Construction

Poland

Previously: Buy

PBG

Hold

Estimates on target, valuation demanding

06/01/07

Previously: PLN213

Bloomberg: PBG PW **Price: PLN256** **12-mth target: PLN243**

- **PBG's 2007 guidance is bang in line with our estimates but below market consensus. The company plans to issue 1.4m rights to fund both organic growth and acquisitions.**
- **The share price is above our revised target price of PLN243 and we thus downgrade our rating from Buy to HOLD.**

Share issue. PGB plans to issue 1.4m pre-emptive shares. The company wants to collect PLN300-420m to finance acquisitions and rising working capital needs. Book building begins 22 January and closes 24 January. The record date for pre-emptive rights is 17 January.

Destination of new resources. The company plans to inject PLN200-250m into working capital. Another PLN60-100m will be spent on acquisitions. Management plans to take over three to five local road construction companies as well as Slovakian peer Gas & Oil Engineering. One acquisition should be announced already at the end of January, and another later in 1Q07. The company needs PLN20-30m for tangible asset capex (mainly on new equipment), and PLN10-25m on expenditures connected with foreign expansion and the opening of sales offices in Norway and Canada. PBG also plans to spend PLN10-15m on integrating its IT system with those of Hydrobudowa Slask and Hydrobudowa Wloclawek.

View on the sector. With our downgrade of PBG to **HOLD** we now have no Buy ratings on Polish contractors. We think large construction companies have already reached generous valuations. We remain negative on Polimex (PXM PW; price PLN151, Sell, TP PLN120) as we see it as a growth stock but not attractive at current valuations. Budimex (BDX PW; price PLN74.3, Hold, TP PLN78) posted disappointing 3Q06 results. The mild winter might enable the construction sector to post strong 4Q06 figures and hence could provide upside for Budimex shares.

Forecasts and ratios

	2004	2005	2006F	2007F	2008F	2009F
Revenue (PLNm)	216	409	785	1,215	1,506	1,681
EBITDA (PLNm)	28	50	101	148	191	214
Net income (PLNm)	13	36	52	81	109	124
EPS (PLN)	1.48	3.43	4.37	6.73	9.02	10.27
PER (x)	173.4	74.7	58.6	38.0	28.4	24.9
EV/EBITDA (x)	66.6	55.4	28.3	22.2	17.2	15.3
P/BV (x)	12.9	15.2	7.5	7.0	5.6	4.6
ROE (%)	15.0	22.5	19.4	20.2	21.9	20.2

Source: Company data, ING estimates

12-month forecast returns (%)

Share price	(5.1)
Dividend	0.0
12m f'cst total return	**(5.1)**

Key ratios (%)

	2007F	2008F
EBITDA margin	12.2	12.7
Operating margin	9.7	10.2
Net debt/equity	74.9	82.0
DPS (PLN)	0.0	0.0
Dividend yield	0.0	0.0

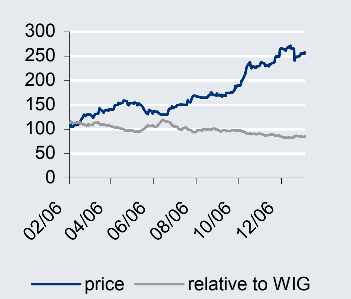
Quarterly data (PLNm)

	3Q06	4Q06F
Revenue	205	363
EBIT	30	34
Net income	20	20
EPS	1.6	1.6

Share data

No. of shares (m)	12.0
Daily t/o (US$m)	1.6
Free float (%)	61
Mkt cap (US$m)	1,036
Mkt cap (PLNm)	3,067

Share price performance



Source: Bloomberg

Tomasz Czyz Warsaw (48 22) 820 50 46 tomasz.czyz@ingsecurities.pl
Andrzej Knigawka Warsaw (48 22) 820 50 15 andrzej.knigawka@ingsecurities.pl
5 January 2007

Streamlined group structure. In December 2006, Hydrobudowa Slask and Hydrobudowa Wloclawek signed a merger agreement and will soon operate as one entity Hydrobudowa Polska (HP). PGB will remain majority shareholder of HP with a 76% controlling stake. The transaction should be completed at the end of 1H07 as it needs approval of Financial Supervisory Commission (KNF). With pro-forma revenues of PLN229m in 2005, the merged company will create a domestic powerhouse in hydro-engineering second to no other domestic company and placing it in pole position to obtain the largest contracts in the industry.

Shareholder structure. Majority shareholder Jerzy Wisniewski (36.4% shares and 52.4% votes) will acquire 115,000 privileged shares from Tomasz Woroch and after the issue remain majority shareholder with 50.14% voting rights. Until mid-January, Tomasz Woroch will additionally float 200,000 shares on the WSE.

2007 guidance. The company issued 2007 guidance, which is bang in line with our expectations. Revenues should increase 72.1% YoY to PLN1.2bn, while net profit should grow 57.4% to PLN82m.

Fig 1 2007 guidance and market consensus (PLNm)

	2005	2006F		2007F	
			PBG	ING	Consensus
Revenues	409	702	1,208	1,215	1,149
EBIT	41	78	118	118	129
Net profit	36	52	82	81	90

Source: Bloomberg, company data and ING estimates

Backlog. PBG Group announced that it has a backlog of PLN2bn versus PLN1.6bn at end-September 2006. In October 2006, the company signed a letter of intent regarding the construction of a LNG terminal for Norway's Lyse Gass worth €70m. Construction has already been initiated. Completion of the project is foreseen within the next 36 months. In December, PBG signed a PLN255.5m contract for the construction of fuel tanks for NATO. Both contracts were previously indicated by management and included in our financial model.

Potential signings. In 1H07, PBG hopes to sign two large contracts. In mid-February, PGNiG should announce the winner of the development of its largest gas and oil field Lubiatow-Miedzychod-Grotow (LMG) worth an estimated PLN430m. Possible signing is not likely until 2Q07 as court appeals from competitors usually delay the process. The tender for the construction of the 'Czajka' wastewater treatment plant in Warsaw worth €260m could generate around €115m additional revenues as PGB Group placed its offer in a consortium with Budimex. With the strong composition of the consortium, we rate its chances of winning the Czajka contract as relatively high.

Our new target price is PLN243. We revise our DCF-based target price from PLN213 to PLN243 as we lower the equity risk premium for all Polish companies from 5.0% to 4.5% and shift our valuation point four months forward for PBG.

Downgrade from Buy to HOLD. PBG delivered on investors' expectations of sizeable new signings and together with subsidiaries has signed contracts worth PLN0.6bn since September 2006. The share price has reflected this and increased 46.3% since September. The shares trade at a 2007F PER of 38.0x, a 15.3% premium to the average for Budimex and Polimex. While we acknowledge the long-lasting nature of the construction boom in Poland and the company's robust growth prospects, we believe its valuation is demanding with a 2007F PEG of 1.2x using the three-year EPS

CAGR of 33%. The rationale for the capital increase is sound given that the company has no presence in the road construction segment and given the clear need to fund both won as well as prospective contract.

Fig 2 Comparison of EPS-based multiples

Company	Price	Target price	Rating	Mkt cap	PER (x)			EPS CAGR (%)	PEG (x)		
	(PLN)	(PLN)		(US$m)	2005	2006F	2007F	2006F-08F	2005	2006F	2007F
Budimex	74.3	78.0	Hold	590	904.4	54.1	31.7	226.1	10.0	0.2	0.8
PBG	256	243	Hold	1,010	74.7	58.6	38.0	38.1	1.1	1.5	1.2
Polimex	151	120	Sell	814	56.6	40.0	35.1	24.2	2.4	1.7	2.2
Average					**345.3**	**50.9**	**34.9**	**96.1**	**4.5**	**1.1**	**1.4**

Prices as of 4 January 2007. Source: ING estimates

Risks. The major risks to our recommendation could be continuing wage increases on the one hand and emigration of qualified workforce to EU15 countries on the other. The construction sector is experiencing the highest wage increases within the Polish economy, while the shortage of high-class specialists has already forced several subcontractors to quit their contracts and resulted in construction delays.

Disclosures Appendix

ANALYST CERTIFICATION

The analyst(s) who prepared this report hereby certifies that the views expressed in this report accurately reflect his/her personal views about the subject securities or issuers and no part of his/her compensation was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views in this report.

IMPORTANT DISCLOSURES

For disclosures on companies other than the subject companies of this report visit our disclosures page at http://research.ing.com or write to The Compliance Department, ING Financial Markets LLC, 1325 Avenue of the Americas, New York, USA, 10019.

US regulatory disclosures

- One or more members of ING Group holds 1% or more of the equity shares (as at the end of the month preceding this publication) in the following subject company/ies of this report: PBG SA

Valuation & risks: For details of the methodologies used to determine our price targets and risks related to the achievement of these targets refer to main body of report and/or the most recent company report at http://research.ing.com.

European regulatory disclosures

- One or more members of ING Group holds 1% or more of the equity shares (as at the end of the month preceding this publication) in the following subject company/ies of this report: PBG SA

The *remuneration of research analysts* is not tied to specific investment banking transactions performed by ING Group although it is based in part on overall revenues, to which investment banking contribute.

Financial interests: One of more members of ING Group may hold financial interests in the companies covered in this report other than those disclosed above.

Securities prices: Prices are taken as of the previous day's close on the home market unless otherwise stated.

Job titles. The functional job title of the person/s responsible for the recommendations contained in this report is equity research analyst unless otherwise stated. Corporate titles may differ from functional job titles.

Conflicts of interest policy. ING manages conflicts of interest arising as a result of the preparation and publication of research through its use of internal databases, notifications by the relevant employees and Chinese walls as monitored by ING Compliance. For further details see our research policies page at http://research.ing.com.

FOREIGN AFFILIATES DISCLOSURES

Each ING legal entity which produces research is a subsidiary, branch or affiliate of ING Bank N.V. See back page for the addresses and primary securities regulator for each of these entities.

RATING DISTRIBUTION (as of end 3Q06)

	Equity coverage	Investment Banking clients*
Buy	47%	19%
Hold	45%	18%
Sell	8%	8%
	100%	

* Percentage of companies in each rating category that are Investment Banking clients of ING Financial Markets LLC or an affiliate.

RATING DEFINITIONS

Buy: Forecast 12-mth absolute total return greater than +15%

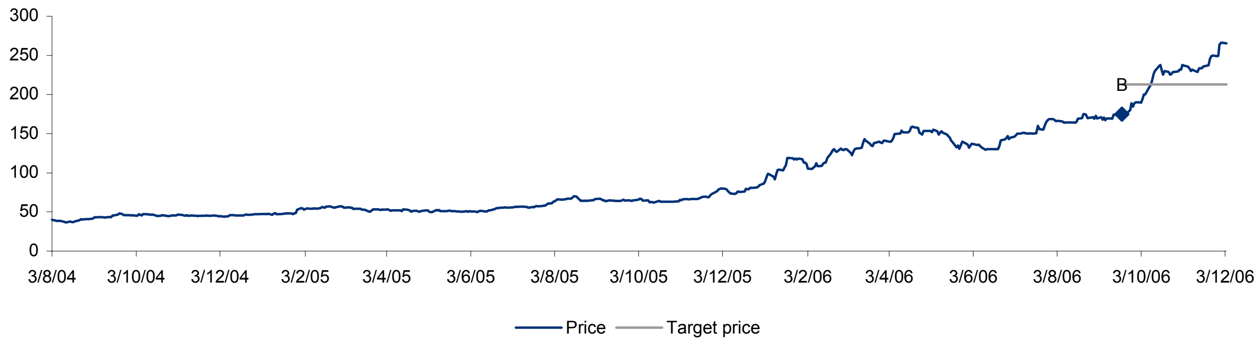
Hold: Forecast 12-mth absolute total return of +15% to -5%

Sell: Forecast 12-mth absolute total return less than -5%

Total return: forecast share price appreciation to target price plus forecast annual dividend. Price volatility and our preference for not changing recommendations too frequently means forecast returns may fall outside of the above ranges at times.

Research published prior to 15/12/05: EMEA equities' ratings were based on US dollar total returns; Western Europe's were based on: absolute return +25%, Strong Buy; greater than +10%, Buy; +10% to -10%, HOLD; lower than -10%, Sell.

PRICE AND RATINGS CHART: PBG (PBGG.WA)



Current analyst/s

SB = Strong Buy; B = Buy; H = Hold; S = Sell; NR = Not Rated; R = Restricted
Where ING coverage is longer than three years, chart shows recommendation current at start of the share price history

Source: ING

ING

AMSTERDAM Tel: 31 20 563 84 17	**BRUSSELS** Tel: 32 2 547 75 34	**LONDON** Tel: 44 20 7767 1000	**NEW YORK** Tel: 1 646 424 6000	**SINGAPORE** Tel: 65 6535 3688
Bratislava Tel: 421 2 5934 61 11	**Edinburgh** Tel: 44 131 527 3000	**Madrid** Tel: 34 91 789 8880	**Paris** Tel: 33 1 56 39 31 41	**Shanghai** Tel: 86 21 6841 3355
Bucharest Tel: 40 21 222 1600	**Geneva** Tel: 41 22 593 8050	**Manila** Tel: 632 840 8888	**Prague** Tel: 420 2 5747 1111	**Sofia** Tel: 359 2 917 6400
Budapest Tel: 36 1 268 0140	**Hong Kong** Tel: 852 2848 8488	**Mexico City** Tel: 52 55 5258 2000	**Santiago** Tel: 562 452 2700	**Taipei** Tel: 886 2 2734 7600
Buenos Aires Tel: 54 11 4310 4700	**Istanbul** Tel: 90 212 258 8770	**Milan** Tel: 39 02 89629 3660	**Sao Paulo** Tel: 55 11 4504 6000	**Tokyo** Tel: 813 5210 0100
Dublin Tel: 353 1 638 4000	**Kiev** Tel: 380 44 230 3030	**Moscow** Tel: 7495 755 5400	**Seoul** Tel: 822 317 1800	**Warsaw** Tel: 48 22 820 5018

Research offices: legal entity/address/*primary securities regulator*

Amsterdam	ING Bank N.V., Foppingadreef 7, Amsterdam, Netherlands, 1102BD. *Netherlands Authority for the Financial Markets*
Bratislava	ING Bank N.V. Bratislava Branch; Jesenskeho 4/C, 811 02 Bratislava, Slovak Republic. *National Bank of Slovakia*
Brussels	ING Belgium S.A./N.V., Avenue Marnix 24, Brussels, Belgium, B-1000. *Banking Finance and Insurance Commission*
Bucharest	ING Bank N.V. Bucharest Branch, 11-13 Kiseleff Avenue, Sector 1, Bucharest, Romania, 71268. *Romanian National Securities and Exchange Commission*
Budapest	ING Bank (Hungary) Rt., Dozsa Gyorgy ut 84\B, H - 1068 Budapest, Hungary. *Hungarian Financial Supervisory Authority*
Edinburgh	ING Bank N.V. London Branch (Edinburgh office), 2 Canning Street Lane, Edinburgh, United Kingdom, EH3 8ER. *Financial Services Authority*
Istanbul	ING Bank N.V. Istanbul Representative Office, Suleyman Seba Cadessi No. 48 BJK Plaza, Blok B Floor 8, 34357 Akaretler-Besiktas, Istanbul, Turkey. *Capital Markets Board*
Kiev	ING Bank Ukraine JSC, 30-a, Spaska Street, Kiev, Ukraine, 04070 *Ukrainian Securities and Stock Commission*
London	ING Bank N.V. London Branch, 60 London Wall, London EC2M 5TQ, United Kingdom. *Financial Services Authority*
Madrid	ING Financial Markets A.V., S.A, C/Genova, 27. 4th Floor, Madrid, Spain, 28004. *Comisión Nacional del Mercado de Valores*
Manila	ING Bank N.V. Manila Branch, 21/F Tower I, Ayala Avenue, 1200 Makati City, Philippines. *Philippine Securities and Exchange Commission*
Mexico City	ING Grupo Financiero (Mexico) S.A. de C.V., Bosques de Alisos 45-B, Piso 4, Bosques de Las Lomas, 05120, Mexico City, Mexico. *Comisión Nacional Bancaria y de Valores*
Milan	ING Bank N.V. Milan Branch, Via Paleocapa, 5, Milano, Italy, 20121. *Commissione Nazionale per le Società e la Borsa*
Moscow	ING Bank (Eurasia) ZAO, 36, Krasnoproletarskaya ulitsa, 127473 Moscow, Russia. *Federal Financial Markets Service*
Mumbai	ING Vysya Bank Limited, A Wing, Shivsagar Estate, 2nd Floor, South Wing, Dr. Annie Besant Road, Worli, Mumbai, 400 018. India *Securities and Exchange Board of India*
New York	ING Financial Markets LLC, 1325 Avenue of the Americas, New York, United States,10019. *Securities and Exchange Commission*
Paris	ING Belgium S.A., Succursale en France, Coeur Defense, Tour A, La Defense 4110, Esplanade du General de Gaulle, Paris La Defense Cedex, 92931. *l'Autorité des Marchés Financiers*
Prague	ING Bank N.V. Prague Branch, Nadrazni 25, 150 00 Prague 5, Czech Republic. *Czech National Bank*
Sao Paulo	ING Bank N.V. Sao Paulo, Av. Brigadeiro Faria Lima n. 3.400, 11th Floor, Sao Paulo, Brazil 04538-132. *Securities and Exchange Commission of Brazil*
Singapore	ING Bank N.V. Singapore Branch, 19/F Republic Plaza, 9 Raffles Place, #19-02, Singapore, 048619. *Monetary Authority of Singapore*
Sofia	ING Bank N.V. Sofia Branch, 12 Emil Bersinski Str, Ivan Vazov Region,1408 Sofia, Bulgaria. *Bulgarian Central Bank and Financial Supervision Commission*
Tel Aviv	UMI/GM Building, Moshe Levy St, Rishon Lezion, Israel, 52522. *Analyst registered with UK Financial Services Authority by ING Bank N.V. London Branch*
Warsaw	ING Securities S.A., Plac Trzech Krzyzy, 10/14, Warsaw, Poland, 00-499. *Polish Securities and Exchange Commission*