Company Report

Apator

Poland, Electrical equipment

Buy

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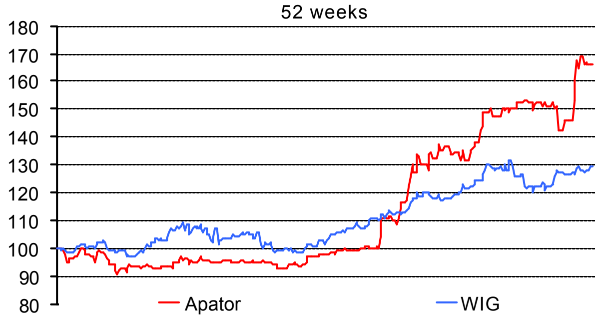
PLN mn	2004	2005e	2006e	2007e
Net sales	200.9	290.7	304.5	319.7
EBITDA	54.7	64.9	71.3	76.2
EBIT	44.4	48.6	52.0	54.2
Net profit	36.8	53.3	44.4	46.3
EPS (PLN)	11.45	16.62	13.85	14.42
CEPS (PLN)	16.00	22.13	19.86	21.28
BVPS (PLN)	28.86	45.49	54.34	58.38
Div/share (PLN)	4.00	5.00	10.00	10.50
EV/EBITDA (x)	9.2	7.8	6.7	6.2
P/E (x)	13.9	9.6	11.5	11.1
P/CE (x)	10.0	7.2	8.0	7.5
Dividend yield	2.5%	3.1%	6.3%	6.6%



Performance	12M	6M	3M	1M
in PLN	66.1%	69.7%	24.6%	10.0%
in EUR	78.1%	81.1%	29.6%	12.8%

Share price (PLN)	159.5	Reuters	APOR.WA	Free float	37.6%
Number of shares (mn)	3.2	Bloomberg	APT PW	Shareholders	Apator Mining(18.7%)
Market capitalization (PLN mn / EUR mn)	511.8 / 131.3	Div. ex-date	12/02/05		Other shareholders > 5% (21.88%)
Enterprise value (PLN mn /EUR mn)	505.2 / 129.6	Target price	212	Homepage:	www.apator.torun.pl

Faster growth, positive effects of restructuring

- **This year has been extremely good for Apator. The company has surprised us every quarter, reporting excellent results that exceed our estimates. The growth is mainly a consequence of acquisitions (Metrix and KFAP in 4Q04), as well as organic growth (mostly via exports).**

- **We have raised our forecast for the top line in 2005 to PLN 290.7mn, from the previous PLN 269.7mn, as Apator reported very good sales in the first nine months of 2005 (PLN 202.7mn). The last quarter of the year is likely to be very strong, due to seasonality.**

- **We are impressed by the strong growth of exports. The rapid growth of exports of profitable metering equipment (+156% y/y) to the European Union is particularly positive.**

- **The company's profitability in 1-3Q05 is slightly better than our earlier estimate. Therefore, we have raised our forecast for the 2005 operating margin from 15.6% to 16.7%, mainly on the back of higher revenues and continuing restructuring, which have made positive contributions much earlier than we assumed. We now expect the 2005 EBIT to come in at PLN 48.6mn.**

- **We set our 12-month target price at PLN 212 per share, which suggests 33% upside potential. Buy maintained.**

Investment story

Top line accelerating, further growth to be driven by exports

This year has been extremely good for Apator. The company has surprised us every quarter, reporting excellent results that exceed our estimates. After nine months, both domestic and export revenues grew by ca. 45% y/y, which is a consequence of acquisitions (Metrix and KFAP in 4Q04), as well as organic growth. Due to the faster than expected rate of growth, we decided to raise our top line estimate for 2005 from PLN 270mn to PLN 290.7mn. We believe that further growth will be driven mainly by exports of the most lucrative product – metering equipment (systems and meters). In particular, EU markets look promising for the company. Our optimism is based on 1-3Q05 data; exports to the EU grew by 156% to PLN 24mn during this period – still a small amount in relation to total sales, but the significance of EU customers will gradually grow over the next few years. We expect exports to continue growing at a double-digit rate over the next five years, starting from a very low base. For the domestic market, we expect much slower growth, as Apator has a very high market share in the majority of its segments. For the entire domestic market, we expect a similar growth rate to that of investment outlays: we estimate this parameter at +5% y/y in 2005, +4.5% y/y in 2006 and +5.0% y/y in 2007.

Apator's management announced that the company lost one client (which had been buying control panels for boilers). Thus, the top line will deteriorate by ca. PLN 15mn p.a. However, Apator will consequently reduce headcount by 40 people. Therefore, we do not expect this issue to result in any substantial damage to profitability.

Top line development

PLNmn	2004	2005e	2006e	2007e	2008e	2009e	2010e
Total sales	**201.0**	**290.7**	**304.6**	**319.7**	**335.7**	**352.5**	**370.3**
y/y dynamics (%)	*89.6%*	*44.7%*	*4.8%*	*5.0%*	*5.0%*	*5.0%*	*5.0%*
Domestic sales	175.1	238.4	244.4	250.5	256.7	261.3	265.8
y/y dynamics (%)	*89.0%*	*36.2%*	*2.5%*	*2.5%*	*2.5%*	*1.8%*	*1.7%*
Export sales	25.9	52.3	60.2	69.2	79.0	91.2	104.5
y/y dynamics (%)	*93.7%*	*102.3%*	*15.1%*	*15.0%*	*14.2%*	*15.4%*	*14.6%*
Share of domestic sales	*87.1%*	*82.0%*	*80.2%*	*78.4%*	*76.5%*	*74.1%*	*71.8%*
Share of exports	*12.9%*	*18.0%*	*19.8%*	*21.6%*	*23.5%*	*25.9%*	*28.2%*

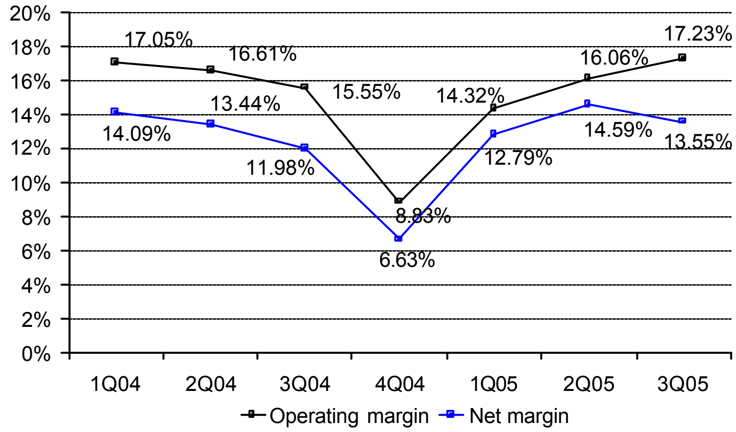
Source: Apator, Erste Bank

Improvement of margins already seen, due to success of new strategy

In assessing the new strategy introduced by the company at the beginning of 2005, we believe that management reached all of the projected goals. The company successfully incorporated and restructured its previously acquired companies. Restructuring the Pafal group reduced costs, although the margin improvement was achieved partly by changing the production profile. Apator is developing the products with the highest value added (like metering systems) and gradually halting the production of less profitable ones. Another fulfilled promise was mentioned above in the context of export development.

The influence of the new strategy has definitely been positive for Apator's margins. We stripped out all extraordinary items from the last two years' margins to show the real margins achieved by the company.

Margin recovery (excluding all one-offs)



Source: Apator, Erste Bank

Since 2Q04 (when the Pafal group was acquired), we have observed a gradual drop in profitability. Margins reached bottom in 4Q04, when a further two companies (Metrix and KFAP) were acquired. However, since the beginning of 2005, we have noticed a substantial improvement in profitability, as a result of the restructuring of acquired assets. In 3Q05, two companies from the Pafal group (Prassmet and Energo Instal) were disposed of, while another – Pafal Form – is expected to be sold by the end of 2005.

Another acquisition might come in 2006

We do not include any potential takeovers in our current model, although management admitted that they are considering further acquisitions in the sector. The company is close to acquiring a small German producer of pre-paid meters. However, Apator treats this as a foothold for expansion in Germany, as Apator intends to use the German company's distribution channels. We think there would be a much more significant impact if Apator acquired a water meter producer. Currently, there are two manufacturers of water meters in Poland - Metron from Torun (with annual revenues of PLN 70-80mn) and Powogaz from Poznan (with annual sales of PLN 60mn). Acquiring one of these companies would be very good for Apator, as it would complete the company's offering of metering systems for all sectors. Both potential targets are in poor financial condition, and would require restructuring. However, we are convinced that Apator would be able to restructure the companies quickly and effectively.

Advance dividend a gift to shareholders

Apator is continuing with its regular dividend policy, which is very favorable for shareholders, in our opinion. For the second year in a row, the company has decided to pay an advance dividend from the current year's net profit in December. The ex-dividend date for the advance (in the amount of PLN 2.3 per share) is December 2, with the payout date December 13. Management has promised to pay a dividend in the amount of at least PLN 5.0 per share from the 2005 net profit. This means at least PLN 2.7 per share will be paid after the AGM, which is expected to be held in June 2006.

Next year's share split should raise liquidity

Management declared that it is thinking about a share split for 2006. Apator is one of the most dynamically growing companies on the WSE, but potential shareholders are discouraged by the stock's low liquidity. This is why we regard a split as a very good idea, which should increase the attractiveness of the stock.

Valuation and recommendation

We have changed some input data in our model.

Changes in assumptions and forecasts

PLN mn	2004	old 2005	new 2005	old 2006	new 2006
Revenue dynamics	89.6%	34.2%	**44.7%**	7.5%	**4.8%**
EBITDA margin	*27.3%*	*21.7%*	***22.3%***	*18.1%*	***23.4%***
EBIT margin	*22.2%*	*15.6%*	***16.7%***	*12.1%*	***17.1%***
Net margin	*17.4%*	*16.4%*	***18.3%***	*11.2%*	***14.6%***
Employment cost	51.2	55.0	**55.0**	56.0	**54.2**
Selling cost	12.2	16.2	**17.4**	17.4	**18.3**
Administration cost	27.1	34.2	**36.1**	33.4	**36.5**
Working capital	32.4	54.7	**66.9**	58.9	**70.1**
Net debt	-5.9	-17.5	**-6.6**	-42.5	**-32.5**

Source: Apator, Erste Bank

Another change influencing our DCF valuation is the change of 5Y Treasury bill yields, which we take as the risk-free rate in our WACC calculation; this has risen from the 4.97% assumed in our previous report to 5.08% currently.

WAAC calculation

	2005e	2006e	2007e	2008e	2009e	2010e	2011e	beyond 2011
WACC	**8.83%**	**9.10%**	**9.12%**	**9.14%**	**9.15%**	**9.16%**	**9.16%**	**9.08%**
Equity cost	10.08%	10.08%	10.08%	10.08%	10.08%	10.08%	10.08%	10.00%
Debt cost	5.59%	5.59%	5.59%	5.59%	5.59%	5.59%	5.59%	5.53%
Equity weighting	72.1%	78.2%	78.6%	79.0%	79.3%	79.4%	79.5%	79.5%
Debt weighting	27.9%	21.8%	21.4%	21.0%	20.7%	20.6%	20.5%	20.5%
Risk free rate	5.08%	5.08%	5.08%	5.08%	5.08%	5.08%	5.08%	5.00%
Equity risk premium	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%
Beta	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Debt premium	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
Tax rate	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%

Source: Reuters, Erste Bank

We assume an effective tax rate of 15%, as the company extracts the dividend tax paid by subsidiary companies from the consolidated CIT payment.

DCF valuation

PLN '000	2005e	2006e	2007e	2008e	2009e	2010e	2011e	beyond 2011
EBIT	**48,585**	**52,030**	**54,198**	**56,096**	**57,549**	**58,356**	**58,519**	
Tax rate	15%	15%	15%	15%	15%	15%	15%	
Tax on EBIT	-7,288	-7,805	-8,130	-8,414	-8,632	-8,753	-8,778	
NOPLAT	**41,298**	**44,226**	**46,069**	**47,681**	**48,917**	**49,603**	**49,741**	**50,736**
Depreciation	16,270	19,286	22,003	25,322	29,378	34,379	40,443	
Capital expenditures	-39,300	-19,100	-22,200	-25,200	-29,400	-34,200	-39,000	
Change in working capital	-34,564	-3,191	-3,681	-3,946	-4,209	-4,499	-4,863	
Free cash flow	**-16,297**	**41,220**	**42,191**	**43,858**	**44,686**	**45,283**	**46,321**	**50,736**
Terminal value								**716,288**
PV of FCF		37,503	35,178	33,505	31,275	29,035	27,410	
Sum of PV of FCF		193,905						
PV of terminal value		423,861						
Enterprise value		**617,766**						
Non-operating assets		0						
Net debt		-6,598						
Fair value at 31.12.2005		**624,364**						
Number of shares		3,209						
Fair value per share		**194.6**						
Cost of equity		10.1%						
Target price		**212.4**						
Stock price		159.5						
Premium/discount		33.2%						

Source: Erste Bank

Change of recommendation system

We have also changed our valuation methodology, replacing the fair value with a 12-month target price . We now discount all free cash flows on December 31, 2005, subtract the 2005 year-end net debt and capitalize the received fair value of equity with the cost of equity for a one-year period ahead.

Target price PLN 212, Buy maintained

Our new target price for Apator in the 12-month time horizon is PLN 212 per share. We maintain our Buy recommendation.

Income Statement (IAS, PLN mn, 31/12)	2003	2004	2005e	2006e	2007e
Sales revenues	**106.0**	**200.9**	**290.7**	**304.5**	**319.7**
Cost of goods sold	-64.7	-131.6	-190.8	-200.0	-211.9
Gross profit	**41.4**	**69.4**	**99.9**	**104.5**	**107.7**
SG&A	-23.0	-39.3	-53.5	-54.8	-55.9
Other operating revenues	4.0	22.8	7.9	8.3	8.7
Other operating expenses	-5.0	-8.5	-5.7	-5.9	-6.3
EBITDA	**22.3**	**54.7**	**64.9**	**71.3**	**76.2**
Depreciation	-5.0	-10.3	-16.3	-19.3	-22.0
EBIT	**17.3**	**44.4**	**48.6**	**52.0**	**54.2**
Financial result	-1.2	-0.4	-0.4	0.7	0.7
EBT	**16.0**	**44.0**	**48.2**	**52.7**	**54.9**
Tax expenses	-4.8	-7.3	-9.5	-7.9	-8.2
Extraordinary result	-0.2	0.0	15.1	0.0	0.0
Minority interests	-0.1	0.0	-0.5	-0.4	-0.4
Net result after minorities	**11.0**	**36.8**	**53.3**	**44.4**	**46.3**

Balance Sheet (IAS, PLN mn, 31/12)	2003	2004	2005e	2006e	2007e
Intangible assets	0.8	4.7	4.6	4.4	4.5
Tangible assets	28.4	52.7	74.6	74.6	74.7
Financial assets	1.7	9.3	5.5	5.5	5.5
Total fixed assets	**30.9**	**66.7**	**84.7**	**84.5**	**84.7**
Inventories	12.9	20.7	38.2	40.0	42.4
Receivables and other current assets	27.8	46.0	61.1	64.0	67.1
Other assets	2.3	4.1	2.1	2.1	2.1
Cash and cash equivalents	7.0	13.4	16.4	32.5	41.9
Total current assets	**50.0**	**84.3**	**117.7**	**138.6**	**153.5**
TOTAL ASSETS	**80.9**	**151.0**	**202.4**	**223.1**	**238.2**
Shareholders' equity	**57.1**	**92.6**	**146.0**	**174.3**	**187.3**
Minorities	**0.5**	**7.6**	**2.9**	**3.5**	**3.7**
Other reserves	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Interest-bearing LT debts	0.0	0.1	0.2	0.0	0.0
Other LT liabilities	4.5	8.7	10.2	10.1	10.1
Total long-term liabilities	**4.5**	**8.8**	**10.3**	**10.1**	**10.1**
Interest-bearing ST debts	0.4	7.4	9.6	0.0	0.0
Other ST liabilities	18.4	34.6	33.5	35.1	37.0
Total short-term liabilities	**18.9**	**42.0**	**43.2**	**35.1**	**37.0**
TOTAL LIAB. & EQUITY	**80.9**	**151.0**	**202.4**	**223.1**	**238.2**

Cash Flow Statement (IAS, PLN mn, 31/12)	2003	2004	2005e	2006e	2007e
Cash flow from operating activities	13.7	37.3	57.7	61.1	64.9
Cash flow from investing activities	-4.5	-12.8	-39.3	-19.1	-22.2
Cash flow from financing activities	-6.5	-18.0	-13.7	-25.9	-33.3
CHANGE IN CASH & CASH EQU.	**2.7**	**6.5**	**4.7**	**16.1**	**9.3**

Margins & Ratios	2003	2004	2005e	2006e	2007e
Sales growth	9.3%	89.6%	44.7%	4.8%	5.0%
EBITDA margin	21.0%	27.2%	22.3%	23.4%	23.8%
EBIT margin	16.3%	22.1%	16.7%	17.1%	17.0%
Net profit margin	10.4%	18.3%	18.3%	14.6%	14.5%
ROE	21.9%	49.1%	44.7%	27.7%	25.6%
ROCE	21.7%	45.9%	42.4%	28.7%	29.3%
Equity ratio	71.2%	66.4%	73.6%	79.7%	80.2%
Net debt	-6.5	-5.9	-6.6	-32.5	-41.9
Working capital	29.0	38.4	73.7	102.7	115.7
Capital employed	55.5	103.0	152.4	155.4	159.3
Inventory turnover	5.1	7.8	6.5	5.1	5.1

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Erste Bank rating definitions	
Buy	> +20% to target price
Accumulate	+10% < target price < +20%
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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