

**Construction**

Poland

Current price	PLN 17.2
Target price	PLN 24.0
Market cap	PLN 0.22bn
Free float	PLN 0.05bn
Avg. daily trading volume	PLN 0.09m

Shareholder Structure

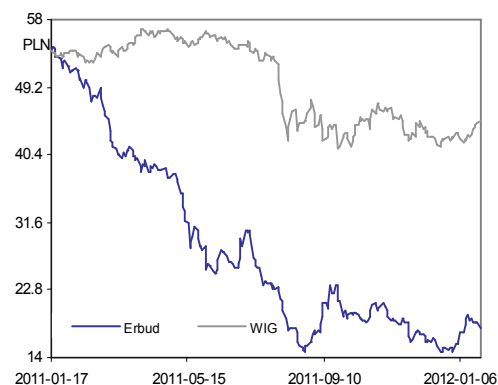
Wolff & Muller	32.84%
Juladal Investment Limited	22.29%
ING OFE	10.04%
Dariusz Grzeszczak	5.93%
AVIVA OFE BZ WBK	9.36%
Pozostali	19.54%

Sector Outlook

The new year deals a new hand. The WIG Budownictwo index of construction stocks is not likely to be outperformed by the broad WIG index in 2012. The opportunities awaiting companies this year come from power plant contracts, and risks stem from road contracts (weak operating cash flows, delayed payments). We would pick small and medium-sized builders over large players when looking for investments in the construction sector because they work on shorter deadlines and enjoy solid balance sheets.

Company Profile

Erbud is a general contractor specializing in housing, retail, office and industrial building projects. It has also bought two local road construction companies, thereby diversifying its business into segments independent of the economic climate.

Erbud vs. WIG**Maciej Stokłosa**

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Erbud

ERB PW; ERBA.WA

Buy

(Reiterated)

Contract Margins On the Mend

Erbud reported weaker-than-expected results for Q3 2011, and the fourth-quarter figures are expected to show flat growth relative to the same period in 2010. The company has been generating low margins on ongoing general contracting jobs, but the margins provided by new contracts for delivery in 2012 look better. Erbud has restructured its loss-making Wrocław branch, and its new residential developments are generating improving margins thanks to lower construction costs. There is a chance that the company will be able to finish a high-margin PLN 116m border-crossing contract, which provided a revenue of just PLN 38m in 2011, faster than scheduled. For all these reasons, we anticipate a strong rebound in Erbud's earnings in 2012. Our forecasts for this year have been revised to reflect lower revenues and more conservative margin estimates. Erbud's 2012 order backlog is 74% full, which is less than achieved so far by other construction companies, but which does not affect the outlook for the year because Erbud works largely on short-term assignments. We are reiterating a buy rating on Erbud with the price target at PLN 24 per share.

2012 order backlog

Erbud has accumulated ca. PLN 817m-worth of orders for delivery in 2012 so far, compared to a backlog of PLN 833m reported at the end of November 2010. The small decline is most probably a result of a more conservative approach to contract acquisition.

2012 will see higher profits on lower revenues

Our conservative financial forecasts for 2012 and 2013 assume a considerable contraction in revenues combined with an increase in profitability owed to completion of old loss-making contracts. Erbud is developing a commercial real estate project in Poznań which we do not take into account in our projections (we expect the project to generate a profit of ca. PLN 15m).

Q4 2011 results expected to be weak

We expect Erbud's Q4 2011 results to be weak due to continuing low-margin general contractor jobs and small provisions set aside for contract losses. The operating cash flow for the period will hover around zero. Revenues from the large border-crossing contract will be only a few million zlotys (the 2011 annual revenue is estimated at PLN 38m. The contract's total value is PLN 116m).

(PLN m)	2009	2010	2011F	2012F	2013F
Revenue	954.6	1 108.1	1 409.4	1 176.0	1 144.0
EBITDA	68.3	33.0	-6.8	45.5	46.7
<i>EBITDA margin</i>	7.2%	3.0%	-0.5%	3.9%	4.1%
EBIT	60.5	24.9	-14.2	38.7	38.2
Net profit	41.7	15.2	-20.6	27.0	27.6
P/E	5.2	14.3	-	8.0	7.8
P/CE	4.4	9.3	-	6.4	6.0
P/BV	0.9	0.9	1.0	0.9	0.8
EV/EBITDA	1.2	3.2	-	4.9	4.2
DYield	0.7%	2.9%	0.1%	0.0%	2.5%

Order Backlog

Erbud's order backlog for 2012 amounts to ca. PLN 816.6m (excluding the property development segment, i.e. preliminary agreements signed). The orders cover ca. 74% of the expected 2012 revenues.

2012 order backlog

Revenues	2012 (PLN m)	As pct. of our forecasts
Construction: Poland (gen. contracting)	601.2	80.2%
Construction: Exports	36.7	35.3%
Road construction	99.7	66.5%
Home sales	42.0	54.5%
Power Engineering	79	83.2%

Source: BRE Bank Securities

Forecasted earnings in 2012F-2015F

Revenue forecast by business segment

(PLN m)	2012F	2013F	2014F	2015F
Construction: Poland (gen. contracting)	750.0	750.0	780.0	811.2
Construction: Exports	104.0	107.1	110.3	113.6
Road construction	150.0	105.0	108.2	111.4
Home sales	77.0	79.3	81.7	84.1
Power Engineering	95.0	102.6	110.8	116.9
Steel Frames				
Total	1 176.0	1 144.0	1 191.0	1 237.3

Source: BRE Bank Securities

EBIT forecasts by business segment

Profit on sales	2012F	2013F	2014F	2015F
Construction: Poland (gen. contracting)	19.8	19.8	20.6	21.4
Construction: Exports	3.1	3.2	3.3	3.4
Road construction	3.8	2.7	2.8	2.8
Home sales	10.9	11.2	11.5	11.9
Power Engineering	2.8	3.0	3.3	3.5
Steel Frames	0.0	0.0	0.0	0.0
Other operating expenses	1.7	1.6	1.7	1.8
Total	38.7	38.2	39.7	41.2

Source: BRE Bank Securities

Valuation

We have valued the Erbud stock using the DCF model and relative valuation. Our 9-month target price is PLN 24.0 per share. The target implies a 39.5% upside potential from current levels, prompting a buy rating.

Valuation

	Valuation	Weight
DCF Analysis	25.9	50%
Relative valuation	18.7	50%
Average	22.3	
9M cost of equity	8.0%	
Valuation	24.0	

Source: BRE Bank Securities

Relative valuation

We compared Erbud to a group of general construction firms listed on the WSE. Based on estimated 2012-2013 P/E and EV/EBITDA multiples, the stock is trading at a 1.3% premium.

The EV/EBITDA multiple is higher than for selected competitors (in the residential segment, debt is counted twice, once in COGS, once in EV). The same is true of residential property developers.

Relative valuation

	2011F P/E	2012F P/E	2013F P/E	2011F EV/EBITDA	2011F EV/EBITDA	2013F EV/EBITDA
Budimex	8.1	8.3	11.0	2.2	4.1	6.9
Elektrobudowa	11.9	10.3	8.7	6.7	6.3	5.3
Mostostal Warszawa	<0	9.3	6.8	<0	3.3	2.5
PBG	5.1	10.9	7.0	10.7	9.4	6.9
Polimex Mostostal	8.3	8.9	8.3	5.9	5.7	5.3
Rafako	7.6	8.2	7.0	6.1	5.0	3.7
Unibep	9.2	7.6	7.5	5.7	6.8	4.1
ZUE	7.5	8.0	7.9	5.5	4.0	3.6
Median	8.1	8.6	7.7	5.9	5.3	4.7
Erbud	-11.3	8.6	8.4	-41.4	5.2	4.6
Premium (discount)	-239.7%	0.3%	9.6%	-795.4%	-2.6%	-2.1%
Multiple weight	0.0%	25.0%	25.0%	0.0%	25.0%	25.0%

Source: BRE Bank Securities; *relative valuation as of 23 January 2012

DCF valuation

DCF Model Assumptions

- Growth rate after FY2020 = 3%.
- Risk-free rate = 5.7% (10Y T-bond yield).
- Receivables turnover cycles longer than payables turnover cycles.
- Inventory in the property development segment amounts to 4 years of output.
- Erbud's EBIT margins on general contracting will be comparable to sector averages.
- Our forecasts do not factor in the launch of a commercial project in Poznań.
- Segmental financial forecasts are as provided above.

DCF Model

(PLN m)	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2020+
Revenue	1 409.4	1 176.0	1 144.0	1 191.0	1 237.3	1 283.2	1 327.5	1 371.3	1 414.5	1 457.0	
Change	27.2%	-16.6%	-2.7%	4.1%	3.9%	3.7%	3.5%	3.3%	3.2%	3.0%	
EBITDA	-6.8	45.5	46.7	48.2	49.8	51.4	52.9	54.5	55.4	55.6	
EBITDA margin	-0.5%	3.9%	4.1%	4.1%	4.0%	4.0%	4.0%	4.0%	3.9%	3.8%	
D&A expenses	7.4	6.8	8.5	8.6	8.7	8.8	8.9	9.1	9.2	9.2	
EBIT	-14.2	38.7	38.2	39.6	41.1	42.6	44.0	45.4	46.2	46.4	
EBIT margin	-1.0%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%	3.3%	3.2%	
Tax on EBIT	-2.7	7.3	7.3	7.5	7.8	8.1	8.4	8.6	8.8	8.8	
Property valuation		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
NOPLAT	-11.5	31.3	30.9	32.1	33.3	34.5	35.6	36.8	37.4	37.6	
CAPEX	-3.9	-7.1	-8.9	-9.0	-9.1	-9.3	-9.4	-9.5	-9.6	-9.2	
Working capital	-121.8	19.5	1.3	-7.3	-7.3	-7.3	-7.2	-7.4	-7.3	-7.2	
Equity investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	-129.8	50.5	31.8	24.4	25.5	26.7	28.0	29.0	29.7	30.4	31.3
WACC	10.0%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.6%	
Discount factor	100.0%	90.3%	81.6%	73.7%	66.6%	60.2%	54.3%	49.1%	44.3%	40.1%	
PV FCF	-129.8	45.6	26.0	18.0	17.0	16.1	15.2	14.2	13.2	12.2	
WACC	10.0%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.6%	
Cost of debt	6.9%	6.9%	6.9%	6.9%	6.9%	6.9%	6.9%	6.9%	6.9%	6.8%	
Risk-free rate	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.6%	
Risk premium	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	14%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
Cost of equity	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.7%	10.6%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	

FCF growth after the forecast period	3.0%	Sensitivity analysis					
Terminal value	412.3	FCF growth in perpetuity					
Present value of terminal value (PV TV)	165.3		2.0%	2.5%	3.0%	3.5%	4.0%
Present value of FCF in the forecast horizon	47.6	WACC -1.0pp	25.9	26.7	27.7	28.7	30.0
Enterprise value (EV)	212.9	WACC -0.5pp	25.7	26.5	27.5	28.5	29.8
Net debt	-115.0	WACC	25.6	26.4	27.4	28.4	29.6
Minority interests	3.0	WACC +0.5pp	25.4	26.2	27.1	28.2	29.4
Equity value	325.0	WACC +1.0pp	25.3	26.1	27.0	28.0	29.2
Number of shares	12.6						
Equity value per share (PLN)	25.9						
9M cost of equity	8.0%						
Equity value	27.4						
EV/EBITDA ('11) for the target price	-27.9						
P/E ('11) for the target price	-16.7						
TV / EV	78%						

Income Statement

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Revenue	663.1	1 046.1	954.6	1 108.1	1 409.4	1 176.0	1 144.0
<i>Change</i>	55.6%	57.8%	-8.8%	16.1%	27.2%	-16.6%	-2.7%
COGS	606.7	943.7	836.5	1 020.8	1 375.5	1 085.0	1 054.1
Gross profit	56.4	102.5	118.1	87.3	33.9	91.0	89.9
<i>Gross margin</i>	8.5%	9.8%	12.4%	7.9%	2.4%	7.7%	7.9%
Selling expenses	-0.4	-1.3	-1.4	-2.2	-3.8	-3.7	-3.6
G&A expenses	-22.2	-36.4	-48.6	-50.6	-48.2	-47.0	-46.5
Property valuation						0.0	0.0
Other net operating income/expenses	-1.0	-3.9	-7.6	-9.5	3.8	-1.7	-1.6
EBIT	32.8	60.8	60.5	24.9	-14.2	38.7	38.2
<i>Change</i>	29.3%	85.4%	-0.5%	-58.8%	-157.0%	-372.4%	-1.3%
<i>EBIT margin</i>	4.9%	5.8%	6.3%	2.2%	-1.0%	3.3%	3.3%
Financing income/expenses	6.5	-46.5	-4.2	-1.8	-5.7	-4.3	-3.1
Extraordinary income/expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax profit	39.2	14.3	56.3	23.2	-19.9	34.3	35.1
Tax	7.4	3.8	13.7	8.1	-0.2	6.5	6.7
Other	0.0	1.2	0.9	-0.2	0.9	0.8	0.8
Net profit	31.8	9.3	41.7	15.2	-20.6	27.0	27.6
<i>Change</i>	57.6%	-70.8%	348.7%	-63.5%	-235.5%	-231.2%	2.3%
<i>margin</i>	4.8%	0.9%	4.4%	1.4%	-1.5%	2.3%	2.4%
D&A expenses	1.8	6.3	7.8	8.1	7.4	6.8	8.5
EBITDA	34.6	67.1	68.3	33.0	-6.8	45.5	46.7
<i>Change</i>	30.1%	93.8%	1.8%	-51.7%	-120.7%	-765.3%	2.6%
<i>EBITDA margin</i>	5.2%	6.4%	7.2%	3.0%	-0.5%	3.9%	4.1%
Shares at year-end (millions)	12.6	12.6	12.6	12.6	12.6	12.6	12.6
EPS	2.5	0.7	3.3	1.2	-1.6	2.2	2.2
CEPS	2.7	1.2	3.9	1.9	-1.1	2.7	2.9
ROAE	27.3%	4.7%	19.1%	6.3%	-8.8%	11.6%	10.7%
ROAA	9.9%	1.6%	6.6%	2.4%	-2.9%	3.6%	3.8%

Balance Sheet

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
ASSETS	491.2	647.9	608.3	646.3	767.8	724.0	739.3
Fixed assets	46.0	99.7	93.0	107.0	130.2	130.6	131.0
Intangible assets	0.4	0.3	0.3	0.4	0.5	0.5	0.5
Goodwill	1.5	19.7	20.1	20.1	20.1	20.1	20.1
Property, plant and equipment	16.7	37.2	35.9	33.6	32.8	33.1	33.6
Investment properties	12.0	11.8	8.4	5.9	5.8	5.8	5.8
Long-term investment	1.5	1.5	6.6	24.7	31.0	31.0	31.0
Other	14.0	29.2	21.6	22.3	40.1	40.1	40.1
Current assets	445.2	548.3	515.3	539.4	637.5	593.4	608.3
Inventories	118.6	144.6	99.5	95.0	109.9	103.8	105.0
Trade debtors	101.0	217.3	187.2	168.6	339.8	273.9	266.4
Construction contracts and prepayments	42.5	70.5	52.9	119.4	116.5	97.3	94.7
Cash and cash equivalents	128.4	115.6	172.5	153.7	70.9	117.9	141.8
Other	54.8	0.3	3.1	2.7	0.5	0.5	0.5
(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
EQUITY AND LIABILITIES	491.2	647.9	608.3	646.3	767.8	724.0	739.3
Equity	192.5	201.4	235.5	248.6	220.1	247.1	269.4
Minority interests	17.5	19.8	2.9	3.0	10.3	11.0	11.8
Long-term liabilities	44.5	90.2	40.9	48.9	131.2	131.2	131.2
Loans	20.9	61.6	4.3	5.8	77.7	77.7	77.7
Provisions and other	23.7	28.6	36.6	43.1	53.5	53.5	53.5
Current liabilities	236.7	336.5	328.9	345.9	406.2	334.6	327.0
Loans	19.9	22.4	29.7	32.9	33.1	33.1	33.1
Trade payables	119.0	155.7	192.4	188.0	226.1	178.4	173.3
Construction contracts and accruals	92.9	109.7	83.9	113.2	136.4	112.5	109.9
Provisions and other	4.9	48.7	22.9	11.8	10.6	10.6	10.6
Debt	40.8	84.0	34.0	38.7	110.8	110.8	110.8
Net debt	-87.6	-31.6	-138.5	-115.0	39.9	-7.0	-30.9
(Net debt / Equity)	-45.5%	-15.7%	-58.8%	-46.3%	18.1%	-2.8%	-11.5%
(Net debt / EBITDA)	-2.5	-0.5	-2.0	-3.5	-5.8	-0.2	-0.7
BVPS	15.3	16.0	18.7	19.8	17.5	19.7	21.4

Cash Flows

(PLN m)	2007	2008	2009	2010	2011F	2012F	2013F
Cash flow from operating activities	36.2	-52.5	153.3	24.2	-137.4	58.5	41.3
Net profit	31.8	9.3	41.7	15.2	-20.6	27.0	27.6
D&A expenses	1.8	6.3	7.8	8.1	7.4	6.8	8.5
Working capital	13.5	-97.8	106.0	40.4	-134.4	19.5	1.3
Property valuation						0.0	0.0
Other	-11.0	29.7	-2.1	-39.5	10.3	5.1	3.9
Cash flow from investing activities	-74.8	6.1	-29.2	-28.4	-6.1	-7.1	-8.9
CAPEX	-2.9	35.8	-3.2	-4.1	-3.9	-7.1	-8.9
Equity investment	-77.1	-40.0	0.0	0.0	0.0	0.0	0.0
Other	5.3	10.4	-26.1	-24.3	-2.2	0.0	0.0
Cash flows from financing activities	137.9	34.0	-67.1	-14.6	67.2	-4.3	-8.5
Stock issue	120.7	0.0	0.0	0.6	0.5	0.0	0.0
Debt	18.9	160.8	86.2	62.0	122.0	0.0	0.0
Dividend (buy-back)	0.0	0.0	-1.5	-6.3	-0.2	0.0	-5.4
Other	-1.7	-126.8	-151.8	-71.0	-55.1	-4.3	-3.1
Change in cash	99.2	-12.4	57.0	-18.8	-76.3	47.0	23.9
Cash at period end	128.4	115.6	172.5	153.7	70.9	117.9	141.8
DPS (PLN)	0.0	0.0	0.1	0.5	0.0	0.0	0.4
FCF	-38.2	-92.3	157.8	73.3	-129.8	50.5	31.8
(CAPEX / Sales)	0.4%	-3.4%	0.3%	0.4%	0.3%	0.6%	0.8%

Trading Multiples

	2007	2008	2009	2010	2011F	2012F	2013F
P/E	6.8	23.4	5.2	14.3	-10.5	8.0	7.8
P/CE	6.4	13.9	4.4	9.3	-16.4	6.4	6.0
P/BV	1.1	1.1	0.9	0.9	1.0	0.9	0.8
P/S	0.3	0.2	0.2	0.2	0.2	0.2	0.2
FCF/EV	-26.0%	-45.0%	194.3%	69.9%	-48.6%	22.9%	16.1%
EV/EBITDA	4.2	3.1	1.2	3.2	-39.1	4.9	4.2
EV/EBIT	4.5	3.4	1.3	4.2	-18.8	5.7	5.2
EV/S	0.2	0.2	0.1	0.09	0.19	0.19	0.17
DYield	0.0%	0.0%	0.7%	2.9%	0.1%	0.0%	2.5%
Price (PLN)	17.3						
Shares at year-end (millions)	12.6	12.6	12.6	12.6	12.6	12.6	12.6
MC (PLN m)	216.8	216.8	216.8	216.8	216.8	216.8	216.8
Equity att. to min. shareholders (PLN m)	17.5	19.8	2.9	3.0	10.3	11.0	11.8
EV (PLN m)	146.7	205.1	81.2	104.8	267.1	220.9	197.7



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List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

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ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
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Previous ratings issued for Erbud

Rating	Accumulate	Buy	Buy	Buy
Date issued	2011-04-29	2011-05-20	2011-08-18	2012-01-23
Price on rating day	37,51	29,70	17,37	18,50
WIG on rating day	50219,70	48747,55	41125,87	39518,87