Company Report

PBG

Buy

Poland, Engineering/Specialized construction

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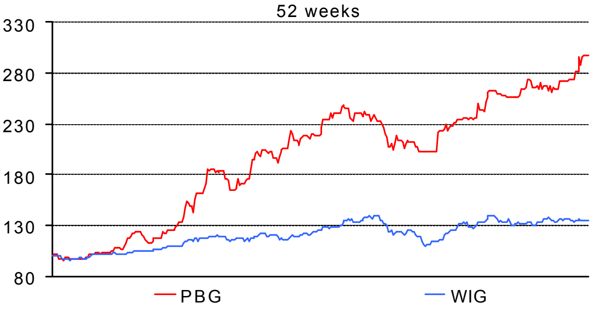
PLN mn	2005	2006e	2007e	2008e
Net sales	408.5	793.0	1,282.6	1,622.9
EBITDA	50.7	87.6	149.6	216.0
EBIT	41.3	73.2	133.6	198.8
Net profit	36.1	51.5	100.2	153.7
EPS (PLN)	3.00	4.28	8.33	12.77
CEPS (PLN)	3.95	7.30	9.66	14.21
BVPS (PLN)	14.77	31.55	39.87	48.48
Div/share (PLN)	0.00	0.00	0.00	4.15
EV/EBITDA (x)	47.7	26.9	15.5	10.4
P/E (x)	63.4	44.3	22.8	14.9
P/CE (x)	48.1	26.0	19.7	13.4
Dividend yield	0.0%	0.0%	0.0%	2.2%



Performance	12M	6M	3M	1M
in PLN	196.9%	34.8%	28.4%	11.1%
in EUR	192.8%	35.6%	29.8%	11.4%

Share price (PLN)	190.0	Reuters	PBGG.WA	Free float	49.2%
Number of shares (mn)	12.0	Bloomberg	PBG PW	Shareholders	Wisniewski Jerzy (36.4%)
Market capitalization (PLN mn / EUR mn)	2,285.7 / 577.0	Div. ex-date	n.a.		BZ WBK AIB AM (7.4%), ING IM (7%)
Enterprise value (PLN mn /EUR mn)	2,356.4 / 594.9	**Target price**	**230.0**	Homepage:	www.pbg-sa.pl

Hydro engineering contracts to greatly boost results in coming years

- **As we expected, PBG is continuing its successful expansion in the environmental protection market. Since our initial report, the company has signed new contracts worth a total of PLN 0.6bn. The majority of the contracts will be in the area of water and wastewater systems and will substantially increase PBG's 2007 and 2008 revenue. Tenders in the pipeline exceed PLN 2.5bn. In our view, PBG offers the best exposure on EU cohesion funds from all WSE listed companies.**
- **We believe that the increased order portfolio will translate into much better results in 2007 and beyond. Compared to our previous report, we have raised our 2007 top line estimate by PLN 242mn. We now expect PBG to post nearly PLN 100mn on the bottom line next year, which would mean a 22.8x P/E ratio. In 2008, the P/E should drop to 14.9x, with net profit at PLN 154mn. The realization of this new forecast would mean the company jumping more than one year ahead in its development.**
- **The 2006 results might be a little bit worse than we anticipated, due to the postponement of some crucial contracts, especially in the segment of installations for the oil & gas industry. The main problem was the management crisis at PGNiG: for several months, the company had a temporary management, which refrained from making decisions regarding key investments. Nevertheless, we believe these tenders will come soon, and that PBG remains the favorite to win them.**
- **The 2Q06 results were slightly below our estimates. As revenue came in PLN 30mn lower than we expected, we have cut our 2006 forecast by this amount. We cut our EBIT estimate by PLN 6.7mn and the bottom line by some PLN 2.5mn.**
- **We adjusted our estimates to reflect the incentive share scheme for management. PBG has dedicated 0.33mn shares for this purpose (we have already included the dilution). This will cost the company approximately PLN 4mn per annum in 2006 and 2007.**
- **We have raised our target price from PLN 175 to PLN 230. As the new target price offers 21% upside, we reiterate Buy recommendation on the stock.**

Investment story

Hydro segment to bear fruit next year

PBG's entry into the hydro engineering and environmental protection segment has proven to be a perfect move. This year, contracts from this segment will help to fill the gap in the portfolio caused by the postponement of some contracts in the oil & gas segment. We estimate that the new segment will constitute 35% of total 2006 revenues. The main contributors in the near term will be Hydrobudowa Wloclawek and Infra. In our opinion, the success of the new division will be more visible next year. We estimate that PBG will exceed PLN 1.2bn on the top line (our forecast does not include the largest hydro-engineering projects: Wastewater installation Czajka in Warsaw and reservoir on Odra river in Raciborz), while the bottom line should be close to PLN 100mn. Earlier, we expected PBG to achieve such results only in 2008. This means that the company has significantly accelerated its development, via its entry into the hydro segment.

Changes of forecasts

PLN mn	**previous 2006**	**current 2006**	**previous 2007**	**current 2007**
Revenue	823.4	**793.0**	1,046.7	**1,282.6**
EBITDA	95.0	**87.6**	107.2	**149.6**
EBIT	79.9	**73.2**	89.6	**133.6**
Net profit	53.8	**51.5**	62.5	**100.2**

Source: Erste Bank

Recent acquisition to bring substantial profits no earlier than 2008

Our recommendation is not dependent on the strong story presented by Hydrobudowa Slask, as this company has to process its two-year portfolio of unprofitable contracts. Like a good chess player, PBG's management is planning two moves ahead, and thus decided to acquire Hydrobudowa Slask , which has large production potential (approximately 500 employees, which should enable PLN 0.5bn in sales per year). Management of PBG gives the company 2 years to reach this level of sales. The success of this acquisition will depend strongly on the successful implementation of PBG's strategy for the company. We are optimistic, as management has declared that the entire group is prohibited from placing bids that would involve a gross margin on sales of less than 20%. This should guarantee that the group's overall margin does not drop substantially. The first test for Hydrobudowa Slask will be a tender for the construction of the "Czajka" wastewater treatment plant in Warsaw. The estimated value of the contract is PLN 750mn, with the tender likely to be announced in October 2006. PBG is likely to take part as a group, with Hydrobudowa Slask as the leader (due to its references from a similar project in Krakow). The group will probably face very tough foreign competition.

Some missteps in oil & gas segment, but no great danger

Thus far, PBG's core business has been installations for the oil & gas industry (especially LNG). After recent successes in environmental protection, the oil & gas segment has seen its share in total revenue shrink. Recently PBG finally signed PLN 120mn contract with PGNiG for construction of nitrogen removal unit in Grodzisk Wielkopolski. Originally the company was to sign this contract by June 2006, but due to appeals from two other consortiums (led by ABB and Bartimpex), which were beaten by PBG in terms of price, PGNiG delayed the moment of signing the contract. So far, the company has not signed yet another four key contracts in this area: two domestic contracts, one for construction of an underground gas storage unit in Wierzchowice (PLN 200mn) and the other for the Lubiatow-Miedzychod-Grotow crude oil plant (PLN 430mn; both projects were for PGNiG), as well as two export ones (LNG plants for Lysse Gas and Statoil in Norway). The construction of a new nitrogen removal unit opens the way to the development of crude oil fields in the region of Lubiatow-Miedzychod-Grotow. PBG placed a bid in the PLN 430mn tender announced by PGNiG. The only competitor was ABB. Similarly to the Grodzisk tender, although PBG placed the best bid, its rivals appealed, forcing

PGNiG is to repeat the tender in October. We expect PBG and ABB to again compete. In our opinion, PBG has a better chance, as ABB failed to meet some conditions in the previous tender and (according to PBG) after finishing some key projects in Poland, is likely to withdraw from the Polish market. The tender will probably be announced in October and decided on during the beginning of 2007. Implementation should last 2.5 years. We are also optimistic about the gas storage depot in Wierzchowice, as there is some pressure on the Polish gas market toward raising storage capacity, in order to prepare the ground for market liberalization (according to Polish law, each provider of natural gas is obliged to keep certain reserves in storage). The value of this contract is estimated at PLN 200mn. The tender will be announced in 2007, and the decision might take 6-9 months. Therefore, even if PBG comes out on top, it will not invoice substantial revenues from the contract during 2007.

PLN 250mn contract with NATO getting closer

After winning two smaller contracts from NATO, PBG is close to winning a PLN 250mn order for the modernization and extension of the fuel and lubricant inland depot for NATO in Cybowo. Two consortiums from Poland and Germany remain on the battlefield, with the bid from PBG the cheaper of the two. This tender should be decided in early October.

First export contracts to come from Norway

Other orders should come from Norway. Lysse Gas has already chosen PBG as a contractor for an LNG plant. After long negotiations and due diligence conducted with the Polish company, the Norwegians are ready to pay EUR 62mn (earlier, we mentioned EUR 56mn for this deal). The contract should be signed in October or November. A second client could be Statoil, but, in contrast with Lysse Gas, potential orders here have fallen from EUR 40mn to EUR 10mn, as the contract has been split up among several contractors.

Important client to triple annual capex to PLN 300mn

National operator of fuel bases OLPP (formerly Naftobazy) announced that it intends to expand the network of pipelines linking the fuel storage depots in order to decrease transportation costs and fuel prices. The company intends to raise the annual capex from PLN 100mn this year to PLN 300mn in 2007. Naftobazy was an important client of PBG, which recently won some contracts for the construction of storage depots in Katowice. We therefore believe it has good chances of winning new orders from OLPP.

Key contracts

Contract	Value	Currency	Settlement	End
Modernisation and extension of the fuel and lubricant inland depot in Cybowo	250.0	PLN	October 2006	n.a.
Lubiatow-Miedzychod-Grotow crude oil plant	430.0	PLN	December 2006	December 2009
Underground Gas Storage in Wierzchowice	200.0	PLN	June 2007	June 2009
LNG plant in Norway`for Lysse Gas	62.0	EUR	December 2006	April 2008
LNG plant in Norway for Statoil	10.0	EUR	November 2006	n.a.
Wastewater treatment installation „Czajka" in Warsaw	750.0	PLN	Oct 2006	October 2009
Racibórz reservoir on the Odra river	650.0	PLN	Nov 2006	May 2010
Total *	**2,564.4**	**PLN**		

**) value of export contracts calculated at 3.95 EUR/PLN currency rate*

Share motivation scheme to cost approximately PLN 4mn p.a.

PBG has dedicated 0.33mn shares to a motivation scheme for key managers. The plan was divided into three years, with 0.11mn shares handed out per year in 2005, 2006 and 2007. PBG estimates that the program will cost the company PLN 4mn each year. Half of the 2006 costs (PLN 2mn) were already incurred in 1H06. Thus, the company will spend another PLN 2mn in 2H06 and PLN 4mn in 2007. This cost is independent of the changing market price of PBG shares. We have already included this dilution in the total share number (the 12.03mn shares includes 0.33mn 'motivation' shares).

New takeovers in engineering and road construction segments

PBG intends to continue its strategy of growth via acquisitions. New takeovers should come in two areas. The first target is a foreign engineering company employing 150 certified engineers and project managers. The second area is road construction, in which PBG targets 3-5 smaller companies (with annual sales up to PLN 50mn) focusing on second-category roads. PBG targets road division to achieve ca. 5% net margin, that due to strong competition will be difficult but doable. In our opinion, this is a good idea, as the road segment will be the strongest beneficiary of EU funds in 2007-13. Due to its concentration on second-category roads, PBG will avoid heavy competition with the European giants that target the motorway segment. At this moment, we do not include these acquisitions in our model, as we do not have any precise financial data or acquisition costs. We would not rule out a further share issue to finance these projects. As PBG aims in 2007-2013 budget we think these acquisitions will happen in late 2006 or early 2007.

One insignificant company disposed of

PBG decided to dispose of one subsidiary, Elwik. This was an example of a public-private partnership. Such a formula limited the development of the company, which has been closely related to the community of Lubicz. Its influence on consolidated revenues was very limited (annual revenue of approximately PLN 2mn), and thus does not influence our forecasts. Moreover, the income for the 61% stake (sold to Lubicz for PLN 0.12mn) is insignificant.

Valuation and recommendation

We have again employed DCF as our basic valuation tool for PBG. In comparison with our initial coverage report, we changed the following assumptions:

- Risk-free rate at 5.33% (previously: 5.15%)
- Beta of 1.05 (previously: 0.98)
- In 2H06, we discount all free cash flows as of December 31, 2006 and subtract the net debt on the same date. The derived fair value is compounded with a one-year (from today) time horizon.
- We maintain our assumption that the current capacity will allow the company to reach the maximum level of PLN 1.5bn in revenue. To exceed this level, the company would have to employ more subcontractors (which lowers profitability) or acquire another company. As we do not know any takeover details, we assume the first scenario, thus the margins decrease slightly since 2009 in our model.

WACC

	2006e	2007e	2008e	2009e	2010e	2011e	beyond 2011e
WACC	**7.31%**	**7.32%**	**7.49%**	**7.58%**	**7.52%**	**7.45%**	**6.82%**
Equity cost	10.58%	10.58%	10.58%	10.58%	10.58%	10.58%	10.00%
Debt cost	5.53%	5.53%	5.53%	5.53%	5.53%	5.53%	4.86%
Equity weighting	35.23%	35.35%	38.83%	40.56%	39.33%	38.08%	38.08%
Debt weighting	64.77%	64.65%	61.17%	59.44%	60.67%	61.92%	61.92%
Risk free rate	5.33%	5.33%	5.33%	5.33%	5.33%	5.33%	5.00%
Equity risk premium	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Beta	1.05	1.05	1.05	1.05	1.05	1.05	1.0
Debt premium	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.0%
Tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%

Source: Erste Bank

- We maintain assumption regarding dividend payout ratio: 50% ratio from 2008 profit, 75% in 2009 and 100% since 2010. Such assumption guarantees stable capital structure (debt/equity ratio between 40-50%).

DCF

PLN '000	2006e	2007e	2008e	2009e	2010e	2011e	beyond 2011e
EBIT	**73,159**	**133,566**	**198,740**	**203,036**	**207,053**	**210,831**	**210,831**
Tax rate	19%	19%	19%	19%	19%	19%	19%
Tax on EBIT	-13,900	-25,377	-37,761	-38,577	-39,340	-40,058	-40,058
NOPLAT	**59,259**	**108,188**	**160,980**	**164,459**	**167,713**	**170,773**	**170,773**
Depreciation	14,397	16,023	17,244	18,569	20,030	21,645	
Capital expenditures	-31,600	-16,000	-16,800	-18,200	-19,700	-21,300	
Change in working capital	-23,798	-84,849	-33,756	-7,639	-12,082	-12,668	
Free cash flow	**18,257**	**23,362**	**127,667**	**157,189**	**155,961**	**158,450**	
Terminal value							**3,092,608**
PV of FCF	0	21,769	110,671	126,663	116,886	110,514	
Sum of PV of FCF	486,504						
PV of terminal value	2,156,991						
Enterprise value	**2,643,495**						
Net debt at 31.12.2006	67,079						
Minorities	12,904						
Fair value at 31.12.2006	**2,563,512**						
Number of shares	12,030						
Fair value per share	**213**						
Equity cost	10.6%						
12-month price target	**230**						
Stock price	190						
Premium/discount	21.0%						

Source: Erste Bank

Our DCF model leads to a target price of PLN 230 per share. As this offers 21% upside, we maintain our Buy rating.

Market multiples

	Market Cap (EUR mn)	P/E 2006e	P/E 2007e	P/E 2008e	EV/Sales 2006e	EV/Sales 2007e	EV/Sales 2008e	EV/EBITDA 2006e	EV/EBITDA 2007e	EV/EBITDA 2008e	Valuation 2006e	Valuation 2007e	Valuation 2008e
Implied fair value (PLN mn)		261	455	617	558	946	1,307	672	1,179	1,569			
Number of shares (mn)		12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0	12.0			
Implied fair value per share		21.7	37.8	51.3	46.4	78.6	108.6	55.8	98.0	130.4	**41.3**	**71.5**	**96.8**
12-month price target											**45.7**	**79.0**	**107.0**
		P/E 2006e	**P/E 2007e**	**P/E 2008e**	**EV/Sales 2006e**	**EV/Sales 2007e**	**EV/Sales 2008e**	**EV/EBITDA 2006e**	**EV/EBITDA 2007e**	**EV/EBITDA 2008e**	**EBITDA margin 2006e**	**EBITDA margin 2007e**	**EBITDA margin 2008e**
median for peer group	**523.58**	**13.04**	**11.77**	**10.21**	**0.41**	**0.38**	**0.35**	**7.14**	**6.53**	**5.85**	**5.5%**	**5.6%**	**6.2%**
Kier Group	972	13.42	12.16		0.29	0.28		6.71	6.20		4.3%	4.5%	
Heijmans	890	10.42	8.93	7.85	0.43	0.40	0.36	8.03	7.16	6.24	5.3%	5.6%	5.7%
Alfred McAlpine Plc	746	14.48	13.03	11.79	0.41	0.37	0.33	9.30	8.81	7.40	4.4%	4.2%	4.5%
Morgan Sindall	726	15.13	13.43	12.57	0.30	0.27	0.26	8.56	7.71	7.15	3.5%	3.6%	3.6%
Arcadis	714	15.04	13.10	11.59	0.62	0.56	0.51	7.91	6.95	6.12	7.8%	8.1%	8.3%
Veidekke ASA	705	9.43	9.27	9.24	0.37	0.35	0.34	6.81	6.26	6.08	5.5%	5.6%	5.6%
Interserve Plc	653	13.04	11.77	10.56	0.41	0.34	0.31	7.79	6.53	5.84	5.3%	5.3%	5.4%
Keller	650	11.03	12.18	11.27	0.52	0.49	0.45	5.85	5.84	5.40	8.9%	8.3%	8.3%
Lemminkaeinen	524	9.86	9.17	8.94	0.41	0.38	0.35	5.95	5.61	5.33	7.0%	6.8%	6.6%
Galliford Try	502	11.40	10.66	9.10	0.30	0.28	0.24	7.13	6.72	5.86	4.2%	4.2%	4.1%
Geo ASA	493	13.75	10.34	7.93	3.52	3.29	2.85	9.30	7.82	6.64	37.9%	42.1%	43.0%
Wsp Group	438	17.21	14.91	13.41	0.79	0.71	0.64	9.72	8.89	7.74	8.2%	8.0%	8.3%
Cfe	433	12.66	9.33	8.17	0.56	0.51	0.48	5.63	4.68	4.22	10.0%	11.0%	11.4%
J & P Avax Sa	404	21.67	16.07	10.48	1.18	1.00	0.39	16.31	11.80	5.39	7.2%	8.5%	7.2%
Sweco AB	363	13.22	12.29	11.53	0.80	0.71	0.64	7.14	6.36	5.71	11.1%	11.1%	11.2%
Ballast Nedam	310	11.23	9.85	8.19	0.20	0.18	0.16	3.91	3.49	2.73	5.0%	5.1%	5.8%
Costain Group	280	11.40	10.60	9.94	0.16	0.15	0.13	6.58	5.47	5.07	2.4%	2.7%	2.6%

Source: JCF

On market multiples, PBG is still traded with an enormous premium to its construction sector peers. However, after raising the forecast for 2007 and 2008, the multiples look more reasonable. The largest premium is on EV/S ratio that confirms superior profitability of PBG (EBITDA margin is more than double comparing median for construction sector). Nevertheless we do not use this method to set our target price as PBG is unique engineering company, hardly to compare with pure construction firms.

Company Report

Income Statement (IAS, PLN mn, 31/12)	2004	2005	2006e	2007e	2008e
Sales revenues	**216.1**	**408.5**	**793.0**	**1,282.6**	**1,622.9**
Cost of goods sold	-172.1	-337.4	-663.1	-1,084.3	-1,355.8
Gross profit	**44.0**	**71.2**	**129.9**	**198.3**	**267.1**
SG&A	-24.1	-33.8	-61.9	-66.8	-71.0
Other operating revenues	4.4	9.5	12.7	14.3	18.0
Other operating expenses	-2.5	-5.5	-7.5	-12.2	-15.4
EBITDA	**28.5**	**50.7**	**87.6**	**149.6**	**216.0**
Depreciation	-6.7	-9.4	-14.4	-16.0	-17.2
EBIT	**21.8**	**41.3**	**73.2**	**133.6**	**198.8**
Financial result	-2.7	4.0	-6.9	-5.7	-4.2
EBT	**19.1**	**45.3**	**66.3**	**127.8**	**194.5**
Tax expenses	-5.1	-8.4	-12.6	-24.3	-37.0
Extraordinary result	0.0	0.0	0.0	0.0	0.0
Minority interests	0.0	-0.9	-2.1	-3.4	-3.9
Net result after minorities	**14.0**	**36.1**	**51.5**	**100.2**	**153.7**

Balance Sheet (IAS, PLN mn, 31/12)	2004	2005	2006e	2007e	2008e
Intangible assets	3.7	9.8	70.1	70.0	69.9
Tangible assets	48.1	177.2	200.8	183.5	183.2
Financial assets	16.2	8.6	30.8	30.8	30.8
Total fixed assets	**68.0**	**195.6**	**301.8**	**284.4**	**283.9**
Inventories	4.8	11.9	21.9	30.4	35.3
Receivables and other current assets	186.8	370.5	623.0	823.3	900.8
Other assets	2.4	6.5	8.8	8.8	8.8
Cash and cash equivalents	43.8	81.8	158.6	256.5	324.6
Total current assets	**237.8**	**470.7**	**812.3**	**1,118.9**	**1,269.4**
TOTAL ASSETS	**305.8**	**666.3**	**1,114.0**	**1,403.3**	**1,553.3**
Shareholders' equity	**142.6**	**177.6**	**379.5**	**479.7**	**583.3**
Minorities	**0.5**	**6.7**	**12.9**	**16.3**	**19.8**
Other reserves	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Interest-bearing LT debts	27.7	79.4	88.5	112.4	110.2
Other LT liabilities	6.0	122.7	156.8	156.8	156.8
Total long-term liabilities	**33.7**	**202.1**	**245.3**	**269.1**	**266.9**
Interest-bearing ST debts	44.0	136.0	140.8	178.8	175.3
Other ST liabilities	85.0	144.0	335.5	459.4	508.0
Total short-term liabilities	**129.1**	**279.9**	**476.3**	**638.2**	**683.3**
TOTAL LIAB. & EQUITY	**305.8**	**666.3**	**1,114.0**	**1,403.3**	**1,553.3**

Cash Flow Statement (IAS, PLN mn, 31/12)	2004	2005	2006e	2007e	2008e
Cash flow from operating activities	-43.2	-54.9	-3.8	65.1	155.1
Cash flow from investing activities	-18.5	-97.3	-97.2	-16.0	-16.8
Cash flow from financing activities	94.8	190.2	177.7	48.8	-70.2
CHANGE IN CASH & CASH EQU.	**33.1**	**38.0**	**76.8**	**97.9**	**68.1**

Margins & Ratios	2004	2005	2006e	2007e	2008e
Sales growth	19.6%	89.1%	94.1%	61.7%	26.5%
EBITDA margin	13.2%	12.4%	11.0%	11.7%	13.3%
EBIT margin	10.1%	10.1%	9.2%	10.4%	12.2%
Net profit margin	6.5%	8.8%	6.5%	7.8%	9.5%
ROE	15.9%	22.5%	18.5%	23.3%	28.9%
ROCE	11.7%	12.9%	11.2%	16.6%	22.9%
Equity ratio	46.8%	27.7%	35.2%	35.3%	38.8%
Inventory turnover	48.1	40.5	39.3	41.5	41.3

Source: Company data, Erste Bank estimates

Company Report

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PBG	--	--

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