

Sector: Construction
Fundamental rating: Hold (↓)
Market relative: Overweight (→)
Price: PLN 218.5
12M EFV: PLN 242.0 (→)

Market Cap.: US\$ 961 m
Reuters code: PBGG.WA
Av. daily turnover: US\$ 1.61 m
Free float: 67%
12M range: PLN 175.30-266.00

Quarterly results corner: 2Q09E preview

PBG will release its 2Q09 results (in consolidated report for 1H09) on August 31. We forecast an impressive yoy profits increase in the quarter (for details please refer to *Figure 1* on the next page), yet it should not constitute a major surprise for the investors community. Additionally, one of the reasons for impressive yoy hike of the bottom line will be one-off item, in our view.

Considering PBG's fat backlog, we forecast the Company to increase its quarterly sales by c. 24% yoy up to PLN 630 million. Please note, that PBG's total contract portfolio was more than doubled yoy and reached PLN 5.5 billion as of the beginning of 2Q09, which notably enhanced the visibility of the Company's future financial results, the way we see it.

As far as PBG's gross profit on sales margin is concerned, it has been materially improving yoy in the last couple of quarters, yet for 2Q09 we forecast it at 13.5%, i.e. slightly lower yoy (it stood at 14.5% in the base quarter of 2Q09), due to elevated cost base of 2Q09E and slightly less favorable product mix during the quarter (early stage of implementation of some large contracts, higher share of low margin road contracts).

At the quarterly operating profit line, in turn, we expect c. PLN 12 million of other operating income to be booked. Specifically, we expect c. PLN 3 million of provision reversal at Hydrobudowa Polska (similar gain was booked also in 1Q09) and c. PLN 9 million one-off (and non-cash) gain from revaluation of land in Poznań where PBG plans to launch a residential construction project Górecka. Consequently, the Company's quarterly operating profit margin should be slightly higher yoy, and the Company's EBIT should witness a healthy 28% yoy growth, according to our estimates.

At the bottom line level we forecast PLN 44.6 million in 2Q09, an impressive 69% yoy hike, helped by lower yoy share of minorities in subsidiaries' net profits.

Financial forecast

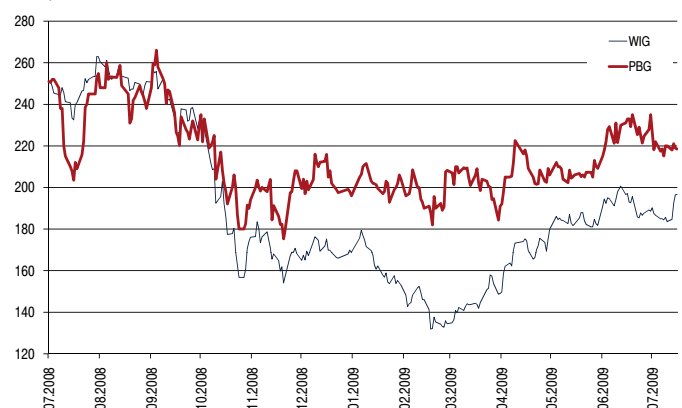
We have slightly upgraded our 2009-2011 net profit forecast for the Company (for details please refer to *Figure 2* on the next page) as a result of incorporation of prospective acquisition of a 25% stake in Energomontaż Południe (according to unofficial sources, PBG has already concluded talks concerning the capital marriage). We assume that the Company will start to recognize a 25% share in profits of EP in its P&L beginning from 4Q09 onwards.

Key data

IFRS consolidated		2008	2009E	2010E	2011E
Sales	PLN m	2,089.3	2,729.7	3,132.1	3,508.0
EBITDA	PLN m	270.3	377.8	427.1	465.5
EBIT	PLN m	223.4	330.6	377.1	412.8
Net profit	PLN m	158.0	198.9	242.7	267.4
EPS	PLN	11.76	13.91	16.98	18.71
EPS yoy chng	%	55	18	22	10
Net debt	PLN m	507.8	425.9	315.5	142.7
P/E	x	18.6	15.7	12.9	11.7
P/CE	x	14.3	12.7	10.7	9.8
EV/EBITDA	x	12.7	9.4	8.1	7.0
EV/EBIT	x	15.4	10.7	9.1	7.9
EV/Sales	x	1.6	1.3	1.1	0.9
Gross dividend yield	%	0.0	0.0	0.0	0.0
No. of shares (eop)	ths.	13,430	14,295	14,295	14,295

Source: Company, DM IDMSA estimates

Stock performance



Source: ISI

Upcoming events

- 1H09 results release: August 31, 2009

Catalysts

1. Signing new large environmental protection contracts co-financed by EU
2. Signing new LT and high-margin gas&oil contracts
3. Looming acquisitions
4. Synergies with Energomontaż Południe

Risk factors

1. Prolonging administrative procedures may negatively affect smooth absorption of EU funds' inflow by investors (public sector)
2. Lower margins on stadium contracts

Valuation

We introduce a couple of changes into our DCF-model for PBG, yet their impact on our assessment of the Company's share intrinsic value is neutral (our 12M EFV continues to dwell at PLN 242 per share). Specifically, our EFV assessment was negatively impacted by (i) higher CAPEX assumption for 2009E (cash outflows on the purchase of stakes in EP and Ukrainian entity), and (ii) the issue of 865 ths. new shares (the issue price

Fig. 1 PBG; 2Q09 and 1H09 results' forecast

IFRS consolidated PLN m	2Q09E	2Q08	yoy change	1-2Q09E	1-2Q08	yoy change	Realization of the FY figures in 2Q:		Realization of the FY figures in 1-2Q	
	2Q09E	2Q08		1-2Q09E	1-2Q08		2009E	2008	2008E	2007
	Sales	630.0	506.3	24%	979.1	826.8	18%	23%	24%	36%
Gross profit on sales	85.1	73.4	16%	145.4	126.6	15%	18%	22%	32%	37%
Gross profit on sales margin	13.5%	14.5%	-	14.8%	15.3%	-	-	-	-	-
EBIT	66.1	51.5	28%	100.8	84.9	19%	20%	23%	31%	38%
EBIT margin	10.5%	10.2%	-	10.3%	10.3%	-	-	-	-	-
Pre-tax profit	60.3	45.3	33%	85.5	68.8	24%	21%	21%	30%	32%
Pre-tax margin	9.6%	9.0%	-	8.7%	8.3%	-	-	-	-	-
Net profit	44.6	26.4	69%	67.6	50.0	35%	22%	17%	34%	32%
Net margin	7.1%	5.2%	-	6.9%	6.0%	-	-	-	-	-

Source: Company, DM IDMSA estimates

Fig. 2 PBG; Changes in IDM's forecast

IFRS consolidated PLN m	2009E			2010E			2011E		
	current	previous	change	current	previous	change	current	previous	change
Sales	2,729.7	2,729.7	0%	3,132.1	3,132.1	0%	3,508.0	3,508.0	0%
EBIT	330.6	330.6	0%	377.1	377.1	0%	412.8	412.8	0%
NI	198.9	196.0	1%	242.7	234.4	4%	267.4	259.5	3%

Source: DM IDMSA estimates

below our per share value assessment), but it was fully offset by positive impact of incorporation of the prospective acquisition of a 25% stake in EP at PLN 3.45 per share (i.e., materially below the current share market price of EP).

Recommendation

With only minor upside (c. 10%), we downgrade our LT fundamental rating for PBG's equities to a Hold (from Buy). We keep, however, our ST market-relative Overweight bias for PBG intact. We remain positive on PBG, due to a number of reasons. First, we like its exposure to infrastructure

constructions (these co-financed by EU), which considerably reduces the Company's sensitivity to the periodic swings in GDP growth rate. Second, we are happy to see large contracts in the Company's portfolio (e.g., LMG, Wierzchowiec, stadium contracts), improving the mid-term visibility of PBG's earnings. Third, we are pleased with PBG's expanding backlog of lucrative gas & oil contracts, which should enable the Company to keep its margins high despite more demanding external environment. Last, but not least, we applaud the Company's moves aimed at building its references in other construction segments (power sector) and abroad (Ukraine), which constitutes a good LT strategy for the post-EU-funds-decline period.

BASIC DEFINITIONS

A/R turnover (in days) = $365/(\text{sales}/\text{average A/R})$

Inventory turnover (in days) = $365/(\text{COGS}/\text{average inventory})$

A/P turnover (in days) = $365/(\text{COGS}/\text{average A/P})$

Current ratio = $(\text{current assets} - \text{ST deferred assets})/\text{current liabilities}$

Quick ratio = $(\text{current assets} - \text{ST deferred assets} - \text{inventory})/\text{current liabilities}$

Interest coverage = $(\text{pre-tax profit before extraordinary items} + \text{interest payable})/\text{interest payable}$

Gross margin = $\text{gross profit on sales}/\text{sales}$

EBITDA margin = $\text{EBITDA}/\text{sales}$

EBIT margin = EBIT/sales

Pre-tax margin = $\text{pre-tax profit}/\text{sales}$

Net margin = $\text{net profit}/\text{sales}$

ROE = $\text{net profit}/\text{average equity}$

ROA = $(\text{net income} + \text{interest payable})/\text{average assets}$

EV = $\text{market capitalization} + \text{interest bearing debt} - \text{cash and equivalents}$

EPS = $\text{net profit}/\text{no. of shares outstanding}$

CE = $\text{net profit} + \text{depreciation}$

Dividend yield (gross) = $\text{pre-tax DPS}/\text{stock market price}$

Cash sales = $\text{accrual sales corrected for the change in A/R}$

Cash operating expenses = $\text{accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes}$

DM IDM S.A. generally values the covered non bank companies via two methods: comparative method and DCF method (discounted cash flows). The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the DCF method is its independence from the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Please note that we also resort to other valuation techniques (e.g. NAV-, DDM- or SOTP-based), should it prove appropriate in a given case.

KEY TO INVESTMENT RANKINGS

This is a guide to expected price performance in absolute terms over the next 12 months:

Buy – fundamentally undervalued (upside to 12M EFV in excess of the cost of equity) + catalysts which should close the valuation gap identified;

Hold – either (i) fairly priced, or (ii) fundamentally undervalued/overvalued but lacks catalysts which could close the valuation gap;

Sell – fundamentally overvalued (12M EFV < current share price + 1-year cost of equity) + catalysts which should close the valuation gap identified.

This is a guide to expected relative price performance:

Overweight – expected to perform better than the benchmark (WIG) over the next quarter in relative terms

Neutral – expected to perform in line with the benchmark (WIG) over the next quarter in relative terms

Underweight – expected to perform worse than the benchmark (WIG) over the next quarter in relative terms

The recommendation tracker presents the performance of DM IDMSA's recommendations. A recommendation expires on the day it is altered or on the day 12 months after its issuance, whichever comes first. Relative performance compares the rate of return on a given recommended stock in the period of the recommendation's validity (i.e. from the date of issuance to the date of alteration or – in case of maintained recommendations – from the date of issuance to the current date) in a relation to the rate of return on the benchmark in this time period. The WIG index constitutes the benchmark. For recommendations that expire by an alteration or are maintained, the ending values used to calculate their absolute and relative performance are: the stock closing price on the day the recommendation expires/ is maintained and the closing value of the benchmark on that date. For recommendations that expire via a passage of time, the ending values used to calculate their absolute and relative performance are: the average of the stock closing prices for the day the recommendation elapses and four directly preceding sessions and the average of the benchmark's closing values for the day the recommendation expires and four directly preceding sessions.

Banks

Net Interest Margin (NIM) = $\text{net interest income}/\text{average assets}$

NIM Adjusted = $(\text{net interest income adjusted for SWAPs})/\text{average assets}$

Non interest income = $\text{fees\&commissions} + \text{result on financial operations (trading gains)} + \text{FX gains}$

Interest Spread = $(\text{interest income}/\text{average interest earning assets})/(\text{interest cost}/\text{average interest bearing liabilities})$

Cost/Income = $(\text{general costs} + \text{depreciation} + \text{other operating costs})/(\text{profit on banking activity} + \text{other operating income})$

ROE = $\text{net profit}/\text{average equity}$

ROA = $\text{net income}/\text{average assets}$

Non performing loans (NPL) = loans in 'substandard', 'doubtful' and 'lost' categories

NPL coverage ratio = $\text{loan loss provisions}/\text{NPL}$

Net provision charge = $\text{provisions created} - \text{provisions released}$

DM IDM S.A. generally values the covered banks via two methods: comparative method and fundamental target fair P/E and target fair P/BV multiples method. The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the fundamental target fair P/E and target fair P/BV multiples method is its independence of the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation.

Assumptions used in valuation can change, influencing thereby the level of the valuation. Among the most important assumptions are: GDP growth, forecasted level of inflation, changes in interest rates and currency prices, employment level and change in wages, demand on the analysed company products, raw material prices, competition, standing of the main customers and suppliers, legislation changes, etc.

Changes in the environment of the analysed company are monitored by analysts involved in the preparation of the recommendation, estimated, incorporated in valuation and published in the recommendation whenever needed.

LT fundamental recommendation tracker

Recommendation		Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/reiteration (PLN)	12M EFV (PLN)	
PBG									
Hold	-	06.02.2008	-	30.11.2008	-26%	30%	281.60	319.00	-
-	-	-	17.02.2008	-	-	-	317.90	319.00	→
-	→	-	21.02.2008	-	-	-	326.70	352.00	↑
-	→	-	30.03.2008	-	-	-	325.00	358.00	↑
-	→	-	14.04.2008	-	-	-	311.00	357.00	↓
-	→	-	29.04.2008	-	-	-	318.00	361.00	↑
-	→	-	15.05.2008	-	-	-	315.00	361.00	→
-	→	-	01.06.2008	-	-	-	318.00	361.00	→
-	→	-	29.06.2008	-	-	-	268.00	356.00	↓
-	→	-	08.07.2008	-	-	-	238.00	348.00	↓
-	→	-	28.07.2008	-	-	-	245.00	348.00	→
-	→	-	04.08.2008	-	-	-	248.00	348.00	→
-	→	-	31.08.2008	-	-	-	238.00	348.00	→
-	→	-	28.09.2008	-	-	-	232.00	348.00	→
-	→	-	19.10.2008	-	-	-	192.10	305.00	↓
-	→	-	29.10.2008	-	-	-	191.50	305.00	→
-	→	-	06.11.2008	-	-	-	198.30	305.00	→
Buy	↑	30.11.2008	-	16.07.2009	5%	-10%	208.00	305.00	→
-	→	-	11.01.2009	-	-	-	211.50	305.00	→
-	→	-	25.01.2009	-	-	-	192.90	279.00	↓
-	→	-	08.02.2009	-	-	-	208.50	279.00	→
-	→	-	08.03.2009	-	-	-	207.00	279.00	→
-	→	-	05.04.2009	-	-	-	205.00	279.00	→
-	→	-	29.04.2009	-	-	-	209.10	242.00	↓
-	→	-	12.05.2009	-	-	-	208.30	242.00	→
-	→	-	17.05.2009	-	-	-	206.00	242.00	→
-	→	-	08.06.2009	-	-	-	221.30	242.00	→
-	→	-	08.07.2009	-	-	-	215.20	242.00	→
Hold	↓	16.07.2009	-	Not later than 16.07.2010	-	-	218.50	242.00	→

Market-relative recommendation tracker

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/reiteration (PLN)	Relative performance
PBG						
Overweight	-	06.02.2008	-	11.01.2009	281.60	30%
-	→	-	17.02.2008	-	317.90	-
-	→	-	21.02.2008	-	326.70	-
-	→	-	30.03.2008	-	325.00	-
-	→	-	14.04.2008	-	311.00	-
-	→	-	29.04.2008	-	318.00	-
-	→	-	15.05.2008	-	315.00	-
-	→	-	01.06.2008	-	318.00	-
-	→	-	29.06.2008	-	268.00	-
-	→	-	08.07.2008	-	238.00	-
-	→	-	28.07.2008	-	245.00	-
-	→	-	04.08.2008	-	248.00	-
-	→	-	31.08.2008	-	238.00	-
-	→	-	28.09.2008	-	232.00	-
-	→	-	19.10.2008	-	192.10	-
-	→	-	29.10.2008	-	191.50	-
-	→	-	06.11.2008	-	198.30	-
-	→	-	30.11.2008	-	208.00	-
Overweight	→	11.01.2009	-	Not later than 11.01.2010	211.50	-10%
-	→	-	25.01.2009	-	192.90	-
-	→	-	08.02.2009	-	208.50	-
-	→	-	08.03.2009	-	207.00	-
-	→	-	05.04.2009	-	205.00	-
-	→	-	29.04.2009	-	209.10	-
-	→	-	12.05.2009	-	208.30	-
-	→	-	17.05.2009	-	206.00	-
-	→	-	08.06.2009	-	221.30	-
-	→	-	08.07.2009	-	215.20	-
-	→	-	16.07.2009	-	218.50	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	16	28	13	1	0
Percentage	28%	48%	22%	2%	0%

Distribution of IDM's current recommendations for companies that were within the last 12M IDM customers in investment banking

	Buy	Hold	Sell	Suspended	Under revision
Numbers	3	3	0	1	0
Percentage	43%	43%	0%	14%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	19	15	23	1	0
Percentage	33%	26%	40%	2%	0%

Distribution of IDM's current market relative recommended weightings for the companies that were within the last 12M IDM customers in investment banking

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	2	3	1	1	0
Percentage	29%	43%	14%	14%	0%

Institutional sales

Director – **Dariusz Wareluk**
tel.: +48 (22) 489 94 12
d.wareluk@idmsa.pl

Leszek Mackiewicz

tel.: +48 (22) 489 94 23
l.mackiewicz@idmsa.pl

Maciej Bąk

tel.: +48 (22) 489 94 14
m.bak@idmsa.pl

Bartosz Zieliński

tel.: +48 (22) 489 94 13
b.zielinski@idmsa.pl

Research

Sobiesław Pająk, CFA
(IT, Media, Equity strategy)

tel.: +48 (22) 489 94 70
s.pajak@idmsa.pl

Sylwia Jaśkiewicz, CFA

(Construction materials, Retail, Mid-caps)
tel.: +48 (22) 489 94 78
s.jaskiewicz@idmsa.pl

Maciej Wewiórski

(Commodities, Construction, Real estate)
tel.: +48 (22) 489 94 62
m.wewiorski@idmsa.pl

Michał Sobolewski

(Banks)
tel.: +48 (22) 489 94 77
m.sobolewski@idmsa.pl

Jakub Viscardi

(Telco, Retail)
tel.: +48 (22) 489 94 69
j.viscardi@idmsa.pl

Adrian Kyrzcz

(Construction)
tel.: +48 (22) 489 94 74
a.kyrzcz@idmsa.pl

Łukasz Prokopiuk

(Associate)
tel.: +48 (22) 489 94 72
l.prokopiuk@idmsa.pl

Marek Kaźmierczak

(Associate)
tel.: +48 (22) 489 94 78
m.kazmierczak@idmsa.pl

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