ERSTE GROUP

Company Report – Other Utility Services – Poland – June 25, 2008

Apator Hold

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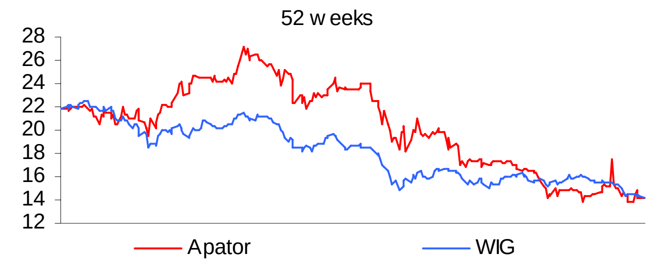
PLN mn	2007	2008e	2009e	2010e
Net sales	311.35	364.53	399.26	417.84
EBITDA	55.62	59.24	65.04	66.97
EBIT	42.82	43.84	48.45	50.74
Net result after min.	34.66	33.39	35.74	37.66
EPS (PLN)	0.98	0.96	1.05	1.11
CEPS (PLN)	1.33	1.41	1.54	1.59
BVPS (PLN)	4.37	4.69	5.00	5.32
Div./share (PLN)	0.50	0.74	0.79	0.83
EV/EBITDA (x)	8.9	9.4	8.5	8.1
P/E (x)	24.4	14.7	13.5	12.8
P/CE (x)	18.1	10.1	9.2	8.9
Dividend Yield	2.1%	5.2%	5.6%	5.8%



Performance	12M	6M	3M	1M
in PLN	-35.2%	-39.6%	-18.4%	-2.1%
in EUR	-27.0%	-35.0%	-14.1%	-0.6%

Share price (PLN)	14.20	Reuters	APOR.WA	Free float	81.3%
Number of shares (mn)	35.3	Bloomberg	APT PW	Shareholders	Apator Mining (18.7%)
Market capitalization (PLN mn / EUR mn)	501 / 149	Div. Ex-date	09/07/08		Pioneer IM (8.55%)
Enterprise value (PLN mn / EUR mn)	495 / 147	**Target price**	**15.5**	Homepage:	www.apator.com.pl

Measuring the risks

- **We have revised our valuation of Apator. We maintain our Hold recommendation, but lower our target price from PLN 23.3 to PLN 15.5. As we had feared, macro changes have negatively influenced the company. Indeed, the dynamics of wage growth and PLN appreciation have been even more significant than we expected. Together with the quite weak market, these factors have driven down the share price. These persistent macro trends will make it very hard for Apator to significantly improve its effectiveness.**

- **On the other hand, the company has been very active in the acquisition sphere. Apator managed to acquire the long-sought-after PoWoGaz (a producer of water meters, which should help to complete Apator's meter offer) and a very promising small IT company (specializing in work for utilities), Rector. We have mixed feelings about the acquisition of PoWoGaz, but a very positive opinion regarding Rector.**

- **At this price level, Apator is becoming interesting as a "cash cow", with a long-term strategy to pay out 75% of net profit as a dividend, running a buyback program worth PLN 20mn (4% of total market cap) in 2008 and squeezing growth out of the new acquisitions. The redemption of an 18.7% stake has forced us to change our assumptions for this issue. We now treat this stake as assets for sale, valuing it at the current market price (deducting the 19% tax that will have to be paid in the case of a sale of the stake). This stake accounts for 16% of the total valuation.**

Investment story

Negative macro changes

There are two major factors exerting a significant influence on Apator. The first is the appreciation of the PLN. In 2H07, the PLN strengthened by 13% y/y (on average) against the USD and by 4% vs. the EUR. In the first five months of 2008, the PLN was 21% (on average) higher y/y vs. the USD and 9% vs. the EUR. This hinders the company in two ways. First, it harms exports, which in 2007 amounted to over 23% of sales (two thirds of export sales are realized in EUR). Secondly (and more importantly), the appreciation of the PLN makes competing imported products more attractive. The second most significant for Apator factor has been the surge in labor costs. The average cost of employment increased by 9% in 2007 y/y and the pace of growth is still high in 2008 (the average in the first five months is +11.7% y/y). The cost of labor accounts for almost 30% of total costs for Apator (a very high ratio), as its products are work-intensive. We estimate that the 2007 increase in labor costs was responsible for about a 2pp decrease of Apator's profit margin.

Weak market

Another factor negatively influencing the company in 2H07 and 1Q08 was its quite weak margin. The appreciation of costs could not be transferred into prices, due to the competition from imports and the weak market, especially in the energy segment. The company claims that the chaos in this sector caused by organizational changes (and preparations to go public) has hampered orders. We agree with this to a certain extent, but it has to be remembered that the sector has big investments ahead of it, and additional orders for (e.g.) meters will probably not receive priority status. So, we will never witness a boom for Apator's products, but we can hope for some growth. The company also claimed that its new and quite promising product, pre-paid meters, had a tough time in 1Q08. It seems that the market has rebounded, at least a little; 2Q08 should be similar to 2Q07.

PoWoGaz acquisition

Since May, Apator has consolidated the results of PoWoGaz. PoWoGaz is a water meter producer from Poznan (Poland), which had been owned by its workers. Apator acquired a 97.1% stake for PLN 70.2mn. This implies a price for the whole stake at PLN 72mn. The net purchase price was in fact lower, as PoWoGaz had a significant amount of net cash (PLN 14.5mn) at the moment of purchase. The company generates sales of about PLN 60mn (in 2008, about PLN 44mn will be consolidated). The past net profitability of the company amounted to about 4%. This year, we think that the result will be much lower, due to restructuring of the workforce. However, in 2009, PoWoGaz should reach a margin of about 6%. There is potential in this company, due especially to the fact that the biggest competitor in the water meter segment, Metron, is having some very serious problems (a court case). Our scenario for Apator's development (which assumes very limited growth, given the restructuring of the workforce) shows that Apator paid quite generously for PoWoGaz. The company claims that very significant additional value can be generated from real estate owned by PoWoGaz (3.2ha in Poznan). This real estate could be transformed into "for sale" status only after the reorganization of its business. Since we do not have enough data to calculate this value, we do not take it into consideration. The real estate (according to our valuation) could be worth PLN 45-57mn. The company estimates the value of this real estate at a higher value.

Own share stake

The lack of will regarding the redemption of own shares (18.7% owned by Apator Mining) forces us to adopt a new attitude on this issue. We now treat the 18.7% stake as an asset for sale (as clearly indicated in the last forecast from Apator) and value it at its current market price (PLN 14.2), deducting the tax that would be paid in case of such a transaction.

Dividend and buyback

Apator has a long-term strategy to pay out 75% of net profit as a dividend, unless some big capex for new acquisitions / projects arises. From 2007 net profit, Apator will pay out only PLN 0.5 per share (a 41% payout rate). Apator will pay the dividend in two phases: 1) pre-payment at the end of the year (it already paid PLN 0.2 per share at the end of 2007), with 2) the "rest" of the dividend paid after the AGM the next year (the ex-dividend for PLN 0.3 is set for July 9).

This year, the company is carrying out a buyback program with a total value of PLN 20mn. Thus far, PLN 0.2mn has been spent.

Additional stories

In our valuation, we do not assume the sale of the real estate in Torun, where the production facility is located (although the company claimed that there is still a chance that this could happen; value - several tens of PLNmn), nor the sale of PoWoGaz real estate (described above). We assume a steady development of PoWoGaz, with the restructuring of labor costs (the alternative scenario would be: bankruptcy of major competitor Metron, leading to a jump in sales for PoWoGaz). In our report, we do not assume any rapid or significant development of markets for innovative products (such as remote-read meters or integrated meter systems). We will closely watch to see if Apator is able to enter/create more technologically advanced and higher-margin markets.

Financials

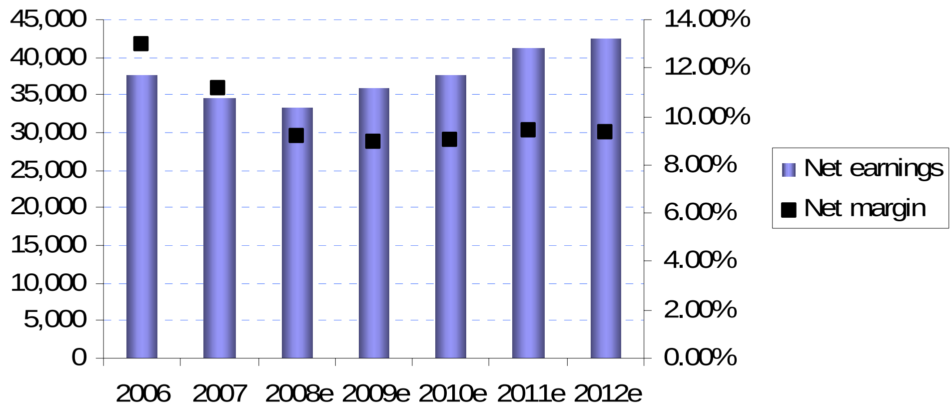
Some recovery after weak last three quarters

The last three quarters were very weak for Apator in terms of generated net profit. The weakest was the last one, 1Q08, when all of the negative factors cumulated. The company has signaled that there has been some recovery of the market in 2Q08 – especially for the pre-paid meter segment (which was a total failure in 1Q08). This may allow Apator to reach a net profit of even about PLN 9mn in the second quarter. We still fear that Apator's full-year net profit forecast of PLN 36mn is too ambitious, in light of the tough macro environment and despite the acquisitions.

Acquisitions to provide some growth

We do not expect a sudden boom in Apator's markets or an improvement of the macro conditions. In the long run, Apator will still have to face a deteriorating gross margin, mainly due to increasing labor costs and cheaper imports.

Net profit forecast (PLN mn)



Source: Apator, Erste Bank

The rapidly changing macro environment should significantly harm Apator's net margin. In addition, the company had to increase its debt (we expect almost PLN 60mn at the end of 2008) to finance the acquisitions of Rector and PoWoGaz. Interest costs are also burdening the margin in 2008. This is partially compensated for by the acquisition of the very profitable Rector. On the other hand, we do not expect a significant positive participation of PoWoGaz in the result, due to the restructuring of labor. The improving PoWoGaz should compensate for the overall weakening of the margin in the longer term. The anticipated improvement in 2011 is due to the assumed realization of the option for buy out minorities in Rector.

Valuation

We employed a DCF valuation tool to estimate the fair value of the company. The DCF is based on our forecasts for 2008-12. We used a discount rate based on WACC and a terminal value based on perpetuity. The DCF led us to a fair value of PLN 15.5 per share, which in our opinion reflects the value of the firm in a proper way. The peer comparison shows that Apator shares are traded more or less fairly. We maintain our Hold recommendation, as we believe that the tough environment, quite weak market and limited area for margin improvement and organic growth are offset by the high amount of generated cash, nice dividend strategy, buyback program and growth from the acquisitions.

Our estimates are based on the following:

- We assume restructuring of labor costs at PoWoGaz.
- We do not assume the bankruptcy of Metron (PoWoGaz competitor).
- We do not assume the sale of real estate in Poznan or Torun.
- We treat the own share stake as assets for sale (and estimate its value at the current price, deducting the potential tax to be paid).
- We assume average growth of wages at 7% in the period 2007-12e
- We assume the copper price in PLN remaining at the current level
- The risk-free rate is set at 6.5%, equity premium at 5%, debt premium at 1.5% and beta at 1 in the forecasted period.
- The terminal growth rate is set at 0.5%.

Peer group comparison

PLN mn	P/E			EV/Sales			EV/EBITDA			Valuation		
	2007	**2008e**	**2009e**	**2007**	**2008e**	**2009e**	**2007**	**2008e**	**2009e**	**2007**	**2008e**	**2009e**
Implied fair value	456.8	634.9	454.1	385.1	372.1	371.2	658.3	550.1	498.1			
Number of shares (mn)	35.29	35.29	35.29	35.29	35.29	35.29	35.29	35.29	35.29	14.2	14.7	12.5
Implied fair value/share (PLN)	12.9	18.0	12.9	10.9	10.5	10.5	18.7	15.6	14.1			
12M Target Price										**15.6**	**16.2**	**13.8**
Median for int. peer group	**13.2**	**19.0**	**12.7**	**1.0**	**0.8**	**0.7**	**10.3**	**7.9**	**6.4**			
Apator	**24.4**	**14.7**	**13.5**	**1.6**	**1.5**	**1.4**	**8.9**	**9.4**	**8.5**			
Nedap	11.3	11.5	11.1	1.6	1.2	1.1	8.6	6.6	6.4			
Radiall SA	13.2	16.2	12.7	1.0	0.6	0.6	7.2	4.9	4.2			
Be Semiconductor Industr.		31.1	13.7	0.8	0.6	0.6	30.1	10.3	6.2			
Dialog Semiconductor		22.9	7.4	1.0	0.5	0.3		5.9	2.8			
Schaffner Holding AG	28.9	19.6	13.4	1.1	1.0	0.9	12.0	9.8	7.6			
New ays Electronics	5.2	4.9	5.9	0.4	0.3	0.4	5.1	7.9	8.1			
Itron	32.3	28.2	22.9	3.0	2.4	2.1	19.7	16.1	13.4			
Vaisala Oyj	19.0	19.0	16.9	2.5	1.7	1.6	12.5	8.8	7.7			
Phoenix Mecano AG	11.2	10.4	9.2	0.9	0.8	0.7	6.3	5.6	5.0			

Source: Erste Bank

WACC

	2008e	**2009e**	**2010e**	**2011e**	**2012e**	**beyond 2012**
WACC	**10.1%**	**10.2%**	**10.4%**	**10.4%**	**10.6%**	**9.1%**
Equity cost	11.5%	11.5%	11.5%	11.5%	11.5%	10.0%
Debt cost	6.5%	6.5%	6.5%	6.5%	6.5%	5.3%
Equity w eighting	72%	75%	78%	79%	82%	82%
Debt w eighting	28%	25%	22%	21%	18%	18%
Risk free rate	6.5%	6.5%	6.5%	6.5%	6.5%	5.0%
Equity risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.00	1.00	1.00	1.00	1.00	1.00
Debt premium	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%

Source: Erste Bank

DCF valuation

PLN mn	2008e	2009e	2010e	2011e	2012e	beyond 2012
EBIT	**43.8**	**48.5**	**50.7**	**53.2**	**54.8**	**53.2**
tax rate	0.2	0.2	0.2	0.2	0.2	0.2
tax on EBIT	6.7	7.4	8.0	8.6	9.0	8.6
NOPLAT	**37.1**	**41.1**	**42.7**	**44.5**	**45.8**	**44.5**
Depreciation	15.4	16.6	16.2	16.0	15.8	16.0
Capital expenditures	-61.2	-14.7	-14.7	-25.7	-15.8	-25.7
Change in working capital	-20.7	-6.4	-4.9	-5.2	-5.2	
Free cash flow	**-29.4**	**36.6**	**39.3**	**29.6**	**40.6**	**44.5**
Terminal value						
Value of FCF at 31.12.2007	-26.7	30.1	29.4	20.0	24.8	
Sum of DFCF	77.6					
Discounted terminal value	313.8					
Enterprise value at 31.12.2007	**391.4**					
Non-operating assets (own shares)	77.0					
Net debt at 31.12.2006	-6.1					
Fair value at 31.12.2007	**474.6**					
Number of shares (mn)	35.3					
Fair value per share at 31.12.2007	**13.4**					
Cost of equity	**10.2%**					
Target Price	**15.5**					
Stock price	14.20					
Premium/discount	9.3%					

Source: Erste Bank

Income Statement	2005	2006	2007	2008e	2009e	2010e
(IAS, PLN mn, 31/12)	31/12/2005	31/12/2006	31/12/2007	31/12/2008	31/12/2009	31/12/2010
Net sales	**276.78**	**288.90**	**311.35**	**364.53**	**399.26**	**417.84**
Cost of goods sold	-182.54	-192.07	-213.42	-252.47	-276.75	-290.43
Gross profit	**94.24**	**96.84**	**97.93**	**112.05**	**122.51**	**127.41**
SG&A	-54.43	-55.34	-56.89	-68.53	-73.86	-76.46
Other operating revenues	-3.32	1.29	1.78	0.32	-0.20	-0.21
Other operating expenses	0.00	0.00	0.00	0.00	0.00	0.00
EBITDA	**49.95**	**55.40**	**55.62**	**59.24**	**65.04**	**66.97**
Depreciation/amortization	-13.46	-12.61	-12.81	-15.40	-16.59	-16.24
EBIT	**36.49**	**42.79**	**42.82**	**43.84**	**48.45**	**50.74**
Financial result	-0.43	0.51	0.62	-2.32	-3.85	-3.44
EBT	**49.07**	**43.29**	**43.44**	**41.52**	**44.60**	**47.30**
Income taxes	-6.78	-6.64	-8.77	-6.73	-7.36	-8.04
Extraordinary result	13.02	0.00	0.00	0.00	0.00	0.00
Minorities and cost of hybrid capital	-0.42	-0.09	-0.02	-1.40	-1.50	-1.59
Net result after minorities	**44.77**	**37.56**	**34.66**	**33.39**	**35.74**	**37.66**

Balance Sheet	2005	2006	2007	2008e	2009e	2010e
(IAS, PLN mn, 31/12)						
Intangible assets	4.05	4.13	2.90	36.19	36.02	35.93
Tangible assets	64.49	72.25	72.15	85.34	83.62	82.18
Financial assets	6.40	9.51	8.79	11.79	11.79	11.79
Total fixed assets	**74.94**	**85.88**	**83.83**	**133.32**	**131.43**	**129.89**
Inventories	30.60	37.85	38.41	59.58	63.65	66.80
Receivables and other current assets	64.84	58.51	60.56	73.71	79.05	82.73
Other assets	1.63	1.25	1.50	1.50	1.50	1.50
Cash and cash equivalents	15.31	9.97	11.32	5.47	5.99	6.27
Total current assets	**112.37**	**107.58**	**111.78**	**140.26**	**150.20**	**157.30**
TOTAL ASSETS	**187.31**	**193.46**	**195.61**	**273.58**	**281.63**	**287.19**
Shareholders'equity	**117.04**	**138.87**	**154.35**	**159.14**	**169.83**	**180.70**
Minorities	**2.05**	**0.43**	**0.08**	**0.08**	**0.08**	**0.08**
Hybrid capital and other reserves	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Pension and other LT personnel accruals	0.00	0.00	0.00	0.00	0.00	0.00
Other LT provisions	9.58	9.96	9.41	9.41	9.41	9.41
Interest-bearing LT debts	0.00	0.00	0.00	0.00	0.00	0.00
Other LT liabilities	0.07	0.01	0.02	0.00	0.00	0.00
Total long-term liabilities	**0.07**	**0.01**	**0.02**	**0.00**	**0.00**	**0.00**
Interest-bearing ST debts	16.94	9.38	5.15	63.11	57.00	49.50
Other ST liabilities	41.63	34.82	26.61	41.84	45.30	47.51
Total short-term liabilities	**58.08**	**44.15**	**31.75**	**104.95**	**102.31**	**97.01**
TOTAL LIAB. , EQUITY	**187.31**	**193.46**	**195.61**	**273.58**	**281.63**	**287.19**

Cash Flow Statement	2005	2006	2007	2008e	2009e	2010e
(IAS,PLN mn, 31/12)						
Cash flow from operating activities	28.82	42.13	33.16	29.64	50.22	52.72
Cash flow from investing activities	-22.21	-17.15	-8.92	-61.20	-14.70	-14.70
Cash flow from financing activities	-4.26	-30.32	-22.90	25.71	-35.00	-37.74
CHANGE IN CASH , CASH EQU.	**2.35**	**-5.33**	**1.34**	**-5.85**	**0.52**	**0.28**

Margins & Ratios	2005	2006	2007	2008e	2009e	2010e
Sales growth	45.2%	4.4%	7.8%	17.1%	9.5%	4.7%
EBITDA margin	18.0%	19.2%	17.9%	16.3%	16.3%	16.0%
EBIT margin	13.2%	14.8%	13.8%	12.0%	12.1%	12.1%
Net profit margin	15.3%	12.7%	11.1%	9.5%	9.3%	9.4%
ROE	45.0%	29.4%	23.6%	21.3%	21.7%	21.5%
ROCE	38.0%	26.0%	22.3%	19.1%	17.7%	18.2%
Equity ratio	63.6%	72.0%	78.9%	58.2%	60.3%	62.9%
Net debt	1.6	-0.6	-6.2	57.6	51.0	43.2
Working capital	52.7	62.2	78.5	33.8	46.4	58.8
Capital employed	130.4	148.7	157.7	226.3	230.3	233.4
Inventory turnover	7.1	5.6	5.6	5.2	4.5	4.5

Source: Company data, Erste Bank estimates

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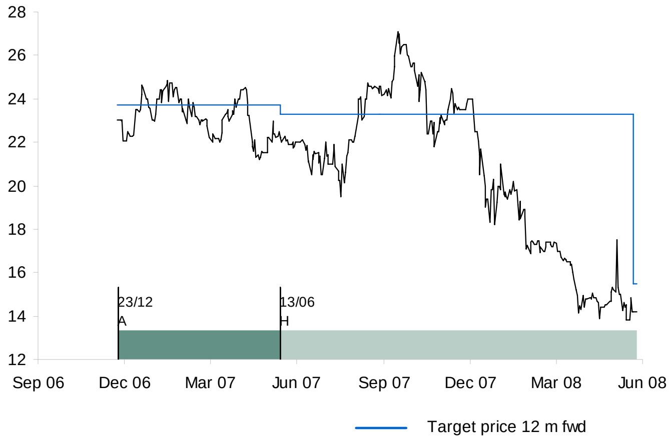

Rating history

Date	Rating	Price	Target Price
13. Jun 07	Hold	22.20	23.30
10. Mar 06	Accumulate	19.41	257.00
27. Jun 05	Buy	8.73	118.40

Company	Disclosure
Apator	4

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Buy	> +20% to target price
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Hold	0% < target price < +10%
Reduce	-10% < target price < 0%
Sell	< -10% to target price

Our target prices are established by determining the fair value of stocks, taking into account additional fundamental factors and news of relevance for the stock price (such as M&A activities, major forthcoming share deals, positive/negative share/sector sentiment, news) and refer to 12 months from now. All recommendations are to be understood relative to our current fundamental valuation of the stock. The recommendation does not indicate any relative performance of the stock vs. a regional or sector benchmark.

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