

2 August 2010

Update

**Construction**

Poland

Current price	PLN 67.50
Target price	PLN 68.60
Market cap	PLN 1.36bn
Free float	PLN 0.43bn
Avg daily trading volume (3M)	PLN 1.57m

Shareholder Structure

Acciona	50.09%
OFE PZU Złota Jesień	17.80%
Others	32.11%

Sector Outlook

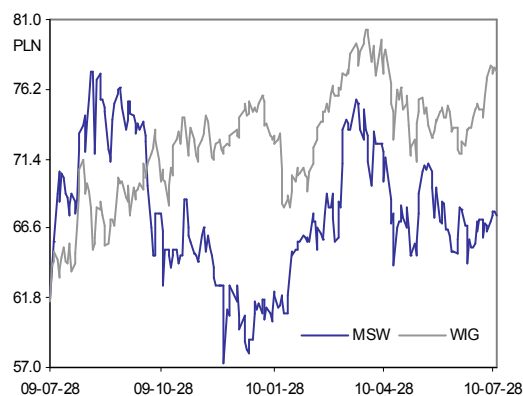
As builders complete the lucrative contracts captured at the high prices prevailing in 2008, they become an increasingly risky investment. Some firms are poised to benefit from the upcoming power-plant building boom. We recommend underweighting the construction sector as a whole, and, within it, we would advise investors to pick smaller and medium-sized companies rather than the major players.

Company Profile

Mostostal Warszawa is one of Poland's largest construction firms. It acts as general contractor for buildings, industrial facilities, and infrastructure projects, as well as chemical and power plants, and environmental-engineering systems.

Important Dates

31.08 - H1 2010 report
15.11 - Q3 2010 report

MSW vs. WIG**Maciej Stokłosa**

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Mostostal Warszawa**Hold**

MOWA. WA; MSW.PW

(Downgraded)

Safety Trumps Profits

In 2009, faced with an industry-wide slowdown and increased competition, Mostostal Warszawa (MSW) decided to minimize contractual risks by focusing on recurring, small and medium-sized jobs for the public sector, and taking a selective approach to large road contracts. This strategy proved an effective way of mitigating potential losses, but, on the downside, since many of the public-sector contracts were won through competitive bids against small local low-cost providers, they will probably generate slim margins. We expect MSW to report a slight contraction in 2010 revenues on a somewhat smaller backlog. We are also lowering our future profit forecasts for the builder to account for the expected squeeze in contract margins, expected to become noticeable in Q3 2010. That said, MSW is the most attractively priced construction stock (the lowest EV/EBITDA ratio) relative to other leading players (PBG, Budimex, Polimex Mostostal). In the longer term, the company is poised to benefit from the slew of power-plant projects expected to come on line in 2012. We are downgrading MSW to hold.

Alliance with Rafako

Mostostal Warszawa and power engineer Rafako have formed an alliance for purposes of future power-plant contract tenders. The track records and resources of the two companies complement each other well, and the only risk that they face are possible delays in the contract-award schedule. Meanwhile, an expected downside in profits will probably be affecting MSW's market value.

Unclear Prospects For Road Contracts

A recent tender for a stretch of the A4 motorway attracted only three bidders: Polimex with Doprastav (who offered PLN 2.2bn), Autostrada Wschodnia with Mapa Insaat Ve Ticaret (PLN 2.4bn), and Mostostal Warszawa with Acciona (PLN 3.0bn). These bids compare to the project's estimated budget of PLN 2.0bn, which supports the rumors that the National Directorate for Roads and Motorways (GDDKiA) has become more conservative in its estimates of road-construction costs. Further, the small number of companies competing for a major opportunity like the A4 contract may be a sign that builders prefer to stay away from large, long-term jobs whose costs are subject to unpredictable variations.

(PLN m)	2008	2009	2010F	2011F	2012F
Revenue	2 211.3	2 712.1	2 585.0	2 789.4	3 026.7
EBITDA	144.6	209.1	134.7	134.7	160.0
EBITDA margin	6.5%	7.7%	5.2%	4.8%	5.3%
EBIT	121.9	181.2	97.7	96.7	121.1
Net profit	81.1	117.3	79.6	76.4	93.9
P/E	16.6	11.5	17.0	17.7	14.4
P/CE	13.0	9.3	11.6	11.8	10.2
P/BV	4.0	2.8	2.7	2.5	2.3
EV/EBITDA	8.1	5.2	9.0	9.0	7.2
DYield	0.4%	0.5%	4.3%	2.9%	2.8%

Valuation

Using DCF analysis and relative valuation, we calculated the price target for MSW stock at PLN 68.6 per share. The target represents a 1.7% upside from the current market price, prompting a hold rating.

Valuation

	Value per share	Weight
DCF Analysis	62.3	75%
Relative Valuation	66.9	25%
Average	63.5	
Cost of equity (9M)	8.1%	
Target Price	68.6	

Source: BRE Bank Securities

Relative Valuation

Compared to a peer group of large publicly-traded construction firms, Mostostal Warszawa is trading at a 4.1% premium to the average of comparable P/E and EV/EBITDA multiples forecasted for 2010 through 2012.

Multiples Comparison

	2010F P/E	2011F P/E	2012F P/E	2010F EV/EBITDA	2011F EV/EBITDA	2012F EV/EBITDA
Budimex	13.1	15.0	14.9	10.4	10.4	10.0
Erbud	12.3	12.6	11.2	8.7	8.2	6.9
Elektrobudowa	16.5	14.8	12.7	10.2	8.7	7.3
PBG	15.3	14.9	14.4	10.7	10.5	9.9
Polimex Mostostal	16.0	17.6	12.2	10.2	10.1	8.0
Rafako	17.3	14.7	13.4	9.4	7.4	6.2
Trakcja Polska	16.3	17.1	12.9	8.9	8.8	5.8
Unibep	14.0	14.5	7.4	10.6	10.6	5.6
Median	15.6	14.8	12.8	10.2	9.4	7.1
Mostostal Warszawa	17.0	17.7	14.4	9.0	9.0	7.2
Premium (discount)	8.4%	19.0%	12.4%	-11.4%	-5.0%	1.0%
Multiple weight	20.0%	20.0%	10.0%	20.0%	20.0%	10.0%

Source: BRE Bank Securities

DCF Analysis

DCF Model Assumptions:

- Expected growth rate after FY2017 = 3%.
- Risk-free rate = 5.9% (10Y T-bond yield).



DCF Model

(PLN m)	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2019+
Sales revenue	2 585.0	2 789.4	3 026.7	3 250.9	3 462.3	3 659.4	3 858.9	4 037.6	4 204.0	4 353.1	
Change	-4.7%	7.9%	8.5%	7.4%	6.5%	5.7%	5.5%	4.6%	4.1%	3.5%	
EBITDA	134.7	134.7	160.0	171.3	182.5	190.5	198.4	199.7	200.1	202.0	
EBITDA margin	5.2%	4.8%	5.3%	5.3%	5.3%	5.2%	5.1%	4.9%	4.8%	4.6%	
D&A expenses	37.0	38.0	38.9	39.9	41.0	42.0	43.1	43.1	43.1	43.1	
EBIT	97.7	96.7	121.1	131.4	141.6	148.5	155.4	156.6	157.0	158.9	
EBIT margin	3.8%	3.5%	4.0%	4.0%	4.1%	4.1%	4.0%	3.9%	3.7%	3.7%	
Tax rate on EBIT	18.6	18.4	23.0	25.0	26.9	28.2	29.5	29.8	29.8	30.2	
NOPLAT	79.2	78.3	98.1	106.4	114.7	120.3	125.8	126.9	127.2	128.7	
CAPEX	-48.1	-45.6	-46.7	-47.9	-49.2	-50.4	-51.7	-48.3	-46.5	-43.1	
Working capital	-140.2	-20.1	12.7	-13.8	-13.0	-11.5	-11.6	-9.2	-8.3	-7.9	
FCF	-72.2	50.7	103.0	84.7	93.5	100.4	105.6	112.5	115.4	120.9	124.5
WACC	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.6%	
discount factor	95.8%	86.4%	77.9%	70.2%	63.3%	57.1%	51.5%	46.4%	41.9%	37.9%	
PV FCF	-69.1	43.8	80.2	59.5	59.2	57.3	54.4	52.2	48.3	45.7	
WACC	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.6%	
Cost of debt	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%	7.1%	6.8%	
Risk-free rate	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%	5.9%	5.6%	
Credit 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	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	
Cost of Equity	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	10.9%	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 horizon		3.0%									
Terminal value		1 638.0									
Present value of terminal value		620.0									
Present value of FCF in the forecast horizon		431.5									
Equity Value		1 051.5									
Net debt		-338.6									
Other non-operating assets		0.0									
Minority interests		143.2									
Equity value		1 246.8									
Number of shares (millions)		20.0									
Equity value per share (PLN)		62.3									
Cost of equity (9M)		8.1%									
Target Price		67.4									
EV/EBITDA for the target price		5.2									
P/E for the target price		11.5									
TV / EV		50%									

Sensitivity Analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0ppt	63.6	65.5	67.7	70.3	73.1
WACC -0.5ppt	63.4	65.4	67.6	70.1	72.9
WACC	63.3	65.2	67.4	69.9	72.7
WACC +0.5ppt	63.1	65.0	67.2	69.7	72.5
WACC +1.0ppt	62.9	64.8	67.0	69.5	72.3

**Income Statement**

(PLN m)	2006	2007	2008	2009	2010F	2011F	2012F
Sales revenue	1 188.1	1 928.4	2 211.3	2 712.1	2 585.0	2 789.4	3 026.7
<i>change</i>	42.0%	62.3%	14.7%	22.7%	-4.7%	7.9%	8.5%
COGS	1 123.1	1 822.2	1 994.0	2 399.9	2 392.4	2 592.4	2 796.8
Gross profit	65.0	106.2	217.3	312.2	192.6	197.0	229.9
<i>gross margin</i>	5.5%	5.5%	9.8%	11.5%	7.5%	7.1%	7.6%
Selling expenses	-0.8	-0.8	-1.1	-2.2	-1.0	-1.1	-1.2
General and administrative expenses	-54.5	-59.2	-74.8	-89.9	-87.9	-94.8	-102.9
Other net operating expenses	11.5	12.7	-19.5	-38.9	-6.0	-4.3	-4.7
EBIT	21.2	58.9	121.9	181.2	97.7	96.7	121.1
<i>change</i>	-395.5%	178.0%	107.0%	48.7%	-46.1%	-1.0%	25.2%
<i>EBIT margin</i>	1.8%	3.1%	5.5%	6.7%	3.8%	3.5%	4.0%
Profit/loss on financial activity	-2.0	1.3	1.0	-5.1	8.2	8.4	10.0
Equity in profits/losses of associates	0.3	2.2	-3.3	-6.7	0.9	1.1	1.2
Gross profit	19.5	62.3	119.5	169.5	106.9	106.1	132.3
Tax	-1.5	-3.7	-27.2	-43.5	-20.3	-20.2	-25.1
Minority interests	1.1	5.7	11.2	8.7	6.9	9.6	13.2
Net income	17.0	52.9	81.1	117.3	79.6	76.4	93.9
<i>change</i>	-	211.7%	53.2%	44.6%	-32.1%	-4.0%	22.9%
<i>Margin</i>	1.4%	2.7%	3.7%	4.3%	3.1%	2.7%	3.1%
D&A expenses	19.4	19.6	22.8	27.9	37.0	38.0	38.9
EBITDA	40.6	78.5	144.6	209.1	134.7	134.7	160.0
<i>change</i>	275.4%	93.2%	84.3%	44.6%	-35.6%	0.0%	18.8%
<i>EBITDA margin</i>	3.4%	4.1%	6.5%	7.7%	5.2%	4.8%	5.3%
Shares at year-end (millions)	17.0	20.0	20.0	20.0	20.0	20.0	20.0
EPS	1.0	2.6	4.1	5.9	4.0	3.8	4.7
CEPS	2.1	3.6	5.2	7.3	5.8	5.7	6.6
ROAE	10.9%	20.8%	26.1%	28.6%	16.2%	14.6%	16.5%
ROAA	2.8%	6.0%	7.1%	8.4%	5.3%	4.9%	5.6%

**Balance Sheet**

(PLN m)	2006	2007	2008	2009	2010F	2011F	2012F
ASSETS	750.2	1 009.0	1 275.8	1 504.9	1 521.7	1 615.7	1 730.2
Fixed assets	165.5	184.2	246.4	361.8	372.9	380.5	388.3
Intangible assets	1.2	1.2	2.2	1.6	1.6	1.6	1.6
Investments in associates	2.2	4.2	1.0	5.7	5.7	5.7	5.7
Property, plant and equipment	139.5	150.7	188.1	285.0	296.1	303.7	311.5
Long-term investments	1.5	1.3	0.9	1.0	1.0	1.0	1.0
Other	21.2	26.8	54.3	68.5	68.5	68.5	68.5
Current assets	584.6	824.8	1 029.4	1 143.1	1 148.8	1 235.2	1 341.9
Inventories	30.7	54.6	41.3	35.7	71.4	77.4	83.5
Accounts receivable	323.2	332.0	516.3	490.0	481.6	473.8	481.0
Short-term prepayments	57.4	147.3	162.0	187.0	297.5	376.0	408.0
Cash and cash equivalents	170.6	287.7	309.3	429.2	297.1	306.8	368.2
Other	2.7	3.2	0.5	1.2	1.2	1.2	1.2
(PLN m)	2006	2007	2008	2009	2010F	2011F	2012F
LIABILITIES	750.2	1 009.0	1 275.8	1 504.9	1 521.7	1 615.7	1 730.2
Equity	224.3	284.9	337.7	482.5	503.4	540.0	595.7
Minority interests	54.4	59.5	65.3	73.7	73.7	73.7	73.7
Long-term liabilities	50.2	34.4	46.0	74.5	73.7	74.0	74.4
Loans, financial leases	24.1	16.5	29.0	60.1	60.1	60.1	60.1
Provisions and other charges	26.1	17.9	17.0	14.4	13.6	13.9	14.3
Short-term liabilities	421.2	630.2	826.8	874.3	871.0	928.0	986.3
Loans	16.8	29.3	30.1	30.4	30.4	30.4	30.4
Trade creditors	249.1	311.7	338.5	368.5	367.1	397.7	429.1
Long-term accruals	90.0	217.3	283.6	311.6	310.6	336.6	363.1
Other	65.3	71.9	174.5	163.7	162.8	163.2	163.6
Debt	40.9	45.8	59.1	90.6	90.6	90.6	90.6
Net debt	-129.7	-241.9	-250.2	-338.6	-206.6	-216.2	-277.6
(Net debt / Equity)	-57.8%	-84.9%	-74.1%	-70.2%	-41.0%	-40.0%	-46.6%
(Net debt / EBITDA)	-3.2	-3.1	-1.7	-1.6	-1.5	-1.6	-1.7
BVPS	13.2	14.2	16.9	24.1	25.2	27.0	29.8

**Cash Flows**

(PLN m)	2006	2007	2008	2009	2010F	2011F	2012F
Cash flows from operating activities	43.9	101.7	66.9	213.8	-26.6	96.2	149.6
Net income	17.0	52.9	81.1	117.3	79.6	76.4	93.9
D&A expenses	19.4	19.6	22.8	27.9	37.0	38.0	38.9
Working capital	42.3	-28.8	32.5	18.1	-10.2	-9.7	-8.7
Other	-34.8	58.0	-69.5	50.5	-133.0	-8.5	25.4
Cash flows from investing activities	-11.6	28.9	-25.7	-69.5	-55.1	-55.1	-60.0
CAPEX	-11.8	28.3	-22.3	-66.8	-48.1	-45.6	-46.7
Capital investments	-36.5	-21.6	-43.6	-70.9	-48.1	-45.6	-46.7
Other	36.7	22.1	40.3	68.2	41.2	36.0	33.5
Cash flows from financing activities	74.9	-13.5	-19.7	-24.4	-50.4	-31.5	-28.2
Stock issues	117.9	0.0	0.0	0.0	0.0	0.0	0.0
Debt	-40.0	-9.1	-10.4	-14.8	0.0	0.0	0.0
Dividend (buy-back)	0.0	-0.9	-5.2	-6.2	-58.7	-39.8	-38.2
Other	-3.0	-3.5	-0.1	-0.1	0.0	0.0	0.0
Change in cash	107.2	117.1	21.5	119.9	-132.1	9.6	61.4
Cash at period-end	170.6	287.7	309.3	429.2	297.1	306.8	368.2
DPS (PLN)	0.0	0.0	0.3	0.3	2.9	2.0	1.9
FCF	-5.3	68.3	11.6	137.8	-72.2	50.7	103.0
(CAPEX / Sales)	1.0%	-1.5%	1.0%	2.5%	1.9%	1.6%	1.5%

Market multiples

	2006	2007	2008	2009	2010F	2011F	2012F
P/E	67.6	25.5	16.6	11.5	17.0	17.7	14.4
P/CE	31.5	18.6	13.0	9.3	11.6	11.8	10.2
P/BV	5.1	4.7	4.0	2.8	2.7	2.5	2.3
P/S	1.0	0.7	0.6	0.5	0.5	0.5	0.4
FCF/EV	-0.5%	5.9%	1.0%	12.7%	-5.9%	4.2%	9.0%
EV/EBITDA	26.4	14.9	8.1	5.2	9.0	9.0	7.2
EV/EBIT	50.7	19.8	9.6	6.0	12.5	12.5	9.5
EV/S	0.9	0.6	0.5	0.4	0.5	0.4	0.4
DYield	0.0%	0.1%	0.4%	0.5%	4.3%	2.9%	2.8%
Price (PLN)	67.5						
Shares at year-end (millions)	17.0	20.0	20.0	20.0	20.0	20.0	20.0
MC (PLN m)	1148.4	1350.0	1350.0	1350.0	1350.0	1350.0	1350.0
Equity attributable to minority shareholders (PLN m)	54.4	59.5	65.3	73.7	73.7	73.7	73.7
EV (PLN m)	1 073.2	1 167.6	1 165.1	1 085.1	1 217.1	1 207.5	1 146.1



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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

Recommendations of BRE Bank Securities

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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 Mostostal Warszawa

Rating	Buy	Accumulate	Buy	Accumulate	Hold	Accumulate
Date issued	2009-11-04	2009-11-17	2009-12-02	2010-03-12	2010-04-07	2010-05-06
Price on rating day	66.00	70.00	68.00	69.00	77.00	68.30
WIG on rating day	37391.24	40785.58	39905.57	41004.33	43562.01	41287.90