

PBG

Poland, Construction

Reuters: PBGG.WA Bloomberg: PBG PW

15 April 2005

Increasing exposure to hydro-construction surge

Resuming coverage with Accumulate recommendation and year-end target price of PLN 58.5

We expect the impressive expansion of PBG's earnings to be sustained in the upcoming years and forecast 2005-07E CAGR in EPS of 36%. Hydro-construction, which is booming on the back of the EU financing influx, is set to be a major earnings driver, though developments in other business areas are also very promising. Despite a 59% increase in PBG's share price since last year's IPO, we see room for further stock appreciation. We resume coverage of the company with an Accumulate rating and target price of PLN 58.5, offering 15% upside by year-end.

Pace of growth in the hydro-construction market exceeded our expectations...Between 2004-06 the inflow of EU financial assistance supporting development of water and sewage systems is set to at least triple, greatly benefiting PBG. Developments in oil & gas engineering seem also to be very promising: we forecast the company will double its sales in that segment to PLN 67m in 2005.

...while acquisition of Hydrobudowa is set to increase PBG's exposure to that market segment. PBG is close to completing the acquisition of a 56% stake in Hydrobudowa for PLN 7.5m, implying a 2005E P/E ratio of 4.7x. The transaction will dilute corporate governance concerns arising from the Wisniewski family's shareholding in both PBG and Hydrobudowa.

We expect 36% EPS CAGR in the 2005-07 period, forecasting 2005E net profit at PLN 30.3m and 2006E at PLN 37.2m. The potential of even higher earnings growth resulting from Hydrobudowa's consolidation is not included in our model.

We rate PBG an Accumulate. The stock trades at a 2005E P/E ratio of 17.7x, a 5% premium to its international sector peers. We view it fully justified by superior growth prospects. Using a DCF we set a target price of PLN 58.5 at the end of 2005, offering 15% upside.

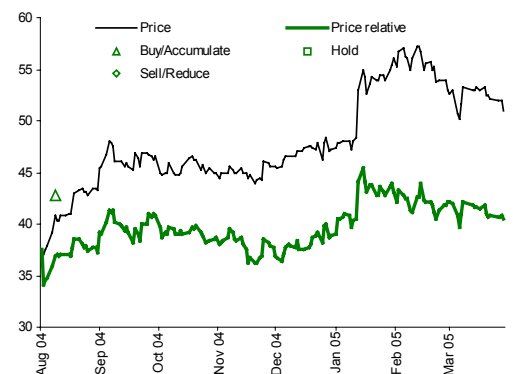
PBG: Financial summary

PLN in millions, unless otherwise stated

	2002	2003	2004	2005E	2006E	2007E
Sales	162.1	180.7	216.1	341.5	408.3	497.8
EBITDA	14.4	21.0	32.7	48.5	57.0	67.0
EBIT	9.2	14.3	26.1	39.8	47.6	58.0
Net profit	4.6	11.3	18.3	30.3	37.2	46.0
EPS (PLN)	0.64	1.57	2.06	2.88	3.53	4.37
P/E (x)	79.4	32.5	24.7	17.7	14.4	11.7
EV/EBITDA (x)	39.4	27.0	17.3	11.7	9.9	8.5

Source: Company data, DM BZ WBK estimates

Recommendation	Accumulate
Price (PLN, 14 April 2005)	51.0
Target price (PLN, year-end 2005)	58.5
Market cap. (PLN m)	537.0
Enterprise value (PLN m)	566.6
Free float (%)	42.8
Number of shares (m)	10.5
Average daily turnover 3M (shares)	34.6k
EURPLN	4.12
USDPLN	3.22



The price relative chart measures performance against the WIG 20 index. On 14/04/05 the WIG 20 index closed at 1963.3.

Rec.	Date	Price		Performance	
		on issue date	end year target	absolute	relative
A	24/08/04	39.2	42.8	30.1%	12.8%

Main shareholders	% of voting rights
Jerzy Wisniewski	54.0
Malgorzata Wisniewska	12.4
Tomasz Woroch	3.9
BZ WBK AIB Asset Management	5.5

Company description

PBG provides engineering and construction services in the area of oil and gas production and transmission as well as hydro-construction.

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Investment summary

We expect the inflow of EU assistance financing hydro-construction projects to triple in 2004-06...

Following accession to the EU, Poland has been witnessing a huge increase in the inflow of financial assistance supporting development of water and sewage systems as well as environmental protection plants. Under the Cohesion Fund programmes, of which app. 50% target hydro-construction projects, the inflow of EU funds to Poland is set to triple to an annual average of app. EUR 1.93bn in 2004-06 vs. EUR 0.48bn in 2000-03.

...with PBG being a top beneficiary

PBG greatly benefits that development. Since mid-2004 PBG has participated in hydro-construction tenders (mainly EU-financed) worth app. PLN 1.8bn and managed to secure contracts worth PLN 150m, yielding a success ratio of 8%. We expect the latter figure to be sustained. Given the anticipated surge in the number of tenders, we expect PBG to win contracts valued at app. PLN 230m each year between 2005 and 2007. Consequently, we forecast PBG's revenues from the hydro-construction sector to triple year on year to PLN 109m in 2005 and increase by a further 44% in 2006 to PLN 156m. We estimate hydro-construction to account for 38% of PBG's total sales in 2006, up from 17% in 2004.

We forecast revenues from oil and gas engineering to double in 2005

In 2005 PGNiG, the primary investor in Poland's oil & gas engineering market, has completed several procurement procedures, with PBG winning two mid-sized contracts totalling PLN 27.8m. Several other tenders are still ongoing. We forecast PBG's revenues from oil and gas construction to double to PLN 67m in 2005, with the company focusing on mid-sized projects only. Given PGNiG's capex cycle, we expect PBG's growth in that market segment in 2006 and beyond to depend on large-scale contracts: a nitrogen rejection unit in Grodzisk, the Miedzichod oil plant and Wierzchowice gas storage facility. Taking into consideration PGNiG's buoyant capex plans and using a probability-weighted approach, we forecast PBG's sales in the oil and gas sector to be on the rise in 2006, posting a 39% growth rate to PLN 94m.

Pending acquisition of Hydrobudowa at 2005E net profit multiple of just 4.7x

PBG seems to be close to acquiring a 56% stake in Hydrobudowa Wloclawek in a transaction that we assess as positive and value creating. First, PBG is set to enter Hydrobudowa at a 2005E net profit multiple of 4.7x, a very attractive ratio in our view. Second, it increases the company's exposure to the booming market in hydro-construction. Third, the transaction dilutes the corporate government concerns arising from the Wisniewski family's shareholding both in Hydrobudowa and PBG.

We forecast PBG to deliver 3-yaer CAGR in EPS of 36%

Given expectation-beating developments mainly in the hydro-construction segment, we have upgraded our earnings forecasts for PBG (our forecasts exclude the pending acquisition of Hydrobudowa Wloclawek). Our 2005 EBIT estimates we lift by 13% to PLN 39.8m and 2006's by 21% to PLN 47.6m. At the bottom-line we forecast net profit of PLN 30.3m in 2005, PLN 37.2m in 2006 (upgrade of 10%) and PLN 46m in 2007. Our estimates imply 36% CAGR in net profit between 2004 and 2007.

Accumulate with year-end target price of PLN 58.5

PBG trades at 2005 and 2006 P/E ratios of 17.7x and 14.4x. One could deem it stretched in the international sector context (2005 P/E of 16.8x). Superior EPS growth as well as the pending acquisition of Hydrobudowa more than justify PBG's premium multiples, in our view. Using a DCF model, we set a target price for PBG's shares of PLN 58.5 at the end of 2005 and issue an Accumulate recommendation on the company.

Valuation

Peer comparison

PBG trades at 2005E P/E of 17.7x, a 5% premium to its peers, which we believe to be fully justified by superior growth opportunities

We selected a peer group of international engineering and construction companies and compared their valuation multiples to those of PBG. Our peer group trades at 2005E P/E and EV/EBITDA ratios of 16.8x and 6.3x, respectively. PBG trades at a 2005E EPS multiple of 17.7x, representing a 5% premium to its peers and 2005E EV/EBITDA of 11.7x, a 86% premium to its peers. We note, however, that PBG boasts a 2005-07 EPS CAGR of 36% vs. 11% as expected for the peer group. Superior growth opportunities justify PBG's premium valuation, in our view.

Figure 1. PBG: Peer comparison valuation

	Price (local)	P/E (x)			2005-07E	EV/EBITDA (x)			
		2005E	2006E	2007E	CAGR in EPS	2005E	2006E	2007E	
Engineering/Construction									
Wood Group	GB	1.54	17.7	18.1	19.5	4%	9.4	8.2	7.2
Saipem	Italy	9.96	19.3	17.1	17.3	10%	9.4	8.8	8.4
ABB	Switzerland	7.65	16.8	13.4	12.6	36%	6.4	5.7	5.5
AMEC	GB	3.28	15.1	13.5	11.5	13%	5.0	4.8	4.4
Median			17.3	15.3	14.9	11%	7.9	7.0	6.3
General construction									
NCC	Sweden	104.00	14.3	13.3	9.8	13%	6.3	6.1	5.4
Skanska	Sweden	87.00	14.8	13.7	12.5	1%	6.2	5.9	5.9
MOWLEM	GB	1.96	15.0	11.6	9.4	nm	4.9	4.2	4.1
ACS	Spain	19.84	12.9	11.8	11.1	10%	7.4	6.9	6.4
Acciona	Spain	71.70	17.9	16.2	14.3	14%	8.5	7.6	6.2
Ferrovial	Spain	45.69	17.1	15.5	14.1	10%	10.5	9.7	10.1
Vinci	France	116.10	13.0	12.2	11.6	10%	5.7	5.4	5.2
Hochtief	Germany	25.00	20.0	22.6	21.2	20%	2.5	2.4	2.4
Bilfinger Berger	Germany	40.05	17.7	15.6	15.4	24%	4.0	3.7	3.7
Median			15.0	13.7	12.5	11%	6.2	5.9	5.4
Median total			16.8	13.7	12.6	11%	6.3	5.9	5.5
PBG	Poland	51.00	17.7	14.4	11.7	36%	11.7	9.9	8.5
<i>Premium/ (discount)</i>			5%	5%	-7%		86%	68%	54%

Source: Bloomberg, I.B.E.S, BZ WBK estimates

DCF

We based our DCF model on the following assumptions:

- We forecast PBG's sales to grow at a CAGR of 14% between 2005 and 2014. We arrive at this through explicit bottom-up forecasts for 2005-2007 and assume growth in line with nominal GDP thereafter.
- We forecast a gross margin of 20% in 2005-07 and 19.5% afterwards. We deem it very realistic given PBG's average gross margin of 20% between 2001 and 2004.
- We estimate PBG's WACC at 9.1%, based on 10.5% cost of equity, 6.5% after tax cost of debt and 34% debt to capital ratio. Please see figure 2 for detailed calculations.

Our DCF analysis sets a year-end target price of PLN 58.5 per PBG share.

Figure 2. PBG: WACC calculations

Risk free rate	6.0%
Unlevered beta	0.70
Levered beta	0.99
Equity risk premium	4.5%
Cost of equity	10.5%
Risk free rate	6.0%
Debt risk premium	2.0%
Tax rate	19%
After tax cost of Debt	6.5%
%D	34%
%E	66%
WACC	9.1%

Source: DM BZ WBK estimates

Figure 3. PBG: DCF model

PLN in millions, unless otherwise stated

	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Net sales	341	408	498	536	574	615	659	705	756	810
EBIT	40	48	58	60	64	69	73	79	84	90
Cash taxes on EBIT	7	9	11	11	12	13	14	15	16	17
NOPAT	32	39	47	48	52	56	59	64	68	73
Depreciation	9	9	9	11	14	17	20	23	26	27
Change in operating WC	11	22	29	12	12	13	14	15	16	9
Capital expenditure	12	20	25	26	26	27	28	28	29	27
Net investment	14	33	45	27	25	23	22	20	19	9
Subsidies from the EU funds*	14	-	-	-	-	-	-	-	-	-
Free cashflow	33	6	2	22	27	32	38	43	49	64
WACC	9.1%									
PV FCF 2005-14	180									
Terminal growth rate	2.4%									
Terminal Value (TV)	975									
PV TV	408									
Total EV (1 Jan 2005)	588									
Net debt (1 Jan 2005)	30									
Equity value (1 Jan 2005)	558									
Number of shares (m)	10.5									
Value per share (1 Jan 2005, PLN)	53.0									
Month	4									
Current value per share (PLN)	54.9									
Target price at end 2005 (PLN)	58.5									
Revenue growth	58.0%	19.6%	21.9%	7.6%	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%
EBIT growth	52.6%	19.6%	21.9%	3.0%	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%
NOPAT growth	57.3%	19.5%	21.9%	3.0%	7.0%	7.1%	7.1%	7.1%	7.1%	7.1%
FCF growth	nm	-81.3%	-61.9%	840.1%	25.3%	18.5%	16.7%	15.2%	12.7%	30.6%
EBIT margin	11.6%	11.6%	11.6%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%	11.1%
Nopat margin	9.5%	9.5%	9.4%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%
Capex/Revenues	3.5%	5.0%	5.0%	4.8%	4.6%	4.4%	4.2%	4.0%	3.8%	3.3%
Change in WC/Revenues	3.1%	5.3%	5.8%	2.3%	2.1%	2.1%	2.1%	2.1%	2.1%	1.1%
Change in WC/Change in revenues	8.6%	32.2%	32.2%	32.2%	32.2%	32.2%	32.2%	32.2%	32.2%	17.2%

*NOTE: In November 2004 PBG was granted PLN 14m in subsidies from the EU funds. Source: DM BZ WBK estimates

Hydro-construction

EU financing

Hydro-construction among major beneficiaries of the inflow of the EU funds to Poland

Modernisation and construction of water and sewage systems as well as environmental protection plants have occurred to be among major beneficiaries of the inflow of EU funds to Poland. Until Poland's accession to the EU, hydro-construction projects had been supported by pre-accession funds, i.e. ISPA and PHARE, and since accession the financing has been granted from Cohesion Fund and Structural Funds.

- Between 2001 and 2003 Poland received EUR 1.45bn in funding from the EU, of which EUR 0.72bn has been dedicated to environmental protection.
- Between 2004-2006 the amount of EU financial assistance to Poland under the Cohesion Fund programmes is set to amount to EUR 4.18bn. According to representatives of the Economy Ministry, the ratio of environment protection to road construction projects is likely to be fifty/fifty.

We expect the inflow of EU funds to Poland in 2004-06 to triple to an annual average of EUR 1.39bn...

Taking into account the Cohesion Fund only, we expect the inflow of EU money to Poland in 2004-06 to triple to an annual average of EUR 1.39bn vs. EUR 0.48bn in 2000-03, with app. 50% being dedicated to environmental protection projects (water and sewage systems, environmental protection plants).

...and those estimates do not include Structural Funds potential

In addition to the Cohesion Fund, development of rural areas (which may include upgrades of water and sewage infrastructure) is among the aims of the financial assistance that Poland has received from the EU under the Structural Funds programmes. Between 2004-06 Poland is expected to be granted app. EUR 4.5bn from the EU's Structural Funds. Although we expect only a fraction of that amount to be dedicated to hydro-construction projects, the risk to the calculations presented in the previous paragraph seems to be on the upside.

The outlook for the inflow of EU financing to hydro-construction after 2007 seem very optimistic

With regards to the inflow of EU funds to Poland from 2007 onwards, the EU has not decided on detailed figures yet. However, the proposal of the National Development Programme prepared by the Polish government assumes that between 2007 and 2013 Poland will receive EUR 73.6bn, of which the Cohesion Fund will amount to EUR 23.7bn (an annual average of EUR 1.82bn). Give this, the outlook for the inflow of EU financing to hydro-construction after 2007 seems very optimistic.

Medium term developments

Since mid-2004 PBG managed to secure 8% of tendered projects in hydro-construction

Since mid-2004 PBG has participated in Hydro-construction tenders of a total value of app. PLN 1.8bn. The company managed to secure for itself contracts worth PLN 150m, or 8% of the tendered value (the figure refers to PBG only, excluding shares of other consortium members). The largest contracts include modernisation of the sewage system in Szczecin and construction of an environmental protection plant in Wloclawek. Most agreements have an app. 3-year execution period.

Figure 4. PBG: Contracts signed by PBG in the hydro-construction since mid-2004

Date	Value (PBG's share, PLN m)	Comment
July 2004	22.3	Water system in Szczecin
August 2004	3.1	Sewage system in Torun
September 2004	36.3	Environment protection plant in Wloclawek
December 2004	88.1	Modernisation of sewage system in Szczecin
Total	149.7	

Source: Company data

We forecast PBG's hydro-construction revenues to reach PLN 244m in 2007...

We have used a top-down approach to forecast PBG's revenues from hydro-construction in 2005-07. Based on expected funding from the Cohesion Fund in 2004-07, we expect the value of tenders in hydro-construction to be announced each year from 2005 forwards at app. PLN 2.8bn (in 2004, tenders were mostly financed from pre-accession funds, rather than through the Cohesion Fund). We assume PBG's 2004 success ratio of 8% will be sustained, and arrive at a value of PLN 232m annually for contracts secured by the company for the three year period 2005-07. Assuming a typical 3-year execution period, we forecast PBG's sales in the hydro-construction segment to increase by 197% y/y to PLN 108.7m in 2005, 44% y/y to PLN 156.2m in 2006, and 50% y/y to PLN 233.7m in 2007. The following figure details our calculations.

Figure 5. PBG: Revenues forecast from the hydro-construction sector
PLN in millions, unless otherwise stated

	Value of tenders announced	PBG's success ratio	Value of contracts secured by PBG	PBG's revenues in		
				2005E	2006E	2007
2004E	1,800	8%	150	70.0	40.0	40.0
2005E	2,800	8%	232	38.7	77.5	77.5
2006E	2,800	8%	232		38.7	77.5
2007E	2,800	8%	232			38.7
Total	-	-	-	108.7	156.2	233.7

Source: DM BZ WBK estimates

... and we deem it conservative

Our forecast as to PBG's hydro-construction revenues we deem somewhat conservative. Our top-down model we base only on financing from the Cohesion Fund, while the EU's Structural Funds will also contribute to project funding. Moreover, PBG's representatives expect in 2005 tenders of a total value of app. EUR 2bn, vs, our assumption of merely EUR 0.7bn.

Focus on niches

PBG's strategy in hydro-construction is to focus on value-added niche projects. This includes renovation of water and sewage systems with *compact pipe* technology, which enables the replacement of damaged pipes without devastation of the above-ground city infrastructure (i.e. roads).

Medium-term developments

Oil & gas engineering

In late 2004 PBG secured two mid-sized contracts with PGNiG worth a total of PLN 27.8m

The Polish Oil and Gas Company (PGNiG) was supposed to finalize procurement procedures with regards to several mid-sized project by the end of 2004; however, in some cases delays have appeared. In late 2004 PBG secured two mid-sized contracts with PGNiG: for the construction of a gas plant in Gorzyca (PLN 16.9m) and a gas compressor facility in Odolanow (PLN 10.9m) and both contracts are scheduled to be executed in 2005.

We forecast an 79% increase in PBG's revenues from oil and gas engineering in 2005 to PLN 67.0m...

Despite delays in procurement procedures, we expect PBG's revenues from oil and gas engineering to increase 79% to PLN 67.0m in 2005. Our forecast we base on the belief that PGNiG is determined to implement its capex strategy focused on increasing the production of oil and gas in Poland. As the projects in questions are mostly of a mid-size nature, the likelihood of further delays we assess as minor. Specifically, we expect PGNiG to select the contractor of gas plants Paproc I and Paproc II yet in 1H05 (each contract valued at app. US\$ 5m) and we believe PBG to be a frontrunner. Additionally in 2005, the company has a chance to secure its first projects for gas plant construction from a client other than state-owned monopoly PGNiG.

...but further sales growth in that market segment...

In 2006 we expect the investment cycle of PGNiG with regards to mid-sized gas/oil plants to ease and consequently PBG's revenues from that market segment could be under pressure. Given this, PBG's growth in oil and gas engineering is likely to be dependant on large-scale projects.

Currently, we see three sizable projects in the area of oil and gas construction that are likely to be launched in the medium run. These are:

- **Nitrogen rejection unit in Grodzisk:** PGNiG intends to construct an engineering facility which will remove excess amounts of nitrogen from natural gas produced in the western part of Poland. The total investment's value amounts to app. US\$ 35m.
- **Medzychod oil plant:** PGNIG plans to construct an oil plant in rich oil reservoirs near Miedzichod (western part of Poland). The project is likely to be executed within three years and cost app. US\$ 100m.
- **Wierzchowice gas storage facility:** Although the project seems to be vital for Poland's energy security, there is still no clarity on how and when exactly it will be implemented. Industry representatives estimate its value at US\$ 100m.

...is likely to depend on large-sized projects: nitrogen rejection unit in Gradzisk, Miedzichod oil plant and Wierzchowice gas storage facility

We believe all three projects will be launched in the medium term; however, we are unable to predict specific dates. This is due to the fact that it has been traditional to observe significant delays in the completion of tenders of this size. In our model we made probability-weighted forecasts. We attached a 30% probability that the construction of the Grodzisk nitrogen rejection unit and the Miedzichod oil plant unit will begin in 2006 and PBG will be the general contractor for those projects. With regards to the Wierzchowice gas storage facility, we assume a 10% probability that the project will kick off in 2006 with PBG being the general contractor. The following figure details our assumptions and forecast of PBG's revenues from the oil and gas engineering sector.

Figure 6. PBG: Revenues forecast from oil and gas engineering*PLN in millions, unless otherwise stated*

	2001	2002	2003	2004	2005E	2006E	2007E
Small-and medium sized contracts	47.2	47.7	40.8	37.5	67.0	40.0	40.0
Large-sized contracts, of which:						53.9	53.9
<i>Nitrogen rejection unit in Grodzisk: 30% probability assumed, total value US\$ 35m, 3-year execution</i>						11.2	11.2
<i>Midzychod oil plant: 30% probability assumed, total value US\$ 100m, 3-year execution</i>						32.0	32.0
<i>Wierzychowice gas storage facility: 10% probability assumed, total value US\$ 100m, 3-year execution</i>						10.7	10.7
Total	47.2	47.7	40.8	37.5	67.0	93.9	93.9

Source: Company data, DM BZ WBK estimates

Other business segments

We expect the pipeline segment to provide a steady source of revenues to PBG

PBG's revenues from pipeline construction and engineering amounted to PLN 89m in 2004. This included the company's stable business of pipeline servicing as well as several mid-sized contracts mainly with PGNiG. In our forecasts we assume the pipeline segment to continue providing a steady source of revenues to PBG, with the growth being capped by Poland's nominal GDP expansion.

PLN 45m in contracts with PKN, a client that seems very promising

In early 2005 PBG gained a new, very promising client – PKN. PBG took over two contracts from Maxer, a financially distressed engineering company, to construct fuel storage facilities. The combined value of the contracts amounts to PLN 45m. Co-operation with PKN may occur to be very beneficial for PBG in the medium run. The oil company intends to strengthen its logistics and distribution system, which is set to be a vital part of its competitive edge in Poland's market. We believe PBG will benefit from this development.

What other upsides exist to our forecasts?

We spotted three very sizable projects...

In the medium run, we expect the market for oil and gas infrastructure in Poland to witness several very sizable projects and PBG seems to be among those that are likely to participate in their execution. The projects in questions are:

- **Extension of Odessa-Brody oil pipeline to Plock:** Following political changes in Ukraine, the plan for construction of an oil pipeline transporting Caspian crude via Ukraine to Poland and Western Europe, has revived. In May 2005 PERN (oil pipeline operator in Poland) and Ukratransnafta (its Ukrainian counterpart) are scheduled to select a consultant which will prepare the business plan of the project. According to Polish press reports, the investment's value is likely to total app. EUR 400-450m, with the construction process kicking off in late 2006. We believe PBG has very strong credentials to participate in the building of the pipeline, due to its experience in construction of advanced engineering facilities.
- **CNG sea terminal:** The Polish Oil and Gas Company (PGNiG) is planning to import Compressed Natural Gas (CGN) from Northern Europe. This, however, requires construction of a sea terminal. The investment value is estimated at app. EUR 300-500m; however, its execution seems to depend on the securing of funds by PGNiG, which plans a PLN 1.5bn IPO on the WSE yet this year. We believe the privatisation of PGNiG would make the company less susceptible to political influences and will streamline the decision-making process. Given PGNiG's substantial capex plans (PLN 7.2bn in 2005-07), a very efficient management process seems desirable.

- **Gas pipeline linking Germany and Poland:** According to press reports, in April PGNiG and VNG of Germany will create an entity which is set to construct a 130-150km pipeline linking Poland's gas system with Germany's. The value of the project amounts to app. US\$ 150m, and we believe PBG has a realistic chance to participate in that project.
- **NATO investments in Poland:** According to press reports, the investments of NATO in military infrastructure in Poland will include the construction of 38 underground fuel storage facilities with a total value of app. PLN 700m. PBG is one of the eight construction companies in Poland that boasts an AQAP certificate required by NATO. Furthermore, the company is in possession of know-how relating to underground storage facilities. For those two reasons, we believe PBG is well positioned to benefit from NATO investments in Poland.

...that constitute significant upside to our forecasts

The projects described in the previous paragraphs are all quite sizable and once they kick off, we believe PBG has strong credentials to be among the top contractors. Conservatively, we do not include any revenues from those projects into our model, indicating that those are potential areas of upside.

Acquisition of Hydrobudowa Wloclawek

Hydrobudowa offers exposure to hydro-construction market...

Hydrobudowa Wloclawek is a construction company specialising in the building of hydro-facilities as well as in general construction. PBG had been owner of Hydrobudowa till December 2003, but disposed of the company prior to PBG's IPO on the WSE. According to PBG's management, the disposal of Hydrobudowa was conducted in order to prevent Hydrobudowa's deep restructuring from negatively affecting PBG's consolidated income statement. PBG sold its stake in Hydrobudowa to its own shareholders (Mr Wisiewski, Ms Wisniewska, Mr Woroch and Mr Grunt).

...which is booming on the back of inflow of EU funds to Poland

However, the market for hydro-construction surged massively in 2004 on the back of the inflow of EU funds to Poland. Hydrobudowa, with over 400 employees and engineering know-how, should greatly benefit from the market revival, if the company strengthens its balance sheet and secures additional working capital.

To address corporate governance concerns, PBG undertook actions to include Hydrobudowa into its group

The Wisniewski family shareholding both in PBG and Hydrobudowa could raise corporate governance concerns given the fact the PBG supported Hydrobudowa with a loan. To address these concerns, in January 2005 the Supervisory Board of PBG made a resolution to undertake actions to include Hydrobudowa Wloclawek into the PBG group.

PBG is set to acquire a 56% stake in Hydrobudowa through a capital increase

Capital increase

In late March the AGM of Hydrobudowa made a resolution to increase its capital by issuing 150,000 new shares, which will represent 55.6% of the company's share capital on a post-issue basis. Following the transaction, PBG is set to hold a 56% stake in Hydrobudowa and consolidate it fully. The Wisniewski family will hold 37.0% of Hydrobudowa's share capital.

Figure 7. Hydrobudowa: Shareholder structure and pending capital increase details

	No of shares	As % of total pre-issue	As % of total post-issue
Mr Wisniewski	78,876	65.7%	29.2%
Ms Wisniewska	21,120	17.6%	7.8%
Mr Grunt	13,332	11.1%	4.9%
Mr Woroch	6,672	5.6%	2.5%
Total pre-issue	120,000	100.0%	44.4%
New issue to PBG	150,000	-	55.6%
Total post-issue	270,000	-	100.0%

Source: Company data, DM BZ WBK estimates

The capital increase is set to be conducted at the price at which PBG divested Hydrobudowa in December 2003 (PLN 50 per Hydrobudowa share)

Valuation

Given the Wisniewski family shareholding both in PBG and Hydrobudowa, we looked in greater detail at the prices at which the transaction of purchasing and selling Hydrobudowa by PBG were conducted. Originally PBG purchased Hydrobudowa between 2002 and 2003 for the total consideration of PLN 4.7m. Subsequently, PBG disposed of all Hydrobudowa shares to Mr and Ms Wisniewski, Mr Grunt and Mr Woroch for PLN 6.0m in December 2003. This implied a price of PLN 50 per Hydrobudowa share, equal to its face value.

Currently, Hydrobudowa will issue and PBG will subscribe to 150,000 shares at PLN 50 per share. PBG will therefore acquire a 56% stake in Hydrobudowa for PLN 7.5m.

In 2004 Hydrobudowa reported sales of PLN 105m and net profit of PLN 0.5m. The bottom line figure was, however, understated by receivables write-downs of app.

PLN 2m. In 2005 PBG's management forecast Hydrobudowa's sales to increase by 75% to PLN 183.3m, with the net profit surging to PLN 2.9m. Those forecasts seem feasible given Hydrobudowa's total backlog of app. PLN 265m.

2005 P/E ratio of Hydrobudowa implied by acquisition price amounts to 4.7x

Looking at valuation ratios, PBG will enter Hydrobudowa at a 2004 P/E of 27x. The 2004 multiple, however, we deem unrepresentative due to a one-off receivable write-down. However, 2005E's net profit multiple, 4.7x, seems very attractive.

Figure 8. Hydrobudowa: Income statement extracts

PLN in millions, unless otherwise stated

	2002	2003	2004E*	2005E**
Sales	35.0	42.4	105.0	183.3
EBIT	0.4	1.3	3.6	7.1
Net profit	0.1	1.8	0.5	2.9
Net debt	n.a.	n.a.	29.6	n.a.

NOTE: *figures not audited, **PBG forecasts, Source: Company data

Earnings forecasts

We forecast hydro-construction to be among major top-line drivers

We forecast PBG's revenues to surge 58% y/y in 2005 to PLN 341.5m. The major growth drivers we expect to be the hydro-construction sector (up 197% to PLN 108.7m) and building of oil and gas production facilities (up 79% to PLN 67.0m). The former we expect to be boosted by an inflow of EU financing, the latter is set to benefit from PGNiG's investments in mid-sized oil/gas plants. In 2006 and 2007 we forecast top-line growth stabilisation at very healthy rates of 20% and 22%, respectively.

Figure 9. PBG: Revenues forecasts

PLN in millions, unless otherwise stated

	2001	2002	2003	2004	2005E	%, y/y	2006E	%, y/y	2007E	%, y/y
Pipelines/ distribution networks	56.7	63.2	91.1	82.5	89.2	8%	96.5	8%	103.8	8%
Crude oil and gas production facilities	47.2	47.7	40.8	37.5	67.0	79%	93.9	40%	93.9	0%
Hydro-construction	0.0	22.5	24.8	36.6	108.7	197%	156.2	44%	233.7	50%
Other	16.6	28.7	24.0	59.5	76.6	29%	61.8	-19%	66.4	7%
Total	120.4	162.1	180.7	216.1	341.5	58%	408.3	20%	497.8	22%

Source: Company data, DM BZ WBK forecasts

We forecast 2004-07 net profit CAGR at 36%

Our 2005 revenue forecast for PBG is 13% above our previous estimate (published in the report *Upbeat prospect become reality*, dated August 24, 2004). Our 2005 EBIT estimates we lift 13% to PLN 39.8m, and net profit 2% to PLN 30.3m. As for 2006 figures, we raise the revenues and EBIT estimates both by 21% to PLN 408.3m and PLN 47.6m, respectively, and net profit by 10% to PLN 37.2m. In 2007 we expect PBG's net profit to increase by a further 24% to PLN 46.0m. That potential of higher earnings growth resulting from Hydrobudawa's consolidation is not included in our model.

Figure 10. PBG: Income statement forecasts

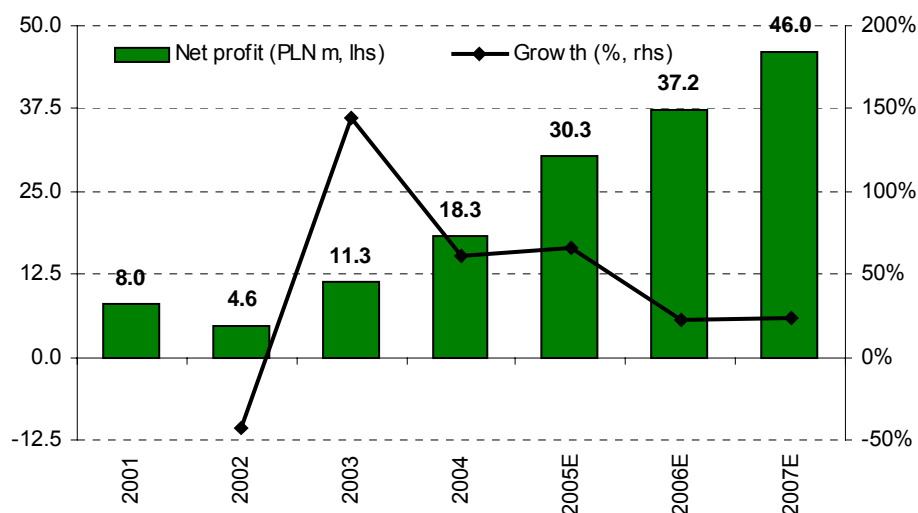
PLN in millions, unless otherwise stated

	2003	2004	2005E			2006E			2007E
			new	old	% change	new	old	% change	
Sales	180.7	216.1	341.5	302.5	13%	408.3	337.4	21%	497.8
EBIT	14.3	26.1	39.8	35.1	13%	47.6	39.2	21%	58.0
EBIT margin (%)	7.9%	12.1%	11.6%	11.6%	-	11.6%	11.6%	-	11.6%
Net profit	11.3	18.3	30.3	29.8	2%	37.2	33.8	10%	46.0

Source: Company data, DM BZ WBK forecasts

Figure 11. PBG: Net profit growth 2001-07E

PLN in millions, unless otherwise stated



Source: Company data, DM BZ WBK estimates

Financial statements

Figure 12. PBG: Income statement forecasts

PLN in millions, unless otherwise stated

	2001	2002	2003	2004	2005E	2006E	2007E
Net sales	120.4	162.1	180.7	216.1	341.5	408.3	497.8
COGS	95.8	132.9	142.2	172.6	273.2	326.7	398.2
depreciation	3.5	5.2	6.7	6.6	8.8	9.4	9.0
Gross profit	24.6	29.3	38.5	43.5	68.3	81.7	99.6
SG&A	10.6	18.9	23.0	19.8	27.3	32.7	39.8
Other operating income, net	0.0	-1.2	-1.2	2.3	-1.2	-1.4	-1.7
EBITDA	17.5	14.4	21.0	32.7	48.5	57.0	67.0
Operating profit	14.0	9.2	14.3	26.1	39.8	47.6	58.0
Net financial costs (income)	2.0	4.4	-0.1	2.5	2.4	1.6	1.2
interest income	1.1	2.4	1.5	3.4	2.4	2.5	2.2
interest costs	4.0	6.1	6.4	6.2	4.8	4.1	3.4
other financial costs (income)	-0.9	0.7	-4.9	-0.2	0.0	0.0	0.0
Extraordinary gains, net	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Goodwill amortisation, net	0.0	0.4	0.6	0.4	0.4	0.4	0.4
Pre-tax profit	12.0	4.4	13.8	23.1	37.0	45.6	56.4
Income tax	4.0	-0.4	2.9	5.0	7.0	8.7	10.7
Income from associates	0.0	0.0	0.3	0.2	0.3	0.3	0.3
Minority interest	0.0	-0.2	0.2	0.0	0.0	0.0	0.0
Net profit	8.0	4.6	11.3	18.3	30.3	37.2	46.0
EPS (PLN)	1.12	0.64	1.57	2.06	2.88	3.53	4.37
Margins							
Gross margin	20.4%	18.1%	21.3%	20.1%	20.0%	20.0%	20.0%
EBITDA margin	14.5%	8.9%	11.6%	15.1%	14.2%	14.0%	13.5%
Operating margin	11.6%	5.7%	7.9%	12.1%	11.6%	11.6%	11.6%
Net margin	6.7%	2.9%	6.3%	8.5%	8.9%	9.1%	9.2%

Source: Company data, DM BZ WBK estimates

Figure 13. PBG: Cash-flow statement forecasts

PLN in millions, unless otherwise stated

	2002	2003	2004	2005E	2006E	2007E
Cash flow from operations	-6.2	27.4	-41.6	26.0	23.9	24.5
Net profit	4.6	11.3	18.3	30.3	37.2	46.0
Provisions	4.6	-3.7	2.8	3.1	1.7	2.2
Depreciation and amortisation	5.2	6.7	6.6	8.8	9.4	9.0
Changes in WC, o/w	-1.4	14.1	-53.7	4.5	-13.4	-17.9
inventories	-2.8	2.4	-4.1	-3.7	-2.0	-2.7
receivables	-23.2	5.7	-75.7	-33.0	-33.4	-44.7
payables	24.6	6.0	26.0	41.3	22.0	29.4
Other, net	-19.2	-1.1	-15.6	-20.7	-11.0	-14.7
Cash flow from investment	-48.5	13.4	-28.8	2.1	-17.3	-21.3
Additions to PPE and intangibles	-42.2	16.9	-16.3	-11.8	-20.4	-24.9
Change in long-term investments	-0.6	-16.6	2.9	10.5	1.1	1.1
Other, net	-5.8	13.1	-15.4	3.4	2.0	2.5
Cash flow from financing	59.2	-35.3	103.5	-10.0	-10.0	-10.0
Change in long-term borrowing	34.5	-18.4	-1.9	-10.0	-10.0	-10.0
Change in short-term borrowing	13.0	-1.8	13.8	0.0	0.0	0.0
Change in equity and profit distribution	-1.5	-2.2	91.6	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0	0.0
Other, net	13.2	-12.9	0.1	0.0	0.0	0.0
Net change in cash and equivalents	4.4	5.5	33.1	18.1	-3.5	-6.7
Beginning cash and equivalents	0.8	5.2	10.7	43.8	61.9	58.5
Ending cash and equivalents	5.2	10.7	43.8	61.9	58.5	51.8

Source: Company data, DM BZ WBK estimates

Figure 14. PBG: Balance sheet forecasts*PLN in millions, unless otherwise stated*

	2001	2002	2003	2004	2005E	2006E	2007E
Current assets	52.3	103.9	101.9	233.1	311.5	356.0	413.4
cash and equivalents	0.8	5.2	10.7	43.8	61.9	58.5	51.8
other short term investments	0.0	2.5	2.0	4.7	4.7	4.7	4.7
accounts receivable	44.5	67.7	62.0	137.7	170.7	204.2	248.9
inventories	1.9	4.7	2.4	6.4	10.2	12.1	14.8
prepaid expenses	5.0	23.8	24.8	40.5	64.0	76.5	93.2
Fixed assets	28.9	69.0	59.4	69.5	61.7	71.2	85.6
PPE	27.5	63.9	40.8	50.3	52.8	63.6	79.3
long-term investments	1.0	1.5	18.1	15.2	4.7	3.6	2.5
intangibles	0.4	1.0	0.5	0.7	1.2	1.4	1.6
goodwill	0.0	2.6	0.0	3.4	3.0	2.6	2.2
long-term receivables	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Long-term deferred charges	1.4	10.9	4.7	6.4	10.1	12.0	14.7
Total assets	82.5	183.9	166.0	309.0	383.2	439.1	513.6
Current liabilities	45.9	89.8	87.8	127.7	175.6	201.2	235.4
bank debt	20.1	33.0	31.2	45.0	45.0	45.0	45.0
accounts payable	14.5	39.1	45.1	71.2	112.4	134.4	163.9
other current liabilities	11.3	17.7	11.5	11.5	18.2	21.8	26.5
Deferred income	0.6	2.6	2.1	4.8	7.7	9.2	11.2
Long-term liabilities	14.1	48.6	40.7	28.4	18.4	8.4	-1.6
bank debt	14.1	48.6	30.2	28.4	18.4	8.4	-1.6
other long-term liabilities	0.0	0.0	10.5	0.0	0.0	0.0	0.0
Provisions	1.7	6.2	2.6	5.4	8.5	10.2	12.4
Equity	20.3	23.4	32.5	142.4	172.7	209.9	255.9
share capital	7.2	7.2	7.2	10.5	10.5	10.5	10.5
capital reserves	5.1	10.3	16.4	117.4	135.7	165.9	203.2
revaluation reserve	0.0	0.0	0.0	0.0	0.0	0.0	0.0
other reserve capital, incl. undistributed loss	0.0	1.3	-2.4	-3.8	-3.8	-3.8	-3.8
net income	8.0	4.6	11.3	18.3	30.3	37.2	46.0
Minority Interest	0.0	13.2	0.3	0.4	0.4	0.4	0.4
Negative goodwill	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total liabilities and equity	82.5	183.9	166.0	309.0	383.2	439.1	513.6
Net debt	33.4	76.5	50.8	29.5	1.4	-5.1	-8.4
Net debt/Equity	164%	327%	156%	21%	1%	-2%	-3%

Source: Company data, DM BZ WBK estimates

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- 2) comparative.

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Explanations of special terminology used in the recommendation:

EBIT – earnings before interest and tax
EBITDA – earnings before interest, taxes, depreciation, and amortization
P/E – price-earnings ratio
EV – enterprise value (market capitalisation plus net debt)
PEG - P/E to growth ratio
EPS – earnings per share
CPI – consumer price index
WACC - weighted average cost of capital
CAGR – cumulative average annual growth
P/CE – price to cash earnings (net profit plus depreciation and amortisation) ratio
NOPAT – net operational profit after taxation
FCF - free cash flows
BV – book value
ROE – return on equity

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