

Valuation Increased | Construction & Engineering

20 December 2010

PBG

SHUFFLING THE CARDS

We maintain our BUY recommendation for PBG and raise our PT to PLN 253 (from PLN 247). The company is reshuffling its profile via disposals to OHL and potential acquisitions in power engineering – it looks likely to go back to being a high margin specialist focused on the oil & gas and power sectors. PBG is entering an alliance with OHL to establish a foothold in concessions / facility operations. Our revised DCF valuation is pre-money (without disposals) but we also present the pro forma 2011E financials. We still like its top-line growth prospects. On the downside, PBG still presents weak cash flows (on our estimates) and its plans to increase its presence in power engineering (Energomontaż Południe) are not going smoothly. The stock is trading at a 2011E P/E of 11.8, -15% below the Polish peers in our construction universe. We are increasing our earnings estimates (2010E by +3%, 2011E by +1% and 2012E by +9%). We are more bullish about the 2012E results on the back of forecast higher revenues in oil & gas and twice as high sales in road construction.

RECURRENT PRO FORMA 2011E EARNINGS SLIGHTLY DOWN

Our base case 2011E net income is PLN 261m (+7.6% YoY), the pro-forma earnings go up to PLN 264m, but with one-off pre-tax gains from disposals of PLN 60m. Recurrent pro-forma forecast 2011E earnings come out at PLN 216m (-11% YoY; slightly below company guidance of PLN 220m+). PBG is trading at a 2011E P/E of 11.8x (-15% discount to peer median). The implied recurrent 2011E P/E on our pro-forma estimates is 14.3, which seems to be a reasonable level (3% premium to domestic peers).

TOP-LINE OPPORTUNITIES LOOK APLENTY

In our view, PBG is well positioned to secure its top-line growth, especially in oil & gas construction, infrastructure and power engineering. The addressable markets are considerable (PGNiG investments, power sector, public sector). Our 2010E-15E revenue CAGR is 12.9%. In our view, selling controlling stakes in HBP and Aprivia to OHL will not impair the Group's ability to win contracts across all segments.

OHL DEAL LOOKS GOOD ON SEVERAL LEVELS

We believe that OHL is a good LT strategic partner. We like PBG reducing its interest in the least attractive construction segments namely EURO2012 stadiums, water and roads. In our view, PBG is selling the assets at attractive prices. The proceeds from sale and deconsolidation will turn PBG's leverage into a net cash position. We believe money may also be spent on acquisitions in power engineering.

	Sales	NI	EPS	%YoY	P/E	EBITDA	%YoY	EV/EBITDA	DY
2008	2,091	156.3	11.64	49.9%	16.8	239.6	44.3%	15.5	0.0%
2009	2,574	210.6	14.73	34.7%	13.8	333.6	39.2%	11.4	0.0%
2010E	3,031	242.7	16.98	15.2%	12.7	353.4	5.9%	10.4	0.6%
2011E	3,494	261.2	18.27	7.6%	11.8	382.6	8.3%	9.6	0.8%
2012E	4,673	321.7	22.50	23.2%	9.6	466.9	22.0%	7.7	0.8%

Source: Company for historical data, Espirito Santo Equity Research Poland for estimates. Sales, NI, EBITDA in PLN m, EPS in PLN.

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BUY – M/L RISK

Price Target (Dec. 11)	PLN 253
Price (16 Dec. 10)	PLN 216
Potential	+17%

Trading

Reuters Code	PBGG.WA
Bloomberg Code	PBG PW
Shares Outstanding (k)	14,295
Market Cap (PLN m)	3,088
3M Avg. Daily Vol. (k shares)	25.6
3M Avg. Daily Vol. (PLN m)	5.8
WIG20 Index Weight	1.4%
WIG Index Weight	0.9%
52 W High/Low	254.3 / 189.5

Performance	Abs.	vs WIG20
3m	-11.4%	-19.6%
6m	-3.1%	-18.7%
YTD	6.3%	-9.0%

Financials

	2011E
Revenue growth	15.3%
Operating margin	9.5%
ROE	13.2%
Net Debt / EBITDA	2.2

Shareholders

	Stake
Jerzy Wiśniewski	29.6%
Pioneer Pekao IM	15.6%
ING OFE	8.8%
Others	46.0%

Source: Bloomberg, Company data, Espirito Santo Research Poland for estimates.

HISTORICAL RELATIVE SHARE-PRICE PERFORMANCE



Source: Bloomberg

SUMMARY FINANCIAL INFORMATION

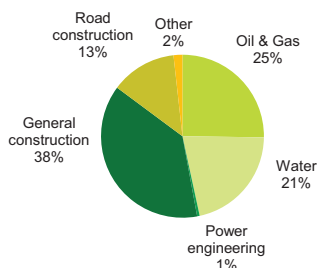
PBG		Valuation Metrics (Year end Dec)					
		2008	2009	2010E	2011E	2012E	
Rating	BUY - M/L	Recurrent P/E (x)	16.8	13.8	12.7	11.8	9.6
Target price (Dec. 2011, PLN):	253.5	Reported P/E (x)	16.8	13.8	12.7	11.8	9.6
Share Price (16/12/2010, PLN):	216.0	EV / Sales (x)	1.8	1.5	1.4	1.2	0.9
Upside / Downside potential	17%	EV / EBITDA (x)	15.5	11.4	10.4	9.6	7.7
Previous Target price (PLN):	246.7	EV / EBIT (x)	19.1	13.2	14.3	13.2	10.6
% change to target price	3%	FCF Yield (%)	-10.7%	9.0%	2.7%	1.4%	1.6%
		Dividend yield (%)	0.0%	0.0%	0.6%	0.8%	0.8%
Bloomberg	PBG PW	Key Ratios					
Reuters	PBGG.WA	2008	2009	2010E	2011E	2012E	
		EBITDA margin	11.5%	13.0%	11.7%	11.0%	10.0%
		EBIT margin	9.3%	11.1%	10.1%	9.5%	8.8%
		Capex / Revenue (x)	0.1	0.0	0.0	0.0	0.0
		Capex / Depreciation (x)	2.4	1.5	2.0	1.7	1.7
		Net Debt / EBITDA (x)	2.2	1.4	2.5	2.2	1.7
		EBITDA / Net Interest (x)	6.5	12.2	16.3	18.5	26.1
		ROE	17%	15%	14%	13%	14%

P&L Summary (PLN m, unless stated)		2008	2009	2010E	2011E	2012E
Revenue	2,091.4	2,574.3	3,030.9	3,494.2	4,673.4	4,673.4
% change		23.1%	17.7%	15.3%	33.7%	33.7%
EBITDA	239.6	333.6	353.4	382.6	466.9	466.9
% change		39.2%	5.9%	8.3%	22.0%	22.0%
% margin		11.5%	13.0%	11.7%	11.0%	10.0%
Depreciation & Amortisation	45.1	47.1	47.3	51.3	55.5	55.5
EBIT	194.5	286.5	306.0	331.3	411.4	411.4
% change		47.3%	6.8%	8.3%	24.2%	24.2%
% margin		9.3%	11.1%	10.1%	9.5%	8.8%
Associates	0.0	0.0	2.2	4.3	5.2	5.2
Operating Profit	194.5	286.5	306.0	331.3	411.4	411.4
Net Financials	(9.7)	(23.9)	(5.8)	(2.3)	6.7	6.7
Other Pre-tax Income	0.0	0.0	0.0	0.0	0.0	0.0
Pre-Tax Profit	184.8	262.6	300.2	329.1	418.0	418.0
Income Tax Expense	(26.6)	(40.6)	(55.1)	(62.5)	(79.4)	(79.4)
Discontinued Operations	0.0	0.0	0.0	0.0	0.0	0.0
Minority Interests	(30.9)	(11.4)	(2.4)	(5.3)	(16.9)	(16.9)
Net Income	127.2	210.6	242.7	261.2	321.7	321.7
Recurrent Net Income	127.2	210.6	242.7	261.2	321.7	321.7

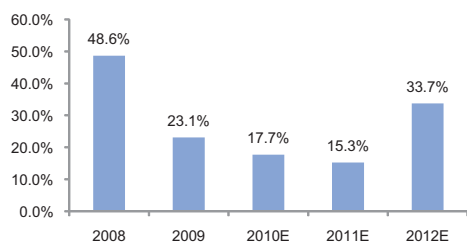
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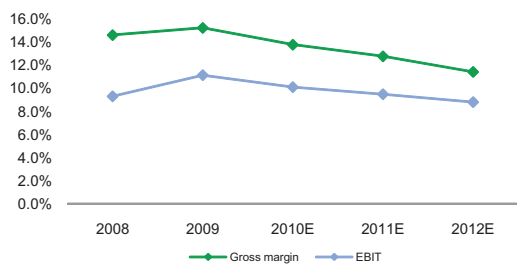
Revenues Breakdown (2010E)



Revenue Growth



Margins Trend



Cash Flow Summary (PLN m)		2008	2009	2010E	2011E	2012E
EBITDA	239.6	333.6	353.4	382.6	466.9	466.9
Taxes Paid	(26.6)	(40.6)	(55.1)	(62.5)	(79.4)	(79.4)
Interest Paid / Received	(9.7)	(23.9)	(5.8)	(2.3)	6.7	6.7
Change in Working Capital	(502.5)	121.0	(80.6)	(171.0)	(226.1)	(226.1)
Associate & Minority Dividends	0.0	0.0	0.0	0.0	0.0	0.0
Other Operating Cash Flow	46.1	(83.6)	(92.5)	(12.2)	0.0	0.0
Operating Cash Flow	(253.1)	306.5	119.4	134.7	168.0	168.0
Capital Expenditure	(110.4)	(69.8)	(96.0)	(87.4)	(93.5)	(93.5)
Free Cash Flow	(363.5)	236.7	23.4	47.3	74.5	74.5
Acquisitions & Disposals	(75.2)	(282.2)	(331.0)	(1.9)	(5.2)	(5.2)
Dividend Paid to Shareholders	0.0	0.0	(20.0)	(24.3)	(26.1)	(26.1)
Equity Raised / Bought Back	292.2	181.8	0.0	0.0	0.0	0.0
Other Financing Cash Flow	23.0	235.1	355.2	(10.2)	5.7	5.7
Net Cash Flow	(123.5)	371.4	27.6	11.0	48.9	48.9

Balance Sheet Summary (PLN m)		2008	2009	2010E	2011E	2012E
Cash & Equivalents	288.8	660.3	687.9	698.8	747.7	747.7
Tangible Fixed Assets	413.7	380.6	417.1	465.3	503.2	503.2
Goodwill & Intangibles	330.4	352.0	365.7	365.7	365.7	365.7
Associates & Financial Investments	50.5	103.7	139.1	139.1	139.1	139.1
Other Assets	1,808.0	2,615.5	3,075.6	3,289.8	3,833.5	3,833.5
Total Assets	2,841.0	4,008.3	4,546.2	4,819.6	5,450.2	5,450.2
Interest Bearing Debt	805.3	1,134.9	1,558.6	1,548.4	1,554.1	1,554.1
Other Liabilities	939.6	1,250.0	1,126.3	1,167.6	1,480.0	1,480.0
Total Liabilities	1,744.9	2,384.9	2,684.9	2,716.0	3,034.1	3,034.1
Shareholders' Equity	1,096.1	1,623.5	1,861.3	2,103.6	2,416.1	2,416.1
Minority Interests	168.6	228.2	231.4	236.7	253.7	253.7
Total Equity	1,264.6	1,851.7	2,092.7	2,340.3	2,669.7	2,669.7
Net Debt	516.6	474.6	870.8	849.6	806.3	806.3

Source: Company data, Reuters, Bloomberg, Espirito Santo Research Poland for estimates

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VALUATION

PBG - DCF Model (PLN m)	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	Terminal Year
Revenue Growth Rate	48.6%	23.1%	17.7%	15.3%	33.7%	4.5%	9.5%	4.0%	3.0%
Revenues	2,091	2,574	3,031	3,494	4,673	4,882	5,345	5,560	5,727
Operating Margin	9.3%	11.1%	10.1%	9.5%	8.8%	9.2%	9.3%	9.3%	9.3%
EBIT	194	286	306	331	411	448	498	518	534
Tax Rate			18.3%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
EBIT(1-t)			250	268	333	363	404	420	432
+ Depreciation			47	51	56	60	64	64	66
- Capital Expenditures			-96	-87	-93	-98	-107	-64	-66
- Chg WC			-81	-171	-226	-20	-22	-24	-25
FCFF			121	61	69	305	340	395	407
Terminal Value (end of 2015)									5,274

Cost of Capital Calculations

Tax Rate	19%
Debt Ratio	32%
Equity Ratio	68%
Unlevered Beta	1.0
Levered (equity) Beta	1.4
Equity risk premium	5.0%
Risk-free rate	6.0%
Cost of Equity	12.9%
Debt risk premium	1.5%
Cost of Debt	7.5%
After-tax cost of debt	6.1%
Cost of Capital	10.7%

Present Value Calculations

Discount factor	1.1	1.2	1.4	1.5	1.7
Discounted FCFF	55	56	225	226	238
PV of FCFF ('10E-'15E)	800				
Present Value of Terminal Value					3170

Source: Company data for historical figures, Espirito Santo Research Poland for estimates.

PBG - DCF Valuation Summary

PV of FCFF during high growth phase =	800
PV of Terminal Value =	3,170
Enterprise Value =	3,970
+ Value of Cash & Non-operating assets =	1,081
- Value of Outstanding Debt =	-1,559
-/+ Adjustment for Minorities & Associates =	-282
Value of Equity =	3,210
Number of shares (m) =	14.3
Value of Equity per share (PLN, Jan. 1st, 2011) =	225
Target Price (PLN, Dec. 31st, 2011)	253

Source: Espirito Santo Research Poland for estimates.

PBG - target price sensitivity (PLN)

Nominal growth in perpetuity	Operating margin in perpetuity				
	8.3%	8.8%	9.3%	9.8%	10.3%
2.0%	198	210	223	235	248
2.5%	210	224	237	250	264
3.0%	225	239	253	268	282
3.5%	241	257	272	287	303
4.0%	260	277	294	310	327

Source: Espirito Santo Research Poland for estimates.

PBG - DCF Model Key Assumptions

Revenue CAGR 2010E-2015E	12.9%
Nominal (Real) growth rate in perpetuity	3.0% (0.0%)
Average operating margin in 2010E-2015E	9.4%
Operating margin in perpetuity	9.3%
Equity risk premium	5.0%
Debt risk premium	1.5%
Levered (equity) Beta	1.4
WACC	10.7%

PBG - target price sensitivity (PLN)

Risk-free rate in perpetuity	Equity risk premium				
	4.0%	4.5%	5.0%	5.5%	6.0%
5.4%	333	305	280	258	239
5.7%	315	289	266	246	228
6.0%	299	275	253	235	218
6.3%	284	261	242	224	208
6.6%	270	249	231	214	199

Source: Espirito Santo Research Poland for estimates.

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KEY DRIVERS

- **Reshuffling its strategic profile – on way back to being a high-margin specialist.** After the potential deal with OHL, PBG will have reduced its exposure to roads and general construction, returning to being a high-margin specialist with focus on oil & gas (and in the future power engineering). We believe this would be value accretive – although road & general construction provide much top-line growth, we do not like the low margins (potentially in the red in some cases). Reducing PBG's interest in HBP and Aprivia would cut the exposure to: (1) road construction (low margins, highly competitive sector); (2) hydro / environmental engineering (declining market, less large contracts in the 2010/12E horizon); and (3) recognising the last quarters on the EURO2012 stadium contracts (on which by 2Q11 we expect very low margins).
- **Unparalleled position in oil & gas engineering in Poland.** We highlight that PBG is the market leader in specialized oil & gas sector construction in Poland with quite limited competition. The company won the contract for construction of an LNG terminal in Jul. '10 (PLN 1bn in revenues for PBG). The end-9M10 segment backlog stands at PLN 2.2bn. We expect oil & gas revenues to grow from PLN 764m in 2010E to PLN 1.7bn at a 17.3% CAGR by 2015E. This segment should be the key value driver for PBG.
- **Alliance with OHL to open new doors.** PBG is entering a strategic alliance with the Spanish company OHL (global player in construction and infrastructure concessions; BESI recommendation: BUY – H; PT Eur 30.0). The objective is to enter the concessions (roads) and facility operations (sewage systems, water grids, parking lots) in Poland and abroad. OHL is considering buying a 51% stake in Hydrobudowa Polska and a 50.1% stake in Aprivia (PBG's hydro engineering and infrastructure subsidiaries) in the process of tightening links with PBG. Moreover PBG plans to bid together with OHL for various construction contracts outside Poland.
- **Entry into power engineering.** We believe that PBG is capable of becoming a sizeable player in the segment. It has already won deals from KGHM worth PLN 228m. We expect 2011E segment sales of PLN 316m to grow at a 123.2% CAGR by 2015E. PBG is bidding for all major power sector tenders that we expect to be awarded in 2011, including: (1) Opole worth PLN 10-12bn – PBG in consortium with Tecint & Ansaldo is among the three shortlisted bidders; and (2) Koziernice worth above PLN 5bn – PBG is teaming up with Alstom to be one of the 7 bidding players.