IDMSA DOM MAKLERSKI

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PBG

Sector: Construction
Fundamental rating: Hold (→)
Market relative: Overweight (→)
Price: PLN 326.7
12M EFV: PLN 352 (↑)

Market Cap.: US$ 1,809 m
Reuters code: PBGG.WA
Av. daily turnover: US$ 3.78 m
Free float: 67%
12M range: PLN 250.10-430.00

Financial forecast; upgrade

PBG's good 4Q07 financial showing, stronger-than-anticipated results of PBG's subsidiaries last year, a fat contract backlog (up 33% yoy) and – most of all – the Company's robust 2008 outlook persuade us to revise slightly upwards our FY2008 and FY2009 financial forecast for the Company. Specifically, we increase (i) 2008 revenues forecast by 7%, to PLN 1,871.2 million and (ii) 2008 and 2009 net profit forecast by 10% and 3%, to PLN 150.5 million and PLN 194.6 million, respectively.

Valuation

Last year the Company proved its stronger bargaining power, resulting in a lower amount of NWC utilized, a development which – according to the management – should prove at least partially sustainable in the coming years. Consequently, for 2008E and beyond, we assume that PBG will slightly shorten its A/R days and extend its A/P days compared to our previous assumptions. Lower NWC financing needs, coupled with aforementioned slight forecast upgrade result in a moderate (11%) increase of our 12M EFV for the Company to PLN 352 per share.

Recommendation

Given current price of PBG's shares and our upgraded 12M EFV of PLN 352 we maintain our LT fundamental Hold recommendation. In the wake of upcoming triggers (in the form of possible large contracts from PGNiG), we continue to recommend to overweight the Company's stocks against their benchmark weighting in the ST.

Investment story

PBG constitutes probably the best vehicle to capture the growth in the influx of EU funds. Please note that the next three years should bring spending on environmental protection at a level of c. PLN 51 billion, and around half of that should constitute investments in sewage disposal and water protection, which drive the Company's results. We believe PBG should maintain its leading market position as far as the execution of environmental protection and hydro construction contracts is concerned. Moreover, entering the road construction business may allow the Company to unlock additional value from realization of complex projects, in our view.

The high growth potential of the Company is reinforced by its M&A strategy. This year should bring an acquisition of a road building company. It is also likely that PBG will acquire PRG Metro, a company that should support PBG in the prospective construction of a second metro line in Warsaw. These acquisitions may prove value-accretive, providing a conditional future upside to our current valuation of PBG's equities.

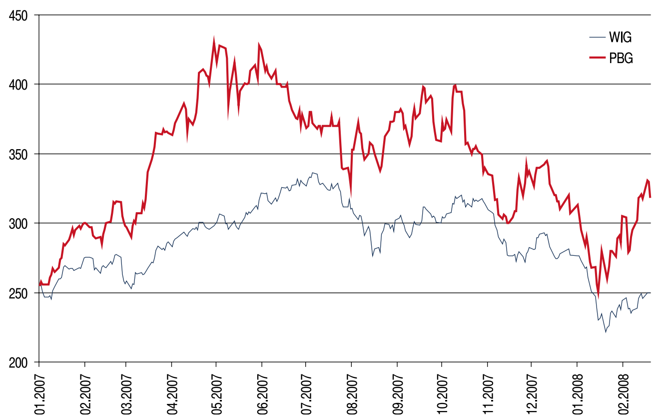
We like PBG's foreign expansion (Gas & Oil Engineering in Slovakia, Excan Oil and Gas Engineering in Canada), which we believe is the way to build a reference for foreign expansion once the flow

Key data

IFRS consolidated		2007	2008E	2009E	2010E
Sales	PLN m	1,377.3	1,871.2	2,357.8	3,136.3
EBITDA	PLN m	136.3	248.6	320.1	466.9
EBIT	PLN m	106.3	219.1	288.4	433.6
Net profit	PLN m	101.8	150.5	194.2	298.5
EPS	PLN	7.58	11.21	14.46	22.23
EPS yoy chng	%	68	48	29	54
Net debt	PLN m	257.4	441.4	426.8	439.6
P/E	x	43.1	29.1	22.6	14.7
P/CE	x	33.3	24.4	19.4	13.2
EV/EBITDA	x	34.1	19.4	15.0	10.3
EV/EBIT	x	43.7	22.0	16.7	11.1
EV/Sales	x	3.4	2.6	2.0	1.5
Gross dividend yield	%	0.0	0.0	0.0	0.0
No. of shares (eop)	ths.	13,430	13,430	13,430	13,430

Source: Company, DM IDMSA estimates

Stock performance



Source: www.money.pl

Upcoming events

1. Release of management's forecast for 2008: 1-2Q08
2. Release of 1Q08 results: May 14, 2008
3. Release of 2Q08 results: August 13, 2008

Catalysts

1. PBG wining the battle for PGNiG contracts
2. Winning other large environmental protection contracts
3. Further M&A's this year could prove shareholder-value-accretive

Risk factors

1. Suspension of PGNiG tenders
2. PBG loses the battle for PGNiG contracts

of EU funds declines. We see numerous triggers on the horizon which should be supportive for the share price performance of PBG, mainly in the form of large tenders to be completed. Within the next 2 months at least two large contracts with a total value of PLN 1.3 billion are expected to be finalized. We believe that PBG is well-positioned to win at least one of them.

Drivers

- *1. Further M&A's.* The M&A-oriented strategy should be followed and bring further acquisitions this year. We believe that the next acquisition target should be a road-building company. Moreover, as Hydrobudowa Polska (PBG's 76% subsidiary) aims to take part in the construction of the second metro line in Warsaw (in a consortium with German Alpine Bau and Spanish FCC Construction), PRG Metro (a company that played a key role in construction of the first line) can become acquisition target (so far relevent intent letter has been signed).

- *2. Tenders for c. PLN 1.3 billion to be completed by the end of this quarter.* 1Q08 should bring the completion of 2 tenders for an impressive PLN 1.3 billion, both announced by PGNiG, which is to speed up its investment process. We believe PBG should win at least one of them. The first one is a contract for the construction of an underground gas storage facility in Wierzchowice (PLN 0.6 billion), and the second one is a contract for construction of the Lubiatów-Międzychód-Grotów crude oil plant (PLN 0.7 billion).

- *3. Announcement of the 2008 management forecast.* Given the Company's strong contract backlog, we believe that the 2008 management financial forecast, which should be announced in 1Q08 or 2Q08, may provide a slightly positive catalyst for the stock price performance.

BASIC DEFINITIONS
A/R turnover (in days) = 365/(sales/average A/R))
Inventory turnover (in days) = 365/(COGS/average inventory))
A/P turnover (in days) = 365/(COGS/average A/P))
Current ratio = ((current assets – ST deferred assets)/current liabilities)
Quick ratio = ((current assets – ST deferred assets – inventory)/current liabilities)
Interest coverage = (pre-tax profit before extraordinary items + interest payable/interest payable)
Gross margin = gross profit on sales/sales
EBITDA margin = EBITDA/sales
EBIT margin = EBIT/sales
Pre-tax margin = pre-tax profit/sales
Net margin = net profit/sales
ROE = net profit/average equity
ROA = (net income + interest payable)/average assets
EV = market capitalization + interest bearing debt – cash and equivalents
EPS = net profit/ no. of shares outstanding
CE = net profit + depreciation
Dividend yield (gross) = pre-tax DPS/stock market price
Cash sales = accrual sales corrected for the change in A/R
Cash operating expenses = 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.

Banks
Net Interest Margin (NIM) = net interest income/average assets
NIM Adjusted = (net interest income adjusted for SWAPs)/average assets
Non interest income = fees&commissions + result on financial operations (trading gains) + FX gains
Interest Spread = (interest income/average interest earning assets)/ (interest cost/average interest bearing liabilities)
Cost/Income = (general costs + depreciation + other operating costs)/ (profit on banking activity + other operating income)
ROE = net profit/average equity
ROA = net income/average assets
Non performing loans (NPL) = loans in 'substandard', 'doubtful' and 'lost' categories
NPL coverrage ratio = loan loss provisions/NPL
Net provision charge = provisions created – 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.

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) + 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.

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*	-	*Not later than 06.02.2009*	16%	12%	281.6	319	
-	→	-	*17.02.2008*	-	-	-	317.9	319	→
-	→	-	*21.02.2008*	-	-	-	326.7	352	↑

Market-relative recommendation tracker

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/ reiteration (PLN)	Relative performance
PBG						
Overweight	–	*06.02.2008*	-	*Not later than 06.02.2009*	281.6	12%
-	→	-	*17.02.2008*	-	317.9	-
-	→	-	*21.02.2008*	-	326.7	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	20	13	5	0	0
Percentage	53%	34%	13%	0%	0%

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

	Buy	Hold	Sell	Suspend	Under revision
Numbers	2	2	1	0	0
Percentage	40%	40%	20%	0%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	13	18	7	0	0
Percentage	34%	47%	18%	0%	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	2	1	0	0
Percentage	40%	40%	20%	0%	0%

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