

**164/2010/RP (221)** November 2, 2010

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# Gant Development

**Sector:** Residential construction  
**Fundamental rating:** Hold (↓)  
**Market relative:** Underweight (↓)  
**Price:** PLN 19.03  
**12M EFV:** PLN 19.8 (↓)

**Market Cap.:** US\$ 138 m  
**Reuters code:** GNT.WA  
**Av. daily turnover:** US\$ 0.69 m  
**Free float:** 68%  
**12M range:** PLN 17.19-26.10

## Investment story & recommendation

The recent track record of Gant Development is anything but a success story. The list of Gant's failures is long: disappointing financial results, hand-over delays due to lacking administrative permissions, downward revision of the management forecast – to name just a few. In 2011E not much improvement should be expected, we believe; the Company should continue to increase its inventory and, in consequence, net debt level, which not necessarily will please the investors' community. Moreover, the sector environment remains quite unfavourable for the Company: there is a stagnation of current sales volumes, whereas supply of new dwellings increases. While all above hold true, Gant seems to have the worst time behind itself and – equally important – the valuation, in our view, seems rather undemanding with 2010E and 2011E P/BV of 0.7x, vs. peers trading at 1.5x and 1.4x, respectively. Expecting rather negative market reaction to Gant's 3Q10 financial results (should they come out close to our expectations), we downgrade our ST market-relative bias for the Company's shares from Neutral to Underweight. Moreover, since our current (lowered) 12M EFV assessment for Gant lies in the vicinity of the share market price, we also downgrade our LT fundamental rating from Buy to Hold.

## Quarterly results corner; 3Q10E preview

Gant will release its 3Q10 results on November 5. We expect the results to be poor, due to low number of dwellings fuelling the P&L account this quarter. We expect the Company to account for only 40 dwellings handed over in 3Q10, mainly in Poznań (I stage) and Opole projects. We expect the gross profit on sales margin in 3Q10 not to exceed 15% level, due to accounting for the poor project in Opole. We expect the Company to post a loss of c. PLN -6 million from revaluation of its real estate portfolio (the Marino shopping center in Wrocław), arising from the translation of Gant's property value from Euro into Zloty, bringing quarterly EBIT below the water mark. In our view, property revaluation loss should be partially offset (at the pre-tax level) by c. PLN 3 million gain from the translation of Euro-denominated debt. Should Gant meet our 3Q10 results expectations, we would expect a slightly negative market reaction.

## Financial forecast

The delays in projects' execution prompt us to cut our financial forecast for the Company. As far as the number of units handed over is concerned, we assume that Gant will pass over to its clients only 433 units this year (321 dwellings were handed over in 1H10), and 1,236 units in 2011, vs. the management guideline of 706 and 1,270 units, respectively.

## Guide to adjusted profits

No factors necessitating adjustments.

## Key data

IFRS unconsolidated		2009	2010E	2011E	2012E
Sales	PLN m	342.9	145.2	396.9	648.6
EBITDA	PLN m	81.2	27.2	35.4	84.5
EBIT	PLN m	79.4	24.4	32.6	81.6
Net profit	PLN m	62.7	4.3	20.3	56.0
EPS	PLN	3.89	0.21	0.99	2.73
EPS yoy chng	%	-35	-95	373	176
Net debt	PLN m	415.6	544.7	614.1	421.6
P/E	x	4.9	91.0	19.2	7.0
P/CE	x	4.6	35.2	14.1	5.0
EV/EBITDA	x	8.9	34.4	28.4	9.6
EV/EBIT	x	9.1	38.3	30.8	10.0
P/BV	x	0.6	0.7	0.7	0.6
EV/Sales	x	2.1	6.4	2.5	1.3
Gross dividend yield	%	0.0	0.0	0.0	0.0
No. of shares (eop)	m	16.1	20.5	20.5	20.5

Source: Company, DM IDMSA estimates

## Stock performance



Source: ISI

## Upcoming events

1. Release of 3Q10 financial results: November 5, 2010

## Catalysts

1. Pick up in volume of pre-sold flats
2. Expansion in other agglomerations
3. Growing prices of dwellings
4. Banks to loosen their mortgage lending policies

## Risk factors

1. Volumes of homes sold
2. Delays in the execution of general construction contracts
3. Delays in obtaining or lack of construction permits
4. Tightening of banking mortgage loan policies
5. Decline of credit capability of Poles
6. Problems with obtaining debt financing for new projects

We conservatively assume that the Pomorska and Kaszubska Wrocław-based projects (together 121 dwellings) will not be given the occupancy permits this year but rather next year. Moreover, we assume that Gant will not manage to finish its projects Morena in Gdańsk and Meissnera in Kraków this year. In 2011,

in turn, we doubt that Gant will manage to hand over dwellings in Stabłowice and Sokotowka projects (for details please see *Figure 2*)

2012E looks much better, however, as we forecast the Company to account for the hand-over of c. 1,700 units, mainly from projects such as Sokotowska, Stabłowice, Ractawice (phase I) and Balzaka. Expecting to see an improvement in volumes on the market (coupled with the geographical expansion of the Company) we believe that Gant will gradually increase the number of dwellings sold over the next few years. We assume the Company to sell 2,200 units starting from 2015E and stabilize at this level thereafter.

In the past Gant generated projects with a gross profit on sales margin of over 30%, which was high. The realization of fat margin was possible thanks to the purchase of land at non-inflated prices and growing prices of dwellings. Enough to say that the gross profit on sales margin reached 38.1% in 2008 and in 2011 and 2012 we forecast it to drop to 17.3% and 18.6%, respectively. This is mainly because of the housing projects with land purchased during the peak of the market on which margins fell far below the expectations (even to a single-digit number). We believe that the margin level of c. 30% can not be maintained in the longer run. We believe that Gant can maintain its mid-cycle gross profit on sales margin close to 20%, which is in line with our forecast for Dom Development and J.W. Construction.

We believe that our hand-over and margin assumptions are rather conservative, since at all larger projects we account for delays.

## Sales volumes

During 1-3Q10 Gant sold 695 dwellings (net) and it seems that the 2010 target of nearly 1,000 will be met. In order to enhance the sales volumes Gant supports (throughout Kantor Sp. z o.o. – former subsidiary of Gant, now owned by Gant founders, the Antkowiak family) the dwelling purchasers with loans. The Company lent to Kantor PLN 61.9 million (according to 2010 semi-annual report). Given the scale of Gant's business (2010E sales from dwellings' disposal should reach PLN 116 million), the amount seems more than material. We question such an activity, since there is a threat that Kantor may underestimate the risk of such loans.

## Valuation

We continue to value Gant using sum-of-the-parts method (SOTP), with residential and commercial projects valued separately. Aforementioned downward revision of our financial forecasts for Gant results in a material decline in our assessment of the stock's intrinsic value. To expand, our SOTP 12M EFV for the Company decreases to PLN 19.8 per share from PLN 28.7 per share previously (31% drop). Our DCF-derived 12M forward EFV for Gant's residential construction business stands at PLN 12.3 per share (versus PLN 21.2 previously). As far as valuation of commercial space is concerned, we continue to value the Marino shopping centre and other assets generating rental revenue at PLN 4.3 and PLN 3.2 per Gant's share, respectively.

We continue not to assign any value to commercial pipeline projects (with NRA totaling 59 ths. sqm and the potential to generate a NOI of approx. PLN 25-30 million), which Gant plans to construct within the next few years.

Fig. 1 Gant Development; 3Q10 and 1-3Q10 results' forecast

IFRS consolidated PLN m			yoy change		yoy change		Realisation of FY figures in 3Q:		Realisation of FY figures in 1-3Q:	
	3Q10E	3Q09		1-3Q10E	1-3Q09		2010E	2009	2010E	2009
Sales	26.0	92.2	-72%	113.3	318.0	-64%	18%	27%	78%	93%
EBITDA	-10.6	12.0	n.m.	25.3	76.5	-67%	-39%	15%	93%	94%
EBITDA margin	-40.8%	13.0%	-	22.3%	24.1%	-	-	-	-	-
EBIT	-11.1	11.0	n.m.	23.8	75.0	-68%	-45%	14%	98%	94%
EBIT margin	-42.7%	11.9%	-	21.0%	23.6%	-	-	-	-	-
Pre-tax profit	-11.5	14.5	n.m.	16.7	60.2	-72%	-139%	22%	201%	93%
Pre-tax margin	-44.2%	15.7%	-	14.7%	18.9%	-	-	-	-	-
Net profit	-11.5	14.7	n.m.	13.9	61.4	-77%	-268%	22%	324%	91%
Net margin	-44.2%	15.9%	-	12.3%	19.3%	-	-	-	-	-

Source: Company, DM IDMSA estimates

Fig. 2 Gant Development; Financial forecast assumptions

Project	Number of units to be handed-over			Revenues (PLN m)			Gross profit on sales	Gross profit on sales (PLN m)			Price per sqm	Average size of a dwelling
	2010E	2011E	2012E	2010E	2011E	2012E	margin	2010E	2011E	2012E	(PLN ths.)	(m <sup>2</sup> )
Pod Fortem	67			24.1	0.0	0.0	20%	4.8	0.0	0.0	6.0	60
Kamienna	15			4.1	0.0	0.0	20%	0.8	0.0	0.0	5.5	50
Opole E1	176			36.1	0.0	0.0	10%	3.6	0.0	0.0	4.1	50
Poznań (phase I)	170	52		49.3	15.1	0.0	20%	9.9	3.0	0.0	5.8	50
Poznań (phase II)		225		0.0	65.3	0.0	20%	0.0	13.1	0.0	5.8	50
Poznań (phase III)			50	0.0	0.0	15.0	20%	0.0	0.0	3.0	6.0	50
Poznań (phase IV)			45	0.0	0.0	13.5	20%	0.0	0.0	2.7	6.0	50
Morena		211	31	0.0	65.4	9.6	20%	0.0	13.1	1.9	6.2	50
Meissnera-Kraków		70		0.0	27.8	0.0	20%	0.0	5.6	0.0	7.5	53
Legnicka		81		0.0	32.4	0.0	20%	0.0	6.5	0.0	8.0	50
Sokołowska (phases I+II)			592	0.0	0.0	281.2	10%	0.0	0.0	28.1	9.5	50
Sokołowska (NRA for sale) *			8,144	0.0	0.0	0.0	35%	0.0	0.0	31.4	11.0	0
Polanica		66	90	0.0	18.2	24.8	20%	0.0	3.6	5.0	5.5	50
Opolska E2		130		0.0	32.2	0.0	20%	0.0	6.4	0.0	5.5	45
Sikorskiego/Podwale			156	0.0	0.0	46.8	20%	0.0	0.0	9.4	6.0	50
Żerniki Małe		27	5	0.0	7.4	1.4	20%	0.0	1.5	0.3	5.5	50
Rynek	5			2.5	0.0	0.0	20%	0.5	0.0	0.0	10.0	50
Stabłowice		136	100	0.0	34.0	25.0	20%	0.0	6.8	5.0	5.0	50
Przyjaźni Wrocław			24	0.0	0.0	7.2	20%	0.0	0.0	1.4	6.0	50
Opole (phase III)		67	59	0.0	15.1	13.3	20%	0.0	3.0	2.7	4.5	50
Belwederska		10	10	0.0	3.0	3.0	20%	0.0	0.6	0.6	6.0	50
Na Grobli			53	0.0	0.0	13.3	20%	0.0	0.0	2.7	5.0	50
Raławice (phase I)			130	0.0	0.0	32.5	20%	0.0	0.0	6.5	5.0	50
Wrocław - new project			93	0.0	0.0	27.9	20%	0.0	0.0	5.6	6.0	50
Gdańsk - New project			99	0.0	0.0	29.7	20%	0.0	0.0	5.9	6.0	50
Balzaka (Wrocław)		24	170	0.0	8.4	59.5	20%	0.0	1.7	11.9	7.0	50
Pomorska (Wrocław)		29		0.0	11.1	0.0	20%	0.0	2.2	0.0	6.4	60
Kaszubska (Wrocław)		108		0.0	27.0	0.0	20%	0.0	5.4	0.0	5.0	50
<b>Total</b>	<b>433</b>	<b>1,236</b>	<b>1,707</b>	<b>116.1</b>	<b>362.3</b>	<b>603.6</b>		<b>19.6</b>	<b>72.5</b>	<b>123.9</b>		

\* NRA for sale

Source: DM IDMSA estimates

Fig. 3 Gant Development; Management forecast vs. DM IDMSA forecast

IFRS consolidated PLN m	2010E		2011E	
	Gant	DM IDMSA	Gant	DM IDMSA
Total sales	256.5	145.2	478.4	396.9
- residential construction	232.3	116.1	432.7	362.3
- construction activity	0.0	5.0	10.0	10.0
- rents	24.2	24.1	35.7	24.6
Net income	47.8	4.3	86.5	20.3

Source: Company, DM IDMSA estimates

Fig. 4 Volumes of dwellings sold

	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10	1-3Q09	1-310	change
Dom Development*	328	352	222	92	106	156	230	300	343	310	320	492	973	98%
J.W. Construction**	200	150	100	70	120	190	257	261	286	270	345	567	901	59%
Gant	177	205	165	205	171	177	113	75	168	236	281	461	685	49%
Polnord	43.5	47.5	81.5	28.5	14	49	116	115	129	151	292	179	572	220%
Ronson	17	23	44	44	55	63	79	66	85	73	56	197	214	9%
Marvipol	30	n.a.	49	56	86	52	61	71	83	34	20	199	137	-31%

\* 3Q10 sales volumes according to "Parkiet" daily estimates

\*\* before cancellations

Source: Company, PAP, Parkiet

## BASIC DEFINITIONS

**A/R turnover** (in days) =  $365/(\text{sales}/\text{average A/R})$

**Inventory turnover** (in days) =  $365/(\text{COGS}/\text{average inventory})$

**A/P turnover** (in days) =  $365/(\text{COGS}/\text{average A/P})$

**Current ratio** =  $(\text{current assets} - \text{ST deferred assets})/\text{current liabilities}$

**Quick ratio** =  $(\text{current assets} - \text{ST deferred assets} - \text{inventory})/\text{current liabilities}$

**Interest coverage** =  $(\text{pre-tax profit before extraordinary items} + \text{interest payable})/\text{interest payable}$

**Gross margin** =  $\text{gross profit on sales}/\text{sales}$

**EBITDA margin** =  $\text{EBITDA}/\text{sales}$

**EBIT margin** =  $\text{EBIT}/\text{sales}$

**Pre-tax margin** =  $\text{pre-tax profit}/\text{sales}$

**Net margin** =  $\text{net profit}/\text{sales}$

**ROE** =  $\text{net profit}/\text{average equity}$

**ROA** =  $(\text{net income} + \text{interest payable})/\text{average assets}$

**EV** =  $\text{market capitalization} + \text{interest bearing debt} - \text{cash and equivalents}$

**EPS** =  $\text{net profit}/\text{no. of shares outstanding}$

**CE** =  $\text{net profit} + \text{depreciation}$

**Dividend yield** (gross) =  $\text{pre-tax DPS}/\text{stock market price}$

**Cash sales** =  $\text{accrual sales corrected for the change in A/R}$

**Cash operating expenses** =  $\text{accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes}$

DM IDM S.A. generally values the covered non bank companies via two methods: comparative method and DCF method (discounted cash flows). The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the DCF method is its independence from the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Please note that we also resort to other valuation techniques (e.g. NAV-, DDM- or SOTP-based), should it prove appropriate in a given case.

## KEY TO INVESTMENT RANKINGS

This is a guide to expected price performance in absolute terms over the next 12 months:

**Buy** – fundamentally undervalued (upside to 12M EFV in excess of the cost of equity) + catalysts which should close the valuation gap identified;

**Hold** – either (i) fairly priced, or (ii) fundamentally undervalued/overvalued but lacks catalysts which could close the valuation gap;

**Sell** – fundamentally overvalued (12M EFV < current share price + 1-year cost of equity) + catalysts which should close the valuation gap identified.

This is a guide to expected relative price performance:

**Overweight** – expected to perform better than the benchmark (WIG) over the next quarter in relative terms

**Neutral** – expected to perform in line with the benchmark (WIG) over the next quarter in relative terms

**Underweight** – expected to perform worse than the benchmark (WIG) over the next quarter in relative terms

The recommendation tracker presents the performance of DM IDMSA's recommendations. A recommendation expires on the day it is altered or on the day 12 months after its issuance, whichever comes first. Relative performance compares the rate of return on a given recommended stock in the period of the recommendation's validity (i.e. from the date of issuance to the date of alteration or – in case of maintained recommendations – from the date of issuance to the current date) in a relation to the rate of return on the benchmark in this time period. The WIG index constitutes the benchmark. For recommendations that expire by an alteration or are maintained, the ending values used to calculate their absolute and relative performance are: the stock closing price on the day the recommendation expires/ is maintained and the closing value of the benchmark on that date. For recommendations that expire via a passage of time, the ending values used to calculate their absolute and relative performance are: the average of the stock closing prices for the day the recommendation elapses and four directly preceding sessions and the average of the benchmark's closing values for the day the recommendation expires and four directly preceding sessions.

## Banks

**Net Interest Margin (NIM)** =  $\text{net interest income}/\text{average assets}$

**NIM Adjusted** =  $(\text{net interest income adjusted for SWAPs})/\text{average assets}$

**Non interest income** =  $\text{fees\&commissions} + \text{result on financial operations (trading gains)} + \text{FX gains}$

**Interest Spread** =  $(\text{interest income}/\text{average interest earning assets})/(\text{interest cost}/\text{average interest bearing liabilities})$

**Cost/Income** =  $(\text{general costs} + \text{depreciation} + \text{other operating costs})/(\text{profit on banking activity} + \text{other operating income})$

**ROE** =  $\text{net profit}/\text{average equity}$

**ROA** =  $\text{net income}/\text{average assets}$

**Non performing loans (NPL)** = loans in 'substandard', 'doubtful' and 'lost' categories

**NPL coverage ratio** =  $\text{loan loss provisions}/\text{NPL}$

**Net provision charge** =  $\text{provisions created} - \text{provisions released}$

DM IDM S.A. generally values the covered banks via two methods: comparative method and fundamental target fair P/E and target fair P/BV multiples method. The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the fundamental target fair P/E and target fair P/BV multiples method is its independence of the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation.

Assumptions used in valuation can change, influencing thereby the level of the valuation. Among the most important assumptions are: GDP growth, forecasted level of inflation, changes in interest rates and currency prices, employment level and change in wages, demand on the analysed company products, raw material prices, competition, standing of the main customers and suppliers, legislation changes, etc.

Changes in the environment of the analysed company are monitored by analysts involved in the preparation of the recommendation, estimated, incorporated in valuation and published in the recommendation whenever needed.

**LT fundamental recommendation tracker**

Recommendation		Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/reiteration (PLN)	12M EFV (PLN)	
<b>Gant Development</b>									
Hold	-	25.08.2009	-	04.03.2010	-10%	-12%	23.55	23.10	-
-	→	-	31.08.2009	-	-	-	23.24	23.10	→
-	→	-	12.10.2009	-	-	-	20.85	23.10	→
-	→	-	19.10.2009	-	-	-	23.77	23.10	→
-	→	-	14.12.2009	-	-	-	22.40	23.10	→
-	→	-	07.01.2010	-	-	-	21.75	23.10	→
-	→	-	03.02.2010	-	-	-	18.27	23.10	→
-	→	-	01.03.2010	-	-	-	19.43	23.10	→
Buy	↑	04.03.2010	-	02.11.2010	-10%	-23%	21.18	26.10	↑
-	→	-	29.03.2010	-	-	-	23.70	26.10	→
-	→	-	29.04.2010	-	-	-	25.05	28.70	↑
-	→	-	09.05.2010	-	-	-	23.07	28.70	→
-	→	-	17.05.2010	-	-	-	23.60	28.70	→
-	→	-	14.06.2010	-	-	-	22.05	28.70	→
-	→	-	19.07.2010	-	-	-	21.70	28.70	→
-	→	-	22.08.2010	-	-	-	21.70	28.70	→
-	→	-	31.08.2010	-	-	-	20.24	28.70	→
-	→	-	12.10.2010	-	-	-	20.00	28.70	→
Hold	↓	02.11.2010	-	Not later than 02.11.2011	-	-	19.03	19.80	↓

**Market-relative recommendation tracker**

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/reiteration (PLN)	Relative performance
<b>Gant Development</b>						
Underweight	-	25.08.2009	-	19.10.2009	23.55	1%
-	→	-	31.08.2009	-	23.24	-
-	→	-	12.10.2009	-	20.85	-
Neutral	↑	19.10.2009	-	01.03.2010	23.77	-18%
-	→	-	14.02.2009	-	22.40	-
-	→	-	07.01.2010	-	21.75	-
-	→	-	03.02.2010	-	18.27	-
Overweight	↑	01.03.2010	-	09.05.2010	19.43	16%
-	→	-	04.03.2010	-	21.18	-
-	→	-	29.03.2010	-	23.70	-
-	→	-	29.04.2010	-	25.05	-
Neutral	↓	09.05.2010	-	02.11.2010	23.07	-29%
-	→	-	17.05.2010	-	23.60	-
-	→	-	14.06.2010	-	22.05	-
-	→	-	19.07.2010	-	21.70	-
-	→	-	22.08.2010	-	21.70	-
-	→	-	31.08.2010	-	20.24	-
-	→	-	12.10.2010	-	20.00	-
Underweight	↓	02.11.2010	-	Not later than 02.11.2011	19.03	-

**Distribution of IDM's current recommendations**

	Buy	Hold	Sell	Suspended	Under revision
Numbers	21	32	16	1	0
Percentage	30%	46%	23%	1%	0%

**Distribution of IDM's current recommendations for companies that were within the last 12M IDM customers in investment banking**

	Buy	Hold	Sell	Suspended	Under revision
Numbers	2	1	1	1	0
Percentage	40%	20%	20%	20%	0%

**Distribution of IDM's current market relative recommended weightings**

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	22	29	17	1	0
Percentage	32%	42%	25%	1%	0%

**Distribution of IDM's current market relative recommended weightings for the companies that were within the last 12M IDM customers in investment banking**

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	2	0	2	1	0
Percentage	40%	0%	40%	20%	0%

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