IDMSA DOM MAKLERSKI

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PBG

Sector: Construction
Fundamental rating: Hold (→)
Market relative: Overweight (→)
Price: PLN 311
12M EFV: PLN 357 (↓)

Market Cap.: US$ 1,922 m
Reuters code: PBGG.WA
Av. daily turnover: US$ 4.30 m
Free float: 67%
12M range: PLN 250.10-430.00

Quarterly results corner; 1Q08E preview

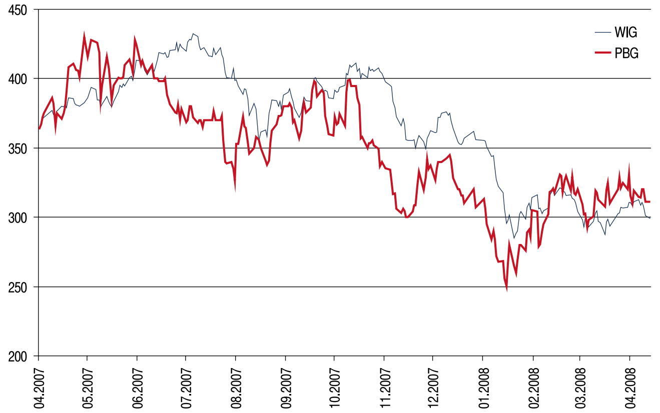
We expect PBG's 1Q08 consolidated results to be good (regarding the details, please refer to *Figure 1* on the next page), however rather neutral for the stock price performance. Driven by a sound backlog of infrastructural contracts, PBG should grow quarterly sales much above the market's dynamics (construction output in January-February grew by 15.9% yoy). We forecast PBG's top line at PLN 262 million, an impressive 93% yoy increase. Material yoy improvement should be also seen at the gross profit on sales level; we forecast the Company's 1Q08 consolidated gross profit on sales at PLN 42.7 million, 103% up yoy, due to fatter yoy margin (16.3% in 1Q08E vs. 15.5% in 1Q07), which should stem from highly profitable backlog of contracts that the Company is currently executing. Furthermore, please note that last year Hydrobudowa Śląsk, PBG's 58% subsidiary (currently incorporated into Hydrobudowa Polska), was executing large contract for the construction of sewage treatment plant in Kraków Płaszów, which proved to be unprofitable (loss on that contract booked in 1Q07 amounted to PLN 7.3 million), and consequently in the base period the contract in question depressed PBG's overall profitability. As the contract had been already completed last year, it should not put a drag on the Company's profitability in 2008. As far as operating profit is concerned, we forecast it to reach PLN 12.3 million, 80% up yoy. We foresee, however, slight decrease in margins, due to growing administration costs, stemming – among others – from employment of specialists who support PBG in the preparation of the bid offers for the PGNiG's contracts. Regarding the bottom line, we forecast PBG's consolidated net profit at PLN 11.8 million, just 16% up yoy. We would like, however, to point out that in 1Q07 Hydrobudowa Śląsk booked one-off profits from the divestment of its stake in Mostostal Zabrze, which fueled the Company's quarterly pre-tax profit and bottom line by c. PLN 12.6 million and PLN 10.2 million, respectively. Due to this one-off item in the 1Q07 financial posting, straightforward yoy comparison of the Company's 1Q08 bottom line will be biased (part of the base period's NI is non-recurring). To sum up, in our view the Company's 1Q08 operating results should be good, showing a material yoy improvement of revenues and EBIT, yet only slight increase at the bottom line level, stemming exclusively from the non-recurrence of the base period's one-off financial gains.

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*	41.0	27.7	21.5	14.0
P/CE	*x*	31.7	23.2	18.5	12.6
EV/EBITDA	*x*	32.5	18.6	14.4	9.9
EV/EBIT	*x*	41.7	21.1	16.0	10.6
EV/Sales	*x*	3.2	2.5	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 1Q08 results: May 14, 2008
2. Release of 2Q08 results: August 13, 2008

Catalysts

1. PBG wining the battle for PGNiG contracts
2. Winning contract for the construction of the second line of metro in Warsaw
3. Winning other large environmental protection contracts
4. Further M&A's this year could prove shareholder-value-accretive

Risk factors

1. Suspension of PGNiG tenders
2. PBG loses the battle for large contracts (among others for PGNiG)
3. Growing prices of construction materials and salaries

Financial forecast

We do not change our forecast for PBG. Regarding the details, please refer to our research report *2/2008/FU (37)* of February 21, 2008.

Valuation

Our 12M forward assessment of PBG's EFV declines marginally to PLN 357 per share (from PLN 358), due to adverse impact of the definite period risk free rate upward revision (to the current level of LT Treasuries' market yields).

Fig. 1 PBG; 1Q08 results forecast

IFRS consolidated PLN m	1Q08E	1Q07	yoy change	realization of the FY figures in 1Q 2008E	2007	FY 2008E	2007	yoy change
Sales	262.0	135.6	93%	14%	10%	1,871.2	1,377.3	36%
Gross profit on sales	42.7	21.0	103%	14%	11%	308.7	186.4	66%
Gross profit on sales margin	*16.3%*	*15.5%*	-	-	-	*16.5%*	*13.5%*	-
EBIT	12.3	6.9	80%	6%	6%	219.1	106.3	106%
EBIT margin	*4.7%*	*5.1%*	-	-	-	*11.7%*	*7.7%*	-
Pre-tax	16.3	18.9	-14%	8%	13%	208.3	141.2	48%
Pre-tax margin	*6.2%*	*14.0%*	-	-	-	*11.1%*	*10.3%*	-
Net profit	11.8	10.2	16%	8%	10%	150.5	101.8	48%
Net profit margin	*4.5%*	*7.5%*	-	-	-	*8.0%*	*7.4%*	-

Source: Company, DM IDMSA estimates

Recommendation

We maintain our recommendations for PBG, which continue to be (i) a LT fundamental Hold, and (ii) a ST market-relative Overweight. Regarding the rationale, please refer to our monthly research report *1/2008/MR (73)* of March 30, 2008.

Investment opinion

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. We believe this year should bring further acquisitions. It is likely that PBG will acquire PRG Metro, a company that should support PBG in the prospective construction of a second metro line in Warsaw, which we believe 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 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 few months at least two large contracts of a total value of c. PLN 2.4 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 could 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 2.4 billion to be completed this year*. 1H08 should bring the completion of 2 tenders for an impressive c. PLN 2.4 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 1.0 billion), and the second one is a contract for construction of the Lubiatów-Międzychód-Grotów crude oil plant (PLN 1.4 billion).

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*	10%	13%	281.6	319	–
-	→	-	*17.02.2008*	-	-	-	317.9	319	→
-	→	-	*21.02.2008*	-	-	-	326.7	352	↑
-	→	-	*30.03.2008*	-	-	-	325.0	358	↑
-	→	-	*14.04.2008*	-	-	-	311.0	357	↓

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	13%
-	→	-	*17.02.2008*	-	317.9	-
-	→	-	*21.02.2008*	-	326.7	-
-	→	-	*30.03.2008*	-	325.0	-
-	→	-	*14.04.2008*	-	311.0	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	20	15	5	0	0
Percentage	50%	38%	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	Suspended	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	15	17	8	0	0
Percentage	38%	43%	20%	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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