14 June 2010

Update

BRE Bank Securities

Oil & Gas
Poland

PGNiG

PGNI.WA; PGN PW

Buy
(Reiterated)

Current price	**PLN 3.45**
Target price	**PLN 4.32**
Market cap	PLN 20.36bn
Free float	PLN 3.05bn
Avg daily trading volume (3M)	PLN 36.67m

Shareholder Structure

State Treasury	72.9%
Employees	12.1%
Others	15.0%

Sector Outlook

Being a gas utility subject to price regulation, PGNiG's financial performance is largely determined by decisions of Polish energy regulator the URE. In a volatile economic environment, regulatory decisions have an even bigger impact on the Company's earnings. The Distribution business makes stable cash flows possible.

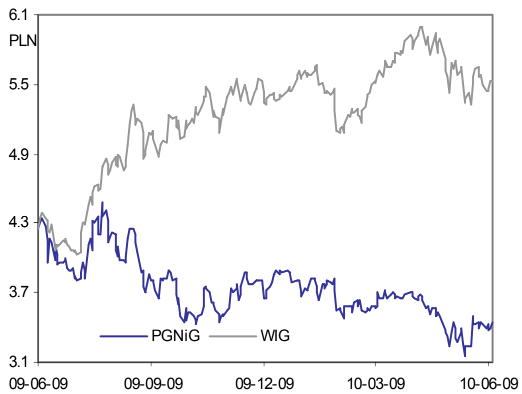
Company Profile

PGNiG is Poland's leading player in natural gas exploration and distribution, with annual sales exceeding 13-14 billion cubic meters. The company is also active in crude-oil mining, a business which is more profitable than gas sales since it is not subject to price regulation.

Important dates

31.08- H1'2010 report

PGNiG vs. WIG



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Underestimated E&P Potential

In the past few weeks, the share price of PGNiG has been affected by the issue of employee shares and the depreciation of the zloty, but in our opinion the market may be attaching too much importance to these risks. Conversely, investors are not attaching enough importance to the increase in the value of the Company's E&P assets, in particular its foreign projects, while we believe attention may come to focus on this area in the next few months, given the planned launch of production from the Norwegian shelf (even PLN 1bn in additional EBIT by 2013) and reports on new discoveries in Pakistan. We are reiterating our buy rating and the PLN 4.32 per-share price target.

Potential in Foreign Assets

In the past few years, PGNiG's foreign upstream assets have done little else than generate CAPEX and increase net debt (overall CAPEX on E&P projects outside Poland has been USD 720m). At the same time, most market valuations do not factor these projects in as future sources of revenues, which structurally depresses valuation. Now, it appears that the market should start paying more attention to them following the recent reports of new discoveries and confirmation of deposit size estimates. According to our estimates, the Skarv field should generate ca. USD 380m in EBIT over the next few years, while the market value of Pakistani and Danish licenses can be estimated at ca. USD 400m. Further, the Company is conducting work on very promising fields in Egypt and Lybia.

Employee Shares: an Overestimated Risk?

In the past few months, PGNiG has greatly underperformed the broad market, which was by and large a consequence of the fact that on 1 July trading will start in 750m employee shares, prompting concerns of increased share supply. We believe far too much weight is being attached to this risk; in fact, the expected increase in free float (by 85%) and the consequent increase in PGNiG's share of indices (from 2.7% to 4.7% in the case of WIG20) could actually help the stock.

Outlook for Coming Quarters: Risk of Non-Increase in the Tariff

The recent depreciation of the zloty vs. the USD has posed problems for the profitability of the Trade&Storage segment, given the rapid increase in the price of imported gas. Note however that due to the Company's hedging policies (with ca. USD 0.5bn hedged for Q2 at 3.11 and most likely a similar amount for Q3 at 3.19), the issue is not likely to significantly affect earnings until the fourth quarter. The Company will surely apply for a new tariff to come into force in October; we believe a 5% hike is a very realistic expectation, and it should allow PGNiG to minimize losses on gas trade (plus, the segment's earnings should be boosted by the reversal of provisions for receivables from Police and ZAK).

(PLN m)	2008	2009	2010F	2011F	2012F
Revenue	18 432.0	19 290.4	20 861.5	21 546.0	22 338.6
EBITDA	2 225.6	2 830.0	3 663.5	3 963.9	5 065.9
EBITDA margin	*12.1%*	*14.7%*	*17.6%*	*18.4%*	*22.7%*
EBIT	800.7	1 333.8	2 087.0	2 270.2	3 141.0
Net profit	865.3	1 202.0	1 685.1	1 602.1	1 929.3
DPS	0.19	0.03	0.08	0.11	0.11
P/E	23.5	16.9	12.1	12.7	10.6
P/CE	8.9	7.5	6.2	6.2	5.3
P/BV	1.0	1.0	0.9	0.9	0.8
EV/EBITDA	8.9	7.5	6.3	6.3	4.8
DYield	5.5%	0.7%	2.3%	3.3%	3.1%

Outlook for 2010 by Segment

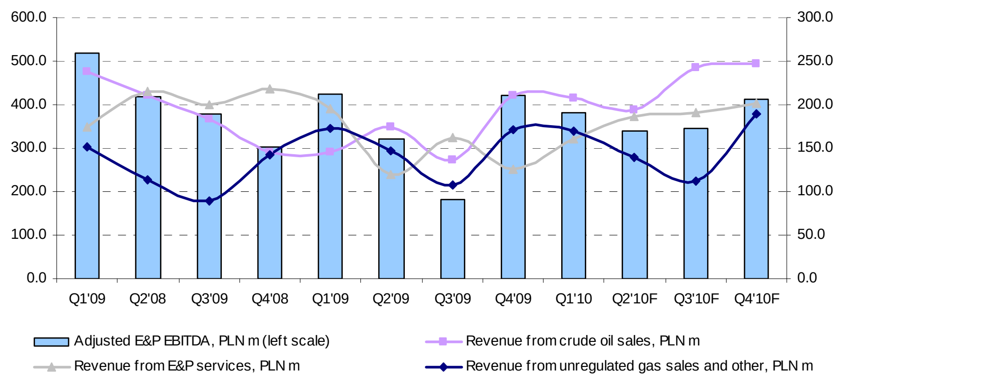
Consolidated First-Quarter Results

(PLN m)	Q1'08	Q2'08	Q3'08	Q4'08	Q1'09	Q2'09	Q3'09	Q4'09	Q1'10
Revenue	**5 330.4**	**3 929.2**	**3 653.5**	**5 518.9**	**6 378.9**	**3 874.7**	**3 407.9**	**5 628.9**	**6 622.2**
EBITDA	**1 337.8**	**665.0**	**529.0**	**-320.4**	**-87.7**	**170.9**	**841.7**	**1 905.0**	**1 582.2**
EBIT	**987.4**	**293.6**	**192.7**	**-687.7**	**-457.2**	**-222.0**	**494.8**	**1 518.2**	**1 216.3**
Upstream	374.4	255.1	248.5	44.6	272.1	-16.2	21.3	123.2	241.5
Trade	320.4	117.2	-39.3	-845.6	-1 126.8	-99.3	481.4	630.9	445.6
Distribution	267.1	-13.7	-5.0	169.9	393.8	-92.2	-16.2	265.4	535.9
Other	25.5	-65.0	-11.5	-56.6	3.7	-14.4	8.3	498.7	-6.7
Gross profit	978.4	392.4	228.1	-662.6	-433.8	-143.1	490.0	1 529.0	1 225.4
Net income	**779.0**	**280.3**	**181.1**	**-373.3**	**-398.8**	**-94.6**	**406.2**	**1 289.2**	**987.7**
Tariff: PLN/'000 m3	778.8	858.5	898.3	964.2	997.1	968.1	910.0	910.0	910.0
Cost of gas: USD/'000 m3	352.2	394.4	468.0	520.4	453.7	343.3	242.9	269.0	313.5
Russian gas in PLN	841.4	859.9	1 031.1	1 496.3	1 564.2	1 121.0	713.8	760.5	905.0
Import price/tariff spread	-62.6	-1.4	-132.8	-532.2	-567.1	-152.9	196.2	149.5	5.0

Source: PGNiG, BRE Bank Securities

- **Upstream:** in 1Q, the segment generated an EBIT of a PLN 241m vs. PLN 226m expected by us. The discrepancy was primarily a consequence of lower depreciation charges; no surprises were noted as regards volumes and reserves. Due to changes in the macroeconomic environment (crude oil pricing and the USD/PLN exchange rate) and the introduction of a new wholesale gas tariff (direct impact on prices in nontariff sales), we have decided to upgrade our FY forecast fro the segment from PLN 785m to PLN 906m. In addition to improved upstream profitability, we expect PGNiG's exploration subsidiaries to generate better earnings thanks to the weakened zloty and to improved sentiment to the sector, which should lead to an increased number of orders. Our forecasts assume no write-offs on upstream assets (a detailed review of these assets was carried out in 2009, and the book value of the segment's PP&E was reduced by 3.6%). Expenses on unsuccessful drilling efforts are likely to remain at a higher level than last year due to the sustained high outlays on prospecting and exploration in Poland and abroad.

Upstream EBITDA, revenue by category

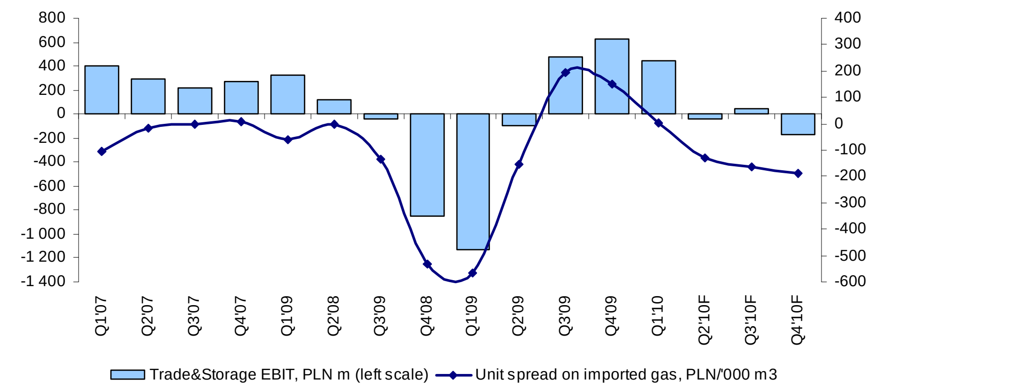


**EBITDA adjusted for write-downs on mining assets at PLN 324m in 2009 (we treat expenses related to unsuccessful drilling efforts as regular operating expenses)*
Source: PGNiG, BRE Bank Securities

- **Trade&Storage:** PGNiG's earnings from gas sales were much lower than expected in the first quarter (PLN 445m vs. PLN 812m), as the cost of the gas sold was much higher than we had anticipated, due to our underestimation of the price of imported gas on the one hand, and a different sales mix on the other (with lower-than-expected use of the cheaper stored gas despite the record-high demand). Further, the segment's earnings were depressed by a write-off on receivables from ZAK (PLN

56m). The weaker earnings and the considerable depreciation of the zloty vs. the USD have prompted us to make a significant revision to our FY10 projections for the segment (down from PLN 1.05bn to PLN 428m). Let us point out that with the current tariff in place (as a reminder, the 4.9% hike came into force on 1 June), Trade&Storage earnings should be close to the break-even point in Q2 and Q3 thanks to its hedging policies (at the end of May, the Company had the purchase of USD 0.5bn hedged at 3.11 for Q2, with USD 240m hedged at 3.19 for Q3). Should the current USD/PLN exchange rate persist, the Company will surely apply to the energy regulator URE for another tariff hike (the Management has already promised such a move). In our forecasts, we assume a 5% increase in the tariff; its only effect will be to reduce losses incurred on imported gas. Let us also point out that given the lifeline loan from the Industrial Development Agency that ZCH Police has received, our forecasts factor in the reversal of PLN 129m worth of provisions for receivables from this client.

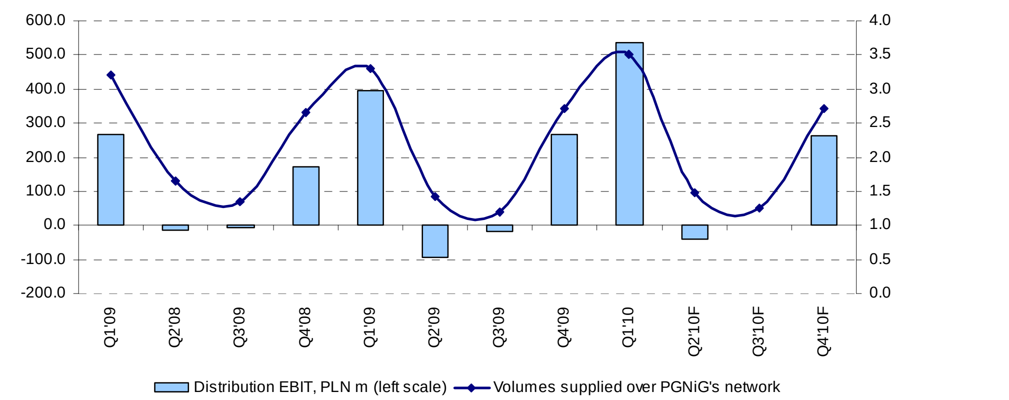
EBIT in Trade and Storage*, spread on imported gas



** T&S EBIT in 2010 without taking into account the reversal of provisions for receivables from ZCH Police, which is factored into our forecasts.*
Source: PGNiG, BRE Bank Securities

- **Distribution:** in Q1'10, Distribution generated an EBIT of PLN 536m, i.e. more than the expected PLN 503m. With such an excellent result in such a crucial quarter, and with the small hike in network tariffs that came into force in June, we are inclined to increase our fairly conservative PLN 661m forecast for the segment. Even if the Company were to merely replicate last year's results, it would exceed this projection by over PLN 30m, and we should take into account the y/y increase in tariffs starting in Q2'10. All in all, we estimate PGNIG's operating earnings in the segment at ca. PLN 750m. Let us point out that given the URE's more friendly approach as regards return on transfer assets (not only in the case of gas pipelines, but also in power generation) we can expect a systematic improvement in earnings in this area in the following years (full return on distribution assets at 10% would entail and EBIT of PLN 1bn).

Distribution EBIT vs. volumes supplied



Source: PGNiG, estimates by BRE Bank Securities

Foreign Upstream Assets

Norway: PGNiG's core asset in the Norwegian shelf is the Skarv project, with reserves directly attributable to the Company estimated at 51.7m boe (including 5bn m3 of natual gas and 1.7m tons of crude oil). In addition, thanks to the recent discoveries at the neighboring Snadd North field, the upstream potential available to PGNiG has increased by ca. 9m boe (the field will be joined with Skarv and exploited with the same infrastructure). At present, the project is at a preparatory stage, and production will be launched in August 2011. Carbohydrates will be extracted using an FPSO (floating production, storage and offloading unit). Transportation will be carried out by shuttle oil tankers and a gas pipeline to the Karsto port. PGNiG's outlays on field preparation total USD 600m, of which USD 300m was spent in 2009, and USD 200m will have been spent by the end of 2010. Taking into account the price paid for a stake in the license (USD 600m), the total CAPEX of the Skarv project will figure to ca. USD 1bn. So far, the project has been factored into our model in the amount of expenses incurred (USD 660m at the end of December 2009), but as the actual production launch approaches, we have decided to consolidate it fully in the income statement. Below, we present our forecasts for the revenues and profits from upstream activities on the Norwegian shelf, noting the high tax rate (78% = 28% CIT + 50% tax on E&P profits). These estimates use Statoil's average cost of extraction at the Norwegian shelf and assume that the field will continue to be used through 2028 (with the optimal level reached in 2013). The volume projections are based on reserves as currently proved, which the Company estimates very conservatively. It is therefore quite possible that further deposits will be found within the license, as was the case with Snadd North.

Income Statement for the Skarv project, USD m

(USD m)	2010F	2011F	2012F	2013F	2014F	2015F
Output in mboe	-	1.5	4.2	6.0	6.0	6.0
Price of Brent crude in USD/Bbl	75	80	90	90	90	90
Sales revenue	-	**105.8**	**340.2**	**486.0**	**486.0**	**486.0**
Production cost	-	11.0	31.5	45.0	45.0	45.0
D&A expenses	-	11.5	32.8	56.5	56.5	56.5
EBIT	-	**83.3**	**275.9**	**384.5**	**384.5**	**384.5**
EBITDA	-	**94.8**	**308.7**	**441.0**	**441.0**	**441.0**
Tax	-	65.0	215.2	299.9	299.9	299.9
Net income	-	**18.3**	**60.7**	**84.6**	**84.6**	**84.6**

Source: estimates by BRE Bank Securities

In addition to the Skarv project, PGNiG is the co-owner of the following four concessions in the Norwegian shelf: PL350 (a 30% stake in a concession for a field located 10km away from Skarv; drilling will commence in 2011), PL419 (a 25% stake in a field located to the north of Troll fields; drilling is set to commence in 2010), PLN521 (a 25% stake, seismic studies are planned for 2010) and PL558 (a 15% stake in a concession for a field directly neighboring Skarv and the PL350 field). So far, the Company has not released even rough estimates of the potential of these fields.

Crude oil deposits in Egypt and Denmark: in 2007, PGNiG obtained two concessions for inland exploration in Egypt and Denmark (in the later case, PGNiG owns an 80% stake, with the remaining 20% belonging to a state-owned Danish company). The African project appears to have more potential (PLN 22m tons of crude oil vs. 2.2m tons in Denmark). So far, in both cases the work has concentrated on seismic imaging. Drilling is set to commence in 2010, which means that the potential of these fields will not be verified until 2011. At the moment, it is impossible to value the Egyptian concession using synthetic multiples such as EV/2P. In the case of the Danish field, the 2.2m ton reserves are very likely to be confirmed, and their value can be estimated at USD 80-105m. 2010 outlays on exploratory work in Egypt and Denmark are estimated at ca. PLN 55m.

Gas deposits in Libya and Pakistan: as far as non-Norwegian gas concessions are concerned, PGNiG is currently present in Pakistan and Libya. In the former case, the Company has been carrying work for several years; at present, it is preparing production analyses. The potential of the field is an estimated 11.6bn cubic meters (PGNiG has a 70% stake in consortium with the state-owned Pakistan Petroleum). Trial drilling and fracking carried out in Q1'10 confirmed the potential of this field, which, with reserves attributable to PGNiG at ca. 56m boe, entails a ca. USD 300-350m value for the asset. In the case of the

Libyan project, confirming the size of the deposits is a more remote perspective, as drilling will only commence this year. Nonetheless, PGNiG has high hopes for the projects, as its reserves are estimated at the staggering 146bn cubic meters of gas and 15m tons of condensate. At the end of December 2009, the book value of the Libyan assets was PLN 218m. This year's CAPEX on the Pakistani and Libyan fields will be PLN 80m and PLN 100m, respectively.

Employee Shares and Free Float

On 1 July, trading will start in ca. 750m employee shares (the total number is 750m, but several dozen thousand shares allocated to Management Board members will not enter trading until July 2011) which were awarded to current and former employees of PGNiG in the privatization process. Over 60,000 people were eligible for these shares (at present, PGNiG employs 31,400 people), which means that the average number of shares per employee is ca. 12,500, with average market value of ca. PLN 42,500. We believe that these shares are one of the reasons for the investors' negative attitude to PGNiG in the past few months: investors are afraid that additional supply of shares (PLN 2.5bn total) will depress price. Note, however that employee shares will be added to the Company's free float, which will lead to an increase in PGNiG's share of stock market indices (most likely during their September revision). According to our estimates, PGNiG's share in WIG20 will increase from 2.7% to 4.9% (taking into account Tauron) and in WIG from 1.7% to 3.2%. If pension funds attempt to reflect this change in their portfolios, this will generate additional demand of PLN 1bn. Therefore, it may turn out that the investors' concerns are unwarranted and the PGNiG stock will actually benefit from the arrival of employee shares on the trading floor.

Macroeconomic Assumptions

Macroeconomic assumptions for the DCF model

	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F
Prices of Brent crude (USD/Bbl)	77	80	90	90	90	90	90	90	90	90
Prices of crude oil, 9M delay (USD/Bbl)	64	75	83	90	90	90	90	90	90	90
Weighted price of imported gas, USD/'000 m3	337	361	360	360	360	360	360	360	360	360
Average weighed wholesale tariff in PLN/'000 m3	948	955	928	928	938	947	952	956	961	966
PLN/USD average	3.20	3.00	2.80	2.70	2.70	2.70	2.70	2.70	2.70	2.70
EUR/PLN, average	4.05	3.80	3.60	3.50	3.50	3.50	3.50	3.50	3.50	3.50
PGNiG's gas sales, billion m3	14.0	14.1	14.5	15.1	15.7	16.3	16.9	17.3	17.7	18.2
Gas imports, billion m3	9.7	9.8	10.0	10.6	11.2	12.0	12.4	12.8	13.2	13.7
Domestic output, billion m3	4.3	4.3	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
Crude oil output (mt)	0.5	0.5	0.5	0.7	0.9	0.9	0.9	0.9	0.9	0.9
Unregulated gas sales, billion m3	0.64	0.64	0.84	1.04	1.04	1.04	1.04	1.04	1.04	1.04
Share in wholesale gas trade in Poland	98.8%	98.5%	98.3%	98.0%	97.8%	97.5%	97.3%	97.3%	97.3%	97.3%

Source: Bloomberg, PGNiG, estimates by BRE Bank Securities

Earnings Forecast and Valuation

Based on the DCF model, which factors in the value of transfer asset leases and shares in EuRoPolGaz, we are setting our 9M price target on PGNiG at PLN 4.32 per share.

	Weight	Price
Relative Valuation	50%	4.07
DCF Analysis	50%	3.96
	Price	4.01
	9M target price	**4.32**

DCF Analysis

Model Assumptions

1. Cash flows are discounted as of 30 June 2010. Enterprise value calculations are based on FY2009 net debt.
2. The macroeconomic assumptions are as laid out above.
3. Relative to our earlier reports, we are changing the way in which Norwegian shelf project is accounted for. With production scheduled for launch in mid 2011, we have decided to fully consolidate earnings from the project (until now we have only included it at the value of expenses incurred, i.e. PLN 2bn).
4. We assume that CAPEX will decrease to values necessary for replacement after 2013 because we project no additional gas and crude oil upstream projects.
5. We expect that the LMG project will be launched in 2013, and that starting in 2014 crude oil output will increase to 0.9 mt. As per the Management's declarations, we expect gas output in 2010-11 at 4.3bn m3 vs. 4.1bn in 2009, due to the increased usage of the Grodzisk denitrification plant and higher purchases on the part of customers directly connected to nitrogen-rich gas mine. Starting in 2012, we expect output to reach 4.5bn cubic meters, thanks to the launch of production in fields in western Poland (Wielichowo, Ruchocice, Międzychód), and the high-methane fields in the Podkarpacie region (Jasionka II, Pilzno II and Rudka).
6. We have augmented our valuation by the current value of transfer asset leases (PLN 0.283m) and the book value of PGNiG's stake in EuRoPol gas (PLN 0.539bn). Note that shareholders approved a PLN 472m dividend from FY09 profits (PLN 0.08 per share), including PLN 340m in-kind dividend for the Treasury. The day of record will be 27 July, which is when our target price will be adjusted by PLN 0.08 to PLN 4.24 per share.
7. The depreciation and amortization expense projected for FY2019 is slightly higher than CAPEX, which is unsustainable over the long term, prompting us to revise the D&A expense to PLN 2.19 billion when calculating the terminal value.
8. When calculating FCF_{TV}, we assume a sales growth rate of 1.5% and EBITDA margin projected for 2019 with the Norwegian project treated separately.
9. We assume that FCF after FY2019 will grow at a rate of 2%. Risk-free rate is 5.83%, and beta is 0.9.

DCF Valuation Model

(PLN m)	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2019+
Sales revenue	**20 862**	**21 546**	**22 339**	**23 765**	**25 023**	**26 069**	**26 907**	**27 587**	**28 061**	**28 590**	**29 129**
Change	*8.1%*	*3.3%*	*3.7%*	*6.4%*	*5.3%*	*4.2%*	*3.2%*	*2.5%*	*1.7%*	*1,9%*	*1.9%*
EBITDA	**3 663.5**	**3 963.9**	**5 065.9**	**5 911.4**	**6 304.6**	**6 247.3**	**6 561.8**	**6 650.4**	**6 538.4**	**6 462,7**	**6 445.2**
EBITDA margin	*17.6%*	*18.4%*	*22.7%*	*24.9%*	*25.2%*	*24.0%*	*24.4%*	*24.1%*	*23.3%*	*22,6%*	*22.1%*
D&A expenses	1 576.5	1 693.7	1 925.0	2 029.7	2 041.2	2 036.9	2 057.8	2 107.5	2 177.9	2 258,9	2 191.4
EBIT	**2 087.0**	**2 270.2**	**3 141.0**	**3 881.7**	**4 263.4**	**4 210.4**	**4 504.0**	**4 542.9**	**4 360.5**	**4 203,8**	**4 253.8**
EBIT margin	*10.0%*	*10.5%*	*14.1%*	*16.3%*	*17.0%*	*16.2%*	*16.7%*	*16.5%*	*15.5%*	*14,7%*	*14.6%*
Tax rate on EBIT	396.5	578.9	1 052.6	1 350.1	1 422.6	1 412.5	1 468.3	1 475.7	1 321.6	1 192,7	1 120.0
NOPLAT	**1 690.5**	**1 691.3**	**2 088.3**	**2 531.6**	**2 840.8**	**2 797.9**	**3 035.7**	**3 067.2**	**3 038.9**	**3 011,1**	**3 133.9**
CAPEX	-4 602	-3 849	-2 745	-2 177	-2 015	-2 061	-2 099	-2 129	-2 160	-2 191	-2 191
Working capital	-426.3	-562.5	274.5	-584.2	-264.4	-217.1	282.3	-115.6	-107.5	-112,3	-112.3
Equity investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0,0	0.0
FCF	**-1 761.6**	**-1 026.0**	**1 542.5**	**1 800.0**	**2 602.1**	**2 556.5**	**3 276.4**	**2 929.7**	**2 949.3**	**2 966,3**	**3 021.5**
WACC	*9.8%*	*9.6%*	*9.7%*	*9.8%*	*10.3%*	*10.3%*	*10.3%*	*10.3%*	*10.3%*	*10,3%*	*10.3%*
discount factor	*95.4%*	*87.1%*	*79.4%*	*72.3%*	*65.5%*	*59.4%*	*53.8%*	*48.8%*	*44.2%*	*40,1%*	*40.1%*
PV FCF	-1 681.1	-893.8	1 225.0	1 301.7	1 705.6	1 518.8	1 764.2	1 429.9	1 304.7	1 189,3	

	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2019F	2019+
WACC	***9.8%***	***9.6%***	***9.7%***	***9.8%***	***10.3%***	***10.3%***	***10.3%***	***10.3%***	***10.3%***	***10,3%***	***10.3%***
Cost of debt	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6.8%*	*6,8%*	*6.8%*
Risk-free rate	*5.83%*	*5.83%*	*5.83%*	*5.83%*	*5.83%*	*5.83%*	*5.83%*	*5.83%*	*5.83%*	*5,83%*	*5.83%*
Risk premium	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1.0%*	*1,0%*	*1.0%*
Effective tax rate	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19.0%*	*19,0%*	*19.0%*
Net debt / EV	*10.9%*	*16.2%*	*13.3%*	*10.8%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0,0%*	*0.0%*
Cost of equity	*10.3%*	*10.3%*	*10.3%*	*10.3%*	*10.3%*	*10.3%*	*10.3%*	*10.3%*	*10.3%*	*10,3%*	*10.3%*
Risk premium	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*	*5,0%*	*5.0%*
Beta	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0,9	0.9

FCF growth after the forecast horizon	*2.0%*
Terminal value	36 273
Present value of the terminal value (PV TV)	14 543
Present value of FCF in the forecast horizon	8 864
Enterprise value (EV)	23 408
Net debt	832
Minority interests	9
Equity value	22 576
Value of the stake in EuRoPolGaz	539
Current value of transfer assets	283
Per-share value of PGNiG	23 389
Number of shares (millions)	5 900
Equity value per share (PLN)	**3.96**
Cost of equity (9M)	*7.8%*
Target Price	**4.27**
EV/EBITDA('10) for the target price	7.1
P/E('10) for the target price	14.9
TV to EV	62%

Sensitivity analysis

	FCF growth in perpetuity				
	0.0%	**1.0%**	**2.0%**	**3.0%**	**4.0%**
WACC +1.0pp	3.59	3.79	4.02	4.32	4.69
WACC +0.5pp	3.68	3.90	4.16	4.49	4.92
WACC	3.79	4.02	4.32	4.69	5.19
WACC -0.5pp	3.90	4.16	4.49	4.92	5,51
WACC -1.0pp	4.02	4.32	4.69	5.19	5,88

Relative Valuation

In selecting companies against which to create a benchmark for PGNiG, we chose utilities (electricity, water, gas distribution and generation) as well as companies focusing on just gas extraction or transmission. Because PGNiG incurs high depreciation charges, we decided to replace the P/E multiple with a more reliable P/CE ratio. The valuation horizon covers fiscal 2010 through 2012, and each year is assigned the same weight. We added the value of PGNiG's transmission asset leases and its interests in EuRoPolGaz to the result of the relative valuation.

		P/CE				EV/EBITDA			
	Price	**2009**	**2010F**	**2011F**	**2012F**	**2009**	**2010F**	**2011F**	**2012F**
Centrica	2.87	8.7	7.3	6.8	6.2	7.4	6.3	5.8	5,4
Enagas	13.82	6.5	5.8	5.4	5.1	8.8	7.9	7.2	6,7
E.ON.	23.49	5.0	5.2	5.0	4.9	6.3	6.2	6.1	6,0
Gaz de France	24.81	5.5	5.3	4.9	4.7	6.5	6.2	5.7	5,4
Gazprom	155.86	4.2	3.4	3.0	2.5	4.9	3.8	3.3	2,9
Gas Natural SDG	12.71	4.3	4.0	3.9	3.6	8.0	7.3	7.0	6,6
Novatek	78.02	8.2	5.0	3.7	3.3	8.0	4.8	3.7	3,1
RWE AG	56.16	5.8	5.1	5.0	4.6	5.1	4.5	4.4	4,1
Maximum		8.7	7.3	6.8	6.2	8.8	7.9	7.2	6,7
Minimum		4.2	3.4	3.0	2.5	4.9	3.8	3.3	2,9
Median		**5.7**	**5.2**	**5.0**	**4.7**	**7.0**	**6.2**	**5.8**	**5,4**
PGNiG*	3.45	6.0	5.9	5.1	4.5	5.6	5.3	4.0	3,4
(premium / discount)		5.4%	14.7%	2.2%	-3.7%	-20.1%	-14.8%	-30.4%	-36,1%
Implied price									
Median		5.7	5.2	5.0	4.7	7.0	6.2	5.8	5,4
Multiple weight			50.0%				50.0%		
Year weight		0.0%	33.3%	33.3%	33.3%	0.0%	33.3%	33.3%	33,3%
Equity value per share (PLN)		3.9							
Per-share value of EuRoPolGaz		0.09							
Per-share value of leases		0.05							
Per-share value of PGNiG		**4.07**							

EV/EBITDA based on net debt at the end of 2009
** market cap adjusted for leases and EuRoPolGaz shares (earnings used to calculate ratios were adjusted for these factors)*

Income Statement

(PLN m)	2007	2008	2009	2010F	2011F	2012F	2013F
Sales revenue	**16 652.1**	**18 432.0**	**19 290.4**	**20 861.5**	**21 546.0**	**22 338.6**	**23 765.3**
Change	*9.6%*	*10.7%*	*4.7%*	*8.1%*	*3.3%*	*3.7%*	*6.4%*
EBIT, incl.	**861.0**	**800.7**	**1 333.8**	**2 087.0**	**2 270.2**	**3 141.0**	**3 881.7**
Upstream	1 019.1	918.4	336.6	905.7	1 076.8	1 738.6	2 320.5
Trade and Storage	1 187.0	-509.9	-50.0	428.8	429.9	530.5	653.1
Distribution	-1 311.1	418.7	1 044.8	750.1	761.1	869.5	905.7
Other, eliminations	-34.1	-26.6	2.4	2.4	2.4	2.4	2.4
One-off gains/losses	-1 384.0	0.0	41.0	129.0	0.0	0.0	0.0
EBIT, adjusted	**2 245.0**	**800.7**	**1 292.8**	**1 958.0**	**2 270.2**	**3 141.0**	**3 880.7**
Change	*-41.4%*	*-7.0%*	*66.6%*	*56.5%*	*8.8%*	*38.4%*	*23.6%*
EBIT margin	*13.5%*	*4.3%*	*6.7%*	*9.4%*	*10.5%*	*14.1%*	*16.3%*
Profit/loss on financial activity	157.8	134.5	108.7	-6.3	-109.8	-196.0	-263.5
Extraordinary gains/losses	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Other	-16.0	0.2	-0.4	-0.4	-0.4	-0.4	-0.4
Gross profit	**1 002.7**	**935.4**	**1 442.1**	**2 080.4**	**2 160.1**	**2 944.6**	**3 618.9**
Tax	86.7	69.6	238.5	395.3	557.9	1 015.3	1 299.9
Minority interests	1.0	0.4	1.6	0.0	0.0	0.0	0.0
Net income	**915.0**	**865.3**	**1 202.0**	**1 685.1**	**1 602.1**	**1 929.3**	**2 318.9**
Change	*-31.1%*	*-5.4%*	*38.9%*	*40.2%*	*-4.9%*	*20.4%*	*20.1%*
Margin	*5.5%*	*4.7%*	*6.2%*	*8.1%*	*7.4%*	*8.6%*	*9.8%*
D&A expenses	1 430.3	1 424.9	1 496.2	1 576.5	1 693.7	1 925.0	2 029.7
EBITDA	**2 291.3**	**2 225.6**	**2 830.0**	**3 663.5**	**3 963.9**	**5 065.9**	**5 911.4**
Change	*-17.2%*	*-2.9%*	*27.2%*	*29.5%*	*8.2%*	*27.8%*	*16.7%*
EBITDA margin	*13.8%*	*12.1%*	*14.7%*	*17.6%*	*18.4%*	*22.7%*	*24.9%*
Shares at year-end (millions)	5 900.0	5 900.0	5 900.0	5 900.0	5 900.0	5 900.0	5 900.0
EPS	0.2	0.1	0.2	0.3	0.3	0.3	0.4
CEPS	0.4	0.4	0.5	0.6	0.6	0.7	0.7
ROAE	*4.3%*	*4.1%*	*5.7%*	*7.7%*	*6.9%*	*8.0%*	*9.1%*
ROAA	*3.1%*	*3.0%*	*4.0%*	*5.2%*	*4.5%*	*5.1%*	*6.0%*

Balance Sheet

(PLN m)	2007	2008	2009	2010F	2011F	2012F	2013F
ASSETS	**28 401.9**	**29 745.3**	**31 082.2**	**34 313.2**	**37 162.1**	**37 860.2**	**39 416.6**
Fixed assets	**22 131.1**	**22 573.6**	**24 665.3**	**27 391.3**	**29 546.2**	**30 366.4**	**30 513.9**
Property, plant and equipment	18 715.5	20 587.0	22 888.9	25 879.9	28 026.5	28 861.0	29 022.2
Intangible assets	84.6	151.7	173.5	208.3	216.6	202.3	188.7
Equity interests	557.5	556.9	556.5	556.5	556.5	556.5	556.5
Other fixed assets	2 773.4	1 278.0	1 046.4	746.5	746.5	746.5	746.5
Current assets	**6 270.8**	**7 171.7**	**6 416.9**	**6 922.0**	**7 616.0**	**7 493.8**	**8 902.7**
Inventories	1 216.0	1 721.3	1 258.9	1 604.8	2 133.5	1 820.0	2 334.0
Short-term receivables	3 331.0	3 716.9	3 680.0	3 992.5	4 123.5	4 275.2	4 548.2
Other current assets	140.2	311.6	281.6	281.6	281.6	281.6	281.6
Cash and cash equivalents	1 583.6	1 421.9	1 196.3	1 043.1	1 077.3	1 116.9	1 738.9

(PLN m)	2007	2008	2009	2010F	2011F	2012F	2013F
LIABILITIES	**28 401.9**	**29 745.3**	**31 082.2**	**34 313.2**	**37 162.1**	**37 860.2**	**39 416.6**
Equity	**21 013.1**	**20 706.9**	**21 391.6**	**22 605.0**	**23 533.5**	**24 822.3**	**26 175.9**
Share capital	5 900.0	5 900.0	5 900.0	5 900.0	5 900.0	5 900.0	5 900.0
Other equity	15 113.1	14 806.9	15 491.6	16 705.0	17 633.5	18 922.3	20 275.9
Minority interests	**8.7**	**9.0**	**10.5**	**10.5**	**10.5**	**10.5**	**10.5**
Long-term liabilities	**3 879.6**	**4 058.6**	**3 779.9**	**3 818.7**	**3 858.4**	**3 843.1**	**3 843.1**
Loans	31.4	41.1	44.1	82.9	122.5	107.2	107.2
Other	3 848.2	4 017.6	3 735.8	3 735.8	3 735.8	3 735.8	3 735.8
Short-term liabilities	**3 500.6**	**4 970.7**	**5 900.2**	**7 879.0**	**9 759.8**	**9 184.3**	**9 387.2**
Loans	106.7	871.8	1 984.1	3 730.8	5 514.3	4 826.2	4 826.2
Trade creditors	2 408.0	3 222.5	2 733.4	2 965.5	3 062.8	3 175.5	3 378.3
Other	985.9	876.4	1 182.7	1 182.7	1 182.7	1 182.7	1 182.7
Debt	138.1	912.8	2 028.2	3 813.7	5 636.8	4 933.4	4 933.4
Net debt	-1 445.5	-509.1	831.8	2 770.6	4 559.5	3 816.5	3 194.5
(Net debt / Equity)	*-6.9%*	*-2.5%*	*3.9%*	*12.3%*	*19.4%*	*15.4%*	*12.2%*
(Net debt / EBITDA)	-0.6	-0.2	0.3	0.8	1.2	0.8	0.5
BVPS	3.6	3.5	3.6	3.8	4.0	4.2	4.4

Cash Flows

(PLN m)	2007	2008	2009	2010F	2011F	2012F	2013F
Cash flows from operating activities	**3 028.7**	**1 492.9**	**2 554.9**	**2 962.8**	**3 033.9**	**4 510.2**	**4 155.8**
Net income	915.0	865.3	1 202.0	1 685.1	1 602.1	1 929.3	2 317.9
D&A expenses	1 430.3	1 424.9	1 496.2	1 576.5	1 693.7	1 925.0	2 029.7
Working capital	-606.5	-145.9	-46.7	-426.3	-562.5	274.5	-584.2
Other	1289.9	-651.4	-96.6	127.5	300.5	381.5	392.3
Cash flows from investing activities	**-2 455.6**	**-2 208.9**	**-3 637.7**	**-4 602.3**	**-3 848.6**	**-2 745.2**	**-2 177.1**
CAPEX	-2 980.0	-2 579.5	-3 840.8	-4 602.3	-3 848.6	-2 745.2	-2 177.1
Other	524.4	370.6	203.1	0.0	0.0	0.0	0.0
Cash flows from financing activities	**-2 547.5**	**552.0**	**858.2**	**1 486.2**	**849.0**	**-1 725.4**	**-1 356.6**
Stock offering	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt	-2 295.4	769.8	1 112.3	1 785.5	1 823.1	-703.4	0.0
Dividends (buyback)	-153.0	-171.0	-148.5	-472.0	-674.0	-640.9	-964.7
Other	-99.1	-46.9	-105.6	172.7	-300.1	-381.1	-392.0
Change in cash	**-1 975.6**	**-161.7**	**-225.6**	**-153.2**	**34.2**	**39.6**	**622.0**
Cash at end of period	1 583.6	1 421.9	1 196.3	1 043.1	1 077.3	1 116.9	1 738.9

DPS (PLN)	0.17	0.19	0.03	0.08	0.11	0.11	0.16
FCF	-1 381.9	-569.4	-1 295.9	-1 760.4	-1 005.1	1 579.8	1 850.1
(CAPEX / Sales)	*17.9%*	*14.0%*	*19.9%*	*22.1%*	*17.9%*	*12.3%*	*9.2%*

Market multiples

	2007	2008	2009	2010F	2011F	2012F	2013F
P/E	22.2	23.5	16.9	12.1	12.7	10.6	8.8
P/CE	8.7	8.9	7.5	6.2	6.2	5.3	4.7
P/BV	1.0	1.0	1.0	0.9	0.9	0.8	0.8
P/S	1.2	1.1	1.1	1.0	0.9	0.9	0.9
FCF/EV	*-7.3%*	*-2.9%*	*-6.1%*	*-7.6%*	*-4.0%*	*6.5%*	*7.9%*
EV/EBITDA	8.3	8.9	7.5	6.3	6.3	4.8	4.0
EV/EBIT	8.4	24.8	16.4	11.8	11.0	7.7	6.1
EV/S	1.1	1.1	1.1	1.1	1.2	1.1	1.0
DYield	*4.9%*	*5.5%*	*0.7%*	*2.3%*	*3.3%*	*3.1%*	*4.7%*

Price (PLN)	**3.45**						
Shares at year-end (millions)	5900.0	5900.0	5900.0	5900.0	5900.0	5900.0	5900.0
MC (PLN m)	20 355.0	20 355.0	20 355.0	20 355.0	20 355.0	20 355.0	20 355.0
Equity attributable to minority shareholders (PLN m)	8.7	9.0	10.5	10.5	10.5	10.5	10.5
EV (PLN m)	18 918.2	19 854.9	21 197.3	23 136.1	24 925.0	24 182.0	23 560.0

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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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Previous ratings issued for PGNiG

Rating	Accumulate	Buy	Buy
Date issued	2009-11-13	2010-03-05	2010-03-24
Price on rating day	3.73	3.55	3.70
WIG on rating day	40229.36	39885.37	41882.58