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Special comment

BRE Bank Securities

ES-SYSTEM

Manufacturers

Poland

ESSM.WA; ESS.PW

Earnings for Q1 2010

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Current price: PLN 5.00

In Q1'10, the Company's sales declined by 12.9% y/y due to the persistent weakness of large-building construction and inclement weather in the two initial months of the year. The lower sales led to an 89.6% y/y decline in operating earnings. While these data are weak in nominal terms, earnings for Q1'10 have shown that the gross margin is stabilizing: while sales declined 28.3% q/q, gross margin fell by a mere 0.4pp. The expected increase in sales in the coming quarters should thus lead to much higher operating earnings. We should also remember that the Company's earnings are subject to seasonal trends (sales reach the highest level in Q3-Q4). The Management has reiterated the promise that earnings for FY 2010 will not decline y/y. He also believes that the sector should see a revival in the second half of the year. We expect sales to increase already in May as a new production line becomes operational at the Dobczyce plant. The Company is planning to present its new growth strategy on 20 May. Should it be able to replicate its FY 2009 earnings in FY 2010, its P/E would figure to 24.5 and EV/EBITDA to 10.8. We believe the situation in the sector should be much more advantageous in 2011, which should bring much better operating earnings.

First-Quarter Results

In Q1'10, sales declined by 12.9% y/y and 23.8% q/q. The biggest drop was seen in exports (-34% y/y), which is likely a consequence of there being fewer large-building construction projects worldwide, and because the zloty appreciated vs. the euro (by 13.2% y/y). In Poland, sales declined by 6.5% y/y (-31.5% q/q) due to the lower number of orders and a decline in the number of construction projects. Another important factor was the inclement weather, which delayed a lot of construction work. All in all, an 8% decline in the Polish architectural lighting market was observed in Q1'10. The situation was better in industrial lighting, which saw a mere 2% y/y decline in revenue, and outdoor lighting (+70% y/y). Pressure on prices and the trend towards cheapest available solutions persisted. Coupled with the decline in sales, this reduced the EBIT (-89.6%, -89.9% q/q). Gross margin was 37.2% vs. 43.5% in Q1'09. The weaker EBIT led to a 90.7% y/y reduction in net profit (-89.9% q/q). We should remember, however, that in Q1'09 net profit was boosted by PLN 0.9m finance gains.

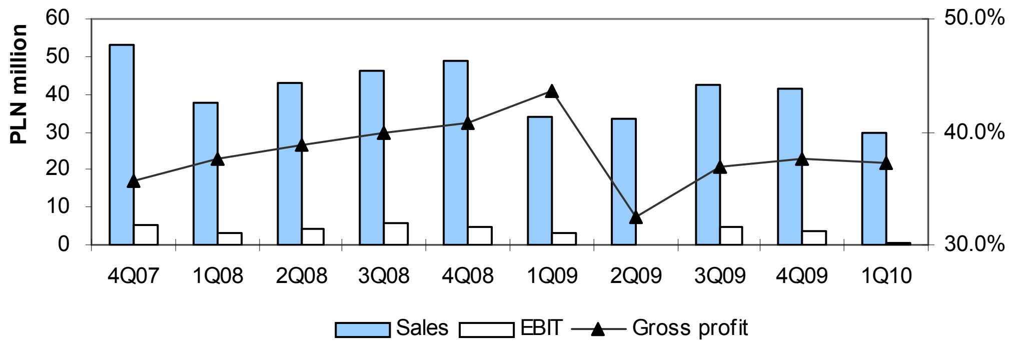
Abbreviated income statement for Q1 2010

(PLN m)	2008	2009	Change (y/y)	Q1 2009	Q1 2010	Change (y/y)	Change (q/q)
Sales	175.4	150.8	-14.0%	34.0	29.6	-12.9%	-28.3%
Sales in Poland	137.2	119.6	-12.8%	26.1	24.36	-6.5%	-31.5%
Share in total sales	78.2%	79.3%	-	76.7%	82.4%	-	-
Exports	38.2	31.185	-18.4%	7.9	5.2	-34.0%	-8.3%
Share in total sales	21.8%	20.7%	-	23.3%	17.6%	-	-
EBIT	18.0	11.8	-34.4%	3.3	0.4	-89.6%	-89.9%
EBIT margin	*10.3%*	*7.8%*	-	*9.8%*	*1.2%*	-	-
EBITDA	23.0	17.8	-22.7%	4.8	1.9	-60.1%	-62.0%
EBITDA margin	*13.1%*	*11.8%*	-	*14.0%*	*6.4%*	-	-
Net profit	14.2	9.0	-36.6%	3.1	0.3	-90.7%	-89.9%

Source: BRE Bank Securities

Sales declined by 28.3% q/q. It should be remembered that in January and February the weather was a huge obstacle to construction work. The big drop in revenue did not result in a considerable reduction in the gross margin, which declined from 37.6% in Q4'09 to 37.2%. We believe the Company's gross margins are already fairly low, and we do not expect them to weaken further in the coming quarters. On occasion of the publication of the earnings, the Management reiterated the promise that EBIT for FY2010 should match last year's level. It was also added that the appreciation of the zloty vs. the euro does not seem to present a big threat at the moment, given that expenses for components used in the production of lighting fixtures in the EUR are offset by export sales in the same currency. At the same time, the Management stressed that the weaker sales in Q1 are a consequence of seasonal trends (H1 tends to be weaker). We believe the Company's margins are stabilizing despite the unfavorable situation in the industry. Despite the much lower sales than in Q4'09 (-23.8% q/q), the gross margin only declined by 0.4pp. This suggests that with higher revenues in the following quarters (incl. postponed construction work), operating earnings should start improving significantly q/q starting in Q2'10.

Sales, EBIT and gross margin by quarter in 2007-2010 (PLN m)



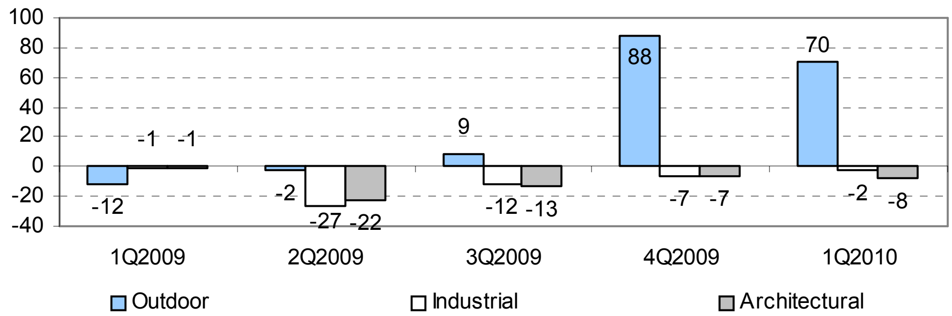
Source: BRE Bank Securities

Sales by segment by quarter

In terms of individual segments, sales look best in outdoor lighting, where the number of orders increased considerably y/y already in Q4'09. The Company wants to benefit from infrastructural projects. It is planning to expand its offer in the area of street and track lighting and to cooperate with road and track constructors and local authorities. In industrial lighting, the past five quarters seem to suggest a stabilization. The situation is slightly worse in architectural lighting, where sales have declined by nearly 10% in the past two quarters. The Management complains that both in Poland and abroad the number of new commercial projects is low. There is some potential, however, in foreign projects interrupted due to the economic downturn. In Poland, the Management sees its chance in smaller projects in small and medium towns. At present there are few big commercial projects in larger cities, but small malls in smaller cities are still being built.

The Management has high hopes for the new plant in Dobczyce. New LED and solar products come with very high margins. Further, as proved by the last Frankfurt lighting fair, the major makers of fixtures consider the LED technology very promising. This might be an opportunity for ES-System, which, when offering its own products, will be supported by big promotional campaigns of major global LED-oriented manufacturers.

Percent change in sales by segment (y/y)



Source: BRE Bank Securities

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List of abbreviations and ratios contained in the report.
EV *– net debt + market value (EV – economic value)*
EBIT *– Earnings Before Interest and Taxes*
EBITDA *– EBIT + Depreciation and Amortisation*
PBA *– Profit on Banking Activity*
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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