Company Report

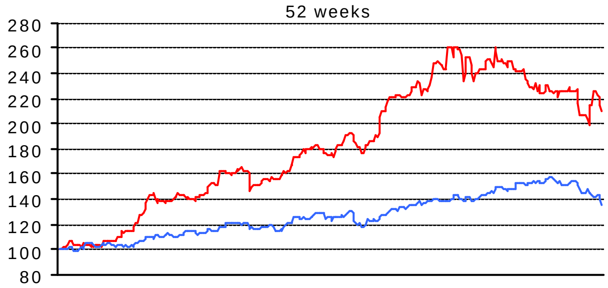
PBG

from Hold to Accumulate

Poland, Engineering/Specialized construction

Piotr Lopaciuk, +48 22 3306 252
Piotr.Lopaciuk@erstebank.net

PLN mn	2006	2007e	2008e	2009e
Net sales	674.6	1,447.9	2,081.3	2,640.0
EBITDA	90.5	163.5	280.1	385.6
EBIT	74.1	137.4	246.1	349.5
Net profit	54.2	102.0	164.5	234.9
EPS (PLN)	4.55	7.66	12.24	17.49
CEPS (PLN)	7.78	15.14	11.05	18.69
BVPS (PLN)	30.60	60.80	73.04	90.53
Div/share (PLN)	0.00	0.00	0.00	0.00
EV/EBITDA (x)	49.5	30.6	18.6	13.6
P/E (x)	76.0	45.1	28.3	19.8
P/CE (x)	44.5	22.9	31.3	18.5
Dividend yield	0.0%	0.0%	0.0%	0.0%



Performance	12M	6M	3M	1M
in PLN	110.3%	19.7%	-16.8%	-6.5%
in EUR	116.0%	23.6%	-17.0%	-6.9%

Share price (PLN)	346.0	Reuters	PBGG.WA	Free float	65.0%
Number of shares (mn)	13.4	Bloomberg	PBG PW	Shareholders	Jerzy Wisniewski and management (35%)
Market capitalization (PLN mn / EUR mn)	4,646.8 / 1,231.3	Div. ex-date	n.a.		
Enterprise value (PLN mn /EUR mn)	5,006.4 / 1,326.5	**Target price**	**380**	Homepage:	www.pbg-sa.pl

Bold moves in lucrative hydro segment

- **This update on PBG is prompted by the firm's acquisition and consolidation of Hydrobudowa 9, the recently revealed plans regarding KRI and the confirmed story on PBG's growing margins. We have increased our target price from PLN 295 to PLN 380 upgrading our recommendation from Hold to Accumulate.**

- **We updated the EPS forecast from PLN 7.08 to PLN 7.66 for 2007 and from PLN 11.1 to PLN 12.24 for 2008.**

- **The acquisition and consolidation (from mid-April) of new subsidiary Hydrobudowa 9 is a very significant event for the PBG group. PBG now holds approximately 67% of the construction market in the environmental protection segment. We expect Hydrobudowa 9 to add around PLN 220mn to 2007 revenues and approximately PLN 400mn to 2008 revenues, with significantly growing margins.**

- **The recently revealed plans concerning subsidiary KRI (a gas trading company) are very promising for PBG. The most important issue for PBG is the expected surge of investments in the gas segment (from the KRI side), which we assume will amount to PLN 650mn over the next few years.**

- **After the first two quarters of 2007, our confidence regarding the increasing margins (especially in the environmental protection segment) has grown. We believe that PBG's excellent management and organization will help it to overcome the barriers in the construction segment (especially the costs of materials and employees).**

- **PBG is among the companies with the best exposure to EU funds (EUR 67bn in structural funds for 2007-13), which ensures a continued high pace of business development. PBG is usually traded with a premium for the quality of its management and its plans to strengthen the group via new acquisitions (recently confirmed with the acquisition of PRID - a road-building and engineering company - for PLN 26mn). For now, we can expect PBG to look for companies in the sanitary systems renovation segment (like Infra) and the local road-building segment.**

Projection changes

USDmn	2007e			2008e		
	Currently	Previously	Change	**Currently**	Previously	Change
Revenue	**1,447.9**	**1,282.9**	12.9%	**2,081.3**	**1,721.5**	20.9%
EBIT	**137.4**	**133.3**	3.1%	**246.1**	**199.7**	23.2%
Net profit	**102.0**	**94.3**	8.2%	**164.5**	**149.1**	10.3%

Source: Erste Bank estimates

In comparison to our previous report, we have significantly increased our results forecast for 2007 and 2008. Most of the changes are due to the most notable success of PBG - the acquisition of its former major competitor, Hydrobudowa 9.

Investment story

Making use of Hydrobudowa 9's weakness

In mid-April, the group finalized the valuable acquisition of Hydrobudowa 9. PBG paid PLN 55mn for the 68.5% stake. The business of Hydrobudowa 9 is mainly focused on the environmental protection and sanitary systems segment (about 75% of revenues), road-building (15%) and general construction (10%). In 2006, the company recorded about PLN 350mn in revenues, with a loss of about PLN 195mn. Most of the loss was due to the creation of provisions for expected losses on weak contracts (as is typical for PBG when acquiring new companies). For Hydrobudowa 9, such provisions amounted to about PLN 160mn (at the end of 2006); about PLN 30mn of the loss was already realized in 1H. The problems at Hydrobudowa 9 were mainly due to the burden of unhedged contracts signed at a very high EUR/PLN rate.

Scooping up hydro segment

With the acquisition of Hydrobudowa 9, PBG (with an estimated share in the environmental protection segment of about 67%) has taken a very firm position in this attractive niche. In light of the EUR 67bn in structural funds allocated for Poland for 2007-13 (including EUR 28bn for the program "infrastructure and environment"), we expect a very strong market for PBG. This was confirmed just recently. In 2Q07, the group signed contracts in the hydro and environmental protection segments worth about PLN 570mn. Separately, the first two quarters confirmed the story of improving gross margins on sale in these niches.

Giving away subsidiary to gain valuable contracts

The second significant element of the story is PBG's recently revealed plans concerning its 100% subsidiary. KRI is a gas trading company, currently selling about 30mn cubic meters of gas per year. According to the deal disclosed by PBG, foreign investment funds (including entities related to the Rothschild family) plan to invest about EUR 100mn in the development of scale of the company. PBG will thus lose control over KRI, with its share decreasing to below 20%. With the additional debt financing, KRI will try to build a significant market position, with about 500mn cubic meters of gas to be sold in five years' time. KRI will still have a close relationship with PBG, via its management. The main story for PBG is the contracts that it is now expected to gain by positioning KRI in the solid-margin gas segment. We assumed the value of such contracts at PLN 650mn over the next few years.

Two subsidiaries from hydro segment to merge into strong Hydrobudowa Polska

We expect the merger of the two major PBG subsidiaries to be completed in one month's time. PBG is merging Hydrobudowa Slask (in which it owns 58%) with Hydrobudowa Wloclawek (in which it owns 92%). Hydrobudowa Wloclawek is to issue shares to exchange with Hydrobudowa Slask, after which the merged entity is to debut on the WSE. The name will be changed to Hydrobudowa Polska, and the firm will be a strong entity in the environmental protection and hydro segments. PBG will hold a 76% stake in the new entity. Calculating with the recent price of the WSE-quoted H.S. (quotations are currently on hold, due to the merger), the market cap of Hydrobudowa Polska could amount to approximately PLN 1.5bn. In the future, the new entity could be enriched by its association with the new group purchase, Hydrobudowa 9. Consolidation within the group is positive for PBG, due to the expected efficiency improvements among the merged companies.

Dynamic growth in attractive niches

After getting an update on the recently signed contracts and contracts under negotiation, we have prepared new forecasts for PBG's top line.

Forecasted revenue breakdown for 2007/2008e

PLN bn	2007e	2008e
Production, storage and transmission of natural gas and crude oil	0.51	0.74
Enviroment protection & sanitary systems (excluding Hydrobudowa 9 and Infra)	0.55	0.64
Hydrobudowa 9	0.22	0.40
Renovations of sewage systems (Infra)	0.14	0.14
Local road building segment	-	0.10
General building	0.03	0.06
Total	**1.45**	**2.08**

Source: Erste Bank

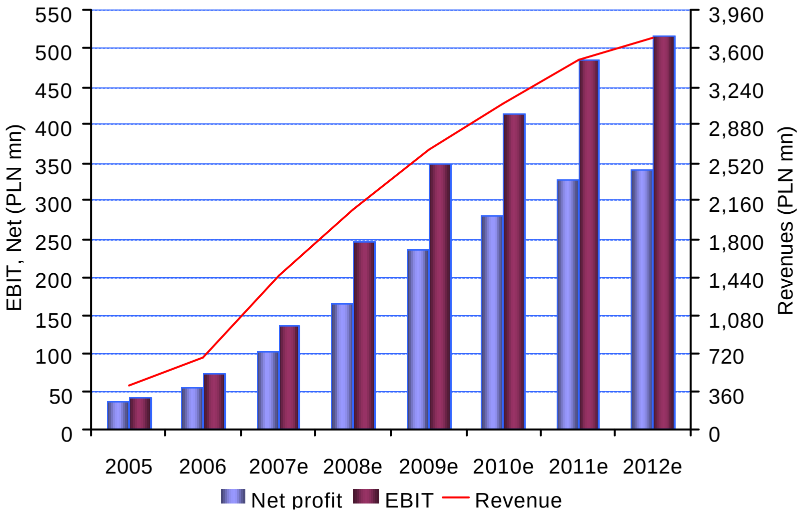
One positive signal came from the recent acquisition of a 56% stake in PRID for PLN 26mn. The company focuses its business in the road-building and engineering construction segments. We estimate the current scale of the acquired company at PLN 30mn in annual revenues at a very high (for a road-building company) net margin of about 10%. However, as usual, we expect PBG to very significantly increase the scale of this company.

In the oil & gas segment, we expect a delay (compared to our previous assumptions) in the contracts with PGNiG (LMG and Wierzchowice underground storage), but this should be compensated for by KRI contracts.

PBG can cope with dangers in building sector

We continue to believe that PBG - with its great management and organization and very careful contract selection - will overcome the very significant obstacles (labor and material costs) that the company faces in the building sector. PBG should be able to avoid the most significant threat, the shrinking labor workforce, thanks to its good organization (partly positioning costs of labor in variable costs - dependent on effectiveness - instead of fixed costs). Furthermore, thanks to its wide-scale motivation schemes, PBG ties its workers to the group. This has been confirmed by the very low number of employees leaving the company. We expect the increasing demand in lucrative niches and continuation of careful contract selection by PBG to more than compensate for the growing costs. Our expectations on PBG's results, based on an analysis of its revenue structure, are illustrated in the graph below.

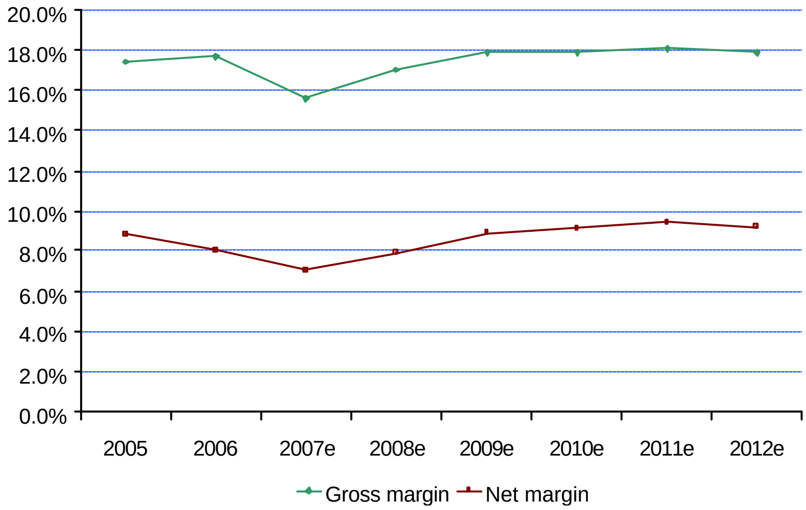
Results forecast 2007-2012e



Source: Erste Bank estimates

We expect net profit to increase by 36% per year, on average, in 2007-12.

Margin forecasts 2007-2012e



Source: Erste Bank estimates

The gross margin expectations reflect the assumed structure of revenues and market conditions.

Where can further growth come from?

PBG is usually traded with a premium based on expectations concerning the further development of the group. PBG should focus on expanding its activities in the sewage systems renovation segment (where it is currently represented by Infra). As this is the highest-margin segment (with great prospects), acquisitions here would positively influence the value of the group. We also expect PBG to continue making acquisitions in the local road-building segment. The coming months should also bring some positive news flow concerning new contracts, especially in the hydro and environmental protection segment.

Valuation

Employing a DCF model as our basic valuation tool for PBG, we increase our valuation and target price from PLN 295 to PLN 380 per share. Our recommendation is therefore upgraded from Hold to Accumulate. This reflects our view that (1) PBG has impressive growth prospects, (2) should perform outstandingly in terms of business ventures and (3) operates in attractive and promising markets. PBG shares are priced with a premium to its peers', reflecting the fact that PBG operates in a lucrative market niche and has very good growth potential.

On top of the assumptions used for our financial forecasts, we assumed the following:

- a risk free rate of 5.5%; equity premium 5%; debt premium 1.5%
- beta 1.0
- terminal value growth 2.5 % (unchanged comparing to the previous version of the report)

WACC

	2007e	2008e	2009e	2010e	2011e	2012e	beyond 2011
WACC	**9.2%**	**8.9%**	**9.0%**	**8.9%**	**8.7%**	**8.6%**	**8.2%**
Equity cost	10.5%	10.5%	10.5%	10.5%	10.5%	10.5%	10.0%
Debt cost	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.3%
Equity weighting	73.6%	65.9%	68.2%	67.6%	63.8%	61.3%	62.0%
Debt weighting	26.4%	34.1%	31.8%	32.4%	36.2%	38.7%	38.0%
Risk free rate	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.0%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Debt premium	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%

Source: Erste Bank estimates

DCF Valuation

	2007e	2008e	2009e	2010e	2011e	2012e	beyond 2012e
EBIT	**137,409**	**246,132**	**349,491**	**415,199**	**487,225**	**517,994**	**517,994**
tax rate	19%	19%	19%	19%	19%	19%	19%
tax on EBIT	26,108	46,765	66,403	78,888	92,573	98,419	98,419
NOPLAT	**111,301**	**199,367**	**283,088**	**336,311**	**394,653**	**419,575**	**419,575**
Depreciation	26,103	33,966	36,100	37,575	38,789	40,136	
Capital expenditures	-166,000	-52,804	-33,250	-33,752	-26,313	-40,136	
Change in working capital	-258,169	-289,481	-258,718	-196,580	-189,640	-99,815	
Free cash flow	**-286,764**	**-108,953**	**27,220**	**143,555**	**217,488**	**319,761**	
Terminal value							
Value of FCF at 31.12.2007	0	-100,090	22,949	111,101	154,778	210,314	
Sum of DFCF	399,053						
Discounted terminal value	5,007,328						
Enterprise value at 31.12.2007	**5,406,381**						
Non-operating assets	0						
Net debt at 31.12.2007	250,015						
Minorities	358,000						
Fair value at 31.12.2007	**4,798,365**						
Number of shares	13,430						
Fair value per share at 31.12.2007	**357**						
Cost of equity	**10.5%**						
Target Price	**380**						
Stock price	346.00						
Premium/discount	10%						

Source: Erste Bank estimates

Peers

	P/E			EV/EBIT			EV/EBITDA			Valuation		
	2007e	2008e	2009e	2007e	2008e	2009e	2007e	2008e	2009e	2007e	2008e	2009e
Implied fair value	3,144,414	3,922,648	4,611,500	2,410,373	3,700,036	3,645,860	1,611,922	2,586,283	2,777,149			
Number of shares	13,430	13,430	13,430	13,430	13,430	13,430	13,430	13,430	13,430	177.9	253.4	273.9
Implied fair value per share	234.1	292.1	343.4	179.5	275.5	271.5	120.0	192.6	206.8			
12M Target Price										**196.6**	**280.0**	**302.6**
Median for int. peer group	**30.8**	**23.9**	**19.6**	**22.0**	**17.5**	**12.2**	**13.6**	**11.4**	**8.8**			
PBG	**45.1**	**28.3**	**19.8**	**36.4**	**21.1**	**15.0**	**30.6**	**18.6**	**13.6**			
Budimex SA	68.5	32.2	21.6	44.4	18.2	12.4	30.8	30.8	30.8			
Polimex-Mostostal Siedlce SA	37.4	26.9	19.6	21.4	14.6	10.9	21.9	12.2	9.3			
Mostostal Warszawa SA	31.5	22.2		87.3	22.8	12.2	21.5	11.6	8.1			
ULMA Construccion Polska SA	30.2	25.5	20.9	22.5	18.8	15.5	13.9	11.2	9.2			
Andritz Ag	16.6	14.0	12.6	10.2	8.4	7.5	8.4	7.1	6.3			
Grupo Ferrovial SA	21.6	21.1	15.6	18.7	18.1	12.2	13.1	12.1	8.4			
Hochtief AG	43.5	34.1	28.3	14.6	10.7	9.6	6.5	5.4	4.9			
J & P Avax Sa	17.4	14.7	12.3	27.0	16.9	14.6	13.3	9.4	10.2			

Source: Erste Bank estimates

Company Report

Income Statement (IAS, PLN mn, 31/12)	2005	2006	2007e	2008e	2009e
Sales revenues	**408.5**	**674.6**	**1,447.9**	**2,081.3**	**2,640.0**
Cost of goods sold	-337.4	-555.6	-1,222.3	-1,727.8	-2,167.3
Gross profit	**71.2**	**119.1**	**225.5**	**353.5**	**472.7**
SG&A	-33.8	-54.2	-88.4	-109.7	-123.6
Other operating revenues	9.5	9.2	0.2	2.4	0.5
Other operating expenses	-5.5	0.0	0.0	0.0	0.0
EBITDA	**50.7**	**90.5**	**163.5**	**280.1**	**385.6**
Depreciation	-9.4	-16.4	-26.1	-34.0	-36.1
EBIT	**41.3**	**74.1**	**137.4**	**246.1**	**349.5**
Financial result	4.0	0.8	10.8	-20.3	-27.2
EBT	**45.3**	**74.9**	**148.2**	**225.8**	**322.2**
Tax expenses	-1.7	-15.5	-28.2	-42.9	-61.2
Extraordinary result	0.0	-2.6	0.0	0.0	0.0
Minority interests	-0.9	-2.7	-18.0	-18.5	-26.1
Net result after minorities	**42.8**	**54.2**	**102.0**	**164.5**	**234.9**

Balance Sheet (IAS, PLN mn, 31/12)	2005	2006	2007e	2008e	2009e
Intangible assets	9.8	76.7	230.3	230.3	230.3
Tangible assets	177.2	266.5	403.7	422.5	419.7
Financial assets	8.6	18.0	25.8	25.8	26.8
Total fixed assets	**195.6**	**361.1**	**659.8**	**678.6**	**676.8**
Inventories	11.9	15.6	30.3	42.8	53.7
Receivables and other current assets	370.5	594.8	1,025.6	1,474.3	1,870.1
Other assets	6.5	7.7	16.9	21.9	27.7
Cash and cash equivalents	81.8	65.2	43.4	62.8	79.2
Total current assets	**470.7**	**683.3**	**1,116.2**	**1,601.8**	**2,030.8**
TOTAL ASSETS	**666.3**	**1,044.4**	**1,776.0**	**2,280.4**	**2,707.5**
Shareholders' equity	**177.6**	**368.1**	**816.5**	**981.0**	**1,215.9**
Minorities	**6.7**	**12.1**	**19.2**	**19.2**	**19.2**
Other reserves	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Interest-bearing LT debts	79.4	180.2	146.7	253.4	283.4
Other LT liabilities	122.7	26.6	209.6	159.6	139.6
Total long-term liabilities	**202.1**	**206.8**	**356.3**	**413.0**	**423.0**
Interest-bearing ST debts	136.0	204.8	146.7	253.4	283.4
Other ST liabilities	144.0	252.7	437.3	613.8	766.0
Total short-term liabilities	**279.9**	**457.4**	**584.0**	**867.2**	**1,049.4**
TOTAL LIAB. & EQUITY	**666.3**	**1,044.4**	**1,776.0**	**2,280.4**	**2,707.5**

Cash Flow Statement (IAS, PLN mn, 31/12)	2005	2006	2007e	2008e	2009e
Cash flow from operating activities	-54.9	-39.8	-46.1	-118.4	21.1
Cash flow from investing activities	-97.3	-155.8	-195.0	-52.8	-33.6
Cash flow from financing activities	190.2	165.1	219.4	190.5	28.9
CHANGE IN CASH & CASH EQU.	**38.0**	**-30.5**	**-21.7**	**19.3**	**16.4**

Margins & Ratios	2005	2006	2007e	2008e	2009e
Sales growth	89.1%	65.1%	114.6%	43.7%	26.8%
EBITDA margin	12.4%	13.4%	11.3%	13.5%	14.6%
EBIT margin	10.1%	11.0%	9.5%	11.8%	13.2%
Net profit margin	10.5%	8.0%	7.0%	7.9%	8.9%
ROE	26.7%	19.9%	17.2%	18.3%	21.4%
ROCE	15.3%	9.6%	11.0%	13.8%	16.3%
Equity ratio	27.7%	36.4%	47.1%	43.9%	45.6%
Net debt	133.5	319.8	250.0	444.1	487.6
Inventory turnover	40.5	40.3	53.2	47.2	44.9

Source: Company data, Erste Bank estimates

Company Report

Contacts

Group Research

Head of Group Research	
Friedrich Mostböck, CEFA	+43 (0)50 100-11902
CEE Equity Research	
Co-Head: Günther Artner, CFA	+43 (0)50 100-11523
Co-Head: Henning Eßkuchen	+43 (0)50 100-19634
Günter Hohberger *(Banks)*	+43 (0)50 100-17354
Franz Hörl, CFA *(Steel, Construction)*	+43 (0)50 100-18506
Gernot Jany *(Banks, Real Estate)*	+43 (0)50 100-11903
Daniel Lion *(IT)*	+43 (0)50 100-17420
Martina Pasching, MBA *(Transp., Paper)*	+43 (0)50 100-11913
Christoph Schultes *(Insurance, Utilities)*	+43 (0)50 100-16314
Vera Sutedja, CFA *(Telecom)*	+43 (0)50 100-11905
Vladimira Urbankova *(Pharma)*	+4202 24 995 940
Gerald Walek, CFA *(Machinery)*	+43 (0)50 100-16360
International Equities	
Hans Engel *(Market strategist)*	+43 (0)50 100-19835
Ronald Stöferle	+43 (0)50 100-11723
Jürgen Rene Ulamec, CEFA	+43 (0)50 100-16574
Macro/Fixed Income Research	
Head: Veronika Lammer *(Euroland,SW)*	+43 (0)50 100-11909
Veronika Posch *(Corporates)*	+43 (0)50 100-19633
Rainer Singer *(US, Japan)*	+43 (0)50 100-11185
Elena Statelov, CIIA *(Corporates)*	+43 (0)50 100-19641
Macro/Fixed Income Research CEE	
Rainer Singer *(Chief Analyst CEE)*	+43 (0)50 100-11185
Editor Research CEE	
Brett Aarons	+420 224 995 904
Research, Croatia	
Damir Cukman *(Equity)*	+385 62 37 28 12
Alen Kovac *(Fixed income)*	+385 62 37 13 83
Research, Czech Republic	
Head: Viktor Kotlan *(Fixed income)*	+420 224 995-217
Petr Bartek *(Equity)*	+420 224 995 227
Maria Feherova *(Fixed income)*	+420 224 995 232
Jan Hajek, CFA *(Equity)*	+420 224 995 324
Radim Kramule *(Equity)*	+420 224 995 213
Martin Lobotka *(Fixed income)*	+420 224 995 192
Lubos Mokras *(Fixed income)*	+420 224 995 456
David Navratil *(Fixed income)*	+420 224 995 439
Jakub Zidon *(Equity)*	+420 224 995 340
Research, Hungary	
József Miró *(Equity)*	+361 235-5131
Orsolya Nyeste *(Fixed income)*	+361 373-2830
Research, Poland	
Artur Iwanski *(Equity)*	+48 22 3306253
Magda Jagodzinska *(Equity)*	+48 22 3306250
Tomasz Kasowicz *(Equity)*	+48 22 3306251
Piotr Lopaciuk *(Equity)*	+48 22 3306252
Marek Czachor *(Equity)*	+48 22 3306254
Grzegorz Zawada, CFA *(Equity)*	+4822 538 6200
Research, Romania	
Head: Lucian Claudiu Anghel	+4021 312 6773
Mihai Caruntu *(Equity)*	+4021 311 27 54
Dumitru Dulgheru *(Fixed income)*	+4021 312 6773 1028
Cristian Mladin *(Fixed income)*	+4021 312 6773 1028
Loredana Oancea *(Equity)*	+4021 311 27 54
Research, Serbia	
Mladen Dodig	+381 11 22 00 866
Research, Slovakia	
Head: Juraj Kotian *(Fixed income)*	+421 2 59 57 4139
Michal Musak *(Fixed income)*	+421 2 59 57 4512
Maria Valachyova *(Fixed income)*	+421 2 59 57 4185

Institutional Sales

Head of Sales Equities & Derivatives	
Michal Rizek	+4420 7623-4154
Brigitte Zeitlberger-Schmid	+43 (0)50 100-83123
Equity Sales Vienna XETRA & CEE	
Hind Al Jassani	+43 (0)50 100-83111
Werner Fuerst	+43 (0)50 100-83114
Josef Kerekes	+43 (0)50 100-83125
Ana Milatovic	+43 (0)50 100-83131
Stefan Raidl	+43 (0)50 100-83113
Simone Rentschler	+43 (0)50 100-83124
Sales Derivatives	
Christian Luig	+43 (0)50 100-83181
Manuel Kessler	+43 (0)50 100-83182
Sabine Kircher	+43 (0)50 100-83161
Christian Klikovich	+43 (0)50 100-83162
Armin Pfingstl	+43 (0)50 100-83171
Roman Rafeiner	+43 (0)50 100-83172
Equity Sales, London	
Dieter Benesch	+4420 7623-4154
Tatyana Dachyshyn	+4420 7623 4154
Jarek Dudko, CFA	+4420 7623 4154
Federica Gessi-Castelli	+4420 7623-4154
Declan Woolougan	+4420 7623-4154
Sales, Croatia	
Zeljka Kajkut *(Equity)*	+385 62 37 28 11
Damir Eror *(Equity)*	+385 62 37 28 13
Sales, Czech Republic	
Michal Brezna *(Equity)*	+420 224 995-523
Ondrej Cech *(Fixed income)*	+420 224 995-577
Michal Rizek	+420 2 2499 5537
Jiri Smehlik *(Equity)*	+420 224 995-510
Pavel Zdichynec *(Fixed income)*	+420 224 995-590
Sales, Hungary	
Róbert Barlai *(Fixed income)*	+361 235-5844
Gregor Glatzer *(Equity)*	+361 235-5144
Krisztián Kandik *(Equity)*	+361 235-5140
Zoltán Szabó *(Fixed income)*	+361 235-5144
Sales, Poland	
Head: Andrzej Tabor	+4822 330 62 03
Pawel Czuprynski *(Equity)*	+4822 330 62 12
Lukasz Mitan *(Equity)*	+4822 330 62 13
Jacek Krysinski *(Equity)*	+4822 330 62 18
Sales, Slovakia	
Head: Dusan Svitek	+421 2 5050-5620
Rado Stopiak *(Derivatives)*	+421 2 5050-5601
Andrea Slesarova *(Client sales)*	+421 2 5050-5629

Treasury - Erste Bank Vienna

Sales Retail & Sparkassen	
Head: Manfred Neuwirth	+43 (0)50100-84250
Equity Retail Sales	
Head: Kurt Gerhold	+43 (0)50100-84232
Domestic Sales Fixed Income	
Head: Thomas Schaufler	+43 (0)50100-84225
Treasury Domestic Sales	
Head: Gottfried Huscava	+43 (0)50100-84130
Corporate Desk	
Head: Leopold Sokolicek	+43 (0)50100-84601
Alexandra Blach	+43 (0)50100-84141
Roman Friesacher	+43 (0)50100-84143
Helmut Kirchner	+43 (0)50100-84144
Christian Skopek	+43 (0)50100-84146
Fixed Income Institutional Desk	
Head: Thomas Almen	+43 (0)50100-84323
Martina Fux	+43 (0)50100-84113
Michael Konczer	+43 (0)50100-84121
Ingo Lusch	+43 (0)50100-84111
Ulrich Inhofner	+43 (0)50100-84324
Karin Rauscher	+43 (0)50100-84112
Michael Schmotz	+43 (0)50100-84114

Company Report

Rating history

Date	Product	Rating	Price	Target price
22. Jun 06	IC/CR	initiating coverage with Buy	130.00	175.00
4. Oct 06	CR	Buy	190.00	230.00
25. Jan 07	CR	downgrade from Buy to Hold	291.00	295.00

Important Disclosures

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Company	Disclosure	Comment
PBG	--	--

Erste Bank rating definitions

Buy	> +20% to target price
Accumulate	+10% < target price < +20%
Hold	0% < target price < +10%
Reduce	-10% < target price < 0%
Sell	< -10% to target price

Our target prices are established by determining the fair value of stocks, taking into account additional fundamental factors and news of relevance for the stock price (such as M&A activities, major forthcoming share deals, positive/negative share/sector sentiment, news) and refer to 12 months from now. All recommendations are to be understood relative to our current fundamental valuation of the stock. The recommendation does not indicate any relative performance of the stock vs. a regional or sector benchmark.

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