

PBG

Fishing for opportunities

20 May 2011

Construction		Current price	PLN 142.00*	Buy
Poland		Fair value	PLN 171.45	Rating upgraded
Performance over	1M	3M	12M	
Absolute	-18%	-29%	-34%	
Rel. WIG20	-17%	-30%	-44%	
12M Hi/Lo	PLN 252 / 135.8			
Reuters	PBGG.WA			
Bloomberg	PBG PW			
Market cap	€ 517.8m			
Next corporate event	2Q11 results on 31 August 2011			
PLN / EUR	3.92			
	PLN m	2010	2011F	2012F
	Sales	2,740.3	3,171.1	3,043.5
	EBITDA	319.4	326.2	348.7
	EBIT	272.7	273.0	275.3
	Net profit	224.3	208.8	212.4
	EPS (PLN)	15.7	14.6	14.9
	P/E (x)	13.2	10.9	11.3
	DPS (PLN)	1.4	3.2	4.3
	Dividend Yield (%)	1.0%	2.3%	3.0%
	EV/EBITDA (x)	8.4	8.5	7.4

Source: KBC Securities

* Priced at COB 19 May 2011

The recent re-rating of PBG's share price in the last few weeks has presented a good buying opportunity. The risk of huge penalties for delays in the construction of the National Stadium has receded, as it became clear that the delays were triggered by the investor's changes to the contract. Earlier this week MSCI announced PBG would be leaving the MSCI Poland index at close of business on 31 May 2011. However, we believe this has already been priced-in and is unlikely to put a further drag on the stock's trading. Prospects for the road construction segment are poor, but PBG could be able to replace this work over time with contracts in the oil & gas segment, representing a real competitive advantage over other Polish construction companies. We have cut our underlying net profit forecasts by 1.6% to PLN 208.8m for 2011, 16.9% to PLN 212.4m for 2012 and 5.3% to PLN 267.8m for 2013. We have lowered our fair value estimate by 20.5% to PLN 171.45 per share, which implies 20.7% upside. We upgrade our rating to Buy.

Rating upgraded to Buy

- OHL deal suspended:** PBG's disposal of Aprivia and Hydrobudowa to OHL was suspended earlier this month but the management is certain the deal will return to the agenda once Hydrobudowa's share price rebounds to levels around PLN 3-4 per share. However, we remain sceptical and do not factor these disposals into our estimates. This has triggered changes in our forecasts as PBG will remain in the road and hydro-engineering segments, which will drag down the overall margins of the group in 2011 and 2012 before the anticipated profits from real estate operations and an increased share of oil & gas in operating profit.
- Looking for road deal replacement:** We expect PBG to gradually replace low-margin road construction projects (currently 38% of PBG's backlog) with more profitable projects in the oil & gas segment. We expect the latter's share in revenues to rise from 28.9% in 2010 to 34.7% in 2013, with gross margins staying at a high 22%. PBG is negotiating an additional deal with Saipem related to an LNG project with a total value of PLN 220m, which we have not yet included in the backlog. PBG is also likely to participate in several Gaz-System SA tenders with a total value of PLN 1.4bn, which are expected to arrive in 3Q11/4Q11. Also, the tender for PGNiG's big Rozansko gas mine project (PLN 1bn) is likely to be announced in late 2011.
- Higher gearing over the short-term:** The absence of proceeds from the Hydrobudowa and Aprivia disposals will weigh on PBG's financials in the medium term. We expect PBG's net debt/EBITDA ratio to rise from 2.3x in 2011 to 2.5x in 2012 before declining to 1.8x in 2013. This should be triggered by long-term debt repayments and the positive impact of real estate operations on operating profit. We expect operating cash flow at PLN 117m in 2011.
- Premium valuation:** On a 2012F EV/EBITDA of 7.4x, PBG trades at a 23.6% premium to domestic peers. We believe the premium is justified by the firm's exposure to the oil & gas segment, which should outpace the general construction market (oil & gas revenues at a 2010-2013F CAGR of 15.5% versus overall construction at a 2010-2012F CAGR of 8.7%) and provide a higher margin than other segments.

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PBG: Income statement (Old vs. New forecast) PLN m

	2011F			2012F			2013F		
	Old	New	Change %	Old	New	Change %	Old	New	Change %
Sales	1,922.55	3,171.12	64.9%	2,280.31	3,043.46	33.5%	2,613.65	3,520.92	34.7%
natural gas and crude oil	1,199.52	1,018.51	-15.1%	1,175.53	1,013.07	-13.8%	1,152.02	1,220.39	5.9%
water/sewage	179.81	299.88	66.8%	170.82	262.20	53.5%	162.28	274.09	68.9%
industrial and residential construction	222.75	565.84	154.0%	233.89	537.75	129.9%	245.59	639.19	160.3%
roads	44.89	1,118.91	2392.8%	0.00	919.20	n.a.	0.00	827.28	n.a.
power engineering	180.00	113.00	-37.2%	630.00	282.50	-55.2%	819.00	367.25	-55.2%
Real estate	44.61	44.61	0.0%	18.08	18.08	0.0%	181.74	181.74	0.0%
other	50.97	10.36	-79.7%	51.99	10.67	-79.5%	53.03	10.99	-79.3%
Gross profit on sales	316.25	379.48	20.0%	363.25	374.95	3.2%	400.31	456.87	14.1%
EBIT	243.70	273.03	12.0%	291.01	275.30	-5.4%	327.45	342.32	4.5%
Financial activity net	-21.91	-14.05	-35.9%	-8.50	-11.83	39.1%	-13.26	-9.53	-28.1%
Share in gains/losses of equity									
method consolidated entities	28.88	2.00	-93.1%	37.11	2.00	-94.6%	39.43	2.00	-94.9%
Pretax profit	250.66	260.97	4.1%	319.62	265.48	-16.9%	353.63	334.78	-5.3%
Net income	264.88	208.78	-21.2%	255.70	212.38	-16.9%	282.90	267.83	-5.3%
Underlying net profit	212.20	208.78	-1.6%	255.70	212.38	-16.9%	282.90	267.83	-5.3%
EBITDA	292.04	326.23	11.7%	349.51	348.73	-0.2%	385.82	425.19	10.2%

Source: KBC Securities

PBG: KBC forecasts versus consensus (PLN m)

	2011F			2012F			2013F		
	Cons.	KBC	diff.	Cons.	KBC	diff.	Cons.	KBC	diff.
Sales	2,865.1	3,171.1	10.7%	3,022.9	3,043.5	0.7%	3,155.0	3,520.9	11.6%
EBITDA	352.6	326.2	-7.5%	373.7	348.7	-6.7%	387.3	425.2	9.8%
EBIT	297.7	273.0	-8.3%	306.8	275.3	-10.3%	290.0	342.3	18.0%
Net profit	231.6	208.8	-9.8%	238.9	212.4	-11.1%	254.3	267.8	5.3%
Margins (%)									
EBITDA	12.3%	10.3%	-2.02 pps	12.4%	11.5%	-0.90 pps	12.3%	12.1%	-0.20 pps
EBIT	10.4%	8.6%	-1.78 pps	10.2%	9.0%	-1.10 pps	9.2%	9.7%	0.53 pps
Net profit	8.1%	6.6%	-1.50 pps	7.9%	7.0%	-0.92 pps	8.1%	7.6%	-0.45 pps

Source: KBC Securities, Bloomberg

Relative valuation of construction coverage universe – on current prices

	EV/EBITDA			P/E		
	2011F	2012F	2013F	2011F	2012F	2013F
Budimex	6.4	7.4	8.3	12.0	13.1	14.2
PBG	8.5	7.4	6.1	9.7	9.6	7.6
Polimex Mostostal	7.0	6.1	6.8	12.6	9.7	12.1
Elektrobudowa	8.3	na	na	13.5	12.6	11.8
Mostostal Warszawa	4.0	2.8	2.3	14.4	11.0	10.5
Erbud	6.7	4.4	3.9	12.4	8.0	7.2
Trakcja Polska	8.5	6.5	7.0	9.6	6.9	7.9
Tier 1 average	7.2	7.1	7.2	11.4	11.1	11.5
PL sector Average	7.1	6.0	6.0	11.7	10.8	10.0
Premium / discount to PL sector average						
PBG	18.6%	23.6%	1.7%	-17.1%	-11.1%	-24.0%

Source: KBC Securities

Valuation summary (PLN)

	Fair value estimate per share
DCF	166.82
DDM	176.07
Average	171.45

PBG - DDM Valuation (PLN m)

	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Dividends	46.0	61.9	104.9	158.7	242.3	249.1	256.2	260.0	270.2	312.4
Discount rate	9.9%	10.1%	10.2%	10.3%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%
Discount factor	0.91	0.83	0.75	0.68	0.62	0.57	0.52	0.47	0.43	0.39
Discounted dividend	41.87	51.13	78.67	107.93	150.47	141.29	132.73	123.00	116.73	123.26
Sum of DD PV's (2011F-2020F)	1,067.08									
Sum of DD PV's (2021F-2045F)	1,406.96									
DIV terminal growth rate	1.0%									
Terminal value	4,458.39									
PV of terminal value	166.16									
Discount unwind	-123.26									
Equity value	2,516.95									
Per share value (PLN)	176.07									

Source: KBC Securities

PBG - DCF Valuation (PLN m)

	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F
Revenues	3,171.1	3,043.5	3,520.9	3,568.2	3,657.1	3,738.0	3,799.9	3,862.5	3,924.7	3,991.8
EBIT	273.0	275.3	342.3	341.0	348.0	361.6	372.7	384.6	396.9	410.0
Tax on EBIT	51.9	52.3	65.0	64.8	66.1	68.7	70.8	73.1	75.4	77.9
NOPLAT	221.2	223.0	277.3	276.2	281.9	292.9	301.9	311.5	321.5	332.1
Depreciation	53.2	73.4	82.9	93.6	106.3	117.4	132.9	150.4	161.4	173.2
Capital expenditures	-133.9	-162.7	-173.6	-189.7	-215.5	-237.6	-267.9	-157.9	-169.4	-181.9
Change in working capital	-182.3	82.9	-21.2	47.5	40.1	-18.7	-14.9	6.3	27.2	-49.5
Free cash flow	-41.8	216.7	165.4	227.6	212.7	154.0	152.1	310.2	340.6	274.0
Growth %			-23.6%	37.6%	-6.5%	-27.6%	-1.3%	104.0%	9.8%	-19.6%
Risk free rate	5.4%	5.6%	5.7%	5.8%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Equity risk premium	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Cost of equity	9.9%	10.1%	10.2%	10.3%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%
Cost of debt (pre-tax)	7.4%	7.6%	7.7%	7.8%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
After-tax cost of debt	6.0%	6.1%	6.2%	6.3%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%
Weight of debt	21.5%	19.9%	17.6%	17.3%	16.0%	15.8%	16.5%	16.8%	16.4%	15.9%
Weight of equity	78.5%	80.1%	82.4%	82.7%	84.0%	84.2%	83.5%	83.2%	83.6%	84.1%
WACC	9.1%	9.3%	9.5%	9.6%	8.9%	8.9%	8.9%	8.9%	8.9%	8.9%
Discount fact	0.92	0.84	0.77	0.70	0.64	0.59	0.54	0.50	0.46	0.42
PV of FCF (2011F-2020F)	-38.4	181.8	126.8	159.1	136.6	90.8	82.4	154.3	155.6	115.0
PV of FCF (2021F-2045F)	1,665.6									
Sum of FCF PV's	2,829.5									
FCF terminal growth rate	1.0%									
Terminal value	6,547.0									
PV of terminal value	307.4									
Unwind of discount	21.7									
Enterprise value	3,158.6									
Net debt 2010	740.2									
Minorities	-33.7									
Discounted share in affiliates	21.7									
Equity value	2,384.7									
Per share value (PLN)	166.8									

Source: KBC Securities

Financial data

Income statement (PLN m)	2008A	2009A	2010A	2011F	2012F	2013F
Sales	2,091.4	2,572.5	2,740.3	3,171.1	3,043.5	3,520.9
natural gas and crude oil	258.1	483.1	791.9	1,018.5	1,013.1	1,220.4
water/sewage	1,115.7	996.0	644.0	299.9	262.2	274.1
fuels	180.1	0.0	0.0	0.0	0.0	0.0
industrial and residential construction	199.2	877.5	995.3	565.8	537.8	639.2
roads	141.2	187.0	298.9	1,118.9	919.2	827.3
power engineering	0.0	0.0	0.0	113.0	282.5	367.3
real estate	0.0	0.0	0.0	44.6	18.1	181.7
other	197.1	28.8	10.3	10.4	10.7	11.0
consolidation exclusions	0.0	0.0	0.0	0.0	0.0	0.0
Cost of goods & products sold	-1,756.8	-2,182.6	-2,393.1	-2,791.6	-2,668.5	-3,064.0
Gross profit on sales	334.6	389.9	347.2	379.5	374.9	456.9
natural gas and crude oil	53.0	92.0	180.4	224.1	222.9	268.5
water/sewage	120.1	121.1	74.9	36.0	31.5	32.9
fuels	29.1	0.0	0.0	0.0	0.0	0.0
industrial and residential construction	45.6	136.8	58.7	39.6	37.6	43.5
roads	29.2	29.7	28.7	55.9	46.0	33.1
power engineering	0.0	0.0	0.0	12.4	31.1	40.4
real estate	0.0	0.0	0.0	9.4	3.8	36.3
other	57.6	10.3	4.6	2.1	2.1	2.2
consolidation exclusions	0.0	0.0	0.0	0.0	0.0	0.0
Cost of sales	0.0	0.0	-0.1	0.0	0.0	0.0
General Administration costs	-110.0	-109.8	-109.1	-112.8	-108.4	-125.7
Net profit on sales	224.6	280.2	238.1	266.7	266.6	331.2
Other operating activity net	-1.0	4.1	33.3	6.4	8.7	11.1
EBIT	223.6	284.3	272.7	273.0	275.3	342.3
Net financial activity	-12.0	-28.1	-7.3	-14.1	-11.8	-9.5
Gain/loss on sales of subordinated entities	2.3	4.3	0.0	0.0	0.0	0.0
Share of gains in affiliates	0.0	0.0	2.2	2.0	2.0	2.0
Pre tax profit	213.9	260.4	267.6	261.0	265.5	334.8
Tax	-26.6	-40.6	-49.1	-49.6	-50.4	-63.6
Minorities	-30.9	-10.8	5.8	-2.6	-2.7	-3.3
Net income	156.3	209.1	224.3	208.8	212.4	267.8
EBITDA	268.7	331.4	319.4	326.2	348.7	425.2

Source: Company data, KBC Securities estimates

Balance sheet (PLN m)	2008A	2009A	2010A	2011F	2012F	2013F
Long-term assets	901.6	1,017.7	1,599.1	1,694.8	1,777.9	1,891.7
Intangible assets	14.8	33.0	41.6	53.9	63.9	70.2
Goodwill from consolidation	315.6	321.4	346.9	346.9	346.9	346.9
Fixed assets	401.7	368.3	665.4	733.8	813.0	897.5
Non-renewable natural resources	12.0	12.3	36.8	36.8	36.8	36.8
Investment properties	23.7	147.8	293.8	293.8	293.8	293.8
Investment in affiliates	27.0	10.0	75.8	75.8	75.8	75.8
Other LT financial assets	36.6	91.6	98.8	114.2	109.6	126.8
LT receivables from financial instruments	12.9	8.7	0.2	0.2	0.2	0.2
LT receivables	20.6	14.6	15.8	17.4	16.7	19.3
LT deferred tax assets	23.1	0.0	0.0	0.0	0.0	0.0
LT deferred assets	13.6	9.9	24.2	22.2	21.3	24.6
Current assets	1,939.4	2,997.8	3,155.8	3,218.6	2,984.3	3,293.0
Inventories	69.4	238.4	293.5	344.2	314.4	352.6
Receivables coming from LT const agreements	783.9	721.9	393.6	460.5	425.3	482.3
Trade receivables	679.4	1,112.2	1,327.2	1,520.4	1,417.5	1,543.4
Tax related receivables	1.0	3.4	7.7	0.1	0.1	0.1
Other short-term receivables	48.8	0.0	0.0	0.0	0.0	0.0
Other short-term financial assets	50.5	217.3	365.8	317.1	273.9	281.7
ST receivables from financial instruments	1.3	20.2	4.9	5.6	5.4	6.3
Cash & equivalents	288.8	660.3	708.5	507.4	487.0	563.3
Short-term deferred assets	16.5	24.2	54.6	63.4	60.9	63.4
Fixed assets for sale	0.0	0.0	0.0	0.0	0.0	0.0
Total assets	2,841.0	4,015.4	4,755.0	4,913.4	4,762.2	5,184.8
Equity	1,096.1	1,618.8	1,831.4	1,994.2	2,144.7	2,307.7
Long-term liabilities	410.0	569.2	985.6	898.4	813.8	746.8
Credits and loans	112.9	101.9	904.9	814.4	733.0	659.7
Provision and retentions	14.8	28.2	26.4	24.5	23.5	27.2
Other payables	282.3	439.2	54.3	59.5	57.3	59.9
Short-term liabilities	1,334.9	1,827.4	1,937.9	2,020.8	1,803.7	2,130.3
Credit and loans	475.1	493.9	524.0	476.2	348.6	458.5
Trade and other payables	672.3	1,032.3	1,205.1	1,315.5	1,257.5	1,443.9
Other payables	98.8	234.3	128.9	145.0	116.8	134.5
Provisions and retentions	88.6	67.0	79.9	84.1	80.7	93.4
Total liabilities	2,841.0	4,015.4	4,755.0	4,913.4	4,762.2	5,184.8

Source: Company data, KBC Securities estimates

Cash flow statement (PLN m)	2008A	2009A	2010A	2011F	2012F	2013F
Net profit	156.3	209.1	224.3	208.8	212.4	267.8
Depreciation	45.1	47.1	46.7	53.2	73.4	82.9
Change in net working capital	-502.5	121.0	-49.6	-182.3	82.9	-21.2
Other items	47.9	-72.1	212.2	37.3	44.4	-11.3
Operating cash flow	-253.1	305.1	433.6	117.0	413.2	318.2
Purchases of tangibles & intangibles	-107.6	-41.1	-268.3	-133.9	-162.7	-173.6
Purchases of companies	-93.7	-44.1	-121.8	0.0	0.0	0.0
Other	15.7	-265.4	-139.8	0.0	0.0	0.0
Investing cash flow	-185.6	-350.6	-530.0	-133.9	-162.7	-173.6
Equity issue proceeds	292.2	181.8	0.0	0.0	0.0	0.0
Change in interest-bearing debt	70.6	291.4	226.9	-138.2	-209.1	36.6
Dividends	0.0	0.0	-20.0	-46.0	-61.9	-104.9
Other	-47.6	-56.3	-61.7	0.0	0.0	0.0
Financing cash flow	315.2	416.9	145.2	-184.3	-270.9	-68.3
Total cash flow	-123.5	371.4	48.8	-201.1	-20.4	76.4
Cash at beginning of period	412.2	288.9	660.0	708.5	507.4	487.0
Cash at end of period	288.8	660.3	708.5	507.4	487.0	563.3

Per share data (PLN)	2008A	2009A	2010A	2011F	2012F	2013F
Shares outstanding (eop m)	13.4	14.3	14.3	14.3	14.3	14.3
Average number of shares	13.4	14.3	14.3	14.3	14.3	14.3
EBITDA per share	20.0	23.2	22.3	22.8	24.4	29.7
EBIT per share	16.6	19.9	19.1	19.1	19.3	23.9
reported EPS	11.6	14.6	15.7	14.6	14.9	18.7
DPS	0.0	0.0	1.4	3.2	4.3	7.3
NBV per share	81.6	113.2	128.1	139.5	150.0	161.4

Source: Company data, KBC Securities estimates

Performance criteria	2008A	2009A	2010A	2011F	2012F	2013F
Sales growth	48.6%	23.0%	6.5%	15.7%	-4.0%	15.7%
EBITDA growth	61.8%	23.3%	-3.6%	2.1%	6.9%	21.9%
EBIT growth	60.5%	27.2%	-4.1%	0.1%	0.8%	24.3%
Net profit growth	49.9%	33.8%	7.3%	-6.9%	1.7%	26.1%
EBITDA margin	12.8%	12.9%	11.7%	10.3%	11.5%	12.1%
EBIT margin	10.7%	11.1%	10.0%	8.6%	9.0%	9.7%
Net profit margin	7.5%	8.1%	8.2%	6.6%	7.0%	7.6%
EPS annual growth	49.9%	25.7%	7.3%	-6.9%	1.7%	26.1%
Pay-out ratio	0.0%	0.0%	9.6%	20.5%	29.6%	49.4%
Effective tax rate	12.4%	15.6%	18.3%	19.0%	19.0%	19.0%
Financial debt / Total Assets	20.7%	14.8%	30.1%	26.3%	22.7%	21.6%
Net financial debt / Equity	27.3%	-4.0%	39.3%	39.3%	27.7%	24.0%
ROE	16.6%	15.4%	13.0%	10.9%	10.3%	12.0%
ROA	6.1%	6.1%	5.1%	4.3%	4.4%	5.4%

Source: Company data, KBC Securities estimates

Valuation data	2008A	2009A	2010A	2011F	2012F	2013F
Financial year high (PLN)	331.0	242.9	250.2	213.0	213.0	213.0
Financial year low (PLN)	175.3	182.0	192.0	135.8	135.8	135.8
Reference market capitalization (PLN m)	1,907.1	2,029.9	2,029.9	2,029.9	2,029.9	2,029.9
Net debt (PLN m)	516.6	474.6	740.2	804.8	615.7	577.7
Enterprise value (PLN m)	2,423.6	2,504.5	2,770.1	2,834.7	2,645.5	2,607.6
P/E high (x)	28.4	16.6	15.9	14.6	14.3	11.4
P/E low (x)	15.1	12.4	12.2	9.3	9.1	7.2
P/E reference	12.2	9.7	13.2	10.9	11.3	0.0
P/Book value (x)	1.7	1.3	1.1	1.0	0.9	0.9
Gross dividend yield (%)	0.0%	0.0%	1.0%	2.3%	3.0%	5.2%
EV/EBITDA (x)	9.0	7.5	8.4	8.5	7.4	6.1
EV/EBIT (x)	10.8	8.8	9.9	10.1	9.3	7.6

Source: KBC Securities estimates

Important Polish Disclosure

Belgian Banking and Finance Commission is exercising the Supervision over KBC Securities NV Branch in Poland.

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The definitions of terms applied in the publication:

EBITDA = EBIT + amortization and depreciation

EPS = Net profit / No of shares outstanding

DPS = Dividend per Share

NBV per share = Net Book Value / No of shares outstanding

EBITDA margin = EBITDA / Revenue

EBIT margin = EBIT / Revenue

CFPS = Cash flow / No of shares outstanding

Net Financial Debt = Financial debt – Cash equivalents

ROE = Net profit / Average Equity

EV = Market Capitalization + Net Financial Debt

P/E = Stock Price / EPS

P/CF = Stock Price / (Net Profit + amortization and depreciation)

P/BV = Stock Price / NBV per share

P/S = Market Capitalization / Revenue

Gross Dividend Yield = Dividend per share / Stock

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Date of issue	Valuation	Market price	Recommendation
20.05.2011	Buy	142.0	171.45
21.02.2011	Hold	201.5	215.60
08.10.2010	Buy	241.0	273.50
09.09.2010	Hold	250.2	261.64
26.04.2010	Buy	218.0	247.0
22.01.2010	Buy	219.0	245.3

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During the last quarter KBC Securities NV Branch in Poland issued 47 recommendations:

20 BUY	43%
20 HOLD	43%
7 SELL	14%

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