Company Report – Construction Services – Poland – August 29, 2008

PBG S.A. from Accumulate to Buy

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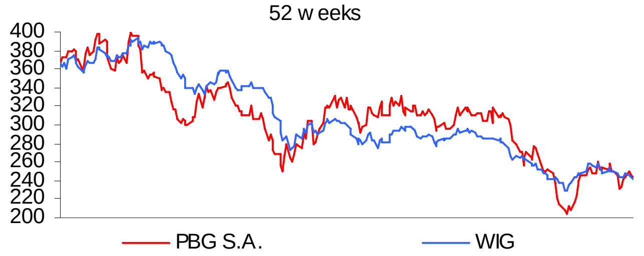
PLN mn	2007	2008e	2009e	2010e
Net sales	1,376.75	2,210.65	2,863.75	3,517.20
EBITDA	139.61	279.02	377.24	477.51
EBIT	109.38	238.81	329.63	423.73
Net result after min.	102.05	154.49	206.67	255.73
EPS (PLN)	8.02	11.50	15.39	19.04
CEPS (PLN)	18.47	10.34	14.75	21.89
BVPS (PLN)	56.36	79.44	94.83	113.87
Div./share (PLN)	0.00	0.00	0.00	0.00
EV/EBITDA (x)	31.6	13.7	10.6	8.6
P/E (x)	38.3	21.2	15.9	12.8
P/CE (x)	16.6	23.6	16.6	11.2
Dividend Yield	0.0%	0.0%	0.0%	0.0%



Performance	12M	6M	3M	1M
in PLN	-33.5%	-23.0%	-22.5%	-0.3%
in EUR	-23.6%	-18.5%	-21.0%	-4.2%

Share price (PLN)	244.20	Reuters	PBGG.WA	Free float	76.0%
Number of shares (mn)	13.4	Bloomberg	PBG PW	Shareholders	Wisniewski&manag. (34.0%)
Market capitalization (PLN mn / EUR mn)	3,280 / 984	Div. Ex-date			
Enterprise value (PLN mn / EUR mn)	3,822 / 1,146	**Target price**	**305.0**	Homepage:	www.pbg-sa.pl

Strong portfolio and niche market - insurance policy for growth

– We have a Buy recommendation on PBG with a target price of PLN 305. We maintain our positive view on the company, regarding it as quite resistant to a potential slowdown of the economy, thanks to the impressive portfolio of contracts (PLN 4.8bn) and focus on niche segments. In the environment of fear concerning a domestic and global slowdown, PBG shines with its potential for growth.

– The construction segment is significantly exposed to the invigorating influence of more than EUR 86bn (over 22% of GDP) of EU co-financed programs for 2007–13 (this includes EU funds of EUR 67bn). We expect an increasing amount of EU-fuelled contracts with 1H-2H09 showing a significant jump. In the years 2008-10, we expect growth of the construction market at an average pace of 14-17%.

– The environmental protection niche of the company is heavily dependent on this factor. The EU infrastructure and environmental program in Poland is estimated at EUR 38bn. The portfolio of contracts of the company in this segment is already very strong at about PLN 2.4bn and there is still a lot to fight for.

– After a few years of a standstill on the market, gas construction segment is showing a significant revival. The geopolitical situation and prices of energy resources force Poland to organize alternative routes of supplies and invest in domestic upstream. This situation is positive for PBG, which already won the biggest contract in its history (PLN 1.4bn) for the construction of an LMG gas and oil mine (located in Poland). The potential market also looks impressive.

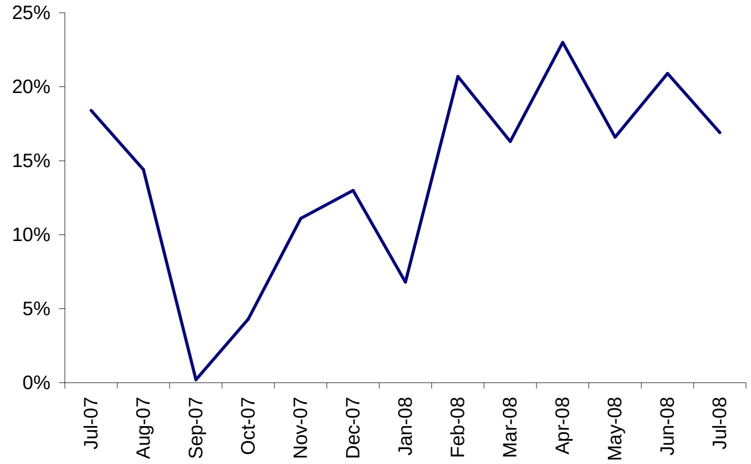
– The low profitability of Hydrobudowa 9 (acquired last year; it seems that provisions made at the time of acquisition were not enough), high cost of debt and slower development of the road segment prompt us to trim our expectations concerning this year's result. We have cut our EPS forecast for 2008 from PLN 12.24 to PLN 11.5 per share. We are also more careful about 2009, as the majority of work within the confines of the LMG contract will start in 2010. We cut the EPS forecast for 2009 from PLN 17.49 to PLN 15.39 per share.

Investment story

Strong construction market

The overall construction segment in Poland remains strong and the dynamics of growth are impressive (graph 1). The companies are filling their portfolios with contracts, while pressure from labor costs (as the strengthening PLN and increasing wages lure Polish workers back home) and costs of materials (excluding steel) is less disturbing. On the other hand, as expected, companies definitely face and observe the weakening in the housing construction market. In our opinion, the best prospects for the future are in the segments relying on the boosting influence of EU funds (the total value of EU co-financed programs is over EUR 86bn for the 2007-13). The annual average of expected inflows is over 3x greater than in the period 2004-06. This jump should be visible in the construction segment statistics at the end of 2009, as EU funds traditionally flow in with a two-year delay (and are accounted for up to about two years after the end of the financing phase). We maintain our forecast for the segment development at an average annual pace of 14-17% in 2008-10.

Construction market dynamics



Source: Statistical Office

Impressive portfolio of contracts signed and huge potential for those to come

The strong portfolio of contracts is in our opinion the primary factor behind the investment attractiveness of companies from the construction segment. In a pessimistic scenario, the slowdown in housing would move to industrial construction (which now looks quite healthy) and then to commercial construction (also in good shape). This would increase competition in other parts of the construction segment. The threat is reduced for companies with strong order backlogs, as opposed to cheaper subcontractors, where a limited increase of competition may prove positive. In this field, PBG looks to be in good condition. The current backlog of orders amounts to a record PLN 4.8bn. PBG is currently bidding on another PLN 5bn in orders and in a half-year intends to place offers for another PLN 6bn. We think highly of the company's careful picking of contracts. PBG is dominant in its attractive niches, which results in attractive prices and a strong backlog.

Gas & oil

This very profitable segment (historical gross margin over 20%) is experiencing a huge revival. Energy security (and especially access to resources) for the country is becoming an important political issue. The signing with PGNiG (after several delays) of a contract for an LMG gas & oil mine in Poland (value: PLN 1.4bn) seems to confirm this. The value of the backlog amounts to about PLN 1.6bn. Among other strategically important potential contracts that should boost the whole segment are:

- underground gas storage in Wierzchowice (PBG has placed the only offer for PLN 1.1bn; this is another (after LMG) confirmation of the very strong position of the company in this segment. This deal should be important for PGNiG – we expect a positive decision for PBG.

- LNG terminal (PGNiG – and now Gaz System - seem to be quite determined to realize it; roughly estimated value of PLN 1.5-2bn).

- northwest Poland gas pipeline network (roughly estimated value of PLN 2bn).

- Baltic Pipe (connecting the Polish and Danish gas systems - roughly estimated value of PLN 1-1.5bn).

- Brody-Plock oil pipeline (which would allow the import of oil from the Caspian Sea region – least probable project among those listed above).

Looking at the rest of the segment, from PBG's perspective, the biggest potential lies in gas investments by KRI (with a roughly PLN 300mn deal to be potentially signed by the end of the year). The total of other smaller potential contracts within reach of PBG amounts to approximately PLN 500mn. The total value of potential contracts on which PBG already has an eye in the segment amounts to PLN 1.8bn.

Environmental protection

Environmental protection construction is the segment most heavily exposed to EU funds. The current backlog of orders for PBG in this segment amounts to about PLN 2.4bn. The most spectacular contract signed recently was for a waste incineration plant in Gdansk (PLN 0.3bn). Despite the continuous flow of new contracts, there is still a huge amount of work to be done in this segment. With the current state of hydro systems in Poland, the potential for contracts seems enormous. Among those that look to be just ahead for PBG to fight for are:

- construction of waste incineration/utilization plants in Krakow, Poznan, Trzebinia, Ostrow Mazowiecki.

- construction/modernization/extension of water treatment plants in Poznan, Wroclaw, Piotrkow Trybunalski, Warsaw, Tarnowskie Gory, Swietochlowice and in other smaller cities.

- sewage systems in Wroclaw, Krakow and other smaller cities.

- renovation of water pipelines in Wroclaw, Kielce, Tarnowskie Gory, Torun, Warsaw, and Sopot.

Infrastructure, public utilities and industry

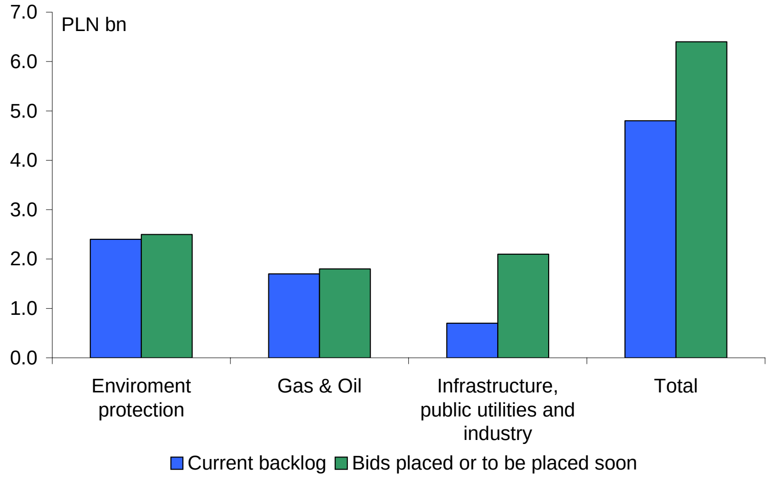
The total value of potential contracts that PBG is already bidding on or is soon to fight for in this segment amounts to about PLN 2.5bn.

PBG focuses on its two major niches (gas & oil, environmental protection), but has also started business in the road construction segment and occasionally grabs attractive contracts in cubature construction. In the road segment, PBG records very strong profitability (which is rather typical for local road constructing companies). Nevertheless, we have to admit that the development of the road division at PBG is slower than we assumed. This year, we expect the road division to reach PLN 140mn in sales and net profit of over PLN 10mn. In the cubature construction segment, PBG won a contract for the Nairit chemical plant in Armenia (PLN 0.46bn). Of course, like all major construction companies, PBG will try to win the big stadium contracts for EURO 2012. We see big chances for PBG to win the extension of the Poznan stadium and construction of the Wroclaw stadium. PBG will also start in the repeated tender for the second line of the underground in Warsaw. The value of the portfolio in this broad segment amounts to approximately PLN 0.7bn. The total value of potential contracts that PBG has already bid on or is about to fight for in this segment amounts to roughly PLN 2.1bn.

Summary of portfolio of contracts

The total backlog of PBG amounts to about PLN 4.8bn. In Graph 2, we illustrate the breakdown of contracts already signed together with the current potential for new contracts to be signed (deals where PBG has already placed an offer or is close to placing an offer).

Portfolio of contracts – current state and potential for near future



Source: Company data, Erste Group Research

Eyeing eastern markets

PBG is also glancing at its eastern neighbor, Ukraine. The company has announced several times that it is interested in acquiring a company there with a profile similar to PBG's (activity in environmental protection and the gas & oil segment). Such an acquisition would be a foothold for entering the promising Ukrainian market. Since the Ukrainian market is not consolidated, we would not expect an acquisition of a big company. We do not assume entry to the Ukrainian market by PBG, but it is a quite promising option to increase the value of the group.

Financing secured thanks to new issue by Hydrobudowa Polska

The PBG group managed in 1H08 to place on the market 35mn new shares in Hydrobudowa Polska. Thanks to this, the group cashed in PLN 308mn, significantly improving the liquidity of the group. The net debt amounts now to only PLN 0.4bn, which is 1.5x EBITDA. This was a very good move, especially taking into consideration the current difficulties on the debt market. This is especially important for the cash-consuming (during the growth) construction branch. The recent deal for financing (easily signed with Pekao SA) the LMG contract is another confirmation of the good liquidity situation for PBG. In our opinion, the potential winning of the Wierzchowice contract would not force PBG to organize a new issue of shares and should even leave some room for other big contracts.

Hard work with cash-burning old Hydrobudowa 9 portfolio

Hydrobudowa 9 turned out to be a rather tough nut to crack. Despite almost PLN 200mn in provisions (the current value of outstanding provisions amounts to over PLN 100mn) created at the time of the acquisition, the company is running at very low profitability. It will struggle to reach a net result above PLN 15mn in 2008, below our earlier expectations. H9 continuously burns cash on the old portfolio of contracts (the significant part should end in 1Q09, while the total throughput of all old contracts may last until 2H09. A separate issue is the merger of H9 with Hydrobudowa Polska. After the exchange of shares, the stake of PBG in HP will increase from the current 60.7% to 62%. In our opinion, this is rather positive for the mother company, as it will remove the cash outflow burden and the exchange ratio is in our view slightly positive for PBG.

PRG Metro acquired

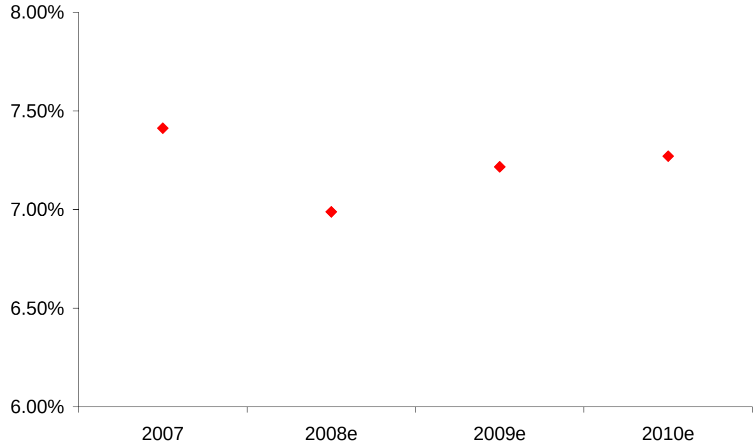
Recently, subsidiary Hydrobudowa Polska acquired PRG Metro (by signing conditional deals for over a 80% stake in the company). PRG Metro participated in the construction of the first line of the underground in Warsaw. In 2007, it had PLN 180mn in sales and profitability close to zero. This year, sales will be lower, as the majority of work on the underground was finished in 2007. The price for 100% of the company should amount to about PLN 35mn. PRG Metro may be a valuable asset in the repeated tender for the second line of the underground, but also has competencies in environmental protection construction.

Financials

On the basis of the weaker than expected performance of H9, the high cost of debt and late beginning of the LMG contract, we have slightly reduced our EPS expectations for 2008 (to PLN 11.5 from PLN 12.24 per share) and 2009 (to PLN 15.39 from PLN 17.49 per share). 2008 is fuelled with the greater than PLN 10mn (on the EBIT level) one-off (revaluation of real estate).

The graph below shows our expectations concerning the net margin for the company (we expect a quite stable level), to be fuelled by improvement of the gross margin in the future (LMG contract) and increased scale, but harmed by the lack of one-offs that appeared in 2007 and increasing debt.

Net profit margin forecast (2007-10)



Source: Company data, Erste Group Research

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 305 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 slight 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 premium is justified. We increased our recommendation to Buy (from Accumulate), pointing out that PBG operates in very attractive niches, has a very strong portfolio of contracts (both signed and potential) and good management, which should cope with the fast growth of the company.

Our estimates are based on the following assumptions:

- The majority of contracts from the old portfolio of H9 will be accomplished by the end of 1H09
- PBG will sign a contract for underground storage in Wierzchowice
- No new acquisitions
- No entry on the Ukrainian market
- Average growth of the construction market in Poland at a pace of 14-17% in 2008-10
- Risk-free rate at 6.2%, equity premium at 5%, debt premium at 1.5% and beta at 1.0 in forecasted period
- The terminal growth rate is set at 2%

WACC

	2008e	2009e	2010e	2011e	2012e	beyond 2012
WACC	**9.4%**	**9.2%**	**9.2%**	**9.5%**	**9.3%**	**8.2%**
Equity cost	11.2%	11.2%	11.2%	11.2%	11.2%	10.0%
Debt cost	6.2%	6.2%	6.2%	6.2%	6.2%	5.3%
Equity weighting	63.2%	59.2%	59.0%	65.2%	62.6%	62.0%
Debt weighting	36.8%	40.8%	41.0%	34.8%	37.4%	38.0%
Risk free rate	6.2%	6.2%	6.2%	6.2%	6.2%	5.0%
Equity risk premium	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
Debt premium	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%

Source: Erste Group Research

DCF valuation

PLN '000	2008e	2009e	2010e	2011e	2012e	beyond 2012
EBIT	**238,808**	**329,628**	**423,734**	**463,395**	**475,205**	**475,205**
tax rate	19%	19%	19%	19%	19%	19%
tax on EBIT	45,374	62,629	80,510	88,045	90,289	90,289
NOPLAT	**193,435**	**266,998**	**343,225**	**375,350**	**384,916**	**384,916**
Depreciation	40,212	47,615	53,780	58,603	62,703	
Capital expenditures	-100,500	-95,239	-78,047	-64,952	-62,703	
Change in working capital	-406,181	-283,753	-324,026	-140,577	-111,069	
Free cash flow	**-273,034**	**-64,378**	**-5,068**	**228,424**	**273,846**	
Terminal value	6,310,175					
Value of FCF at 31.12.2008	0	-58,968	-4,252	175,073	193,979	
Sum of DFCF	305,831					
Discounted terminal value	4,469,803					
Enterprise value at 31.12.2008	**4,775,634**					
Non-operating assets	0					
Net debt at 31.12.2008	355,695					
Minorities	594,601					
Fair value at 31.12.2008	**3,825,338**					
Number of shares ('000)	13,430					
Fair value per share at 31.12.2008	**285**					
Cost of equity	**11.2%**					
Target Price	**305**					
Stock price	244.20					
Premium/discount	25%					

Source: Erste Group Research

Peer group comparison

	P/E			EV/EBIT			EV/EBITDA			Valuation		
	2008e	2009e	2010e	2008e	2009e	2010e	2008e	2009e	2010e	2008e	2009e	2010e
Implied fair value (PLN '000)	2,723,634	2,992,603	3,365,376	2,401,380	3,090,939	3,865,444	2,000,343	2,558,057	2,631,058			
Number of shares ('000)	13,430	13,430	13,430	13,430	13,430	13,430	13,430	13,430	13,430	176.9	214.5	244.8
Implied fair value/share (PLN)	202.8	222.8	250.6	178.8	230.2	287.8	148.9	190.5	195.9			
12M Target Price										**196.7**	**238.5**	**272.2**
Median for int. peer group	**17.6**	**14.5**	**13.2**	**14.0**	**12.3**	**11.4**	**10.6**	**9.3**	**7.5**			
PBG	**21.2**	**15.9**	**12.8**	**16.0**	**12.1**	**9.7**	**13.7**	**10.6**	**8.6**			
Budimex	27.5	21.0	14.9	20.2	14.1	8.8	16.0	11.8	7.7			
Eiffage SA	10.8	10.2	9.8	12.2	11.6	11.5	7.5	7.1	7.1			
Elektrobudowa SA	17.3	15.9	14.0	13.8	12.9	11.3	11.9	10.4	9.1			
Gruppo Ferovial SA	high	19.7	14.8	20.4	18.2	15.2	11.6	10.7	9.5			
Hochtief AG	24.1	18.6	15.8	14.3	11.1	12.5	6.4	5.5	5.1			
J&P-Avax SA	10.4	9.2	8.6	16.3	14.7	15.8	10.7	10.2	10.6			
Mostostal Warszawa	13.4	11.4	10.5									
Polimex	17.9	14.3	11.2	13.7	11.1	9.5	10.4	8.4	7.3			
Strabag	18.1	14.5	13.2	10.6	8.6	8.8	5.6	4.7	4.8			

Source: Erste Group Research

Income Statement	2005	2006	2007	2008e	2009e	2010e
(IAS, PLN mn, 31/12)	31/12/2005	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010
Net sales	**408.54**	**674.65**	**1,376.75**	**2,210.65**	**2,863.75**	**3,517.20**
Cost of goods sold	-337.36	-555.57	-1,191.73	-1,882.39	-2,418.61	-2,966.47
Gross profit	**71.18**	**119.08**	**185.02**	**328.26**	**445.14**	**550.73**
SG&A	-33.84	-54.18	-79.97	-102.45	-115.51	-126.99
Other operating revenues	4.00	9.21	4.33	13.00	0.00	0.00
Other operating expenses	0.00	0.00	0.00	0.00	0.00	0.00
EBITDA	**50.17**	**90.49**	**139.61**	**279.02**	**377.24**	**477.51**
Depreciation/amortization	-8.83	-16.38	-30.23	-40.21	-47.61	-53.78
EBIT	**41.33**	**74.11**	**109.38**	**238.81**	**329.63**	**423.73**
Financial result	4.01	0.81	34.74	-11.75	-26.60	-48.78
Extraordinary result	0.00	-2.55	0.00	0.00	0.00	0.00
EBT	**45.34**	**72.37**	**144.12**	**227.06**	**303.03**	**374.96**
Income taxes	-8.39	-15.46	-26.70	-43.14	-57.58	-71.24
Result from discontinued operations	0.00	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-0.87	-2.73	-15.37	-29.43	-38.78	-47.99
Net result after minorities	**36.08**	**54.18**	**102.05**	**154.49**	**206.67**	**255.73**

Balance Sheet	2005	2006	2007	2008e	2009e	2010e
(IAS, PLN mn, 31/12)						
Intangible assets	9.77	76.67	262.42	313.85	313.85	313.85
Tangible assets	182.80	266.49	333.03	390.18	437.80	462.07
Financial assets	8.63	17.98	108.77	103.46	104.91	106.37
Total fixed assets	**201.20**	**361.14**	**704.22**	**807.49**	**856.57**	**882.29**
Inventories	11.90	15.65	35.27	66.37	64.23	95.96
Receivables and other current assets	341.94	594.78	1,074.78	1,735.36	2,248.04	2,761.00
Other assets	6.46	7.71	14.30	16.65	23.44	25.80
Cash and cash equivalents	104.76	65.16	467.84	265.28	343.65	422.06
Total current assets	**465.07**	**683.29**	**1,592.20**	**2,083.66**	**2,679.37**	**3,304.82**
TOTAL ASSETS	**666.27**	**1,044.43**	**2,296.41**	**2,891.15**	**3,535.94**	**4,187.11**
Shareholders'equity	**177.64**	**368.09**	**756.86**	**1,066.90**	**1,273.57**	**1,529.30**
Minorities	**6.65**	**12.08**	**34.45**	**186.90**	**186.90**	**186.90**
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	5.60	26.59	136.03	82.61	33.16	20.05
Interest-bearing LT debts	80.41	70.64	259.36	341.54	351.14	424.75
Other LT liabilities	117.08	109.60	20.93	20.93	20.93	20.93
Total long-term liabilities	**197.49**	**180.23**	**280.29**	**362.47**	**372.08**	**445.68**
Interest-bearing ST debts	137.90	204.78	465.90	279.44	526.72	637.13
Other ST liabilities	140.99	252.66	622.88	912.85	1,143.51	1,368.06
Total short-term liabilities	**274.10**	**449.75**	**1,080.11**	**1,179.15**	**1,653.21**	**1,984.28**
TOTAL LIAB. , EQUITY	**666.27**	**1,044.43**	**2,296.41**	**2,891.15**	**3,535.94**	**4,187.11**

Cash Flow Statement	2005	2006	2007	2008e	2009e	2010e
(IAS,PLN mn, 31/12)						
Cash flow from operating activities	-36.24	-48.86	-42.52	-231.94	-32.09	39.05
Cash flow from investing activities	-97.29	-155.85	-154.27	-100.50	-95.24	-78.05
Cash flow from financing activities	189.83	165.10	599.47	129.88	205.70	117.41
CHANGE IN CASH , CASH EQU.	**56.30**	**-39.60**	**402.68**	**-202.57**	**78.37**	**78.41**

Margins & Ratios	2005	2006	2007	2008e	2009e	2010e
Sales growth	89.1%	65.1%	104.1%	60.6%	29.5%	22.8%
EBITDA margin	12.3%	13.4%	10.1%	12.6%	13.2%	13.6%
EBIT margin	10.1%	11.0%	7.9%	10.8%	11.5%	12.0%
Net profit margin	9.0%	8.4%	8.5%	8.3%	8.6%	8.6%
ROE	22.5%	19.9%	18.1%	16.9%	17.7%	18.2%
ROCE	11.4%	9.8%	9.2%	13.3%	14.2%	15.4%
Equity ratio	27.7%	36.4%	34.5%	43.4%	41.3%	41.0%
Net debt	113.5	210.3	257.4	355.7	534.2	639.8
Working capital	184.5	225.8	497.8	887.9	1,002.7	1,294.7
Capital employed	420.5	726.6	1,205.7	1,713.0	2,048.8	2,397.0
Inventory turnover	40.5	40.3	46.8	37.0	37.0	37.0

Source: Company data, Erste Group estimates

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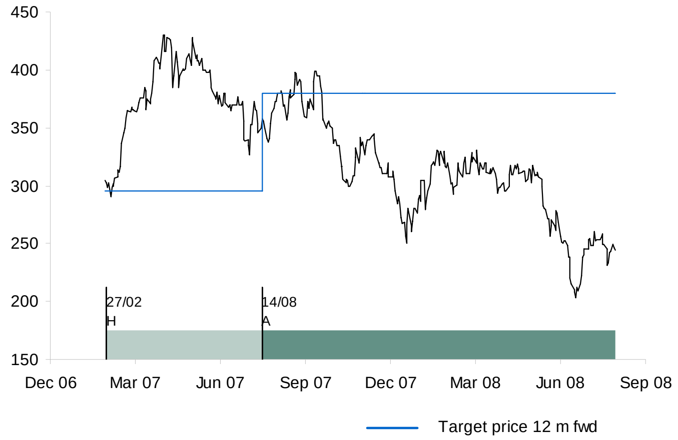

Rating history

Date	Rating	Price	Target Price
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
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