PBG

Waiting for the rebound in sentiment

Maintained

Buy

Construction & building materials — **Bloomberg: PBG PW**

- **With only an 8% return over the past 12 months, PBG shares were one of the worst performing in our Polish universe. Investors were worried about growth prospects beyond 2010 coupled with concerns of profitability deterioration and negative cash flow. Unjustified, in our view. We maintain our BUY rating and expect triggers for a strong share price performance to come no later than by the end of 1H10.**

Investment case

CEO Jerzy Wisniewski has commented that 2009 net profit will exceed PLN200m versus current official guidance of PLN190m. For 9M09, PBG reported PLN109m net profit, however, in the last quarter of each year, PBG generates between 40% and 50% of annual net profit. Current 2009 market consensus is PLN203m.

At the end of 1Q10, PBG should announce its 2010 guidance. Consensus currently forecasts PLN3.5bn revenues and PLN239m net profit, which implies 25% and 26% YoY growth, respectively, versus PBG's 2009 guidance. Guidance should be broadly in line with consensus as CEO Wisniewski recently announced he feels relatively comfortable with market expectations for 2010.

PBG's backlog currently amounts to slightly more than PLN5.3bn (versus PLN6.3bn as of end-2008), of which c.PLN3.0bn is scheduled for execution in 2010. The backlog is dominated by industrial construction (37% of backlog portfolio, constituting primarily three Euro 2010 football stadium contracts in Warsaw, Gdansk and Poznan), followed by gas & oil (29%) and hydro projects (27%).

In line with consensus, we see PBG's top line growing by 21% YoY to PLN3.5bn in 2010F. Major contributors to the company's top line will be Hydrobudowa Polska with PLN1.6bn revenues, PBG as a standalone adds PLN1.0bn, with another PLN0.4bn added by the road construction unit.

The gross margin should decrease to 13.1% in 2010F versus 14.5% in 2009F, following a higher share of lower margin industrial contracts in PBG's revenues. The road segment should also see declining margins in 2010 and 2011. PBG puts more emphasis on the development of its road unit through expansion into lower margin highway contracts. The net margin should remain flat YoY at 6.8%, related to a lower debt burden (net debt at PLN0.4bn as of end-2009F versus PLN0.8bn at end-2008) and cost control.

PBG trades at a PER of 12.6x in 2010F and 11.8x in 2011F, in our view an unjustified 14% and 10% discount to Polish peers, respectively. We reiterate our **BUY** with a revised target price of PLN266, the outcome of DCF valuation (60% weighting applied) and peer group valuation.

Price (15/01/10)	**PLN212**
	Previously PLN248
Target price (12 mth)	**PLN266**

12-month forecast returns (%)

Share price	25.6
Dividend	0.0
12m f'cst total return	**25.6**

Source: ING

Key ratios (%)

	2009F	2010F
EBITDA margin	11.7	11.4
Operating margin	10.3	10.0
Net debt/equity	24.0	5.0
DPS (PLN)	0.0	0.0
Dividend yield	0.0	0.0

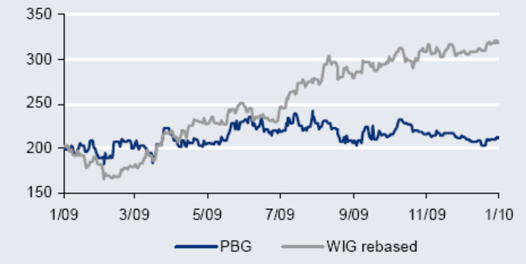
Source: Company data, ING estimates

Share data

No. of shares (m)	14.3
Daily t/o (US$m)	2.8
Free float (%)	70
Mkt cap (US$m)	1,082
Mkt cap (PLNm)	3,031

Source: Company data, ING

Share price performance



Source: Bloomberg

Forecasts and ratios

Year to Dec	2008	2009F	2010F	2011F	2012F
Revenue (PLNm)	2,091	2,903	3,508	3,597	3,550
EBITDA (PLNm)	267	340	399	429	421
Net income (PLNm)	158	199	240	257	279
EPS (PLN)	11.8	14.4	16.8	18.0	19.5
PER (x)	18.0	14.7	12.6	11.8	10.9
EV/EBITDA (x)	12.6	10.0	8.2	7.0	6.7
P/BV (x)	3.1	1.9	1.7	1.6	1.4
ROE (%)	18.9	16.3	14.8	14.0	13.8

Source: Company data, ING estimates

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Quarterly preview

PBG is due to publish its 4Q09 results on Monday, 1 March.

We forecast 4Q09 revenues of PLN1.25bn, a 74% YoY growth, driven primarily by hydro engineering subsidiary, HBP (89% YoY growth) and the gas & oil segment (84% YoY growth).

The gross margin should decrease to 14.5% in 4Q09F versus 18.0% reported in 4Q08, primarily due to an increased share of lower margin industrial and road construction contracts, which are running at high single-digit or low double-digit margins.

No significant one-offs above the EBIT line are forecast in 4Q09. We expect a 10.3% EBIT margin in 4Q09F versus 11.2% in 4Q08. We forecast PLN7m net financial expenses (versus PLN7m net financial income in 4Q08) and PLN9m minorities. Net profit margin at 7.2% versus 10.2% in 4Q08.

4Q09 results preview (PLNm)

	4Q09F	4Q08
Revenue	1,252.3	720.3
EBITDA	140.1	90.8
EBIT	129.1	80.8
Net profit	89.9	73.5
EPS (PLN)	6.3	5.5

Source: Company data, ING estimates

Earnings drivers and outlook

PBG's underperformance over the past 12 months was related to a share issue in 1H09, continuously negative operating cashflow, and concerns on profitability deterioration in 2010 and 2011 (related to stadium construction contracts). The stock lacked triggers, which, in our view, will be delivered throughout 2010 and include repeated positive cash flow, significant new contract signings and delivery on 2010 market expectations.

After several years of rapid development, PBG posted a strong triple-digit positive operating cash flow in 3Q09. We believe the company will continue to monetise past growth in 2010 and expect a positive cash flow in the coming quarters. Given improved receivables turnover related to the declining share of public and EU-funded contracts, the company's cash flow might surprise positively as early as 4Q09 and continue in 1H10.

PBG plans to participate in several significant construction tenders in 2010, which could result in positive newsflow. Major contracts include the award of a €0.7bn LNG contract in Swinoujscie scheduled for 3Q10. PBG's consortium (approximately 33% share in the consortium) is believed to be the front runner. Other bidders include consortiums involving Polimex and Korean Daewoo. Another significant construction contract scheduled for mid-2010 is the €3.0bn Opole power plant contract. The consortium including PBG (we estimate PBG's share in the consortium at 35%) is competing against Polimex, Rafako and Mostostal Warszawa. In 2010, PBG additionally hopes to be awarded two hydro engineering contracts (retention tank in Raciborz, water dam in Nieszawa) amounting to PLN2.7bn.

P&L account (PLNm)

	2008	2009F	2010F	2011F
Revenue	**2,091**	**2,903**	**3,508**	**3,597**
%ch	*48.6*	*38.8*	*20.8*	*2.5*
EBITDA	**267**	**340**	**399**	**429**
EBIT	**226**	**298**	**350**	**379**
%ch	*61.9*	*32.0*	*17.4*	*8.5*
Margin (%)	*10.8*	*10.3*	*10.0*	*10.5*
Pre-tax profit	216	269	330	362
Tax	(26)	(40)	(63)	(69)
Minorities	(32)	(30)	(27)	(36)
Net profit	**158**	**199**	**240**	**257**
%ch	*51.7*	*25.5*	*21.0*	*7.1*
Margin (%)	*7.6*	*6.8*	*6.8*	*7.2*

Source: Company data, ING estimates

Balance sheet (PLNm)

	2008	2009F	2010F	2011F
Cash	290	759	912	949
Goodwill	333	333	333	333
Other current assets	1,318	1,702	1,798	1,712
Total current assets	**1,940**	**2,794**	**3,043**	**2,993**
PPE	437	390	428	468
Intangibles	15	15	15	15
Other fixed assets	466	639	639	639
Total fixed assets	**918**	**1,043**	**1,082**	**1,122**
Total assets	**2,859**	**3,837**	**4,125**	**4,114**
ST debt	671	620	500	500
Other current liabilities	663	953	1,093	1,061
Total current liabilities	**1,335**	**1,573**	**1,593**	**1,561**
LT debt	113	200	200	200
Other LT liabilities	297	340	340	140
Total LT liabilities	**410**	**540**	**540**	**340**
Minorities	185	216	243	279
Equity	**928**	**1,508**	**1,748**	**1,933**
Total liabilities & equity	**2,859**	**3,837**	**4,125**	**4,114**

Source: Company data, ING estimates

Cash flow account (PLNm)

	2008	2009F	2010F	2011F
CF from operations	(259)	144	350	406
CF from investment	(197)	(135)	(77)	(97)
CF from funding	335	460	(120)	(272)
Change in cash	(121)	469	153	37
Cash last year	410	290	759	912
Cash year end	290	759	912	949

Source: Company data, ING estimates

Company profile

Largest Polish construction company active in hydro engineering and gas & oil construction. In 2005-07, PBG acquired three companies active in environmental protection and is also constructing three stadiums for the EURO 2012 championships.

Risks

High quality backlog should enable the company to continue to report premium profitability as traditional construction companies begin to see a deterioration of profitability in 2010. Risk factors remain the execution of the stadium contracts, given the technical difficulty and time limitations they might pose unexpected expenditures. Currently, 40% of the works at the two largest stadium contracts in Gdansk and Warsaw is still not agreed with subcontractors. We believe that a rebound in construction material prices might result in lower-than-budgeted profitability in 2010.