ERSTE GROUP

Polish construction sector

Mind the backlog gap - 18 March 2009

Sector: 2009 should still be solid year, but big trouble will appear in 2010. Good moment to underweight the sector and switch from PBG and Polimex to other high quality peers (e.g. Mostostal Warszawa)

PBG: Our top pick until recently, but no longer. Outperformed market, but some scratches may appear on its flawless reputation, due to downturn (downgrade from Buy to Hold).

Mostostal Warszawa: Well secured against downturn – both in terms of business exposure and financial standing. Our top pick in construction (upgrade from Accumulate to Buy).

Polimex: Among most cyclical companies in segment. We are nervous about performance in 2010. Despite significant decrease of price, we maintain our Hold recommendation.

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Executive summary

After a still decent 2009 in the construction segment, 2010 could be really difficult for the sector. Commercial construction is collapsing and it seems that it will not be fully compensated for by surging investments in infrastructure, environmental protection and power engineering. We expect the construction sector to develop with growth dynamics of 1-4% in 2009 and -3% to 0% in 2010.

So far, the segment has been performing rather well, and big hopes are laid in this segment. This is a good time to underweight the entire segment and to invest selectively in those companies that can benefit from this situation. However, a lot of negative sentiment could yet appear in the sector. It should be remembered that, in times of a downturn, the construction segment tends to fall deeply into the red. During the last cycle, the construction segment was the last to start to perform well; it is also strong in the first phase of a downturn.

PBG, which has handily outperformed the market, has lost its place as our top pick in the segment (downgrade from Buy to Hold), despite the fact that we remain big fans of the business. The good performance of PBG stock has resulted in a very significant premium to some of its high-quality peers. The group will not be completely untouched by the downturn (in particular, we worry about the deterioration of the business of subsidiary Hydrobudowa Polska).

Mostostal Warszawa is our current top pick in the segment. Recently, it has managed to improve its already strong backlog and has big potential to get new contracts (in infrastructure and power engineering). An additional advantage is its strong financial position (net cash of over PLN 200mn). We upgrade our recommendation from Accumulate to Buy. We recommend making a strong bet on this company.

We maintain our Hold recommendation on Polimex, as this leader of the construction segment may have difficulties in maintaining the high profitability of its production segment, while some other branches of the business should also weaken in 2010.

Apart from our covered companies, we think it is worth looking at the other companies in the Polish construction segment in order to get some orientation. We have positive outlook for Energomontaz Polnoc, Trakcja Polska; a negative outlook for Hydrobudowa Polska, Mostostal Plock, Naftobudowa and Erbud and neutral outlook for Pol-Aqua, Budimex and Remak (presented in the general part of this report).

Polish construction market overview

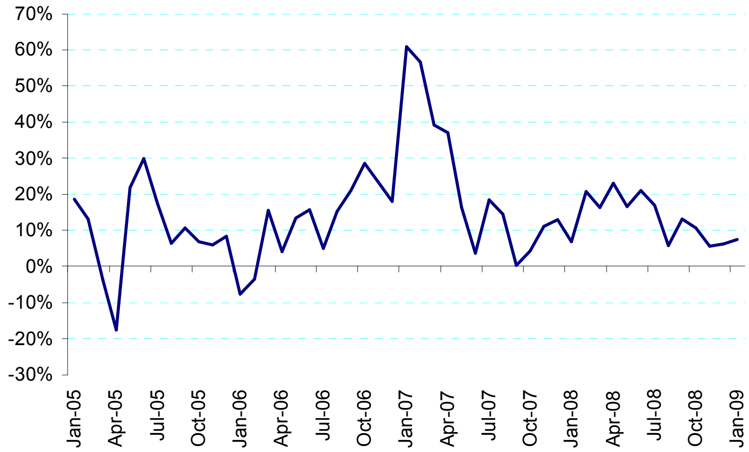
Multi-color market

The Polish construction market is sending out ambiguous signals. On one hand, we have the dynamically deteriorating (in terms of contract supply) commercial construction segment. On the other hand, the market is fuelled by the biggest contract supply in history from public utilities, infrastructure (driven by EU funds and EURO 2012 needs) and (perhaps soon) power engineering. These two sides of the market are wrestling each other to set the final shape of the market. With the traditionally delayed public part and increasingly gloomy views for the future, we expect the market to be weak and shrinking in 2010, after steady but slowing growth in 2009. However, it is important to go into the details and differentiate between the segments, as the downturn can be an opportunity for some.

Decreasing growth dynamics of market

In 2008, the market continued the dynamic growth seen in previous years, but showed the first signs of the slowdown at the end of the year (illustrated in graph 1). The 2008 value of the construction market is estimated at PLN 120bn.

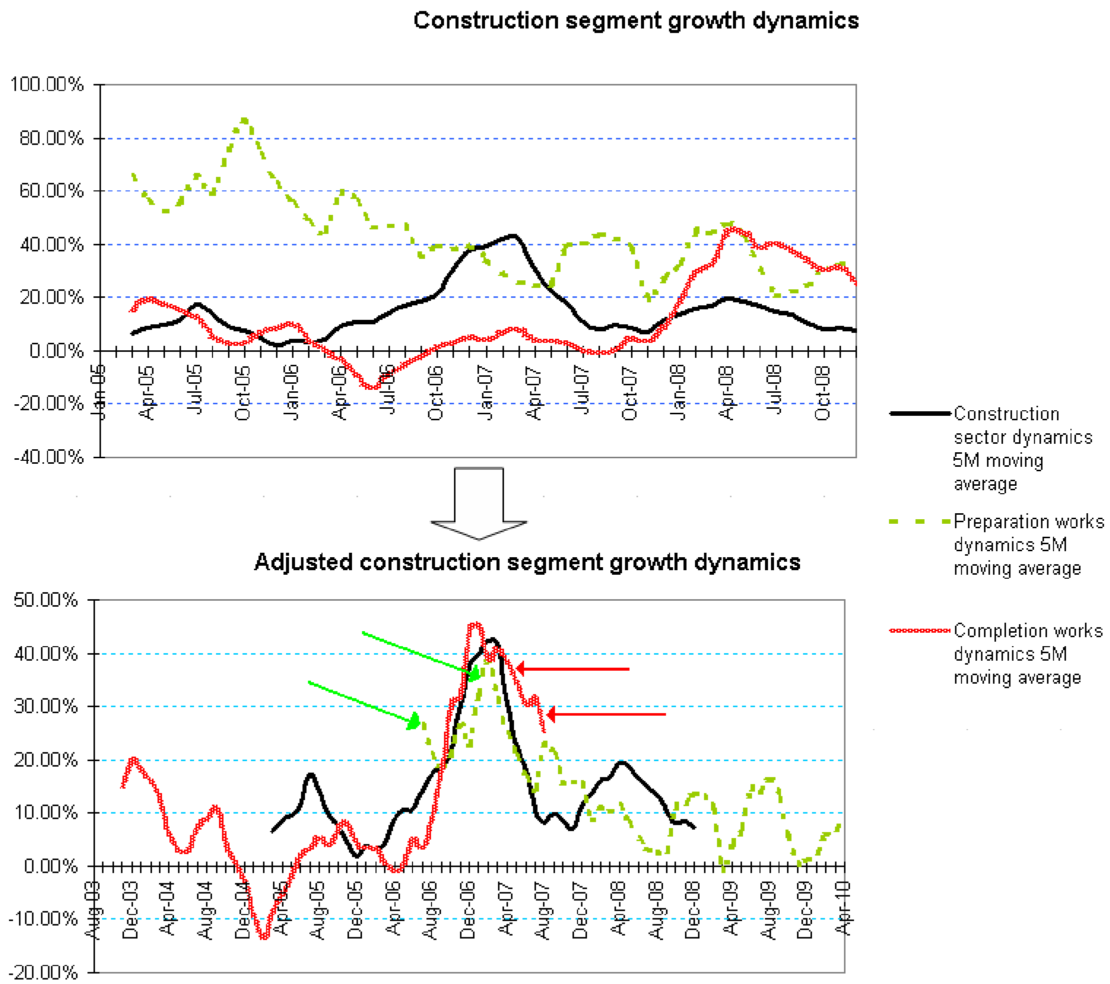
Construction growth pace in Poland - y/y dynamics



Source: Erste Group Research, GUS

The average growth dynamic decreased from the FY08 average of 13% to 7% in 4Q08.

The graph below illustrates the advance and delayed indicators of the market - construction preparation work dynamics and construction completion work, with the mainstream of the market as the background. As we are on the brink of a downturn in construction, we expect a sharp decrease of the preparation work dynamics in the coming months.



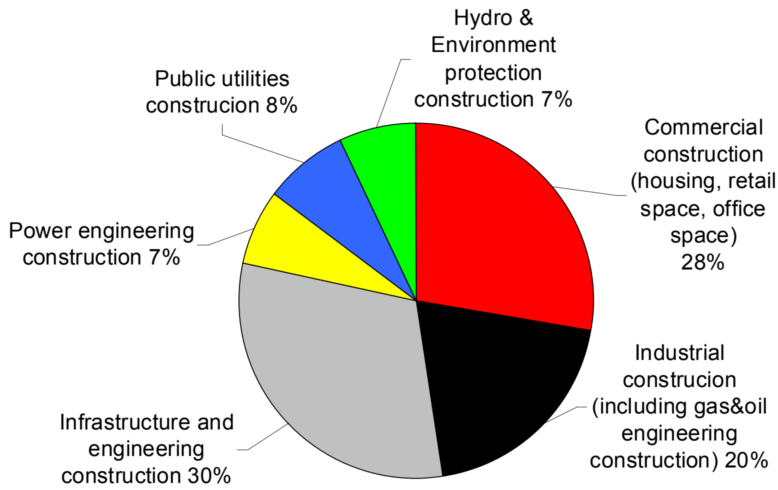
Source: Erste Group Research, GUS

By adjusting the advance indicator and the delayed indicator according to the mainstream of the market (by adjusting the values and moving the completion work graph back by 15 months and the preparation work graph forward by 15 months – moving the values by the length of the construction production cycle), we can observe the future theoretical performance of the market. The delayed indicator (construction completion work) seems to just have started its gradual slide. Analysis of the advance indicator suggests slight and gradual weakening of growth of the overall market in 2009. Of course, this is just a vague picture, as a large part of the market adjusts to the current economic situation much faster.

Differentiated sectors

To estimate the growth of the market, we need to asses the prospects of each segment. To give you a general idea of the composition of the Polish construction segment, we present the rough division of the market.

Construction market segmentation in Poland (2008)



Source: Erste Group Research

Commercial construction

This segment includes housing, retail space, office and hotel construction. Housing construction was the first segment to feel the pinch, with the first weakening of performance in mid-2008. At present, we are witnessing a collapse of this market. The number of flats being constructed may fall by more than half. The retail space construction market was extremely strong in 2008 and the concluded contracts should keep the 2009 performance at a decent level. The lack of new investments in the segment indicates a huge decline for the beginning of 2010. Office space and hotels are somewhere in between. Overall, the commercial construction segment should be the weakest one. Huge competition for output capacities is expected. We expect a sharp decline of the segment in 2009 and 2010.

Industrial construction

Industrial construction should be weak, in line with the downturn of the economy. A hugely negative impact is expected in the oil engineering construction segment, with the ending/decreasing CAPEX programs of two major Polish refineries, PKN Orlen and Lotos, and sharply lower prices of oil. The pipeline segment also does not show any signs of revival. This is well illustrated by the weak backlogs of the companies operating in the segment. The extraordinarily high margins and performance of 2007-08 should fall off quickly. The gas engineering segment is a completely different story, following the huge CAPEX of PGNiG and worries about gas supply stability. Overall, we expect a significant decrease of the whole segment in 2009 and 2010.

Public utilities construction

Stable segment, partially revived by organization of EURO 2012 tournament. The majority of the segment is typical general cubature construction, with no barriers to entry (open to all participants in the construction segment). We expect far more competition and some increase of the market.

Infrastructure construction

One of the hopes for the whole construction market. Despite the traditional delays in this segment and projects always falling short of plans, this part of the market is soaring, fuelled by huge needs, EU funds and (at last) an emerging supply of contracts. The realization of the budget of GDDKiA (a major state institution coordinating road construction) should increase from PLN 17bn in 2008 to about PLN 26bn this year (the planned amount is PLN 32bn for 2009, while the plan for 2008 was PLN 20bn). In any case, a several dozen percent increase should be expected. With the beginning downturn, there is no problem with capacities; on the contrary, tough competition should be expected, but only the big companies with some experience in the segment count in this game. Growth should also be expected in the railway construction segment. This market is at least a step behind the roads segment and should grow less dynamically, but on the other hand has higher barriers to entry (specialist knowledge, equipment, personnel). Overall, railway construction is the major (and almost sole) engine of growth for the segment, with expected growth in 2009 and 2010 of at least several tens of percent.

Power engineering construction

This segment is also one in which big hopes have been laid. This market is in a state of continuous stagnation, with big investments delayed to an unspecified future date. The positive side is that the domestic market probably cannot be weaker and the foreign market (in which many Polish companies are operating, due to the weakness of the domestic market) should see a stronger performance than mainstream construction. The outlook for the domestic power engineering segment remains unchanged and positive, while the market is unchanged but weak. Current estimates anticipate new investments into as much as 11k MW (a 25% increase of current capacities) in new coal and gas energy blocks by 2020 (investments of about EUR 12-14bn). The most optimistic approaches assume a similar investment to be carried out by 2015. Additionally, there are plans to start investing in nuclear power plants (total capacities of as much as 13k MW by 2020). Such investments in power blocks would amount to EUR 40bn by 2020, not including investments in the power grid. This seems to be completely unrealistic, especially in light of the economic crisis. Focusing on the next five years, we can count on at most several investments, with installed power definitely below 4-5k MW (EUR 6-7bn). Even so, the market should grow from the currently very low and unambitious levels. We expect 2010 to be better in terms of dynamics than 2009. The investment preparation process is very long in this segment and it may even be 2011 before we see decent growth.

Environmental protection & hydro construction segment

Segment most exposed to EU funds inflows. The segment value should increase for the next few years. The problem with the segment is that there is a lack of large barriers to entry for competition. The segment is not closed because of significant technological of equipment barriers. We expect heavily increasing competition in this segment, which should nonetheless grow in 2009 and 2010.

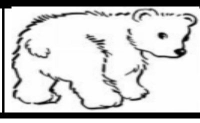
Market growth forecast

Taking into consideration the outlooks for the segments described above, we prepared a dynamics forecast for the whole construction segment. We expect the construction sector to develop with dynamics of 1% to 4% in 2009 and -3% to 0% in 2010. The base scenario is that some first positive signals should emerge in 2H10, but in fact 2011 is a mystery.

Prices and margins

There are several factors influencing construction companies' margins. Firstly, it is obvious that market prices are set by the supply of capacities and tenders. We are now starting to observe a severe decrease of market prices. The table below illustrates how the situation is changing - from a market of general contractors to a market of investors.

Contracts' planned budgets vs final prices

Contract	Original budget of the project	Final price of the contract	Difference	Market
Stadium of Legia in Warsaw	PLN 180mn (budget valid in the beginning of 2007)	PLN 365mn (concluded in the end of 2008)	103%	
Underground gas storages in Wierzchowice	PLN 560mn (PGNiG budget valid in 2005)	PLN 1090mn (concluded in the 2H 2008)	95%	
Lubiatow-Miedzychod-Grotow gas & oil mine	PLN 500mn (PGNiG budget valid in 2005)	PLN 1400mn (concluded in the 2H 2008)	180%	
Augustow ringroad	PLN 250mn (estimations of costs in the 1H 2006)	PLN 360mn (concluded in the 1H 2007)	44%	
North Bridge in Warsaw	PLN 1167 (budget of the city for the project valid in 2008)	PLN 977mn (concluded in the 1H 2009)	-16%	

Source: Erste Group

The second factor is decreasing costs of materials and subcontractors. This should definitely increase the profitability of long-term contracts concluded in times of upturns. The third factor that should most significantly influence companies is operating leverage, which should harm the companies. With part of the costs fixed or not elastic (labor, equipment, administration), the backlog gaps that could start to emerge (at some companies this year and throughout the market in 2010) should be the strongest burden on results. That is why we favor companies with solid backlog bases and potential to get new contracts, especially for 2010 and 2011. We expect still very solid margins in 2009, especially in the stronger segments. However, 2010 may be very difficult. We would not be shocked if much of the segment goes into the red. The graph below illustrates the huge volatility of the profitability of the construction segment.

Cyclical net profitability of the construction segment in Poland (%)

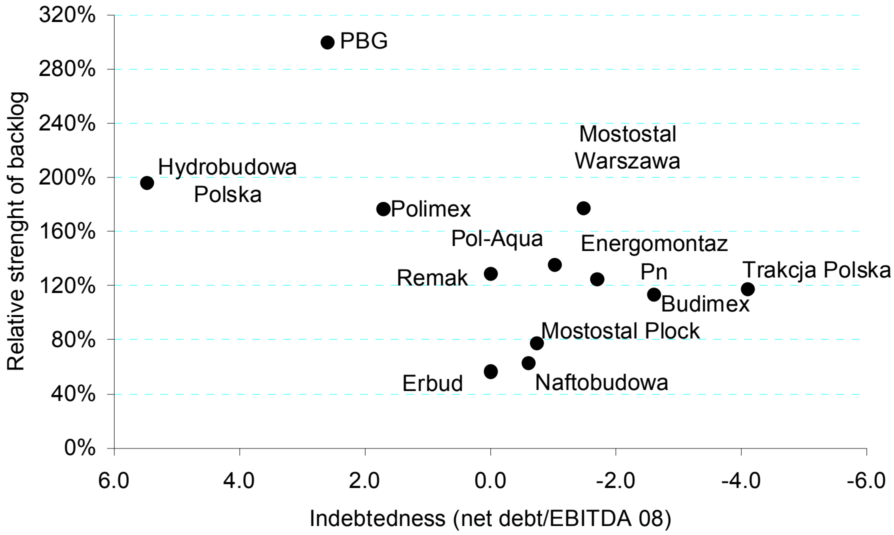
Source: Erste Group Research, GUS

Companies overview

Backlog is primary factor

In assessing the investment attractiveness of the companies from this segment, the primary (in our opinion) factors are the strength of the backlog and the potential to improve it (which is of course related to the sector exposure, but also the size of the company). The other important factor is indebtedness. A strong financial position facilitates strengthening of the backlog and reduces downturn risks. The graph below shows a comparison of the companies in the segment in terms of their relative current backlogs (backlog to 2008 sales) against their indebtedness. We prefer companies in the upper part of the graph (strong backlog), preferably with low debt (the right part of the graph). The graph does not take into consideration many other factors – with the most important on top, the potential to get new contracts.

Relative strength of backlog and indebtedness



Source: Erste Group Research

Investment information

Apart from the companies we cover, we have decided to provide some information about the other companies from the segment. Basically, we expect a lot of negative sentiment to start appearing in the segment. On this basis, even the best companies may suffer. Based on the backlog (current and potential), exposure to the segments, indebtedness and other details, we provide the following statements:

Rated Companies	Investment advice	Story
Mostostal Warszawa	**BUY**	see the report (p. 11)
Polimex	**HOLD**	see the report (p. 19)
PBG	**HOLD**	see the report (p. 15)
Not Rated Companies	**Company outlook**	**Story**
Energomontaz Polnoc	positive	Subsidiary of Polimex - what can have both negative and positive (in order to avoid impairment charges in Polimex, Energomontaz P. has to show decent results) sides. Secured backlog for 2009 (100%) and solid fundamentials for 2010 (30%). Almost full exposition to the attractive power engineering segment (power blocks assembly). Exporter with less than 50% FX exposition hedged. Strong financial position - net cash (net debt to Ebitda 2008 at -1.7).
Hydrobudowa Polska	negative	Subsidiary of PBG - what in our opinion has negative influence on the value. Much weaker relative backlog than in PBG. Exposition for the environment protection segment in which we expect increased competition and decrease of margins. Significant debt (net debt to Ebitda 2008 at 5). Expensive and with the good sentiment (borrowed from PBG), may aditionally suffer with worsening market sentiment.
Mostostal Plock	negative	Subsidiary of Mostostal Warszawa. Exposition to the weak segment of oil construction. This is illustrated by quite weak backlog. On the positive sides - good financial position (net debt to Ebitda 2008 at -0.4). We fear about the performance in the years 2009 and 2010. It will be hard to fill up the backlog.
Naftobudowa	negative	Subsidiary of Polimex. Exposition to the weak segment of oil construction. This is illustrated by quite weak backlog. On the positive sides - good financial position (net debt to Ebitda 2008 at -0.6). We fear about the performance in the years 2009 and 2010. It will be hard to fill up the backlog.
Trakcja Polska	positive	Exposition to one of the best segments of the construction - railways (growing with high barriers of entry). Moderate backlog. There is a small risk of order gap (95% of backlog secured for 2009, 20% for 2010), but there should be no major problems with filling up the contract porftolio. Strong financial position - significant net cash (net debt to Ebitda 2008 at -4).
Pol-Aqua	neutral	All risks of cubature segment construction included. Moderate backlog (secured 100% of sales in 2009 and 35% of 2010). It will be increasingly harder to strenghten the backlog at good prices. Partial exposition to oil construction segment (negative outlook). On the other hand price fell significantly, does not look expensive. Strong financial position (net debt to Ebitda 08 at -1)
Erbud	negative	Full exposition to the weak general cubature construction segment. Very weak backlog (60% of 2009 sales secured). Lost surplus of cash on toxic FX options, but still good financial position (net debt to Ebitda 08 at 0). Good management and quality of services may help to cope with the difficult situation.
Budimex	neutral	Biggest player in the infrastructure segment but also significant exposition to the general construction segment. Entered the crisis with quite weak order backlog (still only 80% of expected sales of 2009 is secured). On the other hand Budimex is a major favourite for winning big infrastructure contracts. Good newsflow is expected in short and middle term. In long term the company may remain with a big burden of long term contracts signed at the low, crisis prices. Strong financial position (net debt to Ebitda 2008 at -2.6)
Remak	neutral	Full exposition to the increasingly attractive power engineering segment (energy blocks assembly). Exporter which will benefit on the unhedged FX position. Huge improvement of the result is expected. Cooperation with biggest boilers producer in Poland - Rafako may be beneficial. On the negative side - small market capitalization and already noticed by the market.

Peer comparison

Analyzing the market expectations, we came to the conclusion, that the real performance of the construction market in 2010 may negatively surprise the market. The construction market tends to go deeply in the red in the times of downturn. That may be the cause of future appearing of very significant, negative sentiment for the segment. In our opinion the best companies in the segment will manage in the years 2010-2011 at most (with very few exceptions) to maintain the result from the years 2008-2009. The profitability of the segment should go sharply down what is not yet visible in the market expectations. The peer analysis confirms our choice of Mostostal Warszawa as a top pick out of covered companies. In our opinion the company is traded with a significant discount. PBG looks very weak in the peer comparison but with some more negative sentiment for the segment this should improve as the results of PBG for 2010 seem to be quite well secured. Polimex - one of the leaders of Polish construction seems to be valued in comparison to peers.

Valuation comparison

	P/E		EV/EBITDA		EV/EBIT		Valuation	
Name	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**
Mostostal Warszawa	**8.4**	**8.7**	**3.9**	**3.6**	**4.7**	**4.5**		
Implied fair value	994,337	997,398	1,165,507	1,113,406	1,308,151	1,323,862		
Number of shares	20,000	20,000	20,000	20,000	20,000	20,000		
Implied fair value per share	49.7	49.9	58.3	55.7	65.4	66.2	57.8	57.2
12M target value							**64.4**	**63.8**
Polimex	**8.3**	**11.6**	**6.3**	**6.8**	**8.9**	**10.4**		
Implied fair value	1,462,023	1,097,225	1,246,173	1,022,590	1,206,370	1,024,294		
Number of shares	467,007	467,007	467,007	467,007	467,007	467,007		
Implied fair value per share	3.1	2.3	2.7	2.2	2.6	2.2	2.79	2.24
12M target value							**3.12**	**2.51**
PBG	**13.3**	**11.7**	**9.6**	**8.2**	**10.9**	**9.2**		
Implied fair value	1,928,603	2,287,928	1,077,340	1,362,149	1,510,854	2,214,607		
Number of shares	13,430	13,430	13,430	13,430	13,430	13,430		
Implied fair value per share	143.6	170.4	80.2	101.4	112.5	164.9	112.1	145.6
12M target value							**125**	**146**
Median for int. peer group	**9.4**	**9.7**	**5.5**	**5.2**	**7.5**	**8.0**		
Budimex	12.3	11.7	7.4	6.5	9.6	8.4		
Erbud SA	7.9	11.6	3.5	4.5	3.9	5.3		
Elektrobudowa SA	10.7	10.0	7.9	7.2	8.7	8.0		
Energomontaz Polnoc	9.3		5.5		7.5			
Hydrobudowa Polska	9.6	8.7	7.9	6.0	9.1	8.0		
Mostostal Plock	8.2		5.4		6.0			
Naftobudowa	9.5		5.3		7.5			
Pol-Aqua	7.5	7.4	3.5	2.9	5.0	3.8		
Remak	9.2		6.5		8.1			
Trakcja Polska	9.4	8.9	4.6	4.1	5.4	4.9		
Eiffage SA	8.9	9.5	7.3	7.4	13.2	13.4		
Gruppo Ferovial SA	94.0	17.9	11.1	10.5	18.6	18.1		
Hochtief AG	10.7	10.2	2.8	2.8	5.2	4.8		
STRABAG	6.8	8.4	3.3	3.7	7.3	9.1		

Source: Erste Group Research

Company Report – Construction Services – Poland – March 18, 2009

Mostostal Warszawa from Accumulate to Buy

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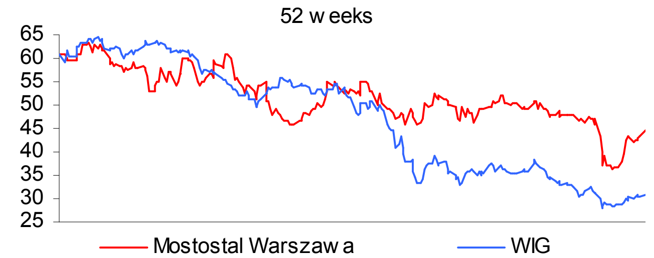
PLN mn	2008	2009e	2010e	2011e
Net sales	2,208.4	2,626.2	2,766.0	2,934.7
EBITDA	141.4	182.2	180.4	186.1
EBIT	118.6	151.4	144.1	146.9
Net result after min.	78.5	106.3	102.5	104.6
EPS (PLN)	3.93	5.32	5.13	5.23
CEPS (PLN)	4.72	5.17	6.23	6.64
BVPS (PLN)	16.76	23.17	28.61	33.84
Div./share (PLN)	0.00	0.00	0.00	0.00
EV/EBITDA (x)	5.6	3.9	3.6	3.1
P/E (x)	12.5	8.4	8.7	8.5
P/CE (x)	10.4	8.6	7.1	6.7
Dividend Yield	0.0%	0.0%	0.0%	0.0%



Performance	12M	6M	3M	1M
in PLN	-27.2%	-15.4%	-14.6%	2.1%
in EUR	-42.4%	-35.9%	-21.8%	9.7%

Share price (PLN)	44.40	Reuters	MOWA.WA	Free float	49.9%
Number of shares (mn)	20.0	Bloomberg	MSW PW	Shareholders	Infraestructuras SA (50.1%)
Market capitalization (PLN mn / EUR mn)	888 / 199	Div. Ex-date			OFE PZU Zlota Jesien (15.86%)
Enterprise value (PLN mn / EUR mn)	717 / 160	**Target price**	**65.0**	Homepage:	www.mostostal.waw.pl

Secured against downturn

- **Mostostal Warszawa has taken over as our top pick in the construction segment. We upgrade our recommendation from Accumulate to Buy and increase our target price from PLN 56 to PLN 65.**
- **Since our previous report, Mostostal Warszawa has managed to significantly improve its backlog, which now amounts to PLN 3.8bn. Thanks to the acquisition of the Wroclaw stadium contract, which significantly improved the situation of subsidiary Wrobis (a cubature construction company operating in Wroclaw), our fears concerning this part of the group have largely vanished.**
- **The power engineering segment is an area that could provide some very positive surprises. The cooperation launched with Rafako (a listed boiler producer) has opened new possibilities for the group and enables it to fight for the most attractive contracts. Separately, subsidiary Remak (which assembles energy boilers on foreign markets) should rapidly improve the result, thanks to its full backlog and the depreciating PLN. The steel construction division is an excellent supplement to this segment.**
- **Mostostal Warszawa is also an experienced company in the infrastructure construction segment. It specializes in bridge construction and is prepared to get some of the biggest road contracts. In 2009, this segment should generate about 32% of sales.**
- **The weakest segment in y/y terms should be oil construction (Mostostal Plock), which recorded peak performance in 2008 (PLN 14mn net profit); we expect a sharp deterioration in 2009 and 2010.**
- **The company has an extremely strong financial position, with net cash of PLN 250mn. This provides stability and opens new opportunities in times of downturn.**

Investment story

Strong order backlog

Recently, Mostostal Warszawa managed to significantly strengthen its order backlog. The portfolio of orders now amounts to about PLN 3.8bn. This includes PLN 2.1bn in contracts for 2009 (not including the expected sales of production companies of over PLN 250mn) and PLN 1.5bn in contracts for 2010. These are solid fundamentals for the crisis. Additionally, in our opinion, Mostostal is well placed to acquire new contracts.

Significant player in infrastructure segment…

The company is one of the beneficiaries of the growth of the infrastructure market. Mostostal Warszawa, together with its daughter production companies (Mostostal Pulawy and Mostostal Kielce), is well experienced in the infrastructure segment and specializes in bridge construction. The company is big enough to fight in the big road tenders or to benefit from Euro 2012 preparations (and has already won the contract for the Wroclaw stadium for PLN 600mn).

…and power engineering

What we like about Mostostal Warszawa is its exposure to the power engineering construction segment. Subsidiary Remak (44% owned, assembler of energy blocks) has a full backlog for 2009 and should almost double its net profit in 2009 (to over PLN 7mn). Recently, the group announced that it will closely cooperate with Rafako (the biggest energy boiler producer) and together enter tenders for big contracts in power engineering. This sounds like a very promising cooperation and good news for Mostostal Warszawa. To start, this consortium will place a bid for the EC Siekierki 800 MW energy block. The value of this deal could amount to over EUR 1bn.

Wrobis now looking much better

In our last report, we expressed worries about Wrobis (a general cubature construction company with a focus on commercial construction) and its performance in 2009 and 2010. We still think that this company will be relatively weak, but its outlook has improved very significantly. Generating over PLN 300mn of sales, it managed to sign a deal for the construction of the Medical University building in Wroclaw (PLN 50mn). Most importantly, it will carry out part of the work on the recently won Wroclaw stadium contract (PLN 600mn).

Weakness in oil segment expected

Mostostal Warszawa has a diversified group of companies. It also has some exposure to the (in our opinion) shrinking oil construction market. Its subsidiary Mostostal Plock (49% owned) recorded a peak performance in 2008 (sales of PLN 184mn and net profit of PLN 17.8mn), but still has a 40% order gap for 2009. We expect the result to almost halve y/y.

Strong financial position

Mostostal Warszawa is in an excellent financial situation. The company is sitting on PLN 250mn in net cash (end-2008). This is very important during a market downturn. It provides stability and opens new opportunities (entering new projects and potential acquisitions after the slump).

Dynamic FX market with slight positive impact for group

Generally, the mother company very accurately hedges its cash flows and FX is, in the long run, neutral for the company. However, subsidiary Remak (operating almost solely in Western Europe) had its FX position unhedged. Remak will strongly benefit from the weakness of the PLN, as it has signed and budgeted most of its contracts in the environment of the EUR/PLN at 3.4. The company is now considering hedging its cash flows. Separately, the dynamic FX movement distorted the 2008 result (due to the fact that part of the hedging was ineffective – as often happens in the construction segment). The result was lowered by about PLN 10mn (which burdened the financial line of the P/L). This will be an additional factor boosting the 2009 result. However, in the meantime, the company may again show a loss on the financial line, due to the dynamic depreciation of the PLN in 1Q09.

Valuation

We employed a DCF valuation tool to estimate the fair value of the company. The DCF is based on our forecasts for the years 2009e-2012e. We used a discounted rate based on WACC and a terminal value based on perpetuity. The DCF led us to a fair value of PLN 65 per share, which in our opinion accurately reflects the value of the company. The peer comparison shows that Mostostal Warszawa shares are quoted with a significant discount. In our opinion the premium confirms our upgrade of recommendation (from Accumulate to Buy). We regard Mostostal Warszawa as the company skilfully secured against economic downturn and well exposed to grasp potential chances on the construction market.

Our estimates are based on the following assumptions:

- No acquisitions are assumed
- We expect the improvement of the power engineering market starting from 2011
- Risk-free rate at 6% equity premium at 5%, debt premium at 2.5% and beta at 1.1 in forecasted period (and 1.0 in the perpetuity)
- No dividend pay-out is assumed in the years 2009-2011
- The terminal growth rate is set at 0.5%

DCF valuation

(in PLN mn)	2009e	2010e	2011e	2012e	beyond 2012
EBIT	**151.4**	**144.1**	**146.9**	**137.6**	**137.6**
tax rate	19%	19%	19%	19%	19%
tax on EBIT	29	27	28	26	26
NOPLAT	**122.6**	**116.7**	**119.0**	**111.5**	**111.5**
Depreciation	30.8	36.3	39.2	40.3	
Capital expenditures	-85.7	-60.7	-55.7	-40.4	
Change in working capital	-98.3	-16.2	-3.6	-2.2	
Free cash flow	**-30.7**	**76.1**	**98.8**	**109.2**	
Terminal value	**1,207**				
Value of FCF at 31.12.2008	-27.6	61.7	72.2	71.8	
Sum of DFCF	178.1				
Discounted terminal value	790.9				
Enterprise value at 31.12.2008	**969.0**				
Non-operating assets	0				
Net debt at 31.12.2008	-252.2				
Minorities	81.5				
Fair value at 31.12.2008	**1,140**				
Number of shares (mn)	20.0				
Fair value per share at 31.12.2008	**57.0**				
Cost of equity	**11.5%**				
Target Price March 2010 (PLN)	**65.0**				
Stock price	44.40				
Premium/discount	46%				

Source: Erste Group Research

WACC

	2009e	2010e	2011e	2012e	beyond 2012
WACC	**11.0%**	**11.0%**	**11.1%**	**11.1%**	**9.7%**
Equity cost	11.5%	11.5%	11.5%	11.5%	10.0%
Debt cost	6.9%	6.9%	6.9%	6.9%	6.1%
Equity weighting	89.0%	90.2%	91.0%	91.7%	93.0%
Debt weighting	11.0%	9.8%	9.0%	8.3%	7.0%
Risk free rate	6.0%	6.0%	6.0%	6.0%	5.0%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.10	1.10	1.10	1.10	1.00
Debt premium	2.5%	2.5%	2.5%	2.5%	2.5%
Tax rate	19.0%	19.0%	19.0%	19.0%	19.0%

Source: Erste Group Research

Income Statement	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS, PLN mn, 31/12)	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010	31/12/2011
Net sales	**1,188.13**	**1,928.42**	**2,208.37**	**2,626.16**	**2,765.97**	**2,934.74**
Cost of goods sold	-1,123.11	-1,822.23	-1,989.86	-2,378.52	-2,519.24	-2,685.05
Gross profit	**65.02**	**106.20**	**218.51**	**247.64**	**246.73**	**249.69**
SG&A	-55.29	-60.00	-75.62	-86.75	-94.37	-99.85
Other operating revenues	36.03	37.28	37.67	22.01	22.13	23.48
Other operating expenses	-24.58	-24.60	-61.97	-31.51	-30.43	-26.41
EBITDA	**40.65**	**78.14**	**141.36**	**182.16**	**180.37**	**186.06**
Depreciation/amortization	-19.47	-19.26	-22.78	-30.77	-36.31	-39.16
EBIT	**21.18**	**58.88**	**118.58**	**151.39**	**144.07**	**146.90**
Financial result	-2.00	1.30	2.66	1.63	1.82	1.92
Extraordinary result	0.35	2.16	-3.35	0.00	0.00	0.00
EBT	**19.53**	**62.34**	**117.90**	**153.02**	**145.89**	**148.83**
Income taxes	-1.48	-3.72	-27.68	-35.93	-34.26	-34.95
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-1.06	-5.67	-11.69	-10.74	-9.13	-9.31
Net result after minorities	**16.99**	**52.95**	**78.53**	**106.35**	**102.51**	**104.57**

Balance Sheet	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS, PLN mn, 31/12)						
Intangible assets	1.16	1.18	2.17	2.21	2.25	2.29
Tangible assets	139.53	150.70	188.07	242.96	267.32	283.82
Financial assets	24.85	32.33	58.61	46.12	48.22	50.75
Total fixed assets	**165.53**	**184.21**	**248.86**	**291.30**	**317.79**	**336.86**
Inventories	30.73	54.61	41.34	61.84	65.50	69.81
Receivables and other current assets	323.20	331.98	516.23	554.88	584.42	620.08
Other assets	57.43	147.32	164.66	195.81	206.24	218.82
Cash and cash equivalents	173.28	290.88	311.25	302.82	368.54	456.33
Total current assets	**584.64**	**824.79**	**1,033.49**	**1,115.35**	**1,224.69**	**1,365.04**
TOTAL ASSETS	**750.17**	**1,009.00**	**1,282.35**	**1,406.65**	**1,542.48**	**1,701.91**
Shareholders'equity	**224.32**	**284.88**	**335.15**	**463.49**	**572.27**	**676.84**
Minorities	**54.43**	**59.49**	**65.81**	**65.81**	**65.81**	**65.81**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	0.00	0.00	0.00	0.00	0.00	0.00
Other LT provisions	37.45	29.08	39.46	36.88	33.02	34.71
Interest-bearing LT debts	24.13	16.49	28.98	23.64	24.90	26.42
Other LT liabilities	0.29	0.20	0.10	0.10	0.10	0.10
Total long-term liabilities	**24.42**	**16.69**	**29.08**	**23.74**	**25.00**	**26.52**
Interest-bearing ST debts	16.79	29.30	30.07	42.01	44.25	46.95
Other ST liabilities	392.76	589.56	782.78	774.72	802.13	851.08
Total short-term liabilities	**308.00**	**397.80**	**512.30**	**540.98**	**569.78**	**604.55**
TOTAL LIAB. , EQUITY	**750.17**	**1,009.00**	**1,282.35**	**1,406.65**	**1,542.48**	**1,701.91**

Cash Flow Statement	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS,PLN mn, 31/12)						
Cash flow from operating activities	43.93	101.72	90.20	43.20	114.83	137.35
Cash flow from investing activities	-11.62	28.88	-53.90	-85.70	-60.70	-55.70
Cash flow from financing activities	77.56	-13.00	-15.92	34.08	11.58	6.14
CHANGE IN CASH , CASH EQU.	**109.87**	**117.60**	**20.37**	**-8.43**	**65.71**	**87.80**

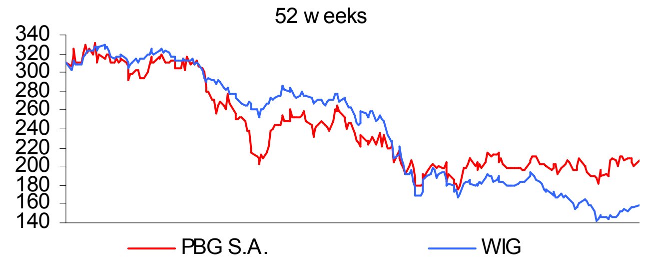
Margins & Ratios	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
Sales growth		62.3%	14.5%	18.9%	5.3%	6.1%
EBITDA margin	3.4%	4.1%	6.4%	6.9%	6.5%	6.3%
EBIT margin	1.8%	3.1%	5.4%	5.8%	5.2%	5.0%
Net profit margin	1.5%	3.0%	4.1%	4.5%	4.0%	3.9%
ROE		20.8%	25.3%	26.6%	19.8%	16.7%
ROCE		36.7%	55.7%	44.8%	31.5%	29.3%
Equity ratio	37.2%	34.1%	31.3%	37.6%	41.4%	43.6%
Net debt	-132.4	-245.1	-252.2	-237.2	-299.4	-383.0
Working capital	219.2	279.7	356.5	378.6	448.7	541.7
Capital employed	184.1	128.6	188.3	329.1	371.8	394.5
Inventory turnover		42.7	41.5	46.1	39.6	39.7

Source: Company data, Erste Group estimates

PBG S.A. from Buy to Hold

Piotr Lopaciuk, +48 22 33062 52 piotr.lopaciuk@erstegroup.com

PLN mn	2008	2009e	2010e	2011e
Net sales	2,089.3	2,849.6	3,343.2	3,577.2
EBITDA	270.3	389.9	462.1	484.2
EBIT	223.4	341.1	408.3	426.3
Net result after min.	158.0	207.5	236.7	246.6
EPS (PLN)	11.77	15.45	17.62	18.37
CEPS (PLN)	11.42	14.78	20.09	23.37
BVPS (PLN)	75.27	96.54	116.17	134.54
Div./share (PLN)	0.00	0.00	0.00	0.00
EV/EBITDA (x)	12.7	9.6	8.2	7.4
P/E (x)	16.7	13.3	11.7	11.2
P/CE (x)	17.2	13.9	10.2	8.8
Dividend Yield	0.0%	0.0%	0.0%	0.0%



Performance	12M	6M	3M	1M
in PLN	-33.8%	-9.1%	-4.6%	7.8%
in EUR	-47.6%	-31.1%	-12.7%	15.9%

Share price (PLN)	205.90	Reuters	PBGG.WA	Free float	76.0%
Number of shares (mn)	13.4	Bloomberg	PBG PW	Shareholders	J. Wisniewski (34.0%)
Market capitalization (PLN mn / EUR mn)	2,765 / 619	Div. Ex-date			
Enterprise value (PLN mn / EUR mn)	3,732 / 836	**Target price**	**230.0**	Homepage:	www.pbg-sa.pl

PBG – Way up from top is difficult

– **PBG is the best company in the construction segment in terms of business. However, it has very significantly outperformed the market and will not remain unaffected by the economic downturn. We fear that the group currently does not have much space to positively surprise the market and, with the coming difficult (for the environmental protection part) 2010, the so-far flawless reputation of PBG may suffer a bit.**

– **By remaining relatively stable, PBG became quite expensive in comparison to some of its peers (those that are also of good quality). We downgrade our recommendation from Buy to Hold and cut our target price from PLN 305 to PLN 230.**

– **We fear that some weakness may come from subsidiary Hydrobudowa Polska, which operates in the segment of hydro & environmental protection. We expect significantly increased competition in this segment and a potential deterioration of margins.**

– **The gas & oil part of the business should go really well, with the two big contracts from PGNiG signed during the bull market. We would also keep in mind that management may come up with new ideas to significantly increase the value of the group. However, such ideas would be somewhat difficult, given the net debt growth to PLN 0.7bn at the end of 2008.**

Recommendation downgrade

We have downgraded our recommendation for the most skillful (in terms of business) company in the Polish construction segment. PBG has hugely outperformed the market since our previous report (August 2008, with performance 30pp above the WIG Index), due to its good results, strong backlog and generally positive sentiment towards the company. By remaining relatively stable, PBG became somewhat expensive compared to some of its good-quality peers. We also believe that, with the weakening economy, the so-far flawless reputation of PBG may suffer a bit. We downgrade our recommendation from Buy to Hold and lower our target price from PLN 305 to PLN 230.

Very strong business, but not completely crisis-proof

PBG has the strongest and (in our opinion) best-quality backlog among Polish construction companies. The PLN 6.3bn backlog of contracts (equal to 300% of 2008 sales) secures the 2009 sales and gives a very solid base for 2010 and even 2011. The quality of the backlog seems to be very good. The two major long-term contracts in the gas sector (underground storage in Wierzchowice and an LMG mine for a total of PLN 2.5bn, budgeted during the bull market) should generate very hefty margins. However, the company may start to have problems meeting the very high expectations or positively surprising the market. Also, due to the weakening market, we expect the environmental protection segment (in which subsidiary Hydrobudowa 9 operates) to be flooded with competition. This burden may be visible already in the 2010 results.

Environmental protection segment to experience severe growth of competition

As described in the market section of this report, we expect the positively developing environmental protection segment to be flooded with competition. Generally, the technological or equipment barriers are not significant enough to stop desperate competition from entering the segment. This should result in lower margins in the environmental protection segment already in 2010. PBG may also be forced to partly halt its tactic of accepting only the highest-margin contracts

Significant debt

With its business still growing, PBG's net debt has grown to PLN 0.7bn. The terms of the credits are good and the company claims to have the possibility to even almost double the credit financing. However, in our opinion, the already significant debt may slightly slow down the expansion of the group.

Dynamic FX market neutral for company

The company fully hedges its FX exposure and has managed to quite successfully implement its accounting for FX hedging. The recent dynamic FX market fluctuations have no major impact on the business and did not distort the 2008 result.

Valuation

We employed a DCF valuation tool to estimate the fair value of the company. The DCF is based on our forecasts for the years 2008-12. We used a discount rate based on WACC and a terminal value based on perpetuity. The DCF led us to a fair value of PLN 230 per share, which in our opinion reflects the value of the firm in a proper way. The peer comparison shows that PBG shares are quoted with significant premium to peers, this reflects the fact that PBG has unique, niche exposition, excellent management and very good long term prospects. In our opinion the size of the premium confirms our downgrade of recommendation (from Buy to Hold). We point out that despite many strengths, PBG will not remain completely untouched by the economic downturn.

Our estimates are based on the following assumptions:

- No new acquisitions
- No entry on the Ukrainian market
- Risk-free rate at 6%, equity premium at 5%, debt premium at 2.5% and beta at 1.0 in forecasted period
- The terminal growth rate is set at 1.5%

DCF valuation

(in PLN mn)	2009e	2010e	2011e	2012e	beyond 2012
EBIT	**341**	**408**	**426**	**449**	**449**
tax rate	19%	19%	19%	19%	19%
tax on EBIT	65	78	81	85	85
NOPLAT	**276**	**331**	**345**	**363**	**363**
Depreciation	49	54	58	62	
Capital expenditures	-80	-65	-58	-62	
Change in working capital	-389	-269	-80	-150	
Free cash flow	**-144**	**50**	**265**	**213**	
Terminal value	4,928				
Value of FCF at 31.12.2008	-132	42	204	151	
Sum of DFCF	265				
Discounted terminal value	3,490				
Enterprise value at 31.12.2008	**3,755**				
Non-operating assets	60				
Net debt at 31.12.2008	704				
Minorities	384				
Fair value at 31.12.2008	**2,727**				
Number of shares	13,430				
Fair value per share at 31.12.2008	**203**				
Cost of equity	**11.0%**				
Target Price March 2010 (PLN)	**230**				
Stock price	205.90				
Premium/discount	12%				

Source: Erste Group Research

WACC

	2009e	2010e	2011e	2012e	beyond 2012
WACC	**9.0%**	**9.1%**	**9.4%**	**9.6%**	**8.4%**
Equity cost	11.0%	11.0%	11.0%	11.0%	10.0%
Debt cost	6.9%	6.9%	6.9%	6.9%	6.1%
Equity weighting	52.2%	54.9%	61.4%	66.2%	60.0%
Debt weighting	47.8%	45.1%	38.6%	33.8%	40.0%
Risk free rate	6.0%	6.0%	6.0%	6.0%	5.0%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.00	1.00	1.00	1.00	1.00
Debt premium	2.5%	2.5%	2.5%	2.5%	2.5%
Tax rate	19.0%	19.0%	19.0%	19.0%	19.0%

Source: Erste Group Research

Income Statement	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS, PLN mn, 31/12)	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010	31/12/2011
Net sales	**674.65**	**1,376.75**	**2,089.33**	**2,849.55**	**3,343.20**	**3,577.22**
Cost of goods sold	-555.57	-1,191.73	-1,751.22	-2,387.92	-2,808.29	-3,019.18
Gross profit	**119.08**	**185.02**	**338.11**	**461.63**	**534.91**	**558.05**
SG&A	-54.18	-79.97	-106.85	-120.49	-126.62	-131.71
Other operating revenues	9.21	4.33	-7.85	0.00	0.00	0.00
Other operating expenses	0.00	0.00	0.00	0.00	0.00	0.00
EBITDA	**90.49**	**139.61**	**270.26**	**389.91**	**462.09**	**484.18**
Depreciation/amortization	-16.38	-30.23	-46.84	-48.77	-53.80	-57.85
EBIT	**74.11**	**109.38**	**223.42**	**341.13**	**408.29**	**426.33**
Financial result	0.81	34.74	-9.88	-60.53	-80.73	-78.78
Extraordinary result	-2.55	0.00	0.00	0.00	0.00	0.00
EBT	**72.37**	**144.12**	**213.53**	**280.61**	**327.56**	**347.56**
Income taxes	-15.46	-26.70	-25.79	-36.48	-49.13	-59.08
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-2.73	-15.37	-29.70	-36.62	-41.76	-41.83
Net result after minorities	**54.18**	**102.05**	**158.04**	**207.51**	**236.66**	**246.64**

Balance Sheet	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS, PLN mn, 31/12)						
Intangible assets	76.67	262.42	347.68	347.68	347.68	347.68
Tangible assets	266.49	333.03	411.53	442.49	454.15	454.57
Financial assets	17.98	108.77	150.14	117.07	118.17	118.69
Total fixed assets	**361.14**	**704.22**	**909.35**	**907.24**	**920.00**	**920.94**
Inventories	15.65	35.27	69.27	54.91	91.12	65.87
Receivables and other current assets	594.78	1,074.78	1,502.92	2,273.94	2,667.87	2,854.62
Other assets	7.71	14.30	21.09	18.81	28.00	22.08
Cash and cash equivalents	65.16	467.84	354.37	341.95	401.18	429.27
Total current assets	**683.29**	**1,592.20**	**1,947.64**	**2,689.60**	**3,188.18**	**3,371.85**
TOTAL ASSETS	**1,044.43**	**2,296.41**	**2,856.99**	**3,596.84**	**4,108.18**	**4,292.79**
Shareholders'equity	**368.09**	**756.86**	**1,010.88**	**1,296.51**	**1,560.17**	**1,806.82**
Minorities	**12.08**	**34.45**	**103.69**	**103.69**	**103.69**	**103.69**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	0.00	0.00	0.00	0.00	0.00	0.00
Other LT provisions	26.59	136.03	91.36	31.34	19.95	23.40
Interest-bearing LT debts	180.23	280.29	340.11	492.13	529.96	470.54
Other LT liabilities	0.00	0.00	0.00	0.00	0.00	0.00
Total long-term liabilities	**180.23**	**280.29**	**340.11**	**492.13**	**529.96**	**470.54**
Interest-bearing ST debts	204.78	465.90	717.84	712.66	769.40	680.28
Other ST liabilities	252.66	622.88	593.12	960.49	1,125.00	1,208.06
Total short-term liabilities	**449.75**	**1,080.11**	**1,294.17**	**1,656.22**	**1,874.54**	**1,867.08**
TOTAL LIAB. , EQUITY	**1,044.43**	**2,296.41**	**2,856.99**	**3,596.84**	**4,108.18**	**4,292.79**

Cash Flow Statement	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS,PLN mn, 31/12)						
Cash flow from operating activities	-48.86	-38.00	-308.58	-60.29	98.73	330.29
Cash flow from investing activities	-155.85	-154.27	-156.65	-79.73	-65.46	-58.28
Cash flow from financing activities	165.10	594.95	351.75	127.59	25.96	-243.93
CHANGE IN CASH , CASH EQU.	**-39.60**	**402.68**	**-113.48**	**-12.42**	**59.24**	**28.08**

Margins & Ratios	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
Sales growth	65.1%	104.1%	51.8%	36.4%	17.3%	7.0%
EBITDA margin	13.4%	10.1%	12.9%	13.7%	13.8%	13.5%
EBIT margin	11.0%	7.9%	10.7%	12.0%	12.2%	11.9%
Net profit margin	8.4%	8.5%	9.0%	8.6%	8.3%	8.1%
ROE	19.9%	18.1%	17.9%	18.0%	16.6%	14.7%
ROCE	9.8%	9.2%	12.6%	14.1%	14.2%	13.5%
Equity ratio	36.4%	34.5%	39.0%	38.9%	40.5%	44.5%
Net debt	319.8	278.3	703.6	862.8	898.2	721.5
Working capital	225.8	497.8	632.4	1,014.6	1,285.6	1,482.7
Capital employed	726.6	1,205.7	1,909.5	2,294.4	2,582.0	2,655.5
Inventory turnover	40.3	46.8	33.5	38.5	38.5	38.5

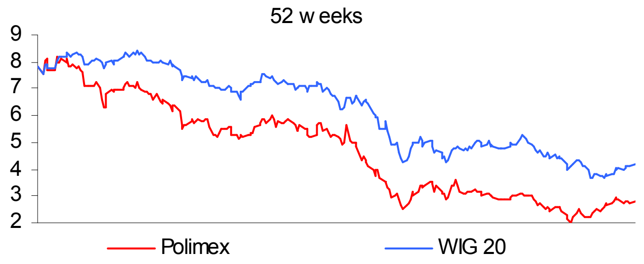
Source: Company data, Erste Group estimates

Company Report – Construction Services – Poland – March 18, 2009

Polimex Hold

Piotr Lopaciuk, +48 22 33062 52 piotr.lopaciuk@erstegroup.com

PLN mn	2008	2009e	2010e	2011e
Net sales	4,316.7	4,865.0	4,817.5	5,159.0
EBITDA	292.8	326.7	298.5	331.3
EBIT	221.2	232.1	195.1	225.3
Net result after min.	121.9	156.4	112.8	123.0
EPS (PLN)	0.26	0.34	0.24	0.26
CEPS (PLN)	0.52	0.57	0.45	0.49
BVPS (PLN)	2.28	2.70	2.88	3.10
Div./share (PLN)	0.01	0.05	0.05	0.04
EV/EBITDA (x)	6.8	6.3	6.8	5.9
P/E (x)	11.6	8.3	11.6	10.8
P/CE (x)	5.8	4.9	6.2	5.7
Dividend Yield	0.3%	1.8%	1.8%	1.4%



Performance	12M	6M	3M	1M
in PLN	-64.1%	-45.1%	-10.3%	26.1%
in EUR	-71.6%	-58.4%	-17.8%	35.6%

Share price (PLN)	2.80	Reuters	MOSD.WA	Free float	100.0%
Number of shares (mn)	464.4	Bloomberg	PXM PW	Shareholders	
Market capitalization (PLN mn / EUR mn)	1,300 / 291	Div. Ex-date			
Enterprise value (PLN mn / EUR mn)	2,069 / 463	**Target price**	**3.1**	Homepage:	www.polimex-mostostal.pl

Cyclical leader of construction segment

– **We maintain our Hold recommendation for the biggest company in the construction segment, Polimex, but lower our target price from PLN 5.7 to PLN 3.1. Polimex is one of the most cyclical companies in the construction segment and the growing scale of the downturn has - as we feared - had a negative impact on its valuation.**

– **Polimex should be able to post a good result on the bottom line, but this would mainly be due to creating an asset for future tax relief (due to investments in a Special Economic Zone) and (a connected factor) the lower or even reversed tax rate. We expect that the core business result for Polimex could thus be boosted by PLN 35mn in 2009.**

– **We expect the crucial and most profitable segment of steel construction and galvanizing services to deteriorate by about 25% in 2009. In our opinion, the decrease would be even deeper, if not for the strong EUR/PLN, which favors the company. We also expect a weak performance from the oil construction segment. Potential upside may stem from the so-far weak power engineering segment.**

– **The strong backlog (PLN 7.6bn) should allow for decent results in 2009, but may not be enough for 2010, which is likely to be the most difficult year for construction services. A further burden is the quite significant net debt (PLN 0.5bn), which by the end of 2009 could increase to PLN 0.65bn (net debt to EBITDA slightly over 2). There is also a risk of an impairment charge of over PLN 0.4bn of goodwill created upon the acquisition of subsidiary Energomontaz Polnoc.**

Investment story

Worries about production segment

In our opinion, the economic crisis will harm the production part (steel construction and galvanizing services) of the company. With huge fixed costs, this segment is very exposed to potential volume decreases, due mainly to the weakness of Western European markets. In 2008, this was the most profitable part of the company, generating (according to our estimates) around 60-70% of net profit. We expect the result of the segment to deteriorate by about 25% in 2009.

Investments in Special Economic Zone to boost

Polimex is to invest about PLN 260mn in Special Economic Zones (investments in the production part of the company and in Sefako, a boiler producer). The company will be granted tax relief amounting to 40% of the value of its investments. The tax relief will be executed after the investments are completed (first cash impact in 2010). However, already in 4Q08, Polimex recorded a positive impact from creating an asset for future tax relief (PLN 15mn). Such an accounting policy for the future tax relief allows Polimex to boost its result by as much as PLN 65mn in 2009. We assume that Polimex will boost its result in 2009 by PLN 35mn (due to the future tax relief; a reversed effective tax rate amounting to 3%, instead of the typical 19%). Thus, the results will look better than the real operating performance. The negative side is that, as we feared earlier, the timing of this investment (especially the production segment) is not too good. Nevertheless, in the long run, this investment program should be rather beneficial for the company.

Weak PLN favors company

Polimex is an exporter (almost 80% of sales in the production division) and benefits from the weakness of the PLN. The company only has about 45% of its expected FX exposure hedged. However, we fear that, with a deeper than expected volume drop in the production segment, the real exposure may be hedged to a larger extent. In any case, the weakness of the PLN is positive for the company and should soften the coming downturn in the production segment.

Weak market expected in 2010

We expect 2010 to be the most difficult year for Polimex, with an expected weak performance in the production segment and a huge deterioration of the construction services segment. The segments that are most sensitive to a downturn, general construction and industrial construction, constitute 40% of sales for the company. The cyclical production segment contributes 20% of sales (and much more in terms of profit). The result for 2010 should again be boosted by creating assets for tax relief, but the impact should be weaker than in 2009 (we assume less than PLN 20mn).

Power engineering segment to provide potential upside

We like the firm’s exposure to the power engineering segment (25% of group sales). So far, it has underperformed, but it seems that we can at last expect a slow and gradual increase of this market. Energomontaz Polnoc has a full backlog for 2009 (PLN 300mn) and a solid base for 2010 (PLN 100mn). The weakness in the segment in recent years means a chance to surprise in the coming years. The foreign markets seem rather stable and the domestic market seems to be slowly awakening.

Very significantly improved backlog should be enough for 2009

Recently, the company managed to very significantly improve its order backlog. The company claims that the current backlog amounts to PLN 7.6bn. However, it should be noted that Polimex claims that the backlog of the production segment amounts to PLN 1.6bn. In our opinion, this corresponds with two years’ of sales (in 2008, sales in the production segment amounted to PLN 0.8bn; at the beginning of the year, the company claimed to have a backlog in production of PLN 1.85bn), rather than with firm and impossible to cancel contracts. Good backlogs are definitely the case for the infrastructure (PLN 2.15bn) and general construction segments (PLN 2bn). Nevertheless, the backlog of the company looks much better than it did six months ago.

Significant indebtedness and goodwill on balance sheet

At the end of 2008, Polimex managed to decrease its net debt to PLN 0.5bn. However, we expect that, at the end of 2009 (with big CAPEX spending and growth of working capital), net debt should increase again to PLN 0.65bn. An additional risk is the goodwill asset (over PLN 0.4bn) created upon the acquisition of subsidiary Energomontaz Polnoc (the current market cap of the company amounts to PLN 0.2bn). There is a risk that, in times of downturn, Polimex could be forced by its auditor to take an impairment charge.

Free float close to 100%

One interesting issue for Polimex during the downturn could be its ownership structure, which is virtually 100% free float. This could be beneficial, as, at some point, Polimex could become an acquisition target. However, it is not very likely that such a transaction would take place. Polimex has a very complicated organizational structure and consists of two different businesses – the production segment and the construction services segment. Separately, the very important role of management in Polimex is also a factor that does not facilitate a potential acquisition (especially a hostile one).

Valuation

We employed a DCF valuation tool to estimate the fair value of the company. The DCF is based on our forecasts for 2008-12. We used a discount rate based on WACC and a terminal value based on perpetuity. The DCF led us to a fair value of PLN 3.1 per share (fully diluted), which in our opinion reflects the value of the firm in a proper way. The peer comparison shows that Polimex shares are at the moment traded at fair price. We maintain our Hold recommendation despite significant decrease of the market price. In our opinion Polimex is quite significantly exposed to several risks: the cyclical steel production segment, cyclical general and industrial construction. Upside could be generated by the future good performance of the power engineering segment (which is so far underperforming). Our estimates are based on the following assumptions:

- Investments in Siedlce and Sefako are to be completed in 2010
- We assume boosting the result by creating tax assets for future tax relief (of value of PLN 35mn in 2009 and 18mn in 2010)
- We assume no impairment charge of goodwill created at the moment of acquisition of Energomontaz Polnoc
- Risk-free rate at 6%, equity premium at 5%, debt premium at 2.5% and beta at 1.0 in the forecasted period
- Terminal growth rate at 1%

DCF valuation

(in PLN mn)	2009e	2010e	2011e	2012e	beyond 2012
EBIT	**232**	**195**	**225**	**249**	**249**
tax rate	19%	19%	19%	19%	19%
tax on EBIT	44	37	43	47	47
NOPLAT	**188**	**174**	**200**	**222**	**202**
Depreciation	95	103	106	106	106
Capital expenditures	-190	-150	-100	-106	-106
Change in working capital	-260	6	-62	-53	-9
Free cash flow	**-167**	**133**	**145**	**169**	**193**
Terminal value	**2,396**				
Value of FCF at 31.12.2007	-152	110	108	115	
Sum of DFCF	181				
Discounted terminal value	1,627				
Enterprise value at 31.12.2008	**1,807**				
Non-operating assets	106				
Net debt at 31.12.2008	470				
Minorities	170				
Fair value at 31.12.2008	**1,273**				
Number of shares	467				
Fair value per share at 31.12.2008	**2.73**				
Cost of equity	**11.3%**				
Target Price March 2010 (PLN)	**3.10**				
Stock price	2.80				
Premium/discount	10.8%				

Source: Erste Group Research

WACC

	2009e	2010e	2011e	2012e	beyond 2012
WACC	**9.9%**	**10.0%**	**10.2%**	**10.5%**	**9.0%**
Equity cost	11.8%	11.8%	11.8%	11.8%	10.0%
Debt cost	6.9%	6.9%	6.9%	6.9%	6.1%
Equity weighting	61.7%	64.9%	69.2%	74.0%	74.0%
Debt weighting	38.3%	35.1%	30.8%	26.0%	26.0%
Risk free rate	6.0%	6.0%	6.0%	6.0%	5.0%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.15	1.15	1.15	1.15	1.00
Debt premium	2.5%	2.5%	2.5%	2.5%	2.5%
Tax rate	19%	19%	19%	19%	19%

Source: Erste Group Research

Income Statement	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS, PLN mn, 31/12)	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010	31/12/2011
Net sales	**2,483.41**	**3,701.70**	**4,316.67**	**4,865.00**	**4,817.50**	**5,159.03**
Cost of goods sold	-2,239.14	-3,371.15	-3,884.44	-4,404.66	-4,387.37	-4,686.92
Gross profit	**244.26**	**330.55**	**432.24**	**460.34**	**430.13**	**472.11**
SG&A	-134.68	-164.59	-212.51	-227.39	-234.21	-245.92
Other operating revenues	0.00	0.00	0.00	0.00	0.00	0.00
Other operating expenses	-11.09	-2.89	1.52	-0.88	-0.87	-0.93
EBITDA	**128.54**	**208.17**	**292.80**	**326.67**	**298.52**	**331.26**
Depreciation/amortization	-30.04	-45.09	-71.55	-94.60	-103.47	-106.00
EBIT	**98.50**	**163.07**	**221.25**	**232.08**	**195.06**	**225.26**
Financial result	-5.26	-14.38	-67.72	-59.35	-62.81	-56.04
Extraordinary result	-1.82	3.32	4.30	3.87	4.07	4.27
EBT	**91.42**	**152.02**	**157.83**	**176.60**	**136.31**	**173.49**
Income taxes	-17.36	-31.35	-15.10	3.45	-6.61	-32.15
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-11.42	-16.85	-20.87	-23.69	-16.93	-18.31
Net result after minorities	**62.64**	**103.82**	**121.86**	**156.37**	**112.77**	**123.03**

Balance Sheet	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS, PLN mn, 31/12)						
Intangible assets	19.62	448.12	500.33	500.33	500.33	500.33
Tangible assets	261.73	456.86	709.33	804.74	851.27	845.27
Financial assets	136.48	121.57	159.29	194.29	199.29	184.29
Total fixed assets	**417.82**	**1,026.55**	**1,368.95**	**1,499.35**	**1,550.88**	**1,529.88**
Inventories	168.26	310.92	418.79	440.47	438.74	468.69
Receivables and other current assets	872.84	1,307.30	1,346.59	1,568.63	1,553.31	1,663.43
Other assets	9.37	34.41	15.20	17.14	16.97	18.17
Cash and cash equivalents	163.47	163.50	284.75	194.60	192.70	206.36
Total current assets	**1,213.93**	**1,816.13**	**2,065.33**	**2,220.83**	**2,201.72**	**2,356.66**
TOTAL ASSETS	**1,631.75**	**2,842.68**	**3,434.28**	**3,720.18**	**3,752.60**	**3,886.54**
Shareholders'equity	**354.87**	**984.69**	**1,057.40**	**1,253.18**	**1,357.42**	**1,478.46**
Minorities	**93.93**	**99.94**	**114.48**	**114.48**	**114.48**	**114.48**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	0.00	0.00	0.00	0.00	0.00	0.00
Other LT provisions	76.39	116.20	146.73	160.83	154.44	160.23
Interest-bearing LT debts	171.28	329.60	438.59	499.36	468.48	417.88
Other LT liabilities	60.60	51.38	104.66	67.53	66.87	71.61
Total long-term liabilities	**231.88**	**380.98**	**543.25**	**566.89**	**535.35**	**489.49**
Interest-bearing ST debts	83.21	230.58	315.97	349.35	327.75	292.34
Other ST liabilities	791.48	1,030.29	1,256.46	1,275.45	1,263.16	1,351.54
Total short-term liabilities	**830.37**	**1,122.83**	**1,461.58**	**1,478.85**	**1,446.38**	**1,489.11**
TOTAL LIAB. , EQUITY	**1,631.75**	**2,842.68**	**3,434.28**	**3,720.18**	**3,752.60**	**3,886.54**

Cash Flow Statement	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
(IAS,PLN mn, 31/12)						
Cash flow from operating activities	167.06	-45.63	373.68	34.42	279.02	265.68
Cash flow from investing activities	-110.51	-251.48	-333.64	-190.00	-150.00	-100.00
Cash flow from financing activities	14.14	297.15	81.20	65.43	-130.92	-152.02
CHANGE IN CASH , CASH EQU.	**70.68**	**0.03**	**121.25**	**-90.15**	**-1.90**	**13.66**

Margins & Ratios	**2006**	**2007**	**2008**	**2009e**	**2010e**	**2011e**
Sales growth	34.2%	49.1%	16.6%	12.7%	-1.0%	7.1%
EBITDA margin	5.2%	5.6%	6.8%	6.7%	6.2%	6.4%
EBIT margin	4.0%	4.4%	5.1%	4.8%	4.0%	4.4%
Net profit margin	3.0%	3.3%	3.3%	3.7%	2.7%	2.7%
ROE	19.3%	15.5%	11.9%	13.5%	8.6%	8.7%
ROCE	13.4%	11.4%	11.5%	11.6%	8.3%	8.1%
Equity ratio	27.5%	38.2%	34.1%	36.8%	39.2%	41.0%
Net debt	91.0	396.7	469.8	654.1	603.5	503.9
Working capital	374.2	658.9	588.6	724.8	738.4	849.4
Capital employed	676.8	1,648.9	1,893.1	2,250.1	2,296.7	2,328.6
Inventory turnover	15.7	14.1	10.6	10.3	10.0	10.3

Source: Company data, Erste Group estimates

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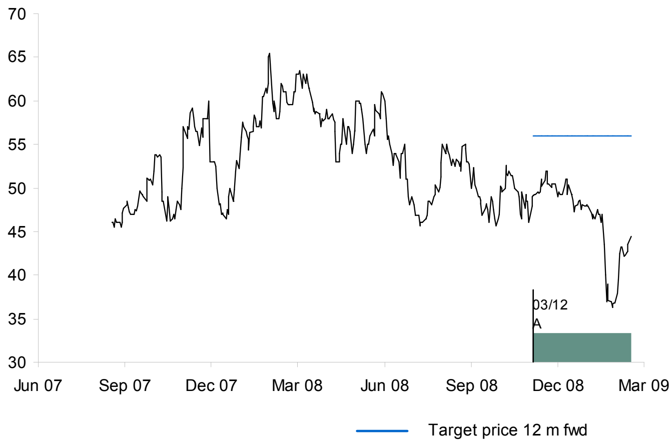
Mostostal Warszawa

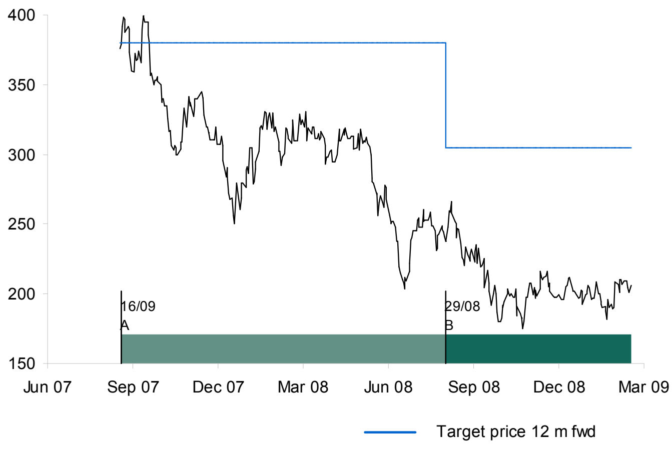


Rating history

Date	Rating	Price	Target Price
03. Dec 08	Accumulate	49.19	56.00

Company	Disclosure
Mostostal Warszawa	

PBG S.A.

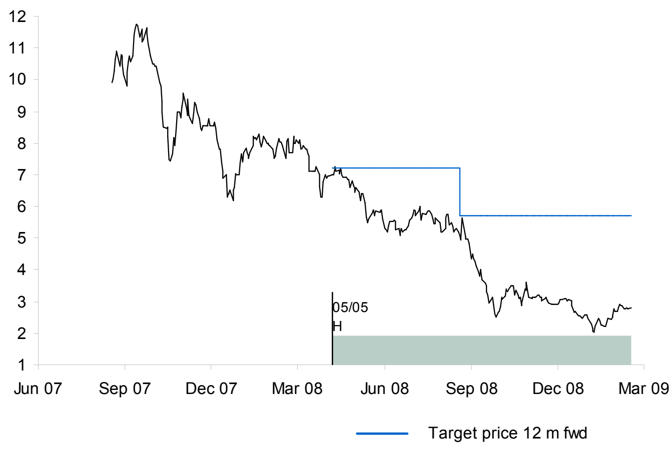


Rating history

Date	Rating	Price	Target Price
29. Aug 08	Buy	238.00	305.00
14. Aug 07	Accumulate	358.00	380.00
25. Jan 07	Hold	291.50	295.00
22. Jun 06	Buy	133.71	175.00

Company	Disclosure
PBG S.A.	

Polimex



Rating history

Date	Rating	Price	Target Price
05. May 08	Hold	6.99	7.20

Company	Disclosure
Polimex	

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Erste Group 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.

Distribution of ratings

	Coverage universe		Inv. banking-relationship	
Recommendation	**No.**	**in %**	**No.**	**in %**
Buy	28	24.1	4	36.4
Accumulate	15	12.9	1	9.1
Hold	37	31.9	3	27.3
Reduce	10	8.6	1	9.1
Sell	4	3.4	0	0.0
N.R./UND.REV./RESTR.	22	19.0	2	18.2
Total	**116**	**100.0**	**11**	**100.0**

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