPS (PLN)                  | 16.9 | 30.5  | 55.7  | 88.8  | 103.3 | 122.6 |
| Weighted average shares (m) | 11   | 12    | 13    | 13    | 13    | 13    |
| Average market cap (PLNm)   | 619  | 2,004 | 4,713 | 3,102 | 3,102 | 3,102 |
| Enterprise value (PLNm)     | 845  | 2,320 | 4,928 | 3,046 | 2,971 | 2,824 |
| <b>Valuation Metrics</b>    |      |       |       |       |       |       |
| P/E (DB) (x)                | 17.2 | 38.4  | 46.2  | 20.6  | 15.9  | 12.0  |
| P/E (Reported) (x)          | 17.2 | 38.4  | 46.2  | 20.6  | 15.9  | 12.0  |
| P/BV (x)                    | 4.97 | 8.42  | 5.51  | 2.60  | 2.24  | 1.88  |
| FCF Yield (%)               | nm   | nm    | nm    | nm    | nm    | 2.1   |
| Dividend Yield (%)          | 0.0  | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| EV/Sales (x)                | 2.1  | 3.4   | 3.6   | 1.6   | 1.3   | 1.0   |
| EV/EBITDA (x)               | 16.9 | 26.2  | 35.7  | 12.6  | 9.4   | 7.2   |
| EV/EBIT (x)                 | 20.5 | 32.2  | 45.1  | 14.6  | 10.6  | 7.9   |

**Income Statement (PLNm)**

|                                     | 2005       | 2006       | 2007         | 2008E        | 2009E        | 2010E        |
|-------------------------------------|------------|------------|--------------|--------------|--------------|--------------|
| <b>Sales revenue</b>                | <b>409</b> | <b>674</b> | <b>1,377</b> | <b>1,963</b> | <b>2,376</b> | <b>2,750</b> |
| <b>Gross profit</b>                 | <b>80</b>  | <b>133</b> | <b>214</b>   | <b>360</b>   | <b>462</b>   | <b>564</b>   |
| <b>EBITDA</b>                       | <b>50</b>  | <b>89</b>  | <b>138</b>   | <b>242</b>   | <b>315</b>   | <b>394</b>   |
| Depreciation                        | 9          | 17         | 29           | 33           | 34           | 35           |
| Amortisation                        | 0          | 0          | 0            | 0            | 0            | 0            |
| <b>EBIT</b>                         | <b>41</b>  | <b>72</b>  | <b>109</b>   | <b>209</b>   | <b>281</b>   | <b>359</b>   |
| Net interest income(expense)        | -4         | -12        | -21          | -15          | -9           | -2           |
| Associates/affiliates               | 0          | 0          | 0            | 0            | 0            | 0            |
| Exceptionals/extraordinaries        | 0          | 0          | 0            | 0            | 0            | 0            |
| Other pre-tax income/(expense)      | 8          | 10         | 56           | 18           | 0            | 0            |
| <b>Profit before tax</b>            | <b>45</b>  | <b>70</b>  | <b>144</b>   | <b>212</b>   | <b>272</b>   | <b>357</b>   |
| Income tax expense                  | 8          | 15         | 27           | 40           | 52           | 68           |
| Minorities                          | 1          | 3          | 15           | 21           | 26           | 30           |
| Other post-tax income/(expense)     | 0          | 0          | 0            | 0            | 0            | 0            |
| <b>Net profit</b>                   | <b>36</b>  | <b>52</b>  | <b>102</b>   | <b>151</b>   | <b>195</b>   | <b>259</b>   |
| DB adjustments (including dilution) | 0          | 0          | 0            | 0            | 0            | 0            |
| <b>DB Net profit</b>                | <b>36</b>  | <b>52</b>  | <b>102</b>   | <b>151</b>   | <b>195</b>   | <b>259</b>   |

**Cash Flow (PLNm)**

|                                      | 2005        | 2006        | 2007        | 2008E       | 2009E      | 2010E      |
|--------------------------------------|-------------|-------------|-------------|-------------|------------|------------|
| <b>Cash flow from operations</b>     | <b>-97</b>  | <b>-98</b>  | <b>-150</b> | <b>-109</b> | <b>22</b>  | <b>107</b> |
| Net Capex                            | -142        | -106        | -106        | -39         | -36        | -41        |
| <b>Free cash flow</b>                | <b>-238</b> | <b>-204</b> | <b>-256</b> | <b>-149</b> | <b>-14</b> | <b>65</b>  |
| Equity raised/(bought back)          | 0           | 0           | 0           | 0           | 0          | 0          |
| Dividends paid                       | 0           | 0           | 0           | 0           | 0          | 0          |
| Net inc/(dec) in borrowings          | 258         | 54          | 340         | -200        | 0          | 0          |
| Other investing/financing cash flows | 18          | 120         | 275         | 441         | 115        | 110        |
| <b>Net cash flow</b>                 | <b>38</b>   | <b>-31</b>  | <b>359</b>  | <b>93</b>   | <b>101</b> | <b>176</b> |
| Change in working capital            | -27         | -31         | -113        | -109        | -77        | -69        |

**Balance Sheet (PLNm)**

|                                   | 2005       | 2006         | 2007         | 2008E        | 2009E        | 2010E        |
|-----------------------------------|------------|--------------|--------------|--------------|--------------|--------------|
| Cash and other liquid assets      | 82         | 51           | 410          | 503          | 604          | 779          |
| Tangible fixed assets             | 177        | 266          | 335          | 341          | 343          | 349          |
| Goodwill/intangible assets        | 10         | 77           | 281          | 281          | 281          | 281          |
| Associates/investments            | 30         | 30           | 134          | 134          | 134          | 134          |
| Other assets                      | 367        | 621          | 1,129        | 1,598        | 1,929        | 2,229        |
| <b>Total assets</b>               | <b>666</b> | <b>1,045</b> | <b>2,289</b> | <b>2,857</b> | <b>3,291</b> | <b>3,773</b> |
| Interest bearing debt             | 332        | 385          | 725          | 525          | 525          | 525          |
| Other liabilities                 | 150        | 281          | 781          | 1,084        | 1,297        | 1,490        |
| <b>Total liabilities</b>          | <b>482</b> | <b>666</b>   | <b>1,507</b> | <b>1,609</b> | <b>1,822</b> | <b>2,015</b> |
| Shareholders' equity              | 178        | 367          | 748          | 1,193        | 1,388        | 1,647        |
| Minorities                        | 7          | 12           | 35           | 56           | 81           | 111          |
| <b>Total shareholders' equity</b> | <b>184</b> | <b>379</b>   | <b>783</b>   | <b>1,248</b> | <b>1,469</b> | <b>1,758</b> |
| Net debt                          | 250        | 334          | 315          | 22           | -78          | -254         |

**Key Company Metrics**

|                        | 2005  | 2006 | 2007  | 2008E | 2009E | 2010E |
|------------------------|-------|------|-------|-------|-------|-------|
| Sales growth (%)       | 89.1  | 65.1 | 104.2 | 42.5  | 21.1  | 15.8  |
| DB EPS growth (%)      | 117.8 | 26.6 | 75.2  | 47.7  | 29.4  | 33.0  |
| EBITDA Margin (%)      | 12.3  | 13.1 | 10.0  | 12.3  | 13.3  | 14.3  |
| EBIT Margin (%)        | 10.1  | 10.7 | 7.9   | 10.6  | 11.8  | 13.0  |
| Payout ratio (%)       | 0.0   | 0.0  | 0.0   | 0.0   | 0.0   | 0.0   |
| ROE (%)                | 22.5  | 19.2 | 18.3  | 15.5  | 15.1  | 17.1  |
| Capex/sales (%)        | 34.7  | 15.7 | 7.7   | 2.0   | 1.5   | 1.5   |
| Capex/depreciation (x) | 16.0  | 6.4  | 3.7   | 1.2   | 1.1   | 1.2   |
| Net debt/equity (%)    | 135.5 | 88.0 | 40.2  | 1.8   | -5.3  | -14.5 |
| Net interest cover (x) | 11.7  | 6.2  | 5.2   | 14.2  | 30.9  | 163.8 |

Source: Company data, Deutsche Bank estimates

# Investment thesis

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## Outlook

We rate PBG a Buy. Our positive stance is based on the valuation (we expect double-digit total shareholder return on a 12-month basis) and bright earnings outlook (we forecast 3-year EPS CAGR of 36%). PBG is a leader in environmental and hydro construction in Poland; these two market segments are currently booming on the projects financed by the EU cohesion and structural funds. Moreover, under the 2007-2013 EU budget, Poland's environmental and hydro construction is to receive EUR 3.6bn for new projects, which we expect to sustain the growth in the market. PBG is also well-positioned to benefit from the planned investments in oil & gas sector, as an entity with seemingly the best track record in the Polish market. Recently, PBG signed a PLN 1.4bn contract with Polish Oil and Gas and we note that other projects of similar size are planned.

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## Valuation

Our 12-month target price of PLN 275 for PBG is based on a 5-year discounted cash flow (DCF) analysis. Major assumption to our DCF are cost of equity of 13.6% and WACC of 9.7%, both derived from CAPM using risk free rate of 6.5%, equity risk premium of 5.0% and unlevered fundamental beta of 0.8x (Damodaran industry average). We use terminal growth rate of 4.7%, calculated by multiplying the company's reinvestment rate and ROIC.

For an illustrative purpose, we also present peer comparison. PBG is trading broadly in line with its peers based on 2008E P/E and EV/EBITDA. We believe the company deserves a premium reflecting 1) above average expected earnings momentum, 2) highest earnings visibility (highest backlog to 2008E revenues ratio), and 3) seemingly highest earning stability (highest operating margins imply lowest operating leverage).

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## Risks

We see several risks to our earnings and valuation of PBG. Risks on the macro side include delays in launching new environmental and hydro-construction projects. We note that although the financing in most cases is secured by the EU funds, the projects tend to get delayed due to imperfections in Poland's construction law and procurement procedures. Looking at company specific risks, we point out that in recent years PBG has acquired a few entities with backlogs of loss-making contracts. Although the potential losses were written off, we note that some of those contracts are not yet completed and the actual losses on them may be higher than created provisions.

# Earnings outlook & valuation

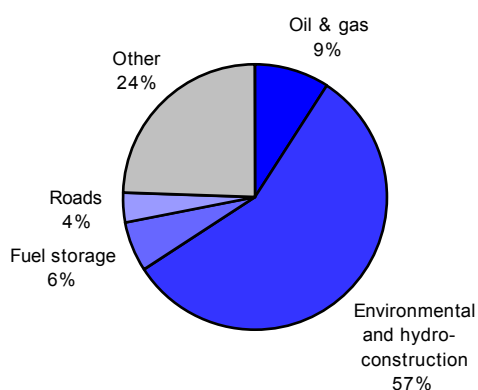
## Key business areas

**Market leader in environmental and hydro construction, as well as oil & gas engineering**

PBG is an engineering and construction company, specializing in two market segments: oil & gas construction (leading position in Poland in crude oil and natural gas extraction facilities, storage facilities and pipelines) and environmental and hydro construction (environmental protection plants, water and sewage systems, water reservoirs). We expect the two market segments to account for 9% and 57% of the company's sales in 2008.

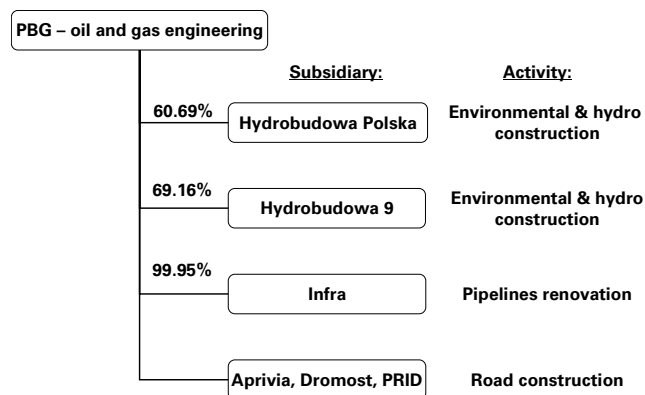
PBG's revenues have been growing at a CAGR of 85% between 2004 and 2007 mainly due to the acquisition in environmental construction. In this market segment, the company operates mainly through its subsidiaries Hydrobudowa Polska, Hydrobudowa 9 and Infra. The competence in oil and gas lies with the parent company.

Figure 20: PBG: 2008E revenues structure



Source: Deutsche Bank estimates

Figure 21: PBG group structure (major subsidiaries)



Source: PBG, Deutsche Bank estimates

## Earnings drivers

**Hydro construction is to receive EUR 3.6bn for new projects between 2007 and 2013 from EU**

### 1. Inflow of EU money into environmental construction and infrastructure

PBG is well-positioned to benefit from the EU money inflow to Poland due to its high exposure (57% of sales in 2008E) to the environmental and hydro construction segment. Hydro construction started to boom around 2005, when the construction of the projects financed from the funds allocated to Poland for the period of 2004-2006 were launched. We expect this boom to continue, as Poland's environmental and hydro construction segment is to receive EUR 3.6bn for new projects under the 2007-2013 EU budget.

Owing to prospects for the infrastructure segment (EUR 21.5bn allocated to Poland under the 2007-2013 EU budget), PBG has decided to enter the road construction business, focusing on regional roads. The expansion is driven by M&As (three entities are already acquired) with PBG targeting to achieve revenues of PLN 0.5bn in three years.

**Full earnings power of 2005-2007 acquisitions only in 2009**

### 2. Restructuring of acquired entities

In 2005-2007, PBG acquired a few entities operating in the environmental construction segment (the largest are Hydrobudowa Polska and Hydrobudowa 9) and many of them at that time were in a financially distressed situation, struggling with liquidity problems and backlog of loss-making contracts. As restructuring and backlog roll-over usually takes two years, the

**One contract for 1.4bn in oil has already been secured; another contract for PLN 1.1bn is likely**

### 3. Contracts with PGNiG in oil & gas

PBG, with leading position in the oil and gas engineering segment in Poland and a track record of successfully completing numerous projects in that market segment, appears to be the best exposed to benefit from the big capex plans of PGNiG in the area of oil and gas extraction, transmission and storage. Recently, PBG, as a consortium leader, signed a PLN 1.4bn contract for the construction of crude oil extraction facilities, LMG, in western Poland. The other big project, for which we believe PBG could be a frontrunner, is the construction of natural gas storage near Wierzychowice. PBG, as the only company participating in the tender, placed its offer amounting to PLN 1.1bn. The tender is expected to be completed by October, though we note that there have been delays on that front in the past.

## Earnings forecasts

### Revenues expansion to decelerate...

**Order backlog amounts to PLN 4.5bn and covers 72% of our revenues projections from now till 2010**

We expect PBG's revenues to increase by 43% YoY to PLN 1,963m in 2008E, 21% to PLN 2,376m in 2009E and by 16% to PLN 2,750m in 2010E. Following recent signings of new contracts, the company's order backlog amounts to PLN 4.5bn and covers 72% of our revenues projections from now till 2010. Looking at particular market segments, we expect environmental and hydro construction to generate stable revenues in 2008E – 2010E at around PLN 1.1bn annually, with growth being driven by oil and gas engineering (LMG contract with PGNiG) and road construction.

**Figure 22: PBG: Revenues forecasts**

| PLNm                                    | 2006       | 2007         | 2008E        | 2009E        | 2010E        |
|-----------------------------------------|------------|--------------|--------------|--------------|--------------|
| Oil & gas engineering                   | 117        | 129          | 208          | 358          | 672          |
| <i>of which LMG contract with PGNiG</i> |            |              | 50           | 200          | 500          |
| Environmental and hydro-construction    | 461        | 756          | 1,121        | 1,181        | 1,054        |
| Fuel storage                            | 51         | 192          | 120          | 130          | 142          |
| Other                                   | 45         | 300          | 514          | 707          | 882          |
| <i>of which road construction</i>       |            |              | 100          | 150          | 300          |
| <b>Total</b>                            | <b>674</b> | <b>1,377</b> | <b>1,963</b> | <b>2,376</b> | <b>2,750</b> |

Source: PBG, Deutsche Bank estimates

**Completion of old contracts in the environmental division and increased share of high value-added oil and gas engineering should drive margins expansion**

### ...but margins should improve

We forecast PBG's EBIT margin to widen from 7.9% in 2007 to 10.6%, 11.8% and 13.0% in 2008E, 2009E and 2010E, respectively. We see two major reasons for margin improvement:

- PBG's subsidiaries operating in environmental and hydro construction (Hydrobudowa Polska, Hydrobudowa 9) should demonstrate their full earnings power only in 2009E, when the results will no longer be negatively affected by loss-making contracts signed before the entities were acquired by PBG.
- The contracts in oil and gas engineering generate above average margins and based on the already signed contracts, we expect the share of this market segment in PBG's total revenues to increase from 9% in 2007 to 24% in 2010E

**We forecast 48%, 29% and 33% net profit growth in 2008E, 2009E and 2010E, respectively**

### We expect 3-year EPS CAGR of 36%, but risks appear to be on the upside

We forecast PBG's net profit to increase by 48% YoY to PLN 150.8m in 2008E. Although our forecast exceeds the company's official guidance by 6%, PBG's management has already suggested the upgrade. In 2009 and 2010, we forecast 29% and 33% increase in net profit to PLN 195.1m and PLN 259.4m, respectively. Risks appear to be on the upside, as our forecast does not incorporate PBG's potential success in securing the PLN 1.1bn project for the construction of gas storage facility as well as potential contracts from KRI, an affiliate of PBG which is planning to expand in the liquefied natural gas distribution business.

**Figure 23: PBG: Earnings forecasts**

| PLNm                     | 2006  | 2007    | 2008E   | %, YoY | 2009E   | %, YoY | 2010    | %, YoY |
|--------------------------|-------|---------|---------|--------|---------|--------|---------|--------|
| Sales                    | 674.3 | 1,376.8 | 1,962.5 | 43     | 2,375.8 | 21     | 2,750.2 | 16     |
| Gross profit (after D&A) | 116.1 | 185.0   | 327.1   | 77     | 428.7   | 31     | 529.3   | 23     |
| Gross margin (%)         | 17.2  | 13.4    | 16.7    | -      | 18.0    | -      | 19.2    | -      |
| EBIT                     | 72.0  | 109.4   | 208.8   | 91     | 281.4   | 35     | 358.8   | 28     |
| EBIT margin (%)          | 10.7  | 7.9     | 10.6    | -      | 11.8    | -      | 13.0    | -      |
| Pre-tax profit           | 69.9  | 144.1   | 212.1   | 47     | 272.3   | 28     | 356.6   | 31     |
| Net profit               | 52.2  | 102.1   | 150.8   | 48     | 195.1   | 29     | 259.4   | 33     |

Source: PBG, Deutsche Bank estimates

## Valuation and recommendation: Buy with 12M TP of PLN 275

### DCF model

We have developed a 5-year DCF model to arrive at a 12-month target price for PBG. The major assumptions are as follows:

- We forecast PBG's revenues to grow at a CAGR of 19% and EBIT of 32% in 2008E-2012E. We forecast an average EBIT margin of 12.5% in the respective period.
- Our terminal growth rate is 4.7%. We calculated this on the basis of the following formula: Terminal growth rate = Reinvestment rate x ROIC
- We use cost of equity of 13.6% and WACC of 9.7%. We used CAPM to achieve those values, using risk free rate of 6.5%, equity risk premium of 5.0% and unlevered beta of 0.8x (Damodaran industry average).

**Based on the above, we arrived at a 12-month target price of PLN 275 for PBG. With expected total shareholder return of 19%, we rate PBG as a Buy.**

**Our DCF model puts 12-month target price at PLN 275**

**Figure 24: PBG: DCF model**

| PLNm                                | 2008E   | 2009E   | 2010E   | 2011E   | 2012E   |
|-------------------------------------|---------|---------|---------|---------|---------|
| Revenues                            | 1,962.5 | 2,375.8 | 2,750.2 | 3,029.6 | 3,260.4 |
| EBIT                                | 208.8   | 281.4   | 358.8   | 409.6   | 433.2   |
| Cash taxes on EBIT                  | 37.5    | 50.0    | 67.3    | 81.0    | 90.6    |
| NOPAT                               | 171.3   | 231.4   | 291.5   | 328.6   | 342.5   |
| Depreciation                        | 33.0    | 33.7    | 34.8    | 36.5    | 38.9    |
| Change in operating WC              | 196.3   | 138.5   | 125.5   | 93.6    | 77.4    |
| Capital expenditure                 | 39.3    | 35.6    | 41.3    | 45.4    | 52.2    |
| Net investment                      | 202.5   | 140.4   | 132.0   | 102.6   | 90.6    |
| Free cash flow                      | (31.2)  | 91.0    | 159.5   | 226.0   | 251.9   |
| WACC (%)                            | 9.7     |         |         |         |         |
| PV FCF 2008E-2012E                  | 482     |         |         |         |         |
| Terminal growth (%)                 | 4.7     |         |         |         |         |
| Terminal Value (TV)                 | 5,205   |         |         |         |         |
| PV TV                               | 3,274   |         |         |         |         |
| Total EV                            | 3,756   |         |         |         |         |
| Net debt (Jan 2008)                 | 315     |         |         |         |         |
| Minority interest                   | 421     |         |         |         |         |
| Equity value                        | 3,020   |         |         |         |         |
| Number of shares (m, fully diluted) | 13.4    |         |         |         |         |
| Value per share (PLN, 1 Jan 2008)   | 225     |         |         |         |         |
| Month                               | 19.0    |         |         |         |         |
| 12-month target price               | 275     |         |         |         |         |
| Revenue growth                      | 42.5    | 21.1    | 15.8    | 10.2    | 7.6     |
| EBIT growth (%)                     | 90.9    | 34.8    | 27.5    | 14.1    | 5.8     |
| NOPAT growth (%)                    | 97.7    | 35.1    | 26.0    | 12.7    | 4.3     |
| FCF growth (%)                      | n.m.    | m.m.    | 75.3    | 41.6    | 11.5    |
| EBIT margin (%)                     | 10.6    | 11.8    | 13.0    | 13.5    | 13.3    |
| NOPAT margin (%)                    | 8.7     | 9.7     | 10.6    | 10.8    | 10.5    |
| Capex/Revenues (%)                  | 2.0     | 1.5     | 1.5     | 1.5     | 1.6     |
| Change in WC/Revenues (%)           | 10.0    | 5.8     | 4.6     | 3.1     | 2.4     |
| Change in WC/Change in revenues (%) | 33.5    | 33.5    | 33.5    | 33.5    | 33.5    |

Source: Deutsche Bank estimates

**Peer comparison**

**PBG is trading at 2008E P/E of 20.6x, broadly in line with its sector peers, while we believe the stock deserves a premium**

PBG is trading at 2008E P/E and EV/EBITDA of 20.6x and 12.6x, respectively, broadly in line with the average for our Polish construction universe. However, we believe that PBG deserves a premium in multiples for seemingly 1) highest earnings visibility (highest backlog to 2008E revenues ratio), 2) highest earning stability (highest operating margins imply lowest operating leverage), and 3) upside risks associated with being a frontrunner to win the over PLN 1.1bn contract from Polish Oil and Gas. PBG's expected 3-year EPS CAGR of 36%, implying 2008E PEG ratio of 0.6x, suggests that earnings growth fully justifies current valuation multiples.

**Figure 25: PBG: Domestic peer comparison**

| (Priced as at 19 August 08) | Ticker         | Recc.      | Price        | MCAP         | P/E (x)     |             |             | 3-year EPS |             | EV/EBITDA (x) |            |
|-----------------------------|----------------|------------|--------------|--------------|-------------|-------------|-------------|------------|-------------|---------------|------------|
|                             |                |            | (PLN)        | (US\$m)      | 2008E       | 2009E       | 2010E       | CAGR (%)   | 2008E       | 2009E         | 2010E      |
| Budimex                     | BMEX.WA        | HOLD       | 82.0         | 926          | 24.4        | 19.8        | 15.4        | 108        | 11.7        | 8.9           | 6.2        |
| <b>PBG</b>                  | <b>PBGG.WA</b> | <b>BUY</b> | <b>231.0</b> | <b>1,372</b> | <b>20.6</b> | <b>15.9</b> | <b>12.0</b> | <b>36</b>  | <b>12.6</b> | <b>9.4</b>    | <b>7.2</b> |
| Polimex                     | MOSD.WA        | SELL       | 5.6          | 1,200        | 20.3        | 17.8        | 14.5        | 23         | 11.0        | 9.4           | 7.9        |
| Pol-Aqua                    | PQAA.WA        | BUY        | 50.8         | 617          | 15.9        | 12.5        | 10.6        | 38         | 10.5        | 7.7           | 6.3        |
| <b>Median</b>               |                |            |              |              | <b>20.5</b> | <b>16.9</b> | <b>13.2</b> | <b>37</b>  | <b>11.4</b> | <b>9.2</b>    | <b>6.8</b> |
| PBG's Premium/(Discount), % |                |            |              |              | 1           | -6          | -9          | -          | 11          | 3             | 7          |

Source: Deutsche Bank estimates

**Mr. Jerzy Wisniewski, PBG's founder and CEO, holds 33.5% of share capital and 50.2% voting rights**

## Appendix: Capital history and shareholder structure

PBG went for an initial public offering on the WSE in July 2004, issuing 3m of new shares at PLN 32. Since then, the company has made two capital increases: in early 2006 and early 2007, raising PLN 138m (1.5m shares at PLN 92/share) and PLN 350m (1.4m shares at PLN 250/share), respectively. Mr. Jerzy Wisniewski, PBG's founder and CEO, remains the company's major shareholder controlling 33.5% of share capital and 50.2% voting rights.

**Figure 26: PBG: Capital history**

| Date   | Series | No. of shares | Issue price (PLN) | Total no. of shares outstanding | Comment           |
|--------|--------|---------------|-------------------|---------------------------------|-------------------|
| Jan-04 | A,B    | 7,200,000     | 1.00              | 7,200,000                       | conversion to plc |
| Jul-04 | C      | 3,000,000     | 32.00             | 10,200,000                      | IPO               |
| Jul-04 | D      | 330,000       | 1.12              | 10,530,000                      | motivation plan   |
| Mar-06 | E      | 1,500,000     | 92.00             | 12,030,000                      | rights issue      |
| Mar-07 | F      | 1,400,000     | 250.00            | 13,430,000                      | rights issue      |

Source: PBG

**Figure 27: PBG: Shareholder structure**

| Shareholder          | No. of shares     | As % of total | No. of voting rights | As % of total |
|----------------------|-------------------|---------------|----------------------|---------------|
| Mr. Jerzy Wisniewski | 4,495,054         | 33.5          | 8,990,108            | 50.2          |
| ING NN Pension Fund  | 912,991           | 6.8           | 912,991              | 5.1           |
| BZWBK Mutual Fund    | 899,265           | 6.7           | 899,265              | 5.0           |
| Other                | 7,122,690         | 53.0          | 7,122,690            | 39.7          |
| <b>Total</b>         | <b>13,430,000</b> | <b>100.0</b>  | <b>17,925,054</b>    | <b>100.0</b>  |

Source: PBG

**Emerging Europe** Poland  
**Building and Construction** Construction

22 August 2008

# Polimex

Reuters: **MOSD.WA** Bloomberg: **PXM PW**

## Too much slowdown exposure

### Initiating coverage with Sell and 12-month target price of PLN 5.0

We initiate coverage of Polimex with a Sell, and a 12-month target price of PLN 5.0. We view the company as being the most exposed in our Polish construction universe to the expected slowdown, owing to its high reliance on exports and on industrial clients. We expect Polimex's earnings growth to fall from 33% in 2008 to 14% in 2009. Our 3-year EPS CAGR forecast of 23%, the lowest in our construction universe, appears not to be reflected: 2008E P/E of 20.3x, in line with the sector average. We see significant downside potential: Sell.

### Only short-term earnings perspective appears to be secured

While Polimex's PLN 5.85bn backlog appears to secure the company's short-term earnings perspective, we see some dark clouds on the horizon. First, exports account for one third of Polimex's sales, while Western European markets are already witnessing negative growth in construction. Second, we expect industrial clients, which in total account for ca. 60% of Polimex's sales, to downsize their capex plans due to weakening demand.

### We expect 3-year EPS CAGR of 23%, the lowest in our construction universe

We forecast Polimex's net profit to increase by 33% to PLN 133m in 2008 but the growth to decelerate to 14% to PLN 152m. Opening of a new capacity in the manufacturing segment should fuel growth in 2010: we expect 23% YoY to PLM 188m, but overall, our forecast of 3-year EPS CAGR of 23% places Polimex at the end of our universe, 14 percentage points below the sector average.

### DCF-based target price of PLN 5.0

Our 12-month target price of PLN 5.0 is based on DCF model. Polimex is currently trading at 2008E P/E and EV/EBITDA of 20.3x and 11.0x, broadly in line with sector averages, while we believe inferior earnings growth prospects demand a discount. On the macro side, major upside risks to our negative stance on the stock include lack of slowdown in investments in Poland and upturn in construction activity in Western Europe. Looking at company-specific issues, we view higher-than-expected utilization rate of 50% at new manufacturing plant in 2010 as the major upside risk.

#### Forecasts and ratios

| Year End Dec 31   | 2007A | 2008E        | 2009E | 2010E |
|-------------------|-------|--------------|-------|-------|
| Revenue (PLNm)    | 3,720 | <b>4,681</b> | 5,329 | 6,138 |
| EBITDA (PLNm)     | 205   | <b>302</b>   | 359   | 421   |
| EBITA (PLNm)      | 160   | <b>238</b>   | 273   | 321   |
| Net Income (PLNm) | 100   | <b>133</b>   | 152   | 188   |
| EPS (PLN)         | 0.21  | <b>0.28</b>  | 0.31  | 0.39  |
| P/E (DB EPS) (x)  | 44.7  | <b>20.3</b>  | 17.8  | 14.5  |
| EV/EBITDA (x)     | 23.8  | <b>11.0</b>  | 9.4   | 7.9   |
| Yield (%)         | 0.0   | <b>0.0</b>   | 0.0   | 0.0   |

Source: Deutsche Bank estimates, company data

### Sell

|                            |                     |
|----------------------------|---------------------|
| Price at 19 Aug 2008 (PLN) | <b>5.61</b>         |
| Price Target (PLN)         | <b>5.00</b>         |
| 52-week range (PLN)        | <b>11.75 - 5.10</b> |

#### Price/price relative



| Performance (%) | 1m   | 3m    | 12m   |
|-----------------|------|-------|-------|
| Absolute        | 3.4  | -20.3 | -33.4 |
| WIG 20 Index    | -0.9 | -13.3 | -24.0 |

#### Stock data

|                    |                |
|--------------------|----------------|
| Market Cap (PLNm)  | <b>2,712.0</b> |
| Market Cap (US\$m) | <b>1,218.8</b> |
| Free float (%)     | <b>100</b>     |
| WIG 20 Index       | <b>2,554.7</b> |

#### Key indicators (FY1)

|                        |             |
|------------------------|-------------|
| ROE (%)                | <b>12.8</b> |
| Book value/share (PLN) | <b>2.3</b>  |
| Price/book (x)         | <b>2.5</b>  |
| Net interest cover (x) | <b>4.8</b>  |
| EBIT margin (%)        | <b>5.1</b>  |

Model updated:Unavailable

**Running the numbers****Emerging Europe****Poland****Construction****Polimex**

Reuters: MOSD.WA

Bloomberg:

**Sell**

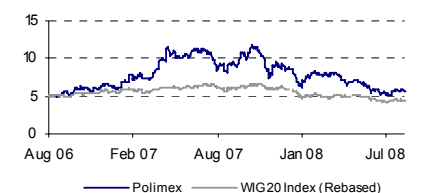
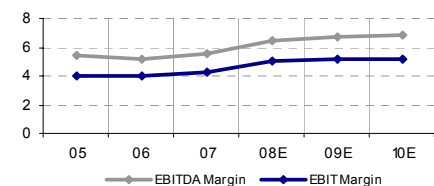
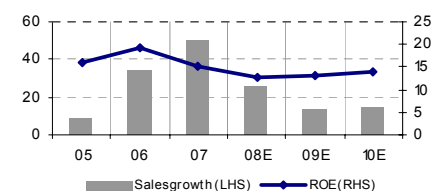
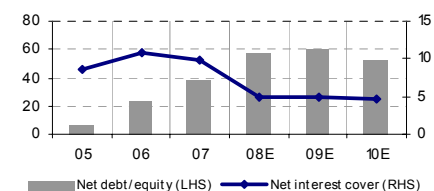
Price (19 Aug 08) PLN 5.61

Target price PLN 5.00

52-week Range PLN 5.10 - 11.75

Market Cap (m) PLNm 2,712  
USDm 1,200**Company Profile**

Polimex is a diversified construction group active primarily in 1) steel structures manufacturing, 2) industrial construction (power generation, oil & gas, chemicals), 3) general construction (housing, commercial centres) and 4) infrastructure (roads and railroads). Last years' expansion conducted mainly through M&A activity made Polimex Poland's largest (by revenues) construction player.

**Price Performance****Margin Trends****Growth & Profitability****Solvency**

Tomasz Krukowski, CFA

+48 22 579-8732

tomasz.krukowski@db.com

Fiscal year end 31-Dec

|                             | 2005 | 2006  | 2007  | 2008E | 2009E | 2010E |
|-----------------------------|------|-------|-------|-------|-------|-------|
| <b>Financial Summary</b>    |      |       |       |       |       |       |
| DB EPS (PLN)                | 0.12 | 0.16  | 0.21  | 0.28  | 0.31  | 0.39  |
| Reported EPS (PLN)          | 0.12 | 0.16  | 0.21  | 0.28  | 0.31  | 0.39  |
| DPS (PLN)                   | 0.00 | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  |
| BVPS (PLN)                  | 0.8  | 0.9   | 2.0   | 2.3   | 2.6   | 2.9   |
| Weighted average shares (m) | 368  | 387   | 483   | 483   | 483   | 483   |
| Average market cap (PLNm)   | 558  | 1,655 | 4,472 | 2,712 | 2,712 | 2,712 |
| Enterprise value (PLNm)     | 568  | 1,753 | 4,892 | 3,303 | 3,382 | 3,317 |
| <b>Valuation Metrics</b>    |      |       |       |       |       |       |
| P/E (DB) (x)                | 13.0 | 26.4  | 44.7  | 20.3  | 17.8  | 14.5  |
| P/E (Reported) (x)          | 13.0 | 26.4  | 44.7  | 20.3  | 17.8  | 14.5  |
| P/BV (x)                    | 3.13 | 6.63  | 4.21  | 2.45  | 2.18  | 1.91  |
| FCF Yield (%)               | 15.0 | 3.8   | nm    | nm    | nm    | 3.0   |
| Dividend Yield (%)          | 0.0  | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| EV/Sales (x)                | 0.3  | 0.7   | 1.3   | 0.7   | 0.6   | 0.5   |
| EV/EBITDA (x)               | 5.6  | 13.5  | 23.8  | 11.0  | 9.4   | 7.9   |
| EV/EBIT (x)                 | 7.8  | 17.8  | 30.5  | 13.9  | 12.4  | 10.3  |

**Income Statement (PLNm)**

|                                     | 2005         | 2006         | 2007         | 2008E        | 2009E        | 2010E        |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Sales revenue</b>                | <b>1,850</b> | <b>2,483</b> | <b>3,720</b> | <b>4,681</b> | <b>5,329</b> | <b>6,138</b> |
| <b>Gross profit</b>                 | <b>228</b>   | <b>275</b>   | <b>367</b>   | <b>514</b>   | <b>602</b>   | <b>700</b>   |
| <b>EBITDA</b>                       | <b>101</b>   | <b>130</b>   | <b>205</b>   | <b>302</b>   | <b>359</b>   | <b>421</b>   |
| Depreciation                        | 28           | 31           | 45           | 64           | 86           | 100          |
| Amortisation                        | 0            | 0            | 0            | 0            | 0            | 0            |
| <b>EBIT</b>                         | <b>73</b>    | <b>98</b>    | <b>160</b>   | <b>238</b>   | <b>273</b>   | <b>321</b>   |
| Net interest income/(expense)       | -8           | -9           | -16          | -49          | -56          | -67          |
| Associates/affiliates               | 0            | -2           | 4            | 4            | 4            | 4            |
| Exceptionals/extraordinaries        | 0            | 0            | 0            | 0            | 0            | 0            |
| Other pre-tax income/(expense)      | 0            | 4            | 1            | 0            | 0            | 0            |
| <b>Profit before tax</b>            | <b>65</b>    | <b>93</b>    | <b>145</b>   | <b>189</b>   | <b>217</b>   | <b>254</b>   |
| Income tax expense                  | 16           | 17           | 33           | 36           | 41           | 38           |
| Minorities                          | 6            | 11           | 17           | 24           | 28           | 32           |
| Other post-tax income/(expense)     | 0            | 0            | 0            | 0            | 0            | 0            |
| <b>Net profit</b>                   | <b>43</b>    | <b>63</b>    | <b>100</b>   | <b>133</b>   | <b>152</b>   | <b>188</b>   |
| DB adjustments (including dilution) | 0            | 0            | 0            | 0            | 0            | 0            |
| <b>DB Net profit</b>                | <b>43</b>    | <b>63</b>    | <b>100</b>   | <b>133</b>   | <b>152</b>   | <b>188</b>   |

**Cash Flow (PLNm)**

|                                      | 2005       | 2006       | 2007        | 2008E       | 2009E      | 2010E      |
|--------------------------------------|------------|------------|-------------|-------------|------------|------------|
| <b>Cash flow from operations</b>     | <b>102</b> | <b>144</b> | <b>-219</b> | <b>122</b>  | <b>154</b> | <b>182</b> |
| Net Capex                            | -19        | -80        | -218        | -278        | -218       | -100       |
| <b>Free cash flow</b>                | <b>84</b>  | <b>64</b>  | <b>-437</b> | <b>-156</b> | <b>-65</b> | <b>82</b>  |
| Equity raised/(bought back)          | 0          | 0          | 0           | 0           | 0          | 0          |
| Dividends paid                       | 0          | -7         | -9          | -5          | -6         | -7         |
| Net inc/(dec) in borrowings          | -44        | 146        | 305         | 250         | 100        | 0          |
| Other investing/financing cash flows | -12        | -140       | 135         | -99         | -37        | -41        |
| <b>Net cash flow</b>                 | <b>27</b>  | <b>62</b>  | <b>-5</b>   | <b>-10</b>  | <b>-8</b>  | <b>33</b>  |
| Change in working capital            | 43         | 5          | -489        | -137        | -127       | -159       |

**Balance Sheet (PLNm)**

|                                   | 2005         | 2006         | 2007         | 2008E        | 2009E        | 2010E        |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Cash and other liquid assets      | 86           | 148          | 143          | 133          | 125          | 158          |
| Tangible fixed assets             | 214          | 262          | 426          | 651          | 783          | 783          |
| Goodwill/intangible assets        | 2            | 20           | 438          | 428          | 428          | 428          |
| Associates/investments            | 85           | 102          | 98           | 164          | 164          | 164          |
| Other assets                      | 722          | 1,100        | 1,696        | 2,062        | 2,343        | 2,694        |
| <b>Total assets</b>               | <b>1,108</b> | <b>1,632</b> | <b>2,801</b> | <b>3,438</b> | <b>3,843</b> | <b>4,228</b> |
| Interest bearing debt             | 109          | 254          | 559          | 809          | 909          | 909          |
| Other liabilities                 | 635          | 928          | 1,157        | 1,445        | 1,640        | 1,883        |
| <b>Total liabilities</b>          | <b>743</b>   | <b>1,183</b> | <b>1,716</b> | <b>2,254</b> | <b>2,549</b> | <b>2,792</b> |
| Shareholders' equity              | 293          | 355          | 983          | 1,105        | 1,244        | 1,418        |
| Minorities                        | 72           | 94           | 103          | 79           | 50           | 18           |
| <b>Total shareholders' equity</b> | <b>365</b>   | <b>449</b>   | <b>1,086</b> | <b>1,183</b> | <b>1,294</b> | <b>1,436</b> |
| Net debt                          | 23           | 106          | 416          | 676          | 784          | 751          |

**Key Company Metrics**

|                        | 2005  | 2006 | 2007 | 2008E | 2009E | 2010E |
|------------------------|-------|------|------|-------|-------|-------|
| Sales growth (%)       | 8.8   | 34.2 | 49.8 | 25.8  | 13.9  | 15.2  |
| DB EPS growth (%)      | -15.2 | 39.2 | 27.9 | 33.2  | 14.1  | 23.3  |
| EBITDA Margin (%)      | 5.5   | 5.2  | 5.5  | 6.4   | 6.7   | 6.9   |
| EBIT Margin (%)        | 4.0   | 4.0  | 4.3  | 5.1   | 5.1   | 5.2   |
| Payout ratio (%)       | 0.0   | 0.0  | 0.0  | 0.0   | 0.0   | 0.0   |
| ROE (%)                | 16.1  | 19.3 | 15.0 | 12.8  | 13.0  | 14.1  |
| Capex/sales (%)        | 1.0   | 3.2  | 5.9  | 5.9   | 4.1   | 1.6   |
| Capex/depreciation (x) | 0.7   | 2.6  | 4.8  | 4.4   | 2.5   | 1.0   |
| Net debt/equity (%)    | 6.2   | 23.7 | 38.3 | 57.1  | 60.6  | 52.3  |
| Net interest cover (x) | 8.6   | 10.7 | 10.0 | 4.8   | 4.9   | 4.8   |

Source: Company data, Deutsche Bank estimates

# Investment thesis

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## Outlook

We rate Polimex a Sell on the basis of our valuation, which provides negative total return on a 12-month basis and deteriorating earnings outlook. We view Polimex as the company with the highest exposure, in our Polish construction universe, to the slowdown in the construction activity we expect. This is due to Polimex's high exposure to Western European markets (exports account for about one-third of total revenues) as well as to the industrial companies, which, we believe, are likely to downsize their capex plans due to contracting demand. We expect Polimex's EPS growth to slow down from 33% in 2008E to 14% in 2009E.

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## Valuation

Our 12-month share price target of PLN 5.0 for Polimex is based on a 5-year discounted cash flow (DCF) analysis. Major assumption to our DCF are cost of equity of 12.3% and WACC of 10.1%, both derived from CAPM using risk free rate of 6.5%, equity risk premium of 5.0% and unlevered fundamental beta of 0.8x (Damodaran industry average). We use terminal growth rate of 4.6%, calculated through multiplication of the company's reinvestment rate and ROIC.

For illustrative purposes, we also present peer comparison. Polimex is trading broadly in line with its peers based on 2008E P/E and EV/EBITDA, while we believe there should be a discount, reflecting 1) lower-than-expected earnings expansion, and 2) higher capex requirements (Polimex generates 45% of its gross profit in the manufacturing segment, where growth and maintenance capex tends to be higher than in purely construction activity).

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## Risks

Since our negative view on Polimex is largely based on the deteriorating industry fundamentals, both in Poland and Western Europe, a reversal on that front (meaning lack of slowdown in investments in Poland, upturn in construction activity in Western Europe) would imply upside risks to our earnings estimates and valuation. On the company-specific side, we point out at company's capex plans in manufacturing division, where we cautiously expect the new facility to operate at 50% capacity utilization rate in 2010, while better rate would imply and increase our estimates for that year. We also note that Polimex appears to have high chances of securing sizable contract for the construction of stadiums in Poland before EURO 2012 soccer championships (the company has already secured one contract in that market segment).

# Earnings outlook & valuation

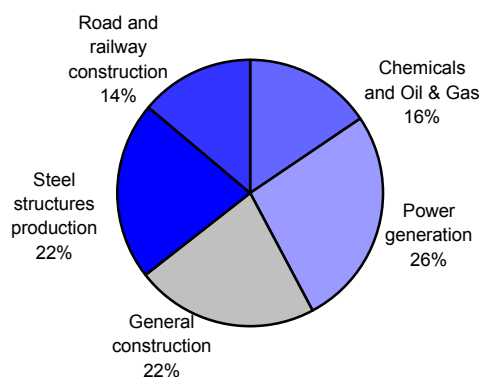
## Key business areas

**Diversified construction company focused on industrial segment**

Polimex is a diversified construction company focused on industrial construction. Specifically, Polimex is active in chemicals, oil & gas and power generation, which when combined accounts for 42% of the company's total revenues in 2008 as per our estimate. Additionally, Polimex operates in infrastructure segment (railroads and roads and it has a steel structures manufacturing division).

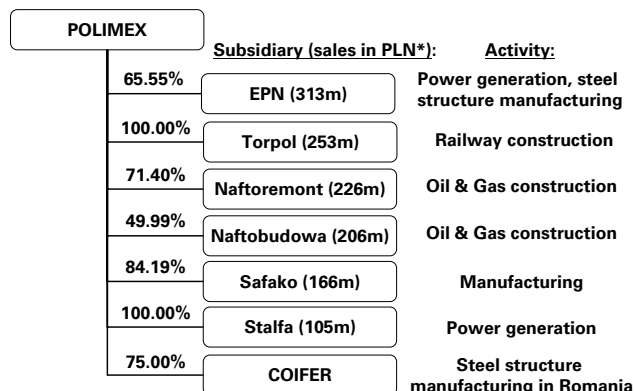
With our 2008 sales forecast of PLN 4.7bn, we expect Polimex to be Poland's largest construction company by revenues. We note that Polimex maintains a holding structure, in which seven major subsidiaries generate approximately one-third of its total sales. From the operating viewpoint, Polimex very often tenders for big construction contracts, where its subsidiaries are utilized as subcontractors.

**Figure 28: Polimex: 2008E revenues structure**



Source: Polimex, Deutsche Bank estimates

**Figure 29: Polimex : Group structure (major subsidiaries)**



Source: Polimex, Deutsche Bank estimates

\*NOTE: 2007 revenues

## Earnings drivers

**Steel structures production generates only 22% of sales but as much as 45% of gross profit**

### 1. Steel structures manufacturing – 45% of gross profit

Polimex's manufacturing activity (production of steel structures used in construction works), although generating only 22% of total revenues, accounts for as much as 45% of the company's gross profit. This division's performance is, therefore, most vital for the company's earnings. We note that sizable portion of steel structures products is being exported, making this division of Polimex susceptible to global economic slowdown.

**Strong backlog of contracts in chemicals, oil & gas and power generation**

### 2. Sizable contracts in the industrial segment

We estimate contracts in the industrial construction business line to account for 42% of Polimex's 2008E revenues and 37% of gross profit. In 2007 and 1H 2008, Polimex signed numerous sizable contracts in chemicals (PLN 550m with PKN), oil & gas (PLN 221m with Technip), Power generation (PLN 203m with Elektrownia Polaniec, PLN 97m with Elektrownia Zeran) which we expect to drive earning in 2008 and 1H 2009. Replacement of backlog in industrial segment (following the completion of current contracts) appears to be one of the major challenges for Polimex, in our view.

**Infrastructure has not yet provided expected margins**

### 3. Infrastructure – going up on the learning curve

Polimex entered the infrastructure segment only in 2006, following the acquisition of railway construction company Torpol and the creation of its own road construction division. In 2008, we expect Polimex's revenues from infrastructure at PLN 650m, but we note that Polimex is still a beginner here (especially in road construction) which translates into low margins (we forecast only 6% contribution to gross profit in 2008E).

### Earnings forecasts

#### We expect 3-year EPS CAGR of 23%...

**Backlog of PLN 5.85 covers majority of our sales forecast till 2009**

We forecast Polimex's revenues to increase by 26% to PLN 4,681m in 2008E, by 14% to PLN 5,329 in 2009E and by 15% to PLN 6,138m in 2010E. We note that the company's backlog of PLN 5.85bn (as of now) covers majority of our sales projections throughout 2009.

On the operating margins front, we expect slight improvement in 2008 to 5.1% (driven by the acquisition of Romania-based COIFER) and flat levels thereafter. We do not believe that the company's total margin will increase in 2010 following the completion of capacity extension program in manufacturing as in its first years the new capacity is unlikely to operate at full utilization which usually warrant high margins.

**Figure 30: Polimex: Earnings forecasts**

|                          | 2006    | 2007    | 2008E   | %, YoY | 2009E   | %, YoY | 2010    | %, YoY |
|--------------------------|---------|---------|---------|--------|---------|--------|---------|--------|
| Sales                    | 2,483.4 | 3,720.5 | 4,680.7 | 26     | 5,329.0 | 14     | 6,137.9 | 15     |
| Gross profit (after D&A) | 244.3   | 322.2   | 450.8   | 40     | 515.1   | 14     | 599.6   | 16     |
| Gross margin (%)         | 9.8     | 8.7     | 9.6     | -      | 9.7     | -      | 9.8     | -      |
| EBIT                     | 98.5    | 160.4   | 238.0   | 48     | 272.8   | 15     | 320.6   | 17     |
| EBIT margin (%)          | 4.0     | 4.3     | 5.1     | -      | 5.1     | -      | 5.2     | -      |
| Net financial costs      | 5.3     | 15.4    | 49.2    | 220    | 55.6    | 13     | 67.1    | 21     |
| Pre-tax profit           | 93.2    | 145.0   | 188.8   | 30     | 217.3   | 15     | 253.5   | 17     |
| Net profit               | 62.6    | 100.1   | 133.3   | 33     | 152.2   | 14     | 187.6   | 23     |

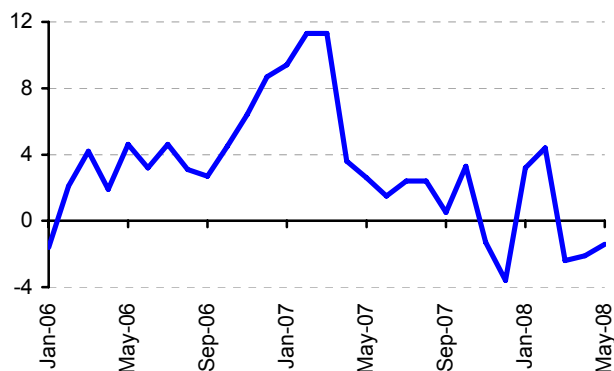
Source: Polimex, Deutsche Bank estimates

**We see roll-over of backlog contract at high margin contracts as well as slowdown in Western Europe as major downside risks to earnings**

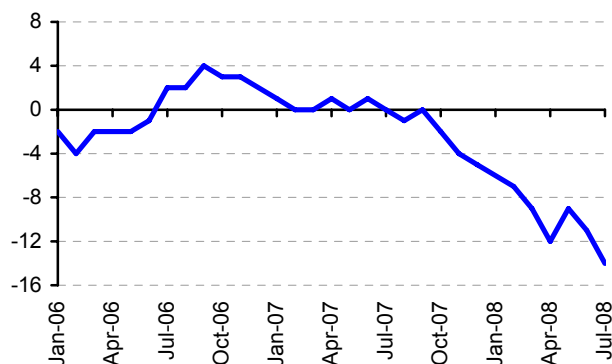
#### ...but we see sustaining of earning momentum as a major challenge

At the bottom line, we forecast net profit of PLN 133.3m in 2008, PLN 152.2m in 2009 and PLN 187.6m in 2010. We note that we expect Polimex's earning's momentum to decelerate from 33% in 2008E to 14% in 2009E and 23% in 2010E. In our view, major challenges associated with this development are:

- Roll-over of backlog with high margin contract: Polimex's current backlog includes many specialized contracts (i.e. in chemicals and power generation sectors) which should yield higher margins than in general construction. While we expect more severe competition in general construction in the coming years resulting from general economic slowdown, we believe it will be crucial for Polimex to roll over backlog with high margin orders. We believe the construction of stadiums associated with EURO 2012 soccer championships will not be a remedy given the high competition there.
- Maintain margins in export-oriented manufacturing division: We expect the slowdown in the construction markets of Western Europe (see Figures 31-32) to undercut demand for Polimex's steel structure sold in those markets. Year-to-date appreciation of zloty against euro is also not supportive of margins.

**Figure 31: Euro area construction output (YoY chg. %)**

Source: Eurostat

**Figure 32: Euro area construction confidence index**

Source: Eurostat

**New manufacturing capacity is a flagship project in PLN 0.5bn 3-year capex plan**

### 3-year capex of PLN 0.5bn

Polimex plans to spend PLN 0.5bn until 2010, with the flagship projects being new steel structure manufacturing capacity in special economic zone near Siedlce (Eastern Poland). The new facility is planned to be completed by the end of 2009 with the company's target for its annual revenues at PLN 0.5 – 0.6bn. While we remain positive on Polimex's developments plans in this market segment, we are sceptical about the company being able to place on the market steel structures from the additional capacity within one year – we expect 2-year period for the plant to reach full capacity utilization and the abundance of new products' supply to put pressure on margins.

**Balance sheet already stretched**

Polimex had net debt of PLN 416m as of December 2007, implying Net Debt to Equity ratio of 42% and Net Debt to EBITDA of 2.0x. With the company's capex plan for 2008-2010, we forecast Polimex's net debt to increase to PLN 676m as of December 2008 and PLN 784m as of December 2009, but the respective leverage ratios should be in check (with Net Debt to EBITDA of 2.2x in both years).

**Our DCF model produced 12-month target price of PLN 5.0**

## Valuation and recommendation: Sell with 12-m target price of PLN 5.0

### DCF model

We have developed a 5-year DCF model to arrive at 12-month target price for Polimex. The major assumptions are as follows:

- We forecast Polimex's revenues to grow at a CAGR of 16% and EBIT of 21% in 2008E-2012E. We forecast the average EBIT margin of 5.2% in the respective period.
- We expect terminal growth rate at 4.6%. We calculated it on the basis of the following formula: Terminal growth rate = Reinvestment rate x ROIC
- We use Cost of Equity of 12.3% and WACC of 10.1%. We used CAPM to achieve those values, using risk free rate of 6.5%, equity risk premium of 5.0% and unlevered beta of 0.8x (Damodaran industry average).

**Based on the above, we arrived at 12-month target price for Polimex of PLN 5.0. With expected total shareholder return of minus 11%, we rate Polimex as a Sell.**

**Figure 33: Polimex: DCF model**

| PLNm                                | 2008E   | 2009E   | 2010E   | 2011E   | 2012E   |
|-------------------------------------|---------|---------|---------|---------|---------|
| Revenues                            | 4,680.7 | 5,329.0 | 6,137.9 | 7,044.3 | 7,812.3 |
| EBIT                                | 238.0   | 272.8   | 320.6   | 368.5   | 408.1   |
| Cash taxes on EBIT                  | 45.2    | 51.8    | 50.8    | 57.9    | 63.7    |
| NOPAT                               | 192.8   | 221.0   | 269.8   | 310.6   | 344.4   |
| Depreciation                        | 63.5    | 86.4    | 100.1   | 108.6   | 118.2   |
| Change in operating WC              | 144.5   | 132.2   | 165.0   | 184.9   | 120.7   |
| Capital expenditure                 | 278.3   | 218.4   | 100.3   | 110.2   | 119.5   |
| Net investment                      | 359.3   | 264.2   | 165.1   | 186.4   | 121.9   |
| Free cashflow                       | (166.5) | (43.2)  | 104.7   | 124.2   | 222.5   |
| WACC (%)                            | 10.1    |         |         |         |         |
| PV FCF 2008E-2012E                  | 113     |         |         |         |         |
| Terminal growth (%)                 | 4.6     |         |         |         |         |
| Terminal Value (TV)                 | 4,229   |         |         |         |         |
| PV TV                               | 2,609   |         |         |         |         |
| Total EV                            | 2,722   |         |         |         |         |
| Net debt (Jan 2008)                 | 416.2   |         |         |         |         |
| Minority interest                   | 288     |         |         |         |         |
| Equity value                        | 2,018   |         |         |         |         |
| Number of shares (m, fully diluted) | 483.4   |         |         |         |         |
| Value per share (PLN, 1 Jan 2008)   | 4.2     |         |         |         |         |
| Month                               | 19.0    |         |         |         |         |
| 12-month target price               | 5.0     |         |         |         |         |
| Revenue growth                      | 25.8    | 13.9    | 15.2    | 14.8    | 10.9    |
| EBIT growth (%)                     | 48.4    | 14.6    | 17.5    | 15.0    | 10.8    |
| NOPAT growth (%)                    | 54.7    | 14.6    | 22.1    | 15.1    | 10.9    |
| FCF growth (%)                      | (66.1)  | (74.1)  | (342.3) | 18.7    | 79.1    |
| EBIT margin (%)                     | 5.1     | 5.1     | 5.2     | 5.2     | 5.2     |
| NOPAT margin (%)                    | 4.1     | 4.1     | 4.4     | 4.4     | 4.4     |
| Capex/Revenues (%)                  | 5.9     | 4.1     | 1.6     | 1.6     | 1.5     |
| Change in WC/Revenues (%)           | 3.1     | 2.5     | 2.7     | 2.6     | 1.5     |
| Change in WC/Change in revenues (%) | 15.1    | 20.4    | 20.4    | 20.4    | 15.7    |

Source: Deutsche Bank estimates

**Polimex is trading in line with peers based on 2008E ratios while we believe inferior growth prospects demand some discount**

### Peer comparison

Polimex is trading at 2008E P/E and EV/EBITDA of 20.3x and 11.0x, broadly in line with the average of our Polish construction universe. However, with 3-year EPS growth of 23% the company lags behind its peers. Consequently, based on 2010E, Polimex is trading at P/E of 14.5x and EV/EBITDA of 7.9x, at respective 9% and 17% premium to peers. We also note that based on 2008E multiples, Polimex is trading at equal multiples to those of PBG, while we believe there should be a discount, not only for lower expected earnings expansion, but also because Polimex generates 45% of its gross profit in the manufacturing segment, where higher capex requirement should imply lower ratios.

**Figure 34: Polimex: Domestic peer comparison**

| (Priced as at 19 August 08)     | Ticker         | Recc.       | Price      |              | P/E (x)     |             |             | 3-year EPS |             | EV/EBITDA (x) |            |  |
|---------------------------------|----------------|-------------|------------|--------------|-------------|-------------|-------------|------------|-------------|---------------|------------|--|
|                                 |                |             | (PLN)      | (US\$m)      | 2008E       | 2009E       | 2010E       | CAGR (%)   | 2008E       | 2009E         | 2010E      |  |
| Budimex                         | BMEX.WA        | HOLD        | 82.0       | 926          | 24.4        | 19.8        | 15.4        | 108        | 11.7        | 8.9           | 6.2        |  |
| PBG                             | PBGG.WA        | BUY         | 231.0      | 1,372        | 20.6        | 15.9        | 12.0        | 36         | 12.6        | 9.4           | 7.2        |  |
| <b>Polimex</b>                  | <b>MOSD.WA</b> | <b>SELL</b> | <b>5.6</b> | <b>1,200</b> | <b>20.3</b> | <b>17.8</b> | <b>14.5</b> | <b>23</b>  | <b>11.0</b> | <b>9.4</b>    | <b>7.9</b> |  |
| Pol-Aqua                        | PQAA.WA        | BUY         | 50.8       | 617          | 15.9        | 12.5        | 10.6        | 38         | 10.5        | 7.7           | 6.3        |  |
| <b>Median</b>                   |                |             |            |              | <b>20.5</b> | <b>16.9</b> | <b>13.2</b> | <b>37</b>  | <b>11.4</b> | <b>9.2</b>    | <b>6.8</b> |  |
| Polimex's Premium/(Discount), % |                |             |            |              | -1          | 6           | 9           | -          | -3          | 3             | 17         |  |

Source: Deutsche Bank estimates

## Appendix: Capital history, shareholder structure

### Pension funds are Polimex's largest shareholder

Polimex in its current structure has been created in 2004 as a result of the merger of Polimex Cekop and Mostostal Siedlce, though the history of the two companies dates back to 1940s. In 2007, the company went for two capital increases (ex-rights, 22% dilution) with new share issues being utilized to pay for acquisition of ZREW and EPN. Polish pension funds are Polimex's largest shareholders.

**Figure 35: Polimex: Capital history**

| Date   | Series | No. of shares | Issue price (PLN) | No. of shares outstanding | Comment                         |
|--------|--------|---------------|-------------------|---------------------------|---------------------------------|
| Sep-04 | F      | 8,948,633     | 1.00              | 18,548,633                | merger with Mostostal Siedlce   |
| May-05 |        | -3,300,142    |                   | 15,248,491                | shares redemption               |
| May-05 | G      | 762,417       |                   | -                         | motivation plan - warrants      |
| Mar-07 | H      | 1,032,905     | 198.47            | 16,281,396                | merger with ZREW                |
| Apr-07 | I      | 2,292,829     | 110.13            | 18,574,225                | Energomontaz-Polnoc acquisition |
| Aug-07 |        |               |                   | 464,355,625               | split 1:25                      |
|        | J      | 23,217,183    |                   | -                         | motivation plan - warrants      |

Source: Polimex

**Figure 36: Polimex: Shareholder structure**

| Shareholders                  | No. of shares      | As % of total | No. of voting rights | As % of total |
|-------------------------------|--------------------|---------------|----------------------|---------------|
| Commercial Union Pension Fund | 41,486,075         | 8.9           | 41,486,075           | 8.9           |
| ING NN Pension Fund           | 40,406,650         | 8.7           | 40,406,650           | 8.7           |
| PZU Pension Fund              | 40,000,000         | 8.6           | 40,000,000           | 8.6           |
| Gloria S.a.r.l.               | 28,702,825         | 6.2           | 28,702,825           | 6.2           |
| Sices International B.V.      | 28,617,900         | 6.2           | 28,617,900           | 6.2           |
| Polimex-Development           | 13,152,500         | 2.8           | 13,152,500           | 2.8           |
| Other                         | 271,989,675        | 58.6          | 271,989,675          | 58.6          |
| <b>Total</b>                  | <b>464,355,625</b> | <b>100.0</b>  | <b>464,355,625</b>   | <b>100.0</b>  |

Source: Polimex

**Emerging Europe** Poland  
**Building and Construction** Construction

22 August 2008

# POL-AQUA

Reuters: **PQAA.WA** Bloomberg: **PQA PW**

## Cheaper exposure to Polish construction

### Initiating with Buy and 12-month target price of PLN 60

We initiate coverage of Pol-Aqua with a Buy recommendation and 12-month target price of PLN 60. Our positive stance is based on 1) the company's high exposure to the civil engineering market where growth is supported by EU financing, 2) M&A-driven expansion into other construction markets (general, roads, building materials), and 3) an inexpensive valuation – we project 18% total return potential on a 12-month horizon and the stock is trading at 2008E P/E of 15.9x vs. our projected three-year EPS CAGR of 38%.

### M&A's fueled expansion

Pol-Aqua's primary specialization in civil engineering is benefiting from the upturn in that market segment driven by EU-financed projects. We expect this prosperity to continue in years to come because Poland's environmental and hydro-construction is scheduled to receive EUR 3.6bn for new projects under the 2007-2013 EU budget. Additionally, in recent years Pol-Aqua has entered (mainly through M&A) other segments of the construction market (general construction, building materials production), which we expect to significantly contribute to the revenues and profit from 2008E.

### We forecast a 3-year EPS CAGR of 38%

Based on organic growth and already-conducted acquisitions we expect Pol-Aqua to report 75% net profit growth in 2008E to PLN 88m. The company's 1H 2008 net profit of PLN 31m, up 58% YoY, suggests that it is on track to deliver on our forecasts. We expect Pol-Aqua's 2009E and 2010E earnings to increase by 27% and 18%, respectively.

### We expect 18% total return potential on a 12-month horizon

Our 12-month target price of PLN 60 is based on a DCF model (WACC 10.4%, coe 11.1%, tg 4.8%). Pol-Aqua is currently trading at 2008E P/E and EV/EBITDA of 15.9x and 10.5x, respectively, at 22% and 7% discounts to our Polish construction universe. Downside risks on the macro side include delays in kick-off of the EU-financed projects and an expected slowdown in general construction; company specific risks include restructuring and the integration of acquired entities, and delays in invoicing leading to the postponement of revenue recognition.

#### Forecasts and ratios

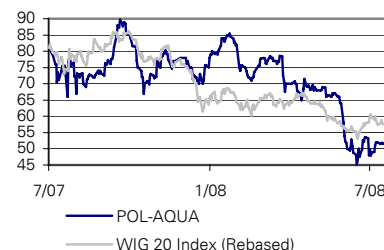
| Year End Dec 31   | 2007A | 2008E | 2009E | 2010E |
|-------------------|-------|-------|-------|-------|
| Revenue (PLNm)    | 706   | 1,262 | 1,579 | 1,773 |
| EBITDA (PLNm)     | 88    | 134   | 175   | 202   |
| EBITA (PLNm)      | 60    | 100   | 137   | 158   |
| Net Income (PLNm) | 50    | 88    | 112   | 131   |
| EPS (PLN)         | 2.10  | 3.19  | 4.06  | 4.78  |
| P/E (DB EPS) (x)  | 36.3  | 15.9  | 12.5  | 10.6  |
| EV/EBITDA (x)     | 22.8  | 10.5  | 7.7   | 6.3   |
| Yield (%)         | 0.0   | 0.0   | 0.0   | 0.0   |

Source: Deutsche Bank estimates, company data

### Buy

|                            |               |
|----------------------------|---------------|
| Price at 19 Aug 2008 (PLN) | 50.75         |
| Price Target (PLN)         | 60.00         |
| 52-week range (PLN)        | 89.70 - 45.00 |

#### Price/price relative



| Performance (%) | 1m   | 3m    | 12m   |
|-----------------|------|-------|-------|
| Absolute        | 0.4  | -27.9 | -34.7 |
| WIG 20 Index    | -0.9 | -13.3 | -24.0 |

#### Stock data

|                    |         |
|--------------------|---------|
| Market Cap (PLNm)  | 1,395.6 |
| Market Cap (US\$m) | 627.2   |
| Free float (%)     | 57      |
| WIG 20 Index       | 2,554.7 |

#### Key indicators (FY1)

|                        |      |
|------------------------|------|
| ROE (%)                | 13.5 |
| Book value/share (PLN) | 25.2 |
| Price/book (x)         | 2.0  |
| Net interest cover (x) | 24.5 |
| EBIT margin (%)        | 8.0  |

Model updated:Unavailable

**Running the numbers****Emerging Europe****Poland****Construction****POL-AQUA**

Reuters: PQAA.WA

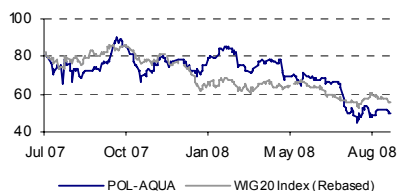
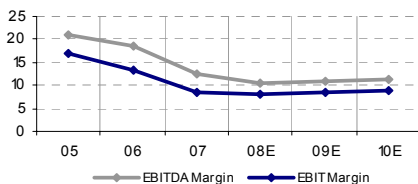
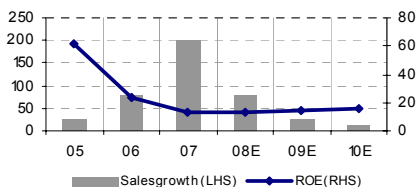
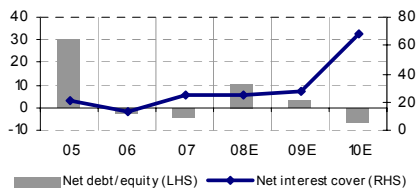
Bloomberg: PQA PW

**Buy**

|                   |                        |
|-------------------|------------------------|
| Price (19 Aug 08) | PLN 50.75              |
| Target price      | PLN 60.00              |
| 52-week Range     | PLN 45.00 - 89.70      |
| Market Cap (m)    | PLNm 1,396<br>USDm 627 |

**Company Profile**

Pol-Aqua is a diversified construction company which initially was specializing in water and sewage system engineering and oil & gas pipeline construction but a few years ago it began the process of diversification into other areas of the construction market, i.e. general construction, steel structure manufacturing and some building material production. Pol-Aqua's business model calls for high integrity and participation in many stages of the value chain of the construction process.

**Price Performance****Margin Trends****Growth & Profitability****Solvency**

Tomasz Krukowski, CFA

+48 22 579-8732

tomasz.krukowski@db.com

Fiscal year end 31-Dec

|                             | 2005 | 2006 | 2007  | 2008E | 2009E | 2010E |
|-----------------------------|------|------|-------|-------|-------|-------|
| <b>Financial Summary</b>    |      |      |       |       |       |       |
| DB EPS (PLN)                | 1.07 | 1.11 | 2.10  | 3.19  | 4.06  | 4.78  |
| Reported EPS (PLN)          | 1.07 | 1.11 | 2.10  | 3.19  | 4.06  | 4.78  |
| DPS (PLN)                   | 0.00 | 0.00 | 0.00  | 0.00  | 0.00  | 0.00  |
| BVPS (PLN)                  | 2.2  | 7.6  | 22.0  | 25.2  | 29.2  | 34.0  |
| Weighted average shares (m) | 16   | 20   | 28    | 28    | 28    | 28    |
| Average market cap (PLNm)   | na   | na   | 2,099 | 1,396 | 1,396 | 1,396 |
| Enterprise value (PLNm)     | na   | na   | 2,011 | 1,402 | 1,355 | 1,269 |
| <b>Valuation Metrics</b>    |      |      |       |       |       |       |
| P/E (DB) (x)                | na   | na   | 36.3  | 15.9  | 12.5  | 10.6  |
| P/E (Reported) (x)          | na   | na   | 36.3  | 15.9  | 12.5  | 10.6  |
| P/BV (x)                    | 0.00 | 0.00 | 3.55  | 2.02  | 1.74  | 1.49  |
| FCF Yield (%)               | na   | na   | nm    | nm    | 2.5   | 5.7   |
| Dividend Yield (%)          | na   | na   | 0.0   | 0.0   | 0.0   | 0.0   |
| EV/Sales (x)                | nm   | nm   | 2.8   | 1.1   | 0.9   | 0.7   |
| EV/EBITDA (x)               | nm   | nm   | 22.8  | 10.5  | 7.7   | 6.3   |
| EV/EBIT (x)                 | nm   | nm   | 33.5  | 14.0  | 9.9   | 8.0   |

**Income Statement (PLNm)**

|                                     |            |            |            |              |              |              |
|-------------------------------------|------------|------------|------------|--------------|--------------|--------------|
| <b>Sales revenue</b>                | <b>131</b> | <b>234</b> | <b>706</b> | <b>1,262</b> | <b>1,579</b> | <b>1,773</b> |
| <b>Gross profit</b>                 | <b>40</b>  | <b>61</b>  | <b>118</b> | <b>207</b>   | <b>266</b>   | <b>304</b>   |
| <b>EBITDA</b>                       | <b>28</b>  | <b>43</b>  | <b>88</b>  | <b>134</b>   | <b>175</b>   | <b>202</b>   |
| Depreciation                        | 5          | 12         | 28         | 33           | 38           | 44           |
| Amortisation                        | 0          | 0          | 0          | 0            | 0            | 0            |
| <b>EBIT</b>                         | <b>22</b>  | <b>31</b>  | <b>60</b>  | <b>100</b>   | <b>137</b>   | <b>158</b>   |
| Net interest income(expense)        | -1         | -2         | -2         | -4           | -5           | -2           |
| Associates/affiliates               | 0          | 0          | 0          | 0            | 0            | 0            |
| Exceptionals/extraordinaries        | 0          | 0          | 0          | 0            | 0            | 0            |
| Other pre-tax income/(expense)      | 1          | 1          | 3          | 6            | 0            | 0            |
| <b>Profit before tax</b>            | <b>22</b>  | <b>29</b>  | <b>60</b>  | <b>102</b>   | <b>132</b>   | <b>156</b>   |
| Income tax expense                  | 5          | 7          | 10         | 16           | 21           | 26           |
| Minorities                          | 0          | 0          | 0          | -1           | -1           | -1           |
| Other post-tax income/(expense)     | 0          | 0          | 0          | 0            | 0            | 0            |
| <b>Net profit</b>                   | <b>17</b>  | <b>22</b>  | <b>50</b>  | <b>88</b>    | <b>112</b>   | <b>131</b>   |
| DB adjustments (including dilution) | 0          | 0          | 0          | 0            | 0            | 0            |
| <b>DB Net profit</b>                | <b>17</b>  | <b>22</b>  | <b>50</b>  | <b>88</b>    | <b>112</b>   | <b>131</b>   |

**Cash Flow (PLNm)**

|                                      |           |             |             |            |           |            |
|--------------------------------------|-----------|-------------|-------------|------------|-----------|------------|
| <b>Cash flow from operations</b>     | <b>6</b>  | <b>-40</b>  | <b>-20</b>  | <b>10</b>  | <b>85</b> | <b>135</b> |
| Net Capex                            | -14       | -67         | -115        | -43        | -50       | -56        |
| <b>Free cash flow</b>                | <b>-8</b> | <b>-107</b> | <b>-135</b> | <b>-33</b> | <b>35</b> | <b>79</b>  |
| Equity raised/(bought back)          | 0         | 0           | 0           | 0          | 0         | 0          |
| Dividends paid                       | -3        | 0           | 0           | 0          | 0         | 0          |
| Net inc/(dec) in borrowings          | 3         | 25          | 64          | 0          | 0         | 0          |
| Other investing/financing cash flows | 11        | 124         | 155         | -61        | 13        | 9          |
| <b>Net cash flow</b>                 | <b>3</b>  | <b>41</b>   | <b>84</b>   | <b>-94</b> | <b>48</b> | <b>88</b>  |
| Change in working capital            | -7        | -51         | -114        | -153       | -88       | -55        |

**Balance Sheet (PLNm)**

|                                   |            |            |              |              |              |              |
|-----------------------------------|------------|------------|--------------|--------------|--------------|--------------|
| Cash and other liquid assets      | 5          | 46         | 130          | 36           | 84           | 172          |
| Tangible fixed assets             | 33         | 87         | 174          | 183          | 195          | 207          |
| Goodwill/intangible assets        | 0          | 0          | 202          | 237          | 237          | 237          |
| Associates/investments            | 2          | 33         | 65           | 65           | 65           | 65           |
| Other assets                      | 64         | 152        | 499          | 867          | 1,067        | 1,191        |
| <b>Total assets</b>               | <b>104</b> | <b>320</b> | <b>1,070</b> | <b>1,388</b> | <b>1,649</b> | <b>1,872</b> |
| Interest bearing debt             | 18         | 42         | 106          | 106          | 106          | 106          |
| Other liabilities                 | 45         | 125        | 359          | 589          | 737          | 827          |
| <b>Total liabilities</b>          | <b>63</b>  | <b>167</b> | <b>465</b>   | <b>695</b>   | <b>842</b>   | <b>933</b>   |
| Shareholders' equity              | 35         | 152        | 605          | 692          | 804          | 935          |
| Minorities                        | 7          | 0          | 0            | 1            | 2            | 4            |
| <b>Total shareholders' equity</b> | <b>41</b>  | <b>152</b> | <b>605</b>   | <b>693</b>   | <b>806</b>   | <b>939</b>   |
| Net debt                          | 13         | -4         | -24          | 70           | 22           | -66          |

**Key Company Metrics**

|                        |       |      |       |      |      |      |
|------------------------|-------|------|-------|------|------|------|
| Sales growth (%)       | 26.2  | 78.0 | 202.5 | 78.6 | 25.1 | 12.3 |
| DB EPS growth (%)      | 177.4 | 3.3  | 90.1  | 51.5 | 27.4 | 17.6 |
| EBITDA Margin (%)      | 21.1  | 18.4 | 12.5  | 10.6 | 11.1 | 11.4 |
| EBIT Margin (%)        | 17.0  | 13.2 | 8.5   | 8.0  | 8.7  | 8.9  |
| Payout ratio (%)       | 0.0   | 0.0  | 0.0   | 0.0  | 0.0  | 0.0  |
| ROE (%)                | 61.3  | 23.7 | 13.3  | 13.5 | 14.9 | 15.1 |
| Capex/sales (%)        | 10.4  | 28.7 | 16.3  | 3.4  | 3.2  | 3.2  |
| Capex/depreciation (x) | 2.5   | 5.5  | 4.0   | 1.3  | 1.3  | 1.3  |
| Net debt/equity (%)    | 30.4  | -2.6 | -4.0  | 10.1 | 2.7  | -7.0 |
| Net interest cover (x) | 21.4  | 12.6 | 24.9  | 24.5 | 27.2 | 68.8 |

Source: Company data, Deutsche Bank estimates

# Investment thesis

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## Outlook

We rate Pol-Aqua Buy; our positive stance is based both on valuation (we expect double-digit total return on a 12-month basis) and a positive earnings outlook. Pol-Aqua, whose primary specialization is civil engineering (mainly construction of water and sewage systems) is benefiting from the upturn in that market segment driven by EU-financed projects. We expect this prosperity to continue in years to come as Poland's environmental and hydro-construction is scheduled to receive EUR 3.6bn for new projects under the 2007-2013 EU budget. Additionally, in recent years Pol-Aqua has entered (mainly through M&A's) other segments of the construction market (general construction, building materials production), which we expect to significantly contribute to the company's top and bottom lines starting from 2008. Overall, we expect Pol-Aqua's EPS to expand at a CAGR of 38% in 2008E-2010E.

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## Valuation

Our 12-month target price for Pol-Aqua of PLN 60.0/share is based on a five-year discounted cash flow analysis. Major assumptions for our DCF are a Cost of Equity of 11.1% and WACC of 10.4%, both derived from CAPM using a risk free rate of 6.5%, equity risk premium of 5.0% and an un-levered fundamental beta of 0.8x (the Damodaran industry average). We use a terminal growth rate of 4.8%, calculated through multiplication of the company's reinvestment rate and ROIC.

For illustrative purposes, we also present a peer comparison. Pol-Aqua is trading at double-digit discounts to its peers based on 2008E P/E and EV/EBITDA, despite its expected EPS expansion being above average. On the other hand, Pol-Aqua is the smallest company in our universe, and its inferior liquidity demands some discount.

---

## Risks

Downside risks to our positive stance on Pol-Aqua on the macro side include delays in the launch of new environmental and hydro-construction projects. Although the financing in most cases is secured by the EU funds, the projects tend to get delayed due to imperfections in Poland's construction law and procurement procedures. Additionally, Pol-Aqua's sizable general construction division appears to be susceptible to the expected slowdown in that market segment. Looking at company-specific risk, we point out that 1) Pol-Aqua's acquisition-driven expansion may create execution problems (i.e. integration and restructuring of acquired entities), and 2) since the company recognizes revenues in its P&L only after invoicing, and delays on that front are not unusual in Poland's public sector, earnings recognition might be postponed.

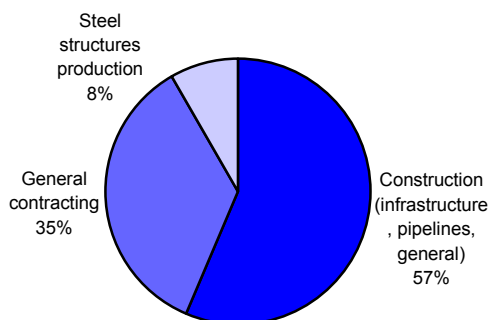
# Earnings outlook & valuation

## Key business areas

**Civil engineering has been Pol-Aqua's core business but acquisitions diversified into general construction and building materials production**

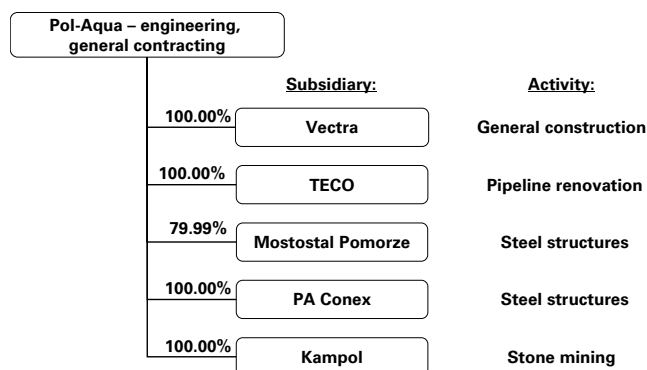
Until 2006 Pol-Aqua was a construction company that specialized in civil engineering (primarily water and sewage systems) and pipelines. In 2007 Pol-Aqua began rapidly expanding, driven by general contracting (through acquisition), general construction (through acquisition) and steel structure manufacturing (through acquisition and organically). On top of that, the company plans to enter the granite mining business through acquired granite deposits. In 2008E we expect construction (mainly infrastructure and pipelines) to account for 57% of total revenues and lower-margin general contracting (mainly commercial centres and residential properties) to account for 35%.

**Figure 37: Pol-Aqua: 2008E revenues structure**



Source: Deutsche Bank estimates

**Figure 38: Pol-Aqua group structure (major subsidiaries)**



Source: Deutsche Bank

## Earnings drivers

### 1. Acquisitions

**Three sizable M&A's were initiated in 2007, two others in 2008, and the pipeline includes a PLN 0.6bn road construction player**

Pol-Aqua conducted three sizable acquisitions in 2007, taking over subsequently the general contraction operations of Polnord (for PLN 100m), Vectra (general construction, for PLN 70m) and Mostostal Pomorze (steel structures manufacturing, for PLN 48m). We estimate that these three entities should generate 52% of Pol-Aqua's 2008E sales and 31% of gross profit. Year to date, two further acquisitions were conducted, though not as sizable: Teco (a pipeline renovations company) and Placidus Investments (a producer of sound-absorbing screens). Pol-Aqua is also still in talks to take over a PLN 0.6bn revenue road construction company, with the chances of the transaction being signed estimated at 50% by the company's management.

### 2. EU inflows into environmental infrastructure

**Under the 2007-2013 EU budget, Poland's environmental and hydro-construction should receive EUR 3.6bn for new projects**

Pol-Aqua is a leader in the Polish water and sewage systems construction market. Additionally, the company has competence and know-how in the construction of solid waste segregation and utilisation facilities. Both market segments are in the boom phase due to the inflow of EU money. We expect this prosperity to continue in years to come as Poland's environmental and hydro-construction is scheduled to receive EUR 3.6bn for new projects under the 2007-2013 EU budget.

**Capex in steel structures is being completed this year, granite mining should kick off in 2009E**

**In 2007 Pol-Aqua failed to deliver on expectations, highlighting execution risk of M&As**

**Current backlog of PLN 1.3bn is likely to increase in the short run...**

**...but it already covers our FY 2008E sales projections**

### 3. Building materials production (steel structures, granite)

In addition to the acquisition of Mostotsal Pomorze (for detail see point 1), Pol-Aqua is developing building materials production activity in two major areas: the manufacturing of steel structures and the extraction of granite. The former is located in 100% owned subsidiary named Conex, which is currently finishing its PLN 30m capex programme. The latter is to be conducted on the basis of 25.7m tonnes of granite deposits, the extraction licence for which Pol-Aqua expects to receive by the end of this year. We estimate Pol-Aqua's building materials production to generate 14% of sales and 20% of gross profit in 2010E.

#### Risks: managing the growth

We see restructuring of the acquired entities and managing of the rapid growth as major challenges for Pol-Aqua's management. This risk already materialised in 2007 as the company failed to deliver on the earnings expectations (on the underlying basis) also due to below-expectation profitability of the general contracting business.

### Earnings forecasts

#### Backlog of PLN 1.3bn...

Pol-Aqua's current backlog amounts to PLN 1.3bn (of which PLN 0.9bn is planned to be booked in 2008) with the figure being flat in recent months. However, the company's management is claiming that:

- Starting from 4Q 2008 the company expects a number of procurement procedures in the EU-financed environmental segment (water and sewage systems, waste utilisation facilities), with the average projects' value increasing vs. what the company has currently in its backlog.
- It is currently in talks with several investors about sizable projects (over PLN 100m) in the area of general construction (commercial centres) and infrastructure.

#### ...fully covers our 2008E sales forecast

We forecast Pol-Aqua's 2008E sales at PLN 1,262m, which implies revenues for 2H 2008E of PLN 760m vs. the company's backlog of PLN 900m for this period. Our conservatism stems from Pol-Aqua's need to invoice for revenue recognition in its construction activity and the frequency of delays on that front (i.e. in 2007).

We expect Pol-Aqua's sales to increase by 25% to PLN 1,579m in 2009E and by 12% to PLN 1,773m in 2010E, driven by environment/infrastructure construction and building materials production (steel and granite). We note that our revenues do not incorporate the potential effects of the acquisitions that the company is working on.

**Figure 39: Pol-Aqua: Revenues forecasts**

| PLNm                           | 2006         | 2007         | 2008E          | 2009E          | 2010E          |
|--------------------------------|--------------|--------------|----------------|----------------|----------------|
| Construction, of which         | 233.6        | 395.1        | 713.3          | 852.9          | 955.2          |
| Civil engineering              | 203.3        | 296.2        | 431.4          | 500.0          | 560.1          |
| Pipelines                      | 30.3         | 88.4         | 131.9          | 152.8          | 171.2          |
| General construction           | 0.0          | 10.5         | 150.0          | 200.0          | 224.0          |
| General construction           | 0.0          | 282.9        | 443.8          | 514.4          | 576.2          |
| Steel structures manufacturing | 0.0          | 28.5         | 105.0          | 150.0          | 180.0          |
| Granite mining                 | 0.0          | 0.0          | 0.0            | 62.0           | 62.0           |
| <b>Total</b>                   | <b>233.6</b> | <b>706.5</b> | <b>1,262.1</b> | <b>1,579.3</b> | <b>1,773.4</b> |
| Change (% YoY)                 | 78           | 202          | 79             | 25             | 12             |

Source: Pol-Aqua, Deutsche Bank estimates

**Restructuring and new businesses should drive margins expansion****We expect a 3-year EPS CAGR of 38%**

We expect Pol-Aqua's gross margin to expand to 13.8% in 2008E from 12.7% in 2007 due to recovery in the company's general contracting business, which was acquired in early 2007 with a backlog of unprofitable contracts. In 2009E and 2010E we forecast Pol-Aqua's gross margin to widen further to 14.4% and 14.7%, respectively, due to a rising share of higher-margin building materials production in total revenues.

**We forecast 2008E net profit of PLN 88m**

On the earnings front, we forecast Pol-Aqua's net profit to increase by 75% YoY to PLN 87.7m in 2008E. This is 12% below management guidance of PLN 100m, which has been recently reiterated, but in 2007 the management failed to deliver on the expectations on the underlying basis. In 2009E we forecast a 27% rise in net profit to PLN 111.7m but in 2010E the momentum should decrease; we forecast 18% YoY growth of PLN 131.4m.

**Figure 40: Pol-Aqua: Earnings forecasts**

| PLNm                     | 2006  | 2007  | 2008E   | %, YoY | 2009E   | %, YoY | 2010E   | %, YoY |
|--------------------------|-------|-------|---------|--------|---------|--------|---------|--------|
| Sales                    | 233.6 | 706.5 | 1,262.1 | 79     | 1,579.3 | 25     | 1,773.4 | 12     |
| Gross profit (after A&D) | 48.4  | 89.6  | 173.8   | 94     | 227.5   | 31     | 260.0   | 14     |
| Gross margin (%)         | 20.7  | 12.7  | 13.8    | -      | 14.4    | -      | 14.7    | -      |
| EBIT                     | 30.8  | 60.0  | 100.4   | 67     | 136.7   | 36     | 158.0   | 16     |
| EBIT margin (%)          | 13.2  | 8.5   | 8.0     | -      | 8.7     | -      | 8.9     | -      |
| Pre-tax profit           | 29.5  | 60.5  | 102.3   | 69     | 131.6   | 29     | 155.7   | 18     |
| Net profit               | 22.1  | 50.2  | 87.7    | 75     | 111.7   | 27     | 131.4   | 18     |

Source: Pol-Aqua, Deutsche Bank estimates

**1H figures suggest that the company is on track****Strong 1H 2008 figures: net profit by 58% up YoY**

Pol-Aqua posted very sound results for 1H 2008 with revenues more than doubling to PLN 501.8m and net profit increasing by 58% to PLN 30.8m. The latter accounts for 34% of our FY forecast, but we note that due to seasonal considerations the company traditionally books the bulk of its earnings in the second half of the year.

**Figure 41: Pol-Aqua: 1H 2008 results review**

| PLNm  | 2Q08  | 2Q07  | %, YoY | 1H08  | 1H07  | %, YoY |
|-------|-------|-------|--------|-------|-------|--------|
| Sales | 293.9 | 172.9 | 70     | 501.8 | 241.4 | 108    |
| EBIT  | 22.2  | 15.5  | 43     | 29.5  | 18.5  | 60     |
| Net   | 23.4  | 15.5  | 51     | 30.8  | 19.4  | 58     |

Source: Pol-Aqua

**Our DCF derived a 12-month target price of PLN 60****Valuation and recommendation: Buy with 12-month TP of PLN 60****DCF model**

We have developed a 5-year DCF model to arrive at 12-month target price for Pol-Aqua. The major assumptions are as follows:

- We forecast Pol-Aqua's revenues and EBIT to grow at a CAGR of 25% in 2008E-2012E. We forecast an average EBIT margin of 8.6% in the period.
- We expect a terminal growth rate of 4.8%. We calculated it based on the following formula: Terminal growth rate = Reinvestment rate x ROIC.
- We use a cost of equity of 11.1% and WACC of 10.4%. We used CAPM to achieve those values, using a risk free rate of 6.5%, an equity risk premium of 5.0% and an unlevered beta of 0.8x (the Damodaran industry average).

**Based on the above, we arrived at 12-month target price for Pol-Aqua of PLN 60.0. With expected total shareholder return of 18%, we rate Pol-Aqua a Buy.**

**Figure 42: Pol-Aqua: DCF model**

| PLNm                                | 2008E | 2009E | 2010E | 2011E | 2012E |
|-------------------------------------|-------|-------|-------|-------|-------|
| Revenues                            | 1,262 | 1,579 | 1,773 | 1,945 | 2,133 |
| EBIT                                | 100   | 137   | 158   | 170   | 184   |
| Cash taxes on EBIT                  | 16    | 22    | 26    | 29    | 31    |
| NOPAT                               | 84    | 114   | 132   | 142   | 153   |
| Depreciation                        | 33    | 38    | 44    | 51    | 60    |
| Change in operating WC              | 139   | 64    | 40    | 36    | 39    |
| Capital expenditure                 | 43    | 50    | 56    | 62    | 75    |
| Net investment                      | 149   | 75    | 52    | 47    | 54    |
| Free cash flow                      | -65   | 39    | 80    | 95    | 99    |
| WACC (%)                            | 10.4  |       |       |       |       |
| PV FCF 2008E-2012E                  | 157   |       |       |       |       |
| Terminal growth (%)                 | 4.8   |       |       |       |       |
| Terminal Value (TV)                 | 1,823 |       |       |       |       |
| PV TV                               | 1,109 |       |       |       |       |
| Total EV                            | 1,266 |       |       |       |       |
| Net debt (Jan 2008)                 | -24   |       |       |       |       |
| Equity value                        | 1,290 |       |       |       |       |
| Number of shares (m, fully diluted) | 27.5  |       |       |       |       |
| Value per share (PLN, 1 Jan 2008)   | 46.9  |       |       |       |       |
| Month                               | 19.0  |       |       |       |       |
| 12-month target price               | 60    |       |       |       |       |
| Revenue growth                      | 78.6  | 25.1  | 12.3  | 9.7   | 9.7   |
| EBIT growth (%)                     | 67.4  | 36.1  | 15.6  | 7.9   | 7.9   |
| NOPAT growth (%)                    | 70.4  | 36.3  | 15.1  | 7.6   | 7.7   |
| FCF growth (%)                      | n.m.  | n.m.  | 105.4 | 19.0  | 3.5   |
| EBIT margin (%)                     | 8.0   | 8.7   | 8.9   | 8.8   | 8.6   |
| NOPAT margin (%)                    | 6.7   | 7.2   | 7.4   | 7.3   | 7.2   |
| Capex/Revenues (%)                  | 3.4   | 3.2   | 3.2   | 3.2   | 3.5   |
| Change in WC/Revenues (%)           | 11.0  | 4.0   | 2.2   | 1.8   | 1.9   |
| Change in WC/Change in revenues (%) | 25.1  | 20.0  | 20.6  | 20.9  | 21.0  |

Source: Deutsche Bank estimates

**Peer comparison**

**Pol-Aqua trades at double-digit discounts to its peers based on 2008E ratios**

Pol-Aqua is trading at 2008E P/E and EV/EBITDA of 15.9x and 10.5x, with respective discounts of 22% and 7% to our Polish construction universe. We note, however, that Pol-Aqua is the smallest company in our universe, with inferior liquidity that demands some discount.

**Figure 43: Pol-Aqua: Domestic peer comparison**

|                                         | Ticker         | Rec.       | Price | 19 Aug      | MCAP       | P/E (x)     |             | 3-year EPS  |           | EV/EBITDA (x) |            |            |
|-----------------------------------------|----------------|------------|-------|-------------|------------|-------------|-------------|-------------|-----------|---------------|------------|------------|
|                                         |                |            |       | (PLN)       | (US\$m)    | 2008E       | 2009E       | 2010E       | CAGR (%)  | 2008E         | 2009E      | 2010E      |
| Budimex                                 | BMEX.WA        | HOLD       |       | 82.0        | 926        | 24.4        | 19.8        | 15.4        | 108       | 11.7          | 8.9        | 6.2        |
| PBG                                     | PBGG.WA        | BUY        |       | 231.0       | 1,372      | 20.6        | 15.9        | 12.0        | 36        | 12.6          | 9.4        | 7.2        |
| Polimex                                 | MOSD.WA        | SELL       |       | 5.6         | 1,200      | 20.3        | 17.8        | 14.5        | 23        | 11.0          | 9.4        | 7.9        |
| <b>Pol-Aqua</b>                         | <b>PQAA.WA</b> | <b>BUY</b> |       | <b>50.8</b> | <b>617</b> | <b>15.9</b> | <b>12.5</b> | <b>10.6</b> | <b>38</b> | <b>10.5</b>   | <b>7.7</b> | <b>6.3</b> |
| <b>Median</b>                           |                |            |       |             |            | <b>20.5</b> | <b>16.9</b> | <b>13.2</b> | <b>37</b> | <b>11.4</b>   | <b>9.2</b> | <b>6.8</b> |
| <i>Pol-Aqua's Premium/(Discount), %</i> |                |            |       |             |            | -22         | -26         | -19         | -         | -7            | -16        | -7         |

Source: Deutsche Bank estimates

**Appendix: Capital history and shareholder structure**

Pol-Aqua conducted an IPO on the Warsaw Stock Exchange in July 2007 raising PLN 231m (3m shares at PLN 77/share).

**Figure 44: Pol-Aqua: Capital history**

| Date   | Series | No. of shares | Issue price (PLN) | Total no. of shares outstanding | Comment                     |
|--------|--------|---------------|-------------------|---------------------------------|-----------------------------|
| Oct-97 | A      | 104,934       | 1.00              | 104,934                         | conversion to plc           |
| Oct-97 | B      | 55,066        | 1.00              | 160,000                         | capital increase            |
| Oct-97 | C      | 1             | 31.00             | 160,001                         | capital increase            |
| Mar-06 |        |               |                   | 16,000,100                      | split 1:100                 |
| Oct-06 | D      | 4,000,000     | 23.00             | 20,000,100                      | Private placement to Prokom |
| Mar-07 | E      | 4,500,000     | 40.00             | 24,500,100                      | Private placement to Prokom |
| Jul-07 | F      | 3,000,000     | 77.00             | 27,500,100                      | IPO                         |

Source: Pol-Aqua, Deutsche Bank

**Mr. Stefanski, founder and CEO, was a sizable insider buyer and selling in recent year**

Mr. Marek Stefanski, Pol-Aqua's founder and CEO, is the company's major shareholder and holds a 43% stake. This stake is scheduled to be increased by an additional 3.6% on the basis of already-signed purchase agreements. Mr. Stefanski has been active in insider transactions in the recent year. First he sold 1m share at the IPO at PLN 77/share in July 2007; afterwards, up until December 2007, Mr. Stefanski repurchased 1.3 shares at prices in the range of PLN 68-79/share. Finally, in August 2008, Mr. Stefanski disposed of 2.9m shares at an average price of PLN 48/share, claiming the previous purchases were leveraged while he had to repay his bank loans.

**Figure 45: Pol-Aqua: Shareholder structure**

| Shareholders                  | No. of shares     | As % of total | No. of voting rights | As % of total |
|-------------------------------|-------------------|---------------|----------------------|---------------|
| Mr. Marek Stefanski           | 11,830,482        | 43.0          | 11,830,482           | 43.0          |
| Commercial Union Pension Fund | 1,700,000         | 6.2           | 1,700,000            | 6.2           |
| Pioneer Pekao Mutual Fund     | 1,606,520         | 5.8           | 1,606,520            | 5.8           |
| ING Pension Fund              | 1,435,949         | 5.2           | 1,435,949            | 5.2           |
| BZ WBK Mutual Fund            | 1,127,181         | 4.1           | 1,127,181            | 4.1           |
| Other                         | 9,799,968         | 35.6          | 9,799,968            | 35.6          |
| <b>Total</b>                  | <b>27,500,100</b> | <b>100.0</b>  | <b>27,500,100</b>    | <b>100.0</b>  |

Source: Pol-Aqua, Deutsche Bank

**Emerging Europe** Poland  
**Building and Construction** Construction

22 August 2008

# Budimex

Reuters: **BMEX.WA** Bloomberg: **BDX PW**

## Initiate with Hold. Earnings recovery appears priced in

### Initiating with a Hold and 12-month target price of PLN 85

We believe Budimex's ongoing earnings recovery is priced in; we forecast 2008E net profit at PLN 86m, up 469% YoY (already reported 1H 2008 net profit accounts for 50% of our FY estimate). The stock is trading at 2008E and 2009E P/E ratios of 24.4x and 19.8x, implying respective 19% and 17% premiums to sector averages.

### Earnings recovery story...

We see Budimex as an earnings turnaround story, with the drivers being both internal (changes in top management in 2007, improved risk management procedures), and external (revival in the Polish construction market, long-awaited kick off in sizable road construction projects). We see Budimex as the best exposure in Poland to road construction, for which the EU has dedicated EUR 15.1bn under its 2007-2013 budget. We expect the share of infrastructure in Budimex's total revenues to reach 52% in 2010E, up from 30% in 2007.

### ...this time on track to deliver on expectations

We forecast Budimex's net profit to increase by 469% to PLN 86m in 2008E and by a further 24% to PLN 106m in 2009E [please check]. While we acknowledge that in recent years Budimex has failed to deliver, this time the company appears to be on track, with 1H 2008 net profit of PLN 43m already accounting for half of our FY projection, while the second half of the year is usually stronger due to seasonal considerations.

### We expect a low, single digit total return on the 12-month horizon

Our 12-month target price of PLN 85.0 is based on a DCF model. Budimex is currently trading at 2008E P/E and EV/EBITDA of 24.4x and 11.7x, implying respective 19% and 3% premiums to the sector average. Delays/acceleration of the EU-financed road construction projects constitute downside/upside risks. Company specific risks are legal disputes with the company's former clients: downside – Warsaw Airport; upside – City of Krakow.

#### Forecasts and ratios

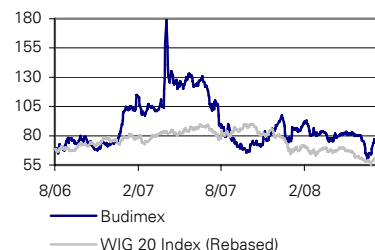
| Year End Dec 31   | 2007A | 2008E        | 2009E | 2010E |
|-------------------|-------|--------------|-------|-------|
| Revenue (PLNm)    | 3,076 | <b>3,302</b> | 3,953 | 4,573 |
| EBITDA (PLNm)     | 52    | <b>134</b>   | 156   | 190   |
| EBITA (PLNm)      | 28    | <b>110</b>   | 132   | 165   |
| Net Income (PLNm) | 15    | <b>86</b>    | 106   | 136   |
| EPS (PLN)         | 0.59  | <b>3.36</b>  | 4.15  | 5.32  |
| P/E (DB EPS) (x)  | 169.1 | <b>24.4</b>  | 19.8  | 15.4  |
| EV/EBITDA (x)     | 41.1  | <b>11.7</b>  | 8.9   | 6.2   |
| Yield (%)         | 0.0   | <b>0.0</b>   | 0.0   | 0.0   |

Source: Deutsche Bank estimates, company data

### Hold

|                            |                      |
|----------------------------|----------------------|
| Price at 19 Aug 2008 (PLN) | <b>82.00</b>         |
| Price Target (PLN)         | <b>85.00</b>         |
| 52-week range (PLN)        | <b>97.70 - 60.25</b> |

#### Price/price relative



| Performance (%) | 1m   | 3m    | 12m   |
|-----------------|------|-------|-------|
| Absolute        | 18.8 | -0.6  | -7.8  |
| WIG 20 Index    | 7.5  | -15.0 | -24.7 |

#### Stock data

|                    |                |
|--------------------|----------------|
| Market Cap (PLNm)  | <b>2,093.5</b> |
| Market Cap (US\$m) | <b>926.0</b>   |
| Free float (%)     | <b>41</b>      |
| WIG 20 Index       | <b>2,546.5</b> |

#### Key indicators (FY1)

|                        |             |
|------------------------|-------------|
| ROE (%)                | <b>14.7</b> |
| Book value/share (PLN) | <b>24.8</b> |
| Price/book (x)         | <b>3.3</b>  |
| Net interest cover (x) | <b>16.2</b> |
| EBIT margin (%)        | <b>3.3</b>  |

Model updated: 04 February 2008

**Running the numbers****Emerging Europe****Poland****Construction****Budimex**

Reuters: BMEX.WA

Bloomberg: BDX PW

**Hold**

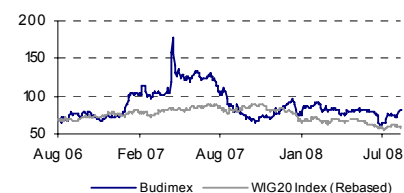
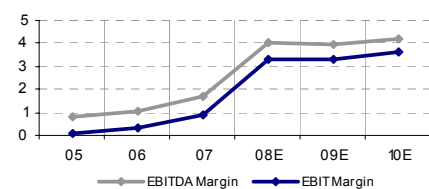
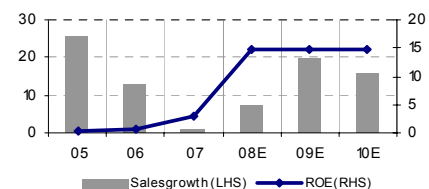
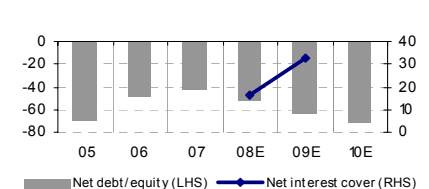
Price (19 Aug 08) PLN 82.00

Target price PLN 85.00

52-week Range PLN 60.25 - 97.70

Market Cap (m) PLNm 2,093  
USDm 926**Company Profile**

Budimex is a Poland's leading general contractor focused on infrastructure (roads, bridges) and general construction (housing, offices, commercial centres) market segments. The company also holds a 50% stake in a sizable residential property developer operating in Poland's largest cities. Ferrovial of Spain is Budimex's strategic shareholder with a 59% stake in share capital.

**Price Performance****Margin Trends****Growth & Profitability****Solvency**

Tomasz Krukowski, CFA

+48 22 579-8732

tomasz.krukowski@db.com

Fiscal year end 31-Dec

|                             | 2005  | 2006  | 2007  | 2008E | 2009E | 2010E |
|-----------------------------|-------|-------|-------|-------|-------|-------|
| <b>Financial Summary</b>    |       |       |       |       |       |       |
| DB EPS (PLN)                | 0.08  | 0.15  | 0.59  | 3.36  | 4.15  | 5.32  |
| Reported EPS (PLN)          | 0.08  | 0.15  | 0.59  | 3.36  | 4.15  | 5.32  |
| DPS (PLN)                   | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  | 0.00  |
| BVPS (PLN)                  | 20.4  | 20.5  | 21.0  | 24.8  | 31.5  | 39.9  |
| Weighted average shares (m) | 26    | 26    | 26    | 26    | 26    | 26    |
| Average market cap (PLNm)   | 1,141 | 1,511 | 2,548 | 2,093 | 2,093 | 2,093 |
| Enterprise value (PLNm)     | 612   | 1,107 | 2,124 | 1,570 | 1,392 | 1,172 |

**Valuation Metrics**

|                    |       |       |       |      |      |      |
|--------------------|-------|-------|-------|------|------|------|
| P/E (DB) (x)       | 562.1 | 388.0 | 169.1 | 24.4 | 19.8 | 15.4 |
| P/E (Reported) (x) | 562.1 | 388.0 | 169.1 | 24.4 | 19.8 | 15.4 |
| P/BV (x)           | 1.89  | 3.66  | 4.38  | 3.31 | 2.61 | 2.06 |
| FCF Yield (%)      | 6.8   | nm    | 2.2   | 4.7  | 7.0  | 8.1  |
| Dividend Yield (%) | 0.0   | 0.0   | 0.0   | 0.0  | 0.0  | 0.0  |
| EV/Sales (x)       | 0.2   | 0.4   | 0.7   | 0.5  | 0.4  | 0.3  |
| EV/EBITDA (x)      | 27.0  | 35.6  | 41.1  | 11.7 | 8.9  | 6.2  |
| EV/EBIT (x)        | 311.5 | 111.4 | 75.8  | 14.2 | 10.5 | 7.1  |

**Income Statement (PLNm)**

|                                     |              |              |              |              |              |              |
|-------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| <b>Sales revenue</b>                | <b>2,703</b> | <b>3,043</b> | <b>3,076</b> | <b>3,302</b> | <b>3,953</b> | <b>4,573</b> |
| <b>Gross profit</b>                 | <b>127</b>   | <b>146</b>   | <b>172</b>   | <b>256</b>   | <b>337</b>   | <b>399</b>   |
| <b>EBITDA</b>                       | <b>23</b>    | <b>31</b>    | <b>52</b>    | <b>134</b>   | <b>156</b>   | <b>190</b>   |
| Depreciation                        | 21           | 21           | 24           | 24           | 24           | 26           |
| Amortisation                        | 0            | 0            | 0            | 0            | 0            | 0            |
| <b>EBIT</b>                         | <b>2</b>     | <b>10</b>    | <b>28</b>    | <b>110</b>   | <b>132</b>   | <b>165</b>   |
| Net interest income/(expense)       | 3            | 9            | 10           | -7           | -4           | 0            |
| Associates/affiliates               | 1            | 2            | 2            | 2            | 2            | 2            |
| Exceptionals/extraordinaries        | 0            | 0            | 0            | 0            | 0            | 0            |
| Other pre-tax income/(expense)      | 2            | -8           | -26          | 0            | 0            | 0            |
| <b>Profit before tax</b>            | <b>6</b>     | <b>10</b>    | <b>12</b>    | <b>104</b>   | <b>128</b>   | <b>165</b>   |
| Income tax expense                  | 6            | 8            | -1           | 20           | 24           | 31           |
| Minorities                          | -1           | 0            | -1           | 0            | 0            | 0            |
| Other post-tax income/(expense)     | 0            | 0            | 0            | 0            | 0            | 0            |
| <b>Net profit</b>                   | <b>2</b>     | <b>4</b>     | <b>15</b>    | <b>86</b>    | <b>106</b>   | <b>136</b>   |
| DB adjustments (including dilution) | 0            | 0            | 0            | 0            | 0            | 0            |
| <b>DB Net profit</b>                | <b>2</b>     | <b>4</b>     | <b>15</b>    | <b>86</b>    | <b>106</b>   | <b>136</b>   |

**Cash Flow (PLNm)**

|                                      |            |             |            |            |            |            |
|--------------------------------------|------------|-------------|------------|------------|------------|------------|
| <b>Cash flow from operations</b>     | <b>92</b>  | <b>0</b>    | <b>70</b>  | <b>125</b> | <b>174</b> | <b>203</b> |
| Net Capex                            | -14        | -25         | -15        | -25        | -28        | -33        |
| <b>Free cash flow</b>                | <b>78</b>  | <b>-24</b>  | <b>55</b>  | <b>99</b>  | <b>146</b> | <b>171</b> |
| Equity raised/(bought back)          | 0          | 0           | 0          | 0          | 0          | 0          |
| Dividends paid                       | 0          | 0           | 2          | 11         | 64         | 79         |
| Net inc/(dec) in borrowings          | 71         | 109         | 43         | 0          | 0          | 0          |
| Other investing/financing cash flows | 1          | -88         | -80        | -11        | -31        | -30        |
| <b>Net cash flow</b>                 | <b>150</b> | <b>-4</b>   | <b>20</b>  | <b>100</b> | <b>179</b> | <b>220</b> |
| <i>Change in working capital</i>     | <i>-67</i> | <i>-135</i> | <i>-23</i> | <i>-19</i> | <i>-54</i> | <i>-52</i> |

**Balance Sheet (PLNm)**

|                                   |              |              |              |              |              |              |
|-----------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Cash and other liquid assets      | 493          | 489          | 509          | 609          | 787          | 1,008        |
| Tangible fixed assets             | 97           | 103          | 97           | 99           | 103          | 110          |
| Goodwill/intangible assets        | 84           | 81           | 78           | 78           | 78           | 79           |
| Associates/investments            | 164          | 150          | 191          | 191          | 191          | 191          |
| Other assets                      | 1,097        | 1,488        | 1,468        | 1,576        | 1,887        | 2,183        |
| <b>Total assets</b>               | <b>1,935</b> | <b>2,312</b> | <b>2,344</b> | <b>2,554</b> | <b>3,047</b> | <b>3,570</b> |
| Interest bearing debt             | 125          | 234          | 277          | 277          | 277          | 277          |
| Other liabilities                 | 1,287        | 1,553        | 1,531        | 1,643        | 1,966        | 2,274        |
| <b>Total liabilities</b>          | <b>1,412</b> | <b>1,788</b> | <b>1,808</b> | <b>1,920</b> | <b>2,243</b> | <b>2,552</b> |
| Shareholders' equity              | 520          | 523          | 536          | 633          | 803          | 1,019        |
| Minorities                        | 3            | 1            | 0            | 0            | 0            | 0            |
| <b>Total shareholders' equity</b> | <b>523</b>   | <b>524</b>   | <b>536</b>   | <b>633</b>   | <b>803</b>   | <b>1,019</b> |
| <i>Net debt</i>                   | <i>-368</i>  | <i>-255</i>  | <i>-232</i>  | <i>-332</i>  | <i>-510</i>  | <i>-730</i>  |

**Key Company Metrics**

|                        |       |       |       |       |       |       |
|------------------------|-------|-------|-------|-------|-------|-------|
| Sales growth (%)       | 25.7  | 12.6  | 1.1   | 7.4   | 19.7  | 15.7  |
| DB EPS growth (%)      | -75.7 | 91.8  | 286.9 | 468.6 | 23.6  | 28.3  |
| EBITDA Margin (%)      | 0.8   | 1.0   | 1.7   | 4.1   | 4.0   | 4.2   |
| EBIT Margin (%)        | 0.1   | 0.3   | 0.9   | 3.3   | 3.3   | 3.6   |
| Payout ratio (%)       | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |
| ROE (%)                | 0.4   | 0.7   | 2.8   | 14.7  | 14.7  | 14.9  |
| Capex/sales (%)        | 0.5   | 0.8   | 0.5   | 0.8   | 0.7   | 0.7   |
| Capex/depreciation (x) | 0.7   | 1.2   | 0.6   | 1.1   | 1.2   | 1.3   |
| Net debt/equity (%)    | -70.3 | -48.6 | -43.3 | -52.4 | -63.5 | -71.7 |
| Net interest cover (x) | nm    | nm    | nm    | 16.2  | 32.6  | nm    |

Source: Company data, Deutsche Bank estimates

# Investment thesis

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## Outlook

We rate Budimex a Hold, as we believe that the company's earnings recovery is already priced in, while our 12-month target price provides for only a low, single-digit total return. Budimex, as a general contractor with a significant infrastructure division, offers one of the best exposures in Poland to the expected boom in road building. Until recently, this market segment was characterized by very low margins, but the increase in the number of sizable, EU-financed projects has improved this. The EU budget for 2007-2013 includes EUR 21.5bn earmarked for the development of Poland's transport infrastructure, of which EUR 15.1bn is being directed into road construction. Although we believe that the plan of the General Directorate for National Roads and Motorways to double spending on road construction in Poland in 2008E to PLN 20.8bn (from PLN 10.3bn in 2007) is unrealistic, we expect the road construction market to grow at double digit rates in the years to come, thus benefiting Budimex. We expect Budimex's net profit to increase by 469%, 24%, and 28%, in 2008E, 2009E, and 2010E, respectively, with the share of infrastructure in total revenues reaching 52% in 2010E (up from 30% in 2007).

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## Valuation

Our 12-month target price for Budimex of PLN 85/share is based on a 5-year discounted cash flow analysis. The major assumptions of our DCF are a cost of equity of 12.2% and a WACC of 10.1%, both derived from CAPM using a risk free rate of 6.5%, an equity risk premium of 5.0%, and an unlevered fundamental beta of 0.8x (Damodaran industry average). We use a terminal growth rate of 4.9%, calculated through multiplication of the company's reinvestment rate and ROIC.

For illustrative purposes, we also present a peer comparison. Budimex is trading at double-digit premiums to its peers based on 2008E P/E and EV/EBITDA.

---

## Risks

Developments in the Polish construction market (mainly infrastructure), with possible delay/acceleration of the EU-financed road construction projects, constitute downside/upside macro risk to Budimex. As for company-specific issues, we note some possible downside risks: 1) the unsettled dispute with Warsaw Airports over Budimex's retention money for the already-completed contract, 2) possible costs overruns (historically many contracts have turned unprofitable); as well as upside risks: 1) write-backs of losses booked in 2007 on contract with City of Krakow (a lawsuit is underway), and 2) success in further tenders for licenses for construction and management of toll motorways by Budimex's affiliate.

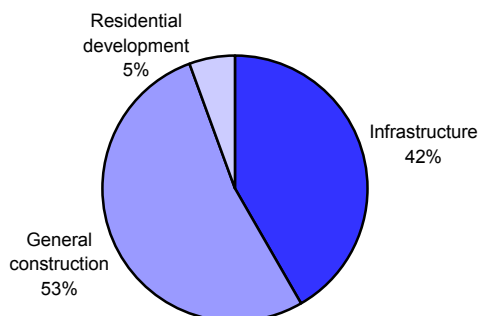
# Earnings outlook & valuation

## Key business areas

**General contractor with sizable infrastructure division**

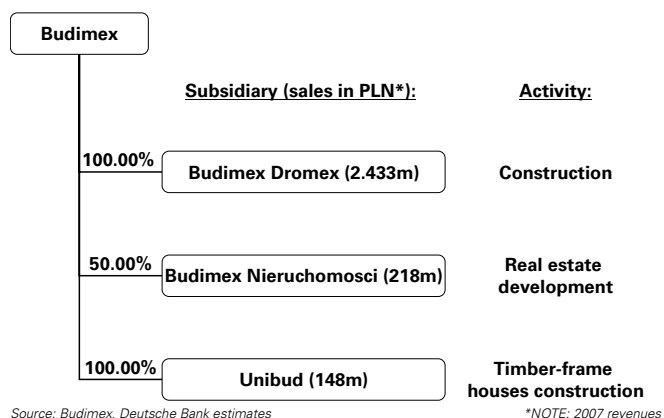
Budimex is a general contractor active in infrastructure segment (roads) and general construction (residential properties, commercial centres, offices). In addition the company owns a 50% stake in a residential property developer (Budimex Nieruchomosci) operating in Poland's major cities.

**Figure 46: Budimex: 2008E revenues**



Source: Deutsche Bank estimates

**Figure 47: Budimex group structure (major subsidiaries)**



Source: Budimex, Deutsche Bank estimates

## Earnings drivers

**The EU budget for 2007-2013 has earmarked EUR 21.5bn for the development of Poland's transport infrastructure, of which EUR 15.1bn is being directed into roads construction**

### 1. Inflow of EU money in development of Poland's infrastructure

Budimex specializes in large infrastructure projects (motorways, expressways, by-passes) – the construction of which has been scarce in recent years in Poland. The EU budget for 2007-2013, however, has earmarked EUR 21.5bn for the development of Poland's transport infrastructure, of which EUR 15.1bn is being directed into road construction. Although we believe that the plan of the General Directorate for National Roads and Motorways to double spending on road construction in Poland in 2008E to PLN 20.8bn (from PLN 10.3bn in 2007) is unrealistic, we expect the road construction market to grow at double digit rates in years to come, thus benefiting Budimex. We note that year to date the value of contracts signed by General Directorate for National Roads and Motorways has already exceeded the total for 2007.

**Strong chances for PLN 6bn motorway construction project**

### 2. Construction of 180km section of A1 motorway

In July, Autostrada Poludnie, an entity in which Budimex holds 5.05%, won a tender to construct and subsequently operate a 180km section of A1 motorway. The detailed agreement is still under negotiation, but should be completed within a few months. If signed, the deal would pave the way for Budimex to carry out the largest construction contract in its history. The total value of the construction works (in which we expect Budimex to be a general contractor in at least 50%) has not yet been disclosed, but we estimate it at around PLN 6bn (EUR 10m per 1 km of motorway).

**We expect stable earning contribution from Budimex's residential property development subsidiary**

### 3. Residential property development

Budimex's residential property development activity is conducted by the company's 50/50 JV with Ferrovial, called Budimex Nieruchomosci. The latter boasts of a land bank located in Warsaw, Krakow and Poznan, which enables construction of almost 0.5m sq. m. of sellable residential space (approximately 8,400 units). Currently, the company is constructing eight

projects. Although residential development in Poland is currently experiencing a slowdown, in years to come we expect Budimex's operations in that market segment to continue their solid contribution to consolidated P&L (in 2007 they amounted to PLN 45m at the EBIT level). This is due to 1) the low cost of land acquisition (much below the current market value) which enables the company to achieve high margins, and 2) the company's practice of booking earnings only after a project's completion, implying that in 2008-2009 bookings should reflect strong pre-sales from 2006-2007.

**Weak track record of delivery, but this time Budimex appears to be on track**

#### Risks: weak track record delivery

In our view Budimex is an earnings turnaround story, and this time the company appears to be on track to deliver. While we recognise positive developments in the construction market (general revival as compared to three years ago, stabilisation in building material prices) and within the company (more focus on risk control and contract selection) we note that until 2007 Budimex had not delivered on analysts' expectations for several years, mainly due to losses on several contracts.

**We expect infrastructure to account for 60% of the backlog following the signing of a contract which has been already won**

### Earnings forecasts

#### Backlog shifts to infrastructure; focus on margins, not top-line growth

Budimex's backlog amounts to PLN 3.3bn and is flat year on year. Its structure, however, has shifted more towards infrastructure projects, which currently account for 51% of total, vs. 43% a year ago. The soon to be signed PLN 0.8bn contract for construction of the by-pass of Wroclaw (the tender has been already completed) should increase infrastructure projects' share of the backlog to nearly 60%.

In 2008E we forecast Budimex's revenues to increase by only 7% (vs. expected construction market growth of 19%) as the company has declared that it will now be very selective in taking orders, as it focuses on margins. In 2009E and 2010E we expect Budimex's top-line expansion to be 20% and 16%, respectively. We forecast infrastructure to be the major growth driver, with a 3-year revenue CAGR of 38% in that market segment.

**Figure 48: Budimex: revenue forecasts**

| PLNm                    | 2006  | 2007  | 2008E | 2009E | 2010E |
|-------------------------|-------|-------|-------|-------|-------|
| Infrastructure          | 928   | 908   | 1,375 | 1,950 | 2,378 |
| General construction    | 1,904 | 1,941 | 1,747 | 1,747 | 1,954 |
| Real estate development | 130   | 216   | 180   | 255   | 241   |
| Other                   | 81    | 11    | 0     | 0     | 0     |
| Total                   | 3,043 | 3,076 | 3,302 | 3,953 | 4,573 |
| Change (YoY, %)         | 13    | 1     | 7     | 20    | 16    |

Source: Budimex, Deutsche Bank estimates

**We forecast 2008E net profit at PLN 86m; already reported 1H earnings account for 50% of our forecast**

On the earnings front, we expect Budimex's EBIT to triple to PLN 110.5 in 2008E, with stable YoY contribution of the real estate development segment (PLN 42m) and a surge in construction EBIT to PLN 69m (from a loss of PLN 17m in the corresponding period a year before). In 2009E and 2010E we forecast increases in EBIT of 20% and 25%, respectively, to PLN 132.2m and PLN 164.8m. We forecast Budimex's net profit to be PLN 85.7m, PLN 105.9m, and PLN 135.9m in 2008E, 2009E, and 2010E, respectively. We note that for 1H 2008 Budimex has already reported net profit of PLN 43m, accounting for 50% of our FY 2008E estimate.

The major risk to our earnings forecast is the contract for the construction of the Okecie Airport in Warsaw, where the airport authority is still holding Budimex's retention money and there is a risk of additional write downs (of up to several dozen PLNm).

**Figure 49: Budimex: earnings forecasts**

| PLNm                     | 2006    | 2007    | 2008E   | %, YoY | 2009E   | %, YoY | 2010E   | %, YoY |
|--------------------------|---------|---------|---------|--------|---------|--------|---------|--------|
| Sales                    | 3,043.2 | 3,075.9 | 3,302.1 | 7      | 3,952.8 | 20     | 4,573.4 | 16     |
| Gross profit (after D&A) | 124.7   | 148.3   | 232.1   | 57     | 312.8   | 35     | 373.8   | 19     |
| Gross margin (%)         | 4.1     | 4.8     | 7.0     | -      | 7.9     | -      | 8.2     | -      |
| EBIT, of which           | 9.9     | 28.0    | 110.5   | 294    | 132.2   | 20     | 164.8   | 25     |
| construction             | -3.5    | -17.4   | 68.7    | n.m.   | 75.0    | 9      | 95.7    | 28     |
| real estate development  | 13.5    | 45.4    | 41.7    | -8     | 57.2    | 37     | 69.1    | 21     |
| EBIT margin (%)          | 0.3     | 0.9     | 3.3     | -      | 3.3     | -      | 3.6     | -      |
| Pre-tax profit           | 10.4    | 12.0    | 103.6   | 766    | 128.1   | 24     | 164.8   | 29     |
| Net profit               | 3.9     | 15.1    | 85.7    | 469    | 105.9   | 24     | 135.9   | 28     |

Source: Budimex, Deutsche Bank estimates

## Valuation and recommendation: Hold with 12-M TP of PLN 85

### DCF model

**Our DCF model returned a 12-month target price of PLN 85**

We have developed a 5-year DCF model to arrive at a 12-month target price for Budimex. The major assumptions are as follows:

- We forecast Budimex's revenues will grow by a CAGR of 12%, while EBIT should grow by 45% over 2008E-2012E. High EBIT growth is the result of a very low base in 2007; in 2009E-2012E we forecast an EBIT CAGR of 13%. We forecast the average EBIT margin of 3.4% in 2008E-2012E.
- We expect a terminal growth rate of 4.9%. We calculated it on the base of the following formula: Terminal growth rate = reinvestment rate x ROIC.
- We use a cost of equity of 12.2% and a WACC of 10.1%. We used CAPM to achieve those values, using a risk free rate of 6.5%, an equity risk premium of 5.0%, and an unlevered beta of 0.8x (Damodaran industry average).

**Based on the above, we arrived at 12-month target price for Budimex of PLN 85.0. With expected total shareholder return of 4%, we rate Budimex as a Hold.**

**Figure 50: Budimex: DCF model**

| PLNm                                | 2008E   | 2009E   | 2010E   | 2011E   | 2012E   |
|-------------------------------------|---------|---------|---------|---------|---------|
| Revenues                            | 3,302.1 | 3,952.8 | 4,573.4 | 5,054.8 | 5,498.8 |
| EBIT                                | 110.5   | 132.2   | 164.8   | 167.1   | 178.4   |
| Cash taxes on EBIT                  | 21.0    | 25.1    | 31.3    | 31.8    | 33.9    |
| NOPAT                               | 89.5    | 107.1   | 133.5   | 135.4   | 144.5   |
| Depreciation                        | 23.6    | 24.3    | 25.6    | 27.0    | 27.9    |
| Change in operating WC              | 18.8    | 54.1    | 51.6    | 40.0    | 36.9    |
| Capital expenditure                 | 25.3    | 28.2    | 32.6    | 31.9    | 30.3    |
| Net investment                      | 20.5    | 58.0    | 58.6    | 45.0    | 39.3    |
| Free cashflow                       | 69.0    | 49.0    | 74.9    | 90.4    | 105.1   |
| WACC (%)                            | 10.1    |         |         |         |         |
| PV FCF 2008E-2012E                  | 286     |         |         |         |         |
| Terminal growth (%)                 | 4.9     |         |         |         |         |
| Terminal Value (TV)                 | 2,107   |         |         |         |         |
| PV TV                               | 1,303   |         |         |         |         |
| Total EV                            | 1,588   |         |         |         |         |
| Net debt (Jan 2008)                 | (232)   |         |         |         |         |
| Equity value                        | 1,820   |         |         |         |         |
| Number of shares (m, fully diluted) | 25.5    |         |         |         |         |
| Value per share (PLN, 1 Jan 2008)   | 71      |         |         |         |         |
| Month                               | 19      |         |         |         |         |
| 12-month target price               | 85      |         |         |         |         |
| Revenue growth                      | 7.4     | 19.7    | 15.7    | 10.5    | 8.8     |
| EBIT growth (%)                     | 293.9   | 19.7    | 24.7    | 1.4     | 6.7     |
| NOPAT growth (%)                    | 193.9   | 19.7    | 24.7    | 1.4     | 6.7     |
| FCF growth (%)                      | 338.2   | (28.9)  | 52.8    | 20.7    | 16.3    |
| EBIT margin (%)                     | 3.3     | 3.3     | 3.6     | 3.3     | 3.2     |
| NOPAT margin (%)                    | 2.7     | 2.7     | 2.9     | 2.7     | 2.6     |
| Capex/Revenues (%)                  | 0.8     | 0.7     | 0.7     | 0.6     | 0.6     |
| Change in WC/Revenues (%)           | 0.6     | 1.4     | 1.1     | 0.8     | 0.7     |
| Change in WC/Change in revenues (%) | 8.3     | 8.3     | 8.3     | 8.3     | 8.3     |

Source: Deutsche Bank estimates

**Peer comparison**

Budimex is trading at 2008E P/E and EV/EBITDA of 24.4x and 11.7x, implying respective 19% and 3% premiums to our Polish construction universe. We believe that Budimex's multiples are already pricing in the expected earnings recovery, which appears to be deliverable based on the company's 1H 2008 results.

**Figure 51: Budimex: domestic peer comparison (priced as of 19 August)**

|                                        | Ticker         | Recc.       | Price<br>(PLN) | MCAP<br>(US\$m) | P/E (x)     |             |             | 3-year EPS |             | EV/EBITDA (x) |            |
|----------------------------------------|----------------|-------------|----------------|-----------------|-------------|-------------|-------------|------------|-------------|---------------|------------|
|                                        |                |             |                |                 | 2008E       | 2009E       | 2010E       | CAGR (%)   | 2008E       | 2009E         | 2010E      |
| <b>Budimex</b>                         | <b>BMEX.WA</b> | <b>Hold</b> | <b>82.0</b>    | <b>926</b>      | <b>24.4</b> | <b>19.8</b> | <b>15.4</b> | <b>108</b> | <b>11.7</b> | <b>8.9</b>    | <b>6.2</b> |
| PBG                                    | PBGG.WA        | Buy         | 231.0          | 1,372           | 20.6        | 15.9        | 12.0        | 36         | 12.6        | 9.4           | 7.2        |
| Polimex                                | MOSD.WA        | Sell        | 5.6            | 1,200           | 20.3        | 17.8        | 14.5        | 23         | 11.0        | 9.4           | 7.9        |
| Pol-Aqua                               | PQAA.WA        | Buy         | 50.8           | 617             | 15.9        | 12.5        | 10.6        | 38         | 10.5        | 7.7           | 6.3        |
| <b>Median</b>                          |                |             |                |                 | <b>20.5</b> | <b>16.9</b> | <b>13.2</b> | <b>37</b>  | <b>11.4</b> | <b>9.2</b>    | <b>6.8</b> |
| <i>Budimex's Premium/(Discount), %</i> |                |             |                |                 | 19          | 17          | 17          | -          | 3           | -3            | -8         |

Source: Deutsche Bank estimates

## Appendix: Capital history and shareholder structure

**Ferrovial of Spain is the strategic shareholder, with a 59.1% stake**

Budimex has been listed on the WSE since 1995, but since 2000 the company has not conducted any new issues. Budimex's strategic shareholder is Ferrovial of Spain, which holds a 59.1%.

**Figure 52: Budimex: capital history**

| Date          | Series     | No. of shares | Issue price (PLN) | No. of shares outstanding | Comment                                                                |
|---------------|------------|---------------|-------------------|---------------------------|------------------------------------------------------------------------|
| Aug-94        | A          | 3,000,000     | 5.00              | 3,000,000                 | conversion to plc                                                      |
| Nov-94        | B          | 2,000,000     | 5.00              | 5,000,000                 | rights issue                                                           |
| May-95        | C          | 1,900,285     | 7.00              | 6,900,285                 | IPO                                                                    |
| Apr-96        | D          | 1,725,072     | 17.00             | 8,625,357                 | rights issue                                                           |
| Aug-97        | E          | 2,000,000     |                   | 10,625,357                | merger with Budimex Trading                                            |
| Jun-98        | F          | 5,312,678     | 15.00             | 15,938,035                | capital increase                                                       |
| Nov-99/Jul-00 | G, H, I, K | 5,337,046     |                   | 21,275,081                | merger with Unibud, Budimex Warszawa, Budimex Poznan, Mostostal Krakow |
| Dec-00        | L          | 4,255,017     | 20.50             | 25,530,098                | rights issue                                                           |

Source: Deutsche Bank

**Figure 53: Budimex: shareholder structure**

| Shareholder        | No. of shares     | As % of total | No. of voting rights | As % of total |
|--------------------|-------------------|---------------|----------------------|---------------|
| Grupo Ferrovial    | 15,078,159        | 59.1          | 15,078,159           | 59.1          |
| BZ WBK Mutual Fund | 3,632,317         | 14.2          | 3,632,317            | 14.2          |
| Other              | 6,819,622         | 26.7          | 6,819,622            | 26.7          |
| <b>Total</b>       | <b>25,530,098</b> | <b>100.0</b>  | <b>25,530,098</b>    | <b>100.0</b>  |

Source: Deutsche Bank

# Appendix 1

## Important Disclosures

Additional information available upon request

| Disclosure checklist |         |                        |            |
|----------------------|---------|------------------------|------------|
| Company              | Ticker  | Recent price*          | Disclosure |
| PBG                  | PBGG.WA | 242.00 (PLN) 21 Aug 08 | NA         |
| Budimex              | BMEX.WA | 82.40 (PLN) 21 Aug 08  | 6          |
| Polimex              | MOSD.WA | 5.45 (PLN) 21 Aug 08   | NA         |
| POL-AQUA             | PQAA.WA | 50.10 (PLN) 21 Aug 08  | 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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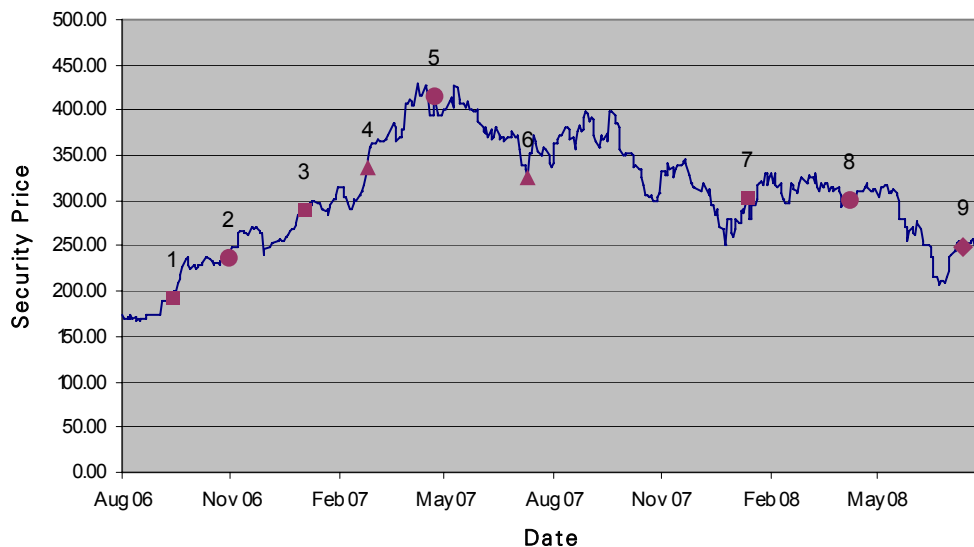
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**Historical recommendations and target price: PBG (PBG.WA)**

(as of 21/08/2008)



Previous Recommendations

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

Current Recommendations

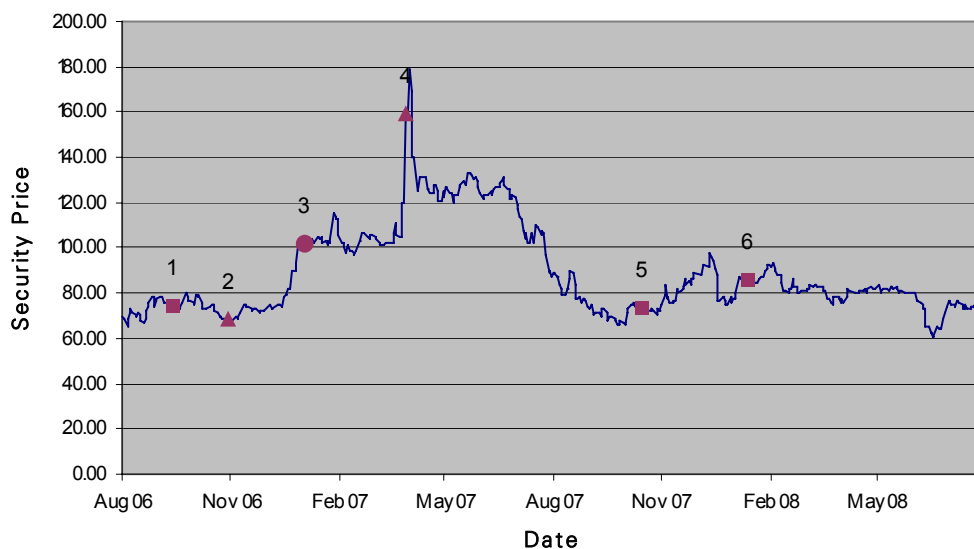
- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

\*New Recommendation Structure as of September 9, 2002

|    |             |                                               |    |            |                                                |
|----|-------------|-----------------------------------------------|----|------------|------------------------------------------------|
| 1. | 5/10/2006:  | Buy, Target Price Change PLN250.00            | 6. | 2/8/2007:  | Upgrade to Buy, PLN400.00                      |
| 2. | 21/11/2006: | Downgrade to Hold, PLN250.00                  | 7. | 4/2/2008:  | No Recommendation, Target Price Change PLN0.00 |
| 3. | 24/1/2007:  | Hold, Target Price Change PLN300.00           | 8. | 30/4/2008: | Transferred to EMC coverage.                   |
| 4. | 19/3/2007:  | Upgrade to Buy, Target Price Change PLN400.00 | 9. | 5/8/2008:  | Transferred to sector coverage.                |
| 5. | 15/5/2007:  | Downgrade to Hold, PLN400.00                  |    |            |                                                |

**Historical recommendations and target price: Budimex (BMEX.WA)**

(as of 21/08/2008)



Previous Recommendations

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

Current Recommendations

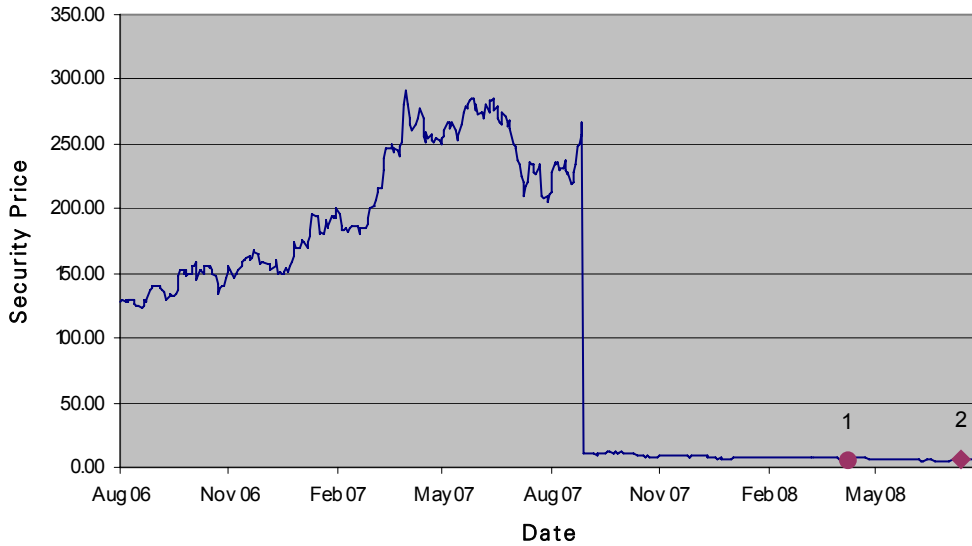
- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

\*New Recommendation Structure as of September 9, 2002

|    |             |                                                 |    |            |                                                |
|----|-------------|-------------------------------------------------|----|------------|------------------------------------------------|
| 1. | 5/10/2006:  | Hold, Target Price Change PLN80.00              | 4. | 20/4/2007: | Upgrade to Buy, Target Price Change PLN200.00  |
| 2. | 21/11/2006: | Upgrade to Buy, PLN80.00                        | 5. | 7/11/2007: | Buy, Target Price Change PLN118.00             |
| 3. | 24/1/2007:  | Downgrade to Sell, Target Price Change PLN90.00 | 6. | 4/2/2008:  | No Recommendation, Target Price Change PLN0.00 |

**Historical recommendations and target price: Polimex (MOSD.WA)**

(as of 21/08/2008)



Previous Recommendations

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

Current Recommendations

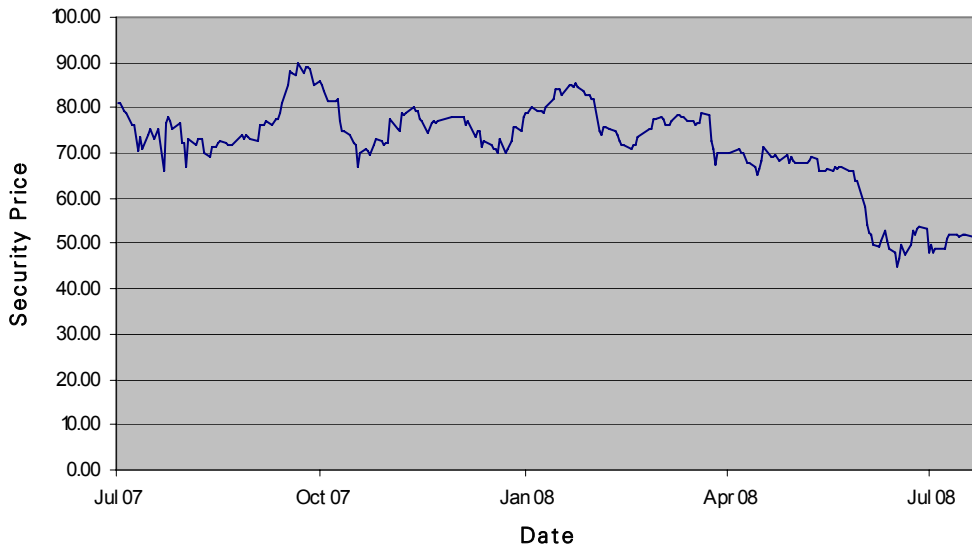
- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

\*New Recommendation Structure as of September 9, 2002

1. 30/4/2008: Transferred to EMC coverage. 2. 5/8/2008: Transferred to sector coverage.

**Historical recommendations and target price: POL-AQUA (POAA.WA)**

(as of 21/08/2008)



Previous Recommendations

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

Current Recommendations

- Buy
- Hold
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- Not Rated
- Suspended Rating

\*New Recommendation Structure as of September 9, 2002

## Equity rating key

## Equity rating dispersion and banking relationships

**Buy:** Based on a current 12-month view of total shareholder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

**Sell:** Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock

**Hold:** We take a neutral view on the stock 12 months out and, based on this time horizon, do not recommend either a Buy or Sell.

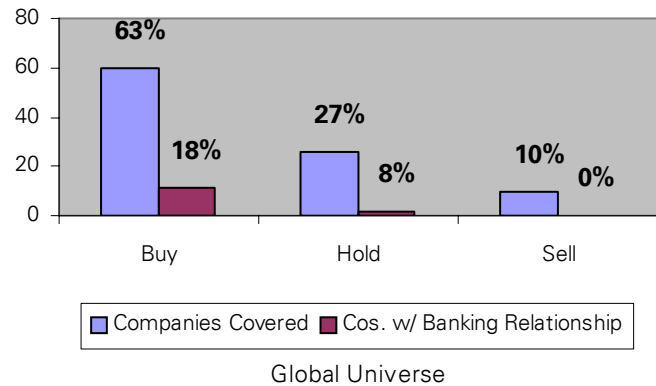
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Buy: Expected total return (including dividends) of 10% or more over a 12-month period

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

Sell: Expected total return (including dividends) of -10% or worse over a 12-month period



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## Deutsche Bank AG/London

### European locations

**Deutsche Bank AG London**

1 Great Winchester Street  
London EC2N 2EQ

Tel: (44) 20 7545 8000

**Deutsche Bank AG**

Herengracht 450  
1017 CA Amsterdam  
Netherlands

Tel: (31) 20 555 4911

**Deutsche Bank AG, Helsinki**

Kaivokatu 10 A, P.O.Box 650  
FIN-00101 Helsinki  
Finland

Tel: (358) 9 25 25 20 0

**Deutsche Bank AG, Turkey**

Eski Buyukdere Cad. Tekfen Tower  
No:209 Kat:17-18  
TR-34394 Istanbul  
Tel: (90) 212 317 01 00

**Deutsche-Bank AG,**

Secursale de Paris  
3, Avenue de Friedland  
75008 Paris Cedex 8  
France  
Tel: (33) 1 44 95 64 00

**Deutsche Securities**

S.V.B, S.A.  
P0 de la Castellana, 42  
7th Floor  
28046 Madrid, Spain  
Tel: (34) 91 782 8400

**Deutsche Bank AG**

Hohenstaufengasse 4  
1010 Vienna  
Austria

Tel: (43) 1 5318 10

**Deutsche Bank AG, Greece**

23A Vassilissis Sofias Avenue  
6th Floor  
10674 Athens, Greece  
Tel: (30) 210 72 56 150

**Deutsche Bank AG**

Equity Research  
Große Gallusstraße 10-14  
60272 Frankfurt am Main  
Germany  
Tel: (49) 69 910 0

**Deutsche Bank AG**

Stureplan 4 A, Box 5781  
S-114 87 Stockholm  
Sweden

Tel: (46) 8 463 5500

**Deutsche Bank AG**

Aurora business park  
82 bld.2 Sadovnicheskaya street  
Moscow, 115035  
Russia  
Tel: (7) 495 797-5000

**Deutsche Bank Sim S.p.a**

Via Santa Margherita 4  
20123 Milan  
Italy

Tel: (39) 0 24 024 1

**Deutsche Bank AG**

Uraniastrasse 9  
PO Box 7370  
8023 Zürich  
Switzerland  
Tel: (41) 1 224 5000

**Deutsche Bank AG, Warsaw**

al.Armi Ludowej 26  
Budynek FOCUS  
00-609 Warsaw  
Poland  
Tel: (48) 22 579-98

### International locations

**Deutsche Bank Securities Inc.**

60 Wall Street  
New York, NY 10005  
United States of America  
Tel: (1) 212 250 2500

**Deutsche Bank AG London**

1 Great Winchester Street  
London EC2N 2EQ  
United Kingdom  
Tel: (44) 20 7545 8000

**Deutsche Bank AG**

Große Gallusstraße 10-14  
60272 Frankfurt am Main  
Germany  
Tel: (49) 69 910 0

**Deutsche Bank AG**

Deutsche Bank Place  
Level 16  
Corner of Hunter & Phillip Streets  
Sydney, NSW 2000  
Australia  
Tel: (61) 2 8258 1234

**Deutsche Bank AG**

Level 55  
Cheung Kong Center  
2 Queen's Road Central  
Hong Kong  
Tel: (852) 2203 8888

**Deutsche Securities Inc.**

2-11-1 Nagatacho  
Sanno Park Tower  
Chiyoda-ku, Tokyo 100-6171  
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