Electrical Equipment, Poland January 15, 2007

Apator

BUY

Share Price: PLN 22.89
Price Target: PLN 29.00

"Measuring up"

Poland's leading producer of utility meters and electrical switching devices has completed the restructuring of its subsidiaries and is set for 10% sales growth CAGR to 2010 spurred on by both the buoyant domestic economy and exports.

The EBITDA margin should rise from 18.7% in 2006 to 21% in 2008, due to the greater share of higher-margin metering apparatus in sales and continued rigorous cost control. Earnings growth, distorted in 2006 by one-off profits booked during the restructuring in 2004 and 2005, will recover to c.19% CAGR to 2010.

Apator's management has demonstrated its ability to acquire and restructure businesses into highly profitable enterprises. It has a clear strategy for future growth, both domestically and internationally, which we are confident it can achieve.

Already domestic leader in many products, Apator is looking ahead, with the next generation of smart metering systems in advanced development. Polish energy market deregulation, scheduled to begin in 2007, will bring on new investments by utility companies in such technology. Apator will be well-placed to take a large share of the pie, or could be a tempting takeover target.

At a 2007 PE of 20x and 2007 EV / EBITDA ratio of 12.5x, this stock is among the more expensive of the international peers, while compared to domestic peers and the Midwig index, it is trading at the lower end. Given the high (c.30%) return on equity and the robust outlook for long-term growth, we judge that 2007 multiples could reasonably be at 25x. We initiate coverage with a target price of PLN 29 - an upside of just under 27% to the current price.

Expected Events

4Q06 results	Feb 2007
10th anniversary of WSE listing	April 2007
1Q07 results	May 2007

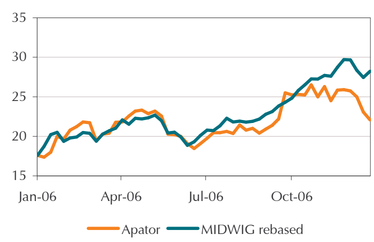
Key Data

Market Cap	USD 269 mil
EV end-07e	USD 269 mil
Free Float	59 %
Average daily volume	USD 0.3 mil
Reuters Code	APOR.WA
Bloomberg Code	APT PW
Ex. Rate (PLN/USD)	3.00
WIG Index	50,283

Price Performance

52-w range (PLN)	17.18 – 27.00
52-w performance	28.3 %

Apator price performance



Year	Sales (PLNm)	Net Profit (PLNm)	EPS (PLN)	EPS gr (%)	PER (x)	EV/ EBITDA (x)	PSR (x)	ROE (%)	ROIC (%)
2010F	443	72	2.03	18%	11.3	7.9	1.8	30%	23.6%
2009F	403	61	1.72	20%	13.3	9.1	2.0	31%	23.2%
2008F	366	51	1.4	25%	16.0	10.5	2.2	31%	22.2%
2007F	335	41	1.2	10%	19.9	12.5	2.4	29%	20.1%
2006F	304	37	1.0	-19%	22.0	14.2	2.7	29%	19.6%
2005	277	46	1.3	13%	17.8	16.1	2.9	43%	28.2%
2004	191	40	1.1	225%	20.1	15.0	4.2	56%	37.7%
2003	106	12	0.4	83%	65.3	36.4	7.6	47%	17.5%

EQUITY RESEARCH

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Closing Prices as of January 10, 2007

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Conclusion & Valuation

Construction & GDP growth fuel domestic sales as export sales speed up.

Apator, Poland's leading producer of utility meters and electrical switching devices, should grow its sales at a CAGR of 10% to 2010. This will be driven internally by its changing sales structure – higher share of metering equipment (70% in 2009); higher share of exports (30% 2009) – and externally by the continuing boom in the construction industry (12% 2006e growth) and strong underlying Polish GDP growth (5.5% 2006e, 5% 2007e).

Restructuring of new acquisitions complete. Payback by end 2008.

Since buying electricity meter maker FAP Pafal in 2004 and gas meter producer Metrix in 2005, Apator has comprehensively restructured both companies, amalgamating them successfully into the Apator Group. Pafal and Metrix' combined contribution to total EBIT in 2005 of less than 19%, should be over 33% in 2006. The company expects full payback on the original investment within three years – to end 2008.

Margins improving with the focus more on meters.

With restructuring over, EBITDA margins should gradually improve, rising from 2006e of 18.7% to 23% by 2010. This will be driven by the larger share of higher-margin metering equipment in sales, sustained cost control via careful management, the new internet tendering system for supplies and the progressive introduction of new, cheaper technologies for existing products.

Apator retains local dominance.

Apator is the dominant supplier of metering equipment in Poland and plays on its cultural advantages over western competitors when exporting in the CEE region. Cheap imports from the Far East are still minimised by licensing restrictions. Within Poland, western competitors tend to focus on the grid and industrial customers (where margins are much higher) leaving Apator with the 15 mil residential customers.

New technology ready for deregulated market when it finally happens.

Energy market deregulation – due to start in June 2007 – will be slow to bring benefits to Apator because of the desultory approach of Poland's government to privatizing the sector. However, Apator already has limited sales of the new generation technology which will be in demand when the deregulation-provoked investment wave finally hits Poland.

Higher margins on new technology may attract a takeover.

Apator should therefore be well-placed to deliver the new technology when the time comes. These technologies will command much higher margins than the existing metering equipment and Apator could become a very tempting takeover target for other European players wanting to access the Polish market, particularly given its fragmented shareholder structure.

EPS 20% CAGR to 2010. 2007 PER 20x and ROE at 30% p.a

Stripping out 2005 one-offs (negative goodwill on the purchase of Metrix) and profits from the Rug Riello contract (discontinued activity after production switched to China), we forecast net profit growth of 24% in 2006 and 18-20% CAGR to 2010. Apator has a dividend yield of 3% (payout ratio approx 70% p.a.), no debt and forecast ROE of 30+% through to 2010.

Initiate Buy with target price PLN 29, a 27% upside.

Trading on a 2007 PER of 20x, falling to 16x and 13x in 2008 and 2009, Apator offers inexpensive, indirect exposure to the Polish construction sector. We regard Apator as a high quality midcap stock with excellent long-term prospects and believe a 2007 PER of around 25x is justifiable. Thus we initiate coverage with a Buy recommendation and a target price of PLN29, making the stock a good long-term buy with a 27% upside to the current price.

Apator trades at a discount to the Midwig index……

Apator's share price rose 33% in 2006, compared to the Midwig's 56% rise. While the Midwig has partially recovered from its mild correction (down 5% since mid-December highs), Apator's share price is down 11%. The company announced that 2006 gross margins would be hit by high copper and oil prices affecting COGS, but net profits would be unaffected. This was already priced into our model and we see it as an opportunity to buy into the stock more cheaply. On 2006 earnings, Apator is trading at the cheap end of the scale against profitable domestic peers (22x 2006 earnings), with a far superior ROE, while the Midwig average is 34x.

Current valuations compared to domestic peers

		P/E 2006e	P/S 2006e	ROE % 2006e
Ampli	elec. goods distrib.	13	0.4	16
Relpol	relay switch producer	23	0.9	6
Budimex	general contractor	63	0.7	7
Tim	elec. goods distrib.	20	1.3	35
Polimex	construction	37	1.1	17
ZEG	mining elec. equipm.	40	1.1	3
ZPUE	energy transm. equipm.	33	2.1	15
Apator		22	2.7	29
Midwig		34		

Source: Wood & Co, Bloomberg/Reuters.

…and sits comfortably among international peers, while showing better ROE.

Most international peers are European or US-based and are trading on PERs in the mid teens, but these are in mature markets. Its Chinese counterpart Henan Pinggao is on 22x, but none is approaching Apator's ROE.

Selected valuations compared to international peers

		P/E x		EV/EBITDA x		PSR x		ROE %	
		2007e	2008e	2007e	2008e	2007e	2008e	2007e	2008e
Phoenix Mecano, Switz	Electronic components	11.9	10.8	6.5	5.8	1.0	0.9	16.4	15.7
Schneider Elec., France	Med & low voltage elec products, meter	12.3	11.2	7.7	6.9	1.3	1.2	15.4	15.6
Spectris, UK	Precision instruments	15	13.4	8.8	7.7	1.2	1.2	19.3	19.6
Vaisala Oyj, Finland	Electronic measurement kit	18.3	17.2	9.2	8.9	2.2	2.1	16.1	16.2
Vossloh, Germany	Electronic components, railway infrastr.	12.5	11.6	6.3	5.7	0.7	0.7	14.9	14.6
Renishaw, UK	Sensors for precision engineering	17.5	15.3	11.7	10.2	3.0	2.8	21.3	21.1
Henan Pinggao, China	High-voltage switch-gear manufacture	22.7	16.1	15.0	11.1	1.8	1.3	19.1	22.9
Legrand, France	Electrical and communication products	15.6	14.2	8.4	7.8	1.4	1.4	15.5	15.4
XJ Electric, China	Metering systems and other electronics	17.7	14.8	8.2	7.2	1.4	1.2	10.4	10.7
Nexans, France	Energy and telecoms cabling	14.7	11.5	6.1	5.3	0.4	0.4	10.5	12.2
HF Company, French	electronic equipment distributor	10.6	8	5.2	4.0	0.6	0.6	11.5	14.3
Apator		19.9	16.0	12.5	10.5	2.4	2.2	31.0	30.7

Source: Wood & Co, Reuters

Sales growth powered by domestic economic boom .....

Manufacturing a wide range of metering and switchgear equipment,....

Apator produces and sells metering equipment and switching equipment. Meter products include electricity meters, both induction and electronic, gas meters and heat meters. It also plans to acquire a water meter manufacturer. Switching equipment includes items like disconnectors, rotary cam switches (manual and automatic), fuse bases, vertical switches, low-voltage surge arrestors and a range of surge protective devices (SPD) e.g. lightning conductors.

......Apator dominates the Polish residential metering equipment market.

The Polish electricity market has three distinct segments:

The grid – consisting of less than 100 customers for very specialist, high-voltage equipment. This segment is supplied 99% by Landys & Gyr;

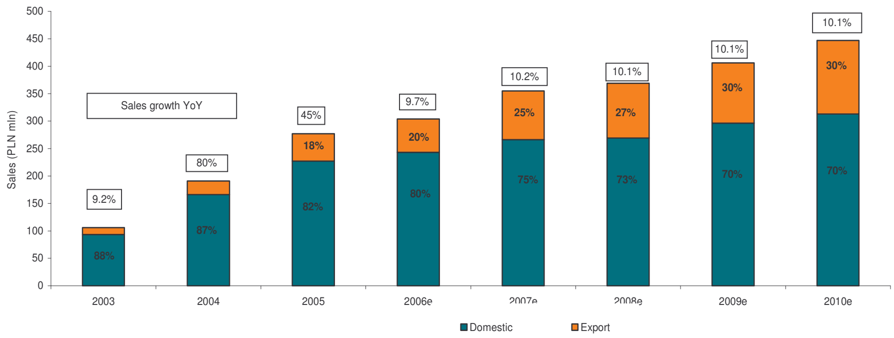
Industrial & Commercial – between 2.5 and 3.5 million clients using mainly medium- and high-voltage equipment. Dominated by Actaris and Landys and Gyr, although Apator makes some sales.

Residential segment – 15 mil users of low voltage metering equipment. Apator dominates here. In the main, Apator is selling directly to the utility companies and construction companies, with some wholesale.

Buoyant economy and increasing export sales will drive 10% CAGR in sales.

Apator recorded fast sales growth in 2004 and 2005 due to the acquisitions of Pafal (electricity meters) and Metrix (gas meters). Going forward we forecast that Apator will achieve around 10% sales growth p.a., driven by the domestic economy and export sales. Should they succeed in buying a water meter manufacturer these figures would be higher.

Sales growth – domestic and export



Source: Apator, Wood & Co estimates

Little room to increase market share, so economy will be main driver of domestic sales..

Just under 80% of total sales occur in Poland. Apator is the dominant player in most of its products with 64% and 85% market share in electronic and induction electricity meters, 45% market share in gas meters and 25% in heat meters. See the section "Meter by Meter" for a more detailed discussion of the prospects for individual products. It supplies between 40% and 60% of Poland's switchgear, with SPD lagging behind at just 25%. This leaves little room to increase sales through higher market share, so the chief driver of Apator's domestic sales growth will be the dynamics of the Polish economy, in particular construction investment.

Rising consumption, FDI and EU funds inflows will drive GDP growth.

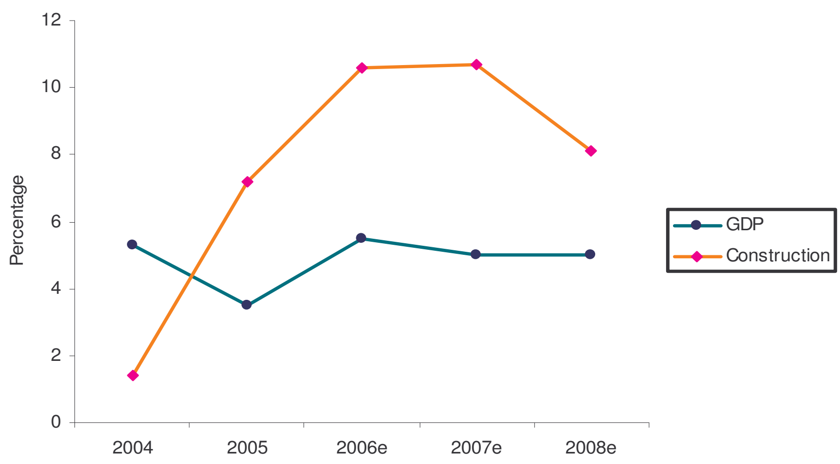
Poland's strong GDP growth in 2006 (5.5%) is forecast to stay at around 5% to at least end 2008. Poland's growth will continue to be fuelled by rising domestic consumption, rising foreign direct investment (USD 10 bil 2006e) and inflows of EU funds. From 2007 – 2013, there will be approx EUR 12 bil p.a. coming from Brussels which it is estimated will add 0.5%-1% p.a. to GDP.

The construction boom, 'though slowing, should continue to 2010…

Construction and assembly output growth was 5% in 2005 and 14% in 1H2006, while issued construction permits for residential buildings for 1H2006 were up 30% YoY. Listed construction companies are reporting bulging order books through to 2009 and interest rates are expected to remain low. Industry estimates of Polish demand for electricity meters puts the annual growth rate at 5% with 3.5% of this accounted for by the residential sector, in which Apator reigns supreme.

…while GDP is expected to grow c. 5% p.a. for the next few years.

Poland GDP and construction growth forecasts



Source: GUS, Institute of Market Economics, Wood & Co

Apator's sales are subject to some seasonality. Winter 2005/2006 was unusually harsh and long and this adversely affected 1Q2006 revenues. In contrast we expect a strong 4Q2006, the mild weather allowing construction projects to forge ahead.

… and export sales to play an increasing role.

Exports to rise to 30% of sales, led by meters.

As well as riding the domestic growth wave, Apator is looking for sales growth in export markets. The company has an active policy to increase the share of export sales in revenues, both from metering equipment and switching equipment. At a meagre 13% of sales in 2004, export sales should top 20% in 2006, rising to 30% by 2009. Metering equipment will be the main driver, but sales of switchgear equipment, particularly in Eastern Europe should be supportive.

Diverse export markets allow Apator to increase sales across the world.

Apator's export sales growth will be driven largely by their own success or failure at marketing (through their subsidiary sales offices in Hungary, Russia and Germany), but also, of course, by general global economic conditions. Apator exports both East and West, to emerging markets (such as South America and the Balkans) as well as to Western Europe. So, barring a global slump, Apator should be able to pick up sales across the board.

Competition from European giants and the Far East may make Apator a tempting take-over target one day.

International competition is the main external risk to Apator's sales growth. European producers, like Landys & Gyr and Actaris, dominate the global meter market and are present in most countries, competing with one or two major domestic players. They have around 60% of the EU electronic electricity meter market and there is a risk that, as deregulation unfolds in Poland, they could try to steal market share, undercutting Apator on price. However, Polish utility companies are used to dealing with Apator, understand and like their products and would need compelling reasons to risk switching suppliers. Rather than bankrupt Apator, we think a competitor would prefer to buy them, taking advantage of their dominant domestic position. The Far East is still a limited, immediate threat to Apator's business as all electrical equipment is subject to cumbersome technical permits, specific to each country of sale. Apator's prices are up to 50% lower than EU competitors (although competitors claim they have a higher quality product), while Far Eastern suppliers can be 40% cheaper again.

No great constraints on production capacity

The key question is how fast Apator can grow without making a major new acquisition itself. Apator's domestic sales grew by 7% YoY for 9m2006, while export sales were up by 9%. By segment, metering equipment grew by 9% YoY in nine months of 2006 and switchgear, having a good run, by 11%. Apator estimates that it has around 15% spare production capacity, given the completed restructuring at Pafal and Metrix and the remnants of the Rug Riello production line. In practice however, Apator can always outsource production to meet contracts, so capacity should not be a brake on sales growth.

We forecast that with a good fourth quarter, 2006 sales growth will come in just under 10%. With their international marketing efforts beginning to pay dividends from 2007 on (particularly in Germany and Hungary) and stable or rising share of the growing domestic market we are confident that Apator can sustain sales growth of 10% per annum going forward.

Meter by meter…. growth should flow

Apator will use its dominant market position in induction meters to keep a similar share of the electronic meter market.

Electricity: There are two types of electricity meters: induction (the "old" style) and electronic. Electricity companies are gradually moving away from induction meters in favour of electronic meters. About 80% of installed Polish meters are still induction meters, but, within 2 years, Apator estimates the figure will be down to 50%. Some 60% of Apator's sales are replacements of induction meters by electronic meters and 40% from new buildings. In addition utility companies are supposed to recertify each meter's safety every 15 years (removing it from the property and sending it off for testing). In practice it is cheaper and simpler to replace and upgrade – thus providing continual demand for new meters. Electronic meters are cheaper to maintain (can be read remotely), cannot be cheated, will be central to so-called intelligent utility management systems and the price differential is closing. Induction meters cost around 50PLN (c.$18) while an induction meter will cost from (c. $20-$35) 60-100 PLN . Domestic competition is tougher in the electronic meter market, Apator dominates the residential market and is confident it can retain its 64% market share going forward.

EU demand for electronic meters predicted to rise 7% CAGR to 2009.

There are 1.3 billion electricity meters in the world: 87% induction meters, 13% electronic and global demand is expected to grow at 1.3% p.a. Demand for electronic electricity meters in the EU is predicted to rise more than 20% by 2009 (from c. 7.5 mil units to around 9 mil units pa) while EU demand for induction meters should still be 14 mil units p.a. As the price gap between electronic and induction meters falls, electronic systems become more economically viable and the installation of electronic meters (rather than induction) will accelerate. In the EU, 100% of Italian electricity meters are already electronic, with 50% in Scandinavia and the UK. According to ABS Energy Research, the German electricity meter market is set to grow by 1.6% pa to 2010. The on-going deregulation of the European electricity market will help drive the switch from induction to electronic meters. We should remember that Apator also operates outside the EU in markets where the demand for induction meters is still strong.

Apator to focus on greater export volumes of gas meters and cheaper costs of production to compete.

Gas: Gas meter technology is not changing like electricity meters and so Apator will focus on expanding export sales, while retaining its domestic share. Domestic and international competitors like Actaris, Kamstrup and Kromschroder are putting pressure on prices, particularly abroad, so the company will focus on reducing the costs of production. Ukraine, Russia and Hungary are important markets and Apator has recently signed contracts in Italy, Germany and Austria. They will also introduce technology to make them compatible with the AMR systems.

Heat meters – fast growth from a low base.

Heat: The heat meter market is one of the most promising – Apator currently has only a 25% domestic market share and the Polish market is predicted to grow at 12% CAGR to 2010.

Switchgear – solid demand at home and abroad.

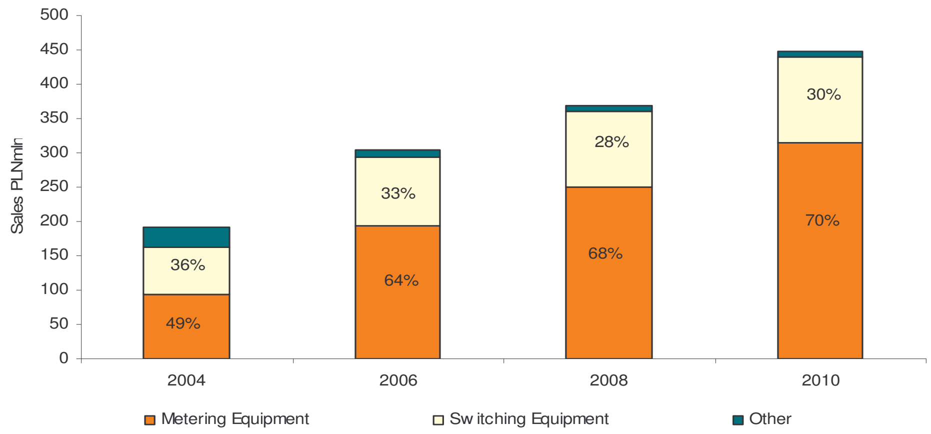
Switchgear: Domestic sales should grow in line with the economy and construction boom and, assuming they can continue to keep production costs down, they should be able to increase market share in some items. Abroad, Russia, the Balkans, Turkey and Ukraine are all important markets.

Strategy and cost-control mould good margins

Apator wants to make higher-margin metering equipment their core business. To this end, the share of metering equipment in total sales has risen from 49% in 2004 to 64% in 2006. We conservatively estimate that, by 2010, this share will rise to 70%.

Company strategy focused on making metering equipment core business.

Apator sales structure



Source: Apator, Wood & Co estimates

Metering equipment has higher operating profit margins than other Apator products at around 28%.

The company estimates that EBIT margins on metering equipment are around 28% and on switching equipment around 25%. (These figures differ from our model due to different treatment of SG&A). The high prices of copper and oil (used in wiring and plastics) have squeezed margins in 2006, but strict control of each cost element should ensure stable and improving margins over the coming years. Likewise in 2006, Apator decided to use a more expensive non-flammable plastic in its new switchgear products, giving it a competitive advantage which will be reflected in higher sales volumes and higher margins. There are several elements to Apator's margin story:

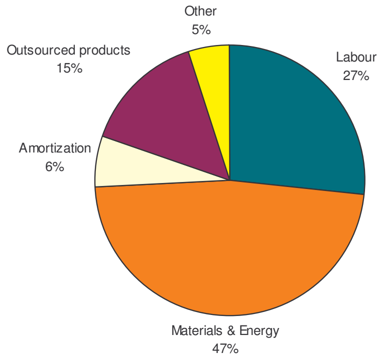
Focus is on electronic meters, retention of domestic leadership and export sales expansion.

1) Product and market profile: margins are 5-10% better on electronic meters than induction meters and generally 5-10% better on domestic sales than export sales (although Apator stress that some foreign markets have much higher margins). So, company strategy is to increase meter sales, increase electronic meter sales and retain their dominant position in the domestic market, while expanding the export markets. Meter sales are rising as a percentage of overall sales and are expected to be 70% by 2010. Electronic meter sales are rising – currently only 30% of electricity meter sales, but should be 50% by 2010. There are no signs that Apator is losing market share in Poland and no reason to expect it to do so unless the Asian producers force their way in, or one of the European producers decides to storm the market with high volumes and a price war. Even when the Asian producers appear, Apator's strategy to increasingly use Far Eastern components and its strong customer relationships within Poland should afford it some protection.

Input costs controlled through outsourcing and an internet tender system which should bring annual savings of PLN 1-3 mil.

2) Strict control of input costs: Materials and energy represent almost 50% of COGS, of which well over 50% are electronic components with metals, plastics and derivatives taking a further 45%. Apator is addressing these costs in two ways. Firstly, they outsource component production where it makes economic sense. Outsourcing component production within Poland makes up 15% of total costs, up 33% YoY (1H2006), and this will steadily rise. Secondly, Apator is refining its supply management system and has developed an internet-based tendering system. This means they can attract a wider range of potential suppliers and select the best combination of quality and price for inputs and outsourcing contracts. Apator estimates this will reduce COGS by around 1% per year. No single supplier provides more than 10% of inputs and increasingly Apator is sourcing inputs from the Far East (10% in 2006 but rising fast).

Apator cost structure 1H2006



Source: Apator

Copper and oil price fluctuations can be passed on to the end customer

3) Commodity prices. Because of the prevalence of plastics and copper in its products, some of Apator's input costs are very sensitive to oil and copper prices. For example, high prices in 2006 have affected margins – we estimate COGS are up by c. 2%. However, Apator can normally fully mitigate these increases by raising prices (with c. 6 month delay). Hence the price increases in October 2006 and January 2007 (planned).

Appreciation of the złoty has an adverse effect on profits.

4) Similarly, Apator's profits are sensitive to exchange rate fluctuations. Directly imported goods currently account for around 16% of total costs, about 80% of which are paid for in Euros, with 20% in US Dollars. Exports sales in 2006 will be c. 20% of total revenues and are also denominated in Euros (80%) and US Dollars (20%). A strong PLN has an adverse effect on Apator's bottom line. In rough terms a 1% appreciation of the złoty against the Euro or Dollar reduces net profits by 0.5%.

Apator exchange rate sensitivity

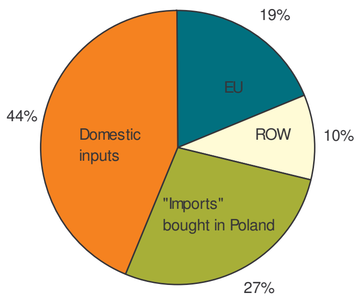
% appreciation of PLN	Effect on Net Profits
1% vs EUR and USD	-0.5%
5% vs EUR and USD	-2.5%
10% vs EUR and USD	-10.0%

Source: Apator, Wood & Co estimates

COGS can also be adversely affected by the exchange rate effect on direct and "indirect" imports.

In fact, Apator directly and indirectly imports over 50% of its materials, buying many of them in Poland from companies which have themselves imported the goods for sale. Sharp depreciation of the Złoty would put pressure on the overall cost of materials, since both direct and indirect input costs would rise, perhaps more than the offsetting improvement to export sales revenues. As Apator expands its export sales (to 30% of total sales by 2010), it will also be increasing the proportion of directly imported materials, particularly from the Far East, in a way naturally "hedging" the currency risk.

Real share of imports in material cost



Source: Apator, Wood & Co estimates

Now staff reductions are complete, Apator can start to take advantage of its scale, keeping growth of these costs well below sales growth.

5) Staff costs and SG&A. Apator has reduced group staffing by nearly 10% from 1765 employees at the end of 2005 to 1594 at the end of September 2006, part of the restructuring after the acquisitions of Pafal and Metrix. The restructuring per se was reflected in higher staff costs (severance payments). Going forward there should be no further costs from restructuring and staff productivity should increase, so we would expect to see staff costs stable as a percentage of sales, if not falling slightly, in spite of the mild wage inflation in Poland. SG&A costs have been growing slower than sales – a sign of Apator taking proper advantage of its scale. We see no reason for costs to escalate and conservatively predict SG&A will remain at around 20% of sales.

Apator employee figures

	end 2005	Sep 2006
Apator SA	476	469
PAFAL SA	738	479
Pafal subsidiaries	150	-
Mining, Metrix, Kfap & Control	482	490

Source: Apator

Deal-making, broad-minded & forward-looking management

Bought at a discount, Pafal and Metrix should payback the investment by end 2008.

Apator's management have shown their ability both to make deals and also to restructure and incorporate their purchases effectively, raising earnings per share. In Pafal and Metrix, Apator has made acquisitions which fit its strategic aims and, in both cases, Apator bought the companies at less than book value. Apator paid a grand total of PLN 39 mil for PAFAL and Metrix, booking a negative goodwill profit of 4 and 13.5 mil PLN respectively. Apator confidently expects the two companies to be generating 33% of EBIT between them by the end of 2008 – a 3 year payback.

Metrix doing better, but both doing well.

The table below shows the respective contributions of 1-3Q earnings from Pafal and Metrix in 2005 and 2006. Although Pafal's share of 2006 sales fell in percentage terms, its revenue growth, 'though modest was still positive at 4.5% – not surprising given the depth of the restructuring which has only just finished - but EBIT rose faster at 35%. Metrix – which required much less restructuring – has nearly tripled its EBIT contribution from 12% sales growth. Pafal and Metrix' combined profits in 2005 of less than 25% of total EBIT are set to rise in 2006 to over 40%.

Contribution made by acquisitions so far

	Pafal		Metrix		Apator Group growth
(% of Total)	**2005**	**2006e**	**2005**	**2006e**	**% '05-'06e**
Revenues	41%	40%	16%	18%	9.7%
EBIT	13%	15%	11%	26%	14%

Source: Apator, Wood & Co estimates

We expect these subsidiaries' figures to improve both revenue growth and margins as they continue to benefit from the international marketing efforts and the synergies of the group supply and administrative structures.

For the next acquisition – a water meter maker, but not if the price isn't right.

Apator wants to buy a water meter company and has two – Metron and Powogaz (50-60 mil revenues/20% Apator's revenues)– in its sights. Apator recognizes that a quality water metering product would complete its product portfolio and be accretive to sales. However, they also wish to protect the bottom line and will not engage in a deal which will not be EPS-accretive. Both Metron and Powogaz have complications around their sale and there is also strong interest from international competitors. Apator does not expect to close a deal in 2007.

Accessing new markets is the key and Apator isn't afraid of the challenge.

The management understands that it is not sufficient to sit on its haunches at home trying to defend its domestic dominance. They recognize that continued strong earnings growth will only come from penetrating new international markets, particularly in the EU, Russia, Ukraine and the Balkans and are not scared to go after them. Their approach to cost-control is innovative and outward-looking.

Likewise they have a bold dividend policy, preferring to distribute spare profit if they see no clear better use for it within the company – no rash investments to dilute profits. The company is considering a share option scheme, but currently operates happily on a bonus system, disbursed by the supervisory board and judged against both quantifiable financial performance as well as non-financial management objectives.

Wired for the future

Step 1. Pre pay electronic meters eliminate bad debts.

Electronic, intelligent and integrated metering systems are on the way. The first step is pre-pay meter systems where the meter is linked to a module which accepts payment codes. Customers "feed" the meter, paying by internet, mobile 'phone or at the supermarket. Popular with utility companies and landlords alike, bad debts disappear. This is however a relatively small niche market.

Step 2. Automated meter reading eliminates meter readers, fraud and bad debts and can be deployed across all media simultaneously.

Step 3. Two-way communications allow tariff choice and supply management.

The real prizes are AMR – Automated Meter Reading and its child AMM – Advanced Meter Management. One system could control all utility meters simultaneously - electricity, gas, water and heat. One IT system collects information from all the meters in a given property (office, factory or apartment block). The AMR version gives utility companies cheaper invoicing, control over bad payments and no electricity theft – no more slow, expensive two-legged meter readers. The next level, AMM is fitted with a 2-way communications system. This gives end-users clear, consumption-based invoicing and tariff differentiation and gives utility companies detailed consumption information, helping them optimize network and load management. A win-win situation where utility companies can make big cost savings by managing supply better and users can reduce bills by timing usage to coincide with lower tariffs. The systems can be pre-pay or credit-based.

Apator has developed proprietary pre pay and AMR systems, already deployed in some areas.

Apator has already developed its own pre-pay metering systems - Lew Energomat, Lew GSM, Lew SMS, Lew Serwis, Lew IVR. These are already being used, to a limited extent, by some Polish utility companies (eg. GZE Toruń and Energa Słupsk) and Apator is in negotiations with Energa for other regions, ZE Lublinek, Energia Pro and Enion. They want to expand the systems to gas and water meters in time.

Deregulation of the energy sector and eventual privatization will unleash the investment in this new technology. Don't hold your breath waiting for Poland.

There is great uncertainty about the future shape of the Polish energy sector and wide spread privatization of energy generation, transmission and distribution is unlikely to happen in the lifetime of the current Polish government (scheduled to run until 2009). The principle of third party access to energy has been established for some years and will go "live" for residential customers in July 2007. However, take-up in the industrial market has been very low. The energy market will be split into 8 regional distribution companies, 1 transmission company (PSE) and electricity generation facilities. Customers will be able to choose which generation company they buy their electricity from, but not the distribution company, whose prices will be regulated by government. The hope is that this process will bring with it privatization of the sector, generating a flood of investment into infrastructure and a leap in demand for the AMR/AMM systems. However, while state control of many of the companies is maintained, we believe there will be only limited investment.

Will Apator cope with the scale of future AMR/AMM contracts, or be bought out by, say, Landys & Gyr?

Apator will face fierce competition in this new market. Landys & Gyr dominate the AMM market for the grid operators, while they also have many industrial and commercial clients. In the nascent residential AMR/AMM market, where Apator should be strongest domestically, the scene is dominated by technological tie-ups between companies like Iskra and HP, LG and Enermet. The big contracts also require big bank guarantees and this another area where Apator may find itself in time, subject of a takeover or requiring a strategic investor.

Our sales, profit, cash flow and balance sheet forecast

Sales to rise by 10% with the value of export sales to grow at CAGR of 19%.

Sales should rise just under 10% this year, in spite of the loss of the Rug Riello contract (4% of revenues in 2005) powered by the continuing boom in the Polish economy (2006e 5.5% GDP growth) and buoyant industrial and residential investment (2006e 12-14%). Export sales should grow at c. 19% CAGR to 2010, in spite of the appreciating złoty. Advanced systems are not included in our model since they are unlikely to contribute significantly to Apator's sales in the near future.

COGS to fall as Apator exercises its buying power for inputs and squeezes more from its staff and administration.

COGS were under pressure in 2006 at 62% of sales, due mainly to high oil and copper prices and also the introduction of more expensive non-flammable plastics to switchgear products. This should be offset by the internet tendering system, increasing bargaining power with suppliers and a good ability to pass on cost increases in product prices. Thus we forecast COGS falling 1% pa and SG&A should stay at around the current 20% of sales.

Profit margins should rise as the company exploits existing markets and expands into new ones.

We see gross profit margins rising gradually to 43% from their current level of 38% as Apator takes advantage of its synergies as an integrated firm with widening export markets. We forecast that EBIT margins will rise from 14% to 20% by 2010, but could dip slightly if Apator buys a water meter manufacture.

Stripping out one-off gains and the discontinued Rug Riello contract, 2006 underlying profit growth is firmly positive at 24%.

2004 and 2005 bottom line figures were distorted by significant one-off gains. Apator made PLN 16.8 mil on the sale of a building in Toruń and they booked PLN 4 mil and PLN 13 mil of negative goodwill from the acquisitions of Pafal and Metrix. To clarify the picture of the underlying business further we should remove the profits from the now discontinued contract with Rug Riello, worth 4% and 1% of 2004 and 2005 revenues respectively. After these adjustments we can see that although headline 2006 net profit growth is -19%, underlying growth is a healthy 24%.

Apator revenues and profits

	2003	2004	2005	2006e	2007e	2008e	2009e	2010e
Sales	106	191	277	304	335	369	406	447
EBIT	17	27	37	42	53	62	75	88
NP adjusted	12	17	30	37	44	52	62	73
NP growth adjusted	83%	39%	72%	24%	19%	18%	20%	18%
Net profit reported	12	40	46	37	44	52	62	73
NP growth reported	83%	225%	13%	-19%	19%	18%	20%	18%

Source: Apator, Wood & Co estimates, Note: adjusted for one-offs and discontinued activities in 2004 & 2005

PLN 37 mil of net profit for 2006, growing at 20% CAGR going forward

We forecast PLN 37 mil of net profits for 2006 (below the company's own estimates of 41 mil). This gives a CAGR for net profits of 20% and EPS CAGR of 18% (using the adjusted NP figure for 2005) .

Healthy free cash-flow leaves room for new acquisitions and fast expansion. No change in dividend policy.

Apator has no debt and strong free cash flow generation – PLN 23/24 mil each year. They are therefore in a strong position to pay for any potential acquisition of a water meter company or rapid development of other foreign subsidiaries. Dividend payouts have risen substantially over the last few years with the 2006 payout ratio standing at 70%. Apator intends to maintain its high dividend payout policy, so we forecast a payout of around 67% of profits each year going forward, giving a yield of c. 3% p.a.

Financials

Price: **22.89** Target: **30** Mkt cap: 808

Income statement

(PLN m except where stated)	2002*	2003*	2004	2005	2006e	2007e	2008e	2009e	2010e
Metering aparatus		**26**	**93**	**177**	**194**	**221**	**249**	**279**	**312**
Switching gear		**53**	**69**	**75**	**99**	**104**	**109**	**117**	**123**
Other		**26**	**29**	**25**	**11**	**10**	**8**	**7**	**7**
Total sales	**97**	**106**	**191**	**277**	**304**	**335**	**366**	**403**	**443**
Sales growth (%)			*79.9%*	*45.4%*	*9.7%*	*10.2%*	*9.3%*	*10.1%*	*9.9%*
CoGS ex-dep'n	63	60	113	169	188	204	216	234	253
Energy and materials		38	50	75					
Labour		20	36	50					
External services		9	15	24					
Other		0	12	19					
Gross margin	35%	39%	35%	34%	33%	35%	37%	38%	39%
SG&A	23	23	39	54	61	67	74	81	89
Other income / costs	-2	-1	15	-3	2	1	1	1	1
EBITDA	**9**	**22**	**54**	**50**	**57**	**65**	**77**	**89**	**102**
EBITDA margin (%)		*20.8%*	*28.2%*	*18.2%*	*18.7%*	*19.3%*	*21.0%*	*22.1%*	*23.1%*
Depreciation		5	10	13	15	15	16	16	16
EBIT	**9**	**17**	**44**	**37**	**42**	**50**	**61**	**73**	**86**
Operating profit margin (%)		*16%*	*23%*	*13%*	*14%*	*15%*	*17%*	*18%*	*20%*
Net interest expenses		0	1	1	1	1	1	1	1
As % of avg net debt			*0*	*6*	*2*	*2*	*1*	*1*	*1*
Interest cover (x)		*113*	*49*	*32*	*42*	*50*	*61*	*73*	*86*
Other incl. Fx gains/losses		0	0	1	1	1	1	1	1
Goodwill from purchase of subsidiary			4	13	0	0	0	0	
Tax	3	4	9	7	7	9	11	13	15
Effective tax rate (%)		*25.9%*	*20.7%*	*19.2%*	*17.5%*	*17.5%*	*17.5%*	*17.5%*	*17.5%*
Profit from discontinued activity			2	3	2	0	0	0	0
Net profit	**7**	**12**	**40**	**46**	**37**	**41**	**51**	**61**	**72**
Net profit growth (%)		83%	225%	13%	-19%	12%	23%	20%	18%
Cash earnings	7	17	50	59	52	56	67	77	88
Number of shares (m)	35.3	35.3	35.3	35.3	35.3	35.3	35.3	35.3	35.3
EPS (PLN)	**0.19**	**0.35**	**1.14**	**1.29**	**1.04**	**1.17**	**1.43**	**1.72**	**2.03**
EPS growth (%)		*82.6%*	*225.3%*	*13.1%*	*-19.2%*	*11.9%*	*22.7%*	*20.0%*	*18.0%*
DPS (PLN)			0.36	0.64	0.73	0.84	1.00	1.15	1.40
Payout ratio (%)		*0.00%*	*31.57%*	*49.63%*	*70.04%*	*72.05%*	*69.89%*	*66.97%*	*69.07%*
Dividend yield (%)					*3%*	*4%*	*4%*	*5%*	*6%*

Key cashflow and balance sheet items

	2002*	2003*	2004	2005	2006e	2007e	2008e	2009e	2010e
Increase in working capital		3	5	-17	0	0	0	0	0
Capex (net)		7	-11	20	14	14	14	14	14
Other cashflow items		0	-46	-34	-10	-21	-31	-40	-51
Free cash flow		**7**	**6**	**9**	**28**	**21**	**22**	**23**	**23**
Share issues		0	0	0	0	0	0	0	0
Dividends paid		3	9	12	24	24	24	24	24
Increase in net debt		-4	3	3	-3	3	3	1	0
Net debt, end of year		-4	-1	2	-1	2	0	1	0
Enterprise value		804	806	810	807	810	808	809	808
Shareholders' equity		**53**	**91**	**119**	**131**	**149**	**175**	**212**	**259**
BVPS (PLN)		1.5	2.6	3.4	3.7	4.2	5.0	6.0	7.3
Net debt / equity (%)		*-8%*	*-2%*	*2%*	*-1%*	*1%*	*0%*	*1%*	*0%*
Total assets	**67**	**76**	**142**	**187**	**196**	**216**	**245**	**283**	**331**

Key return and valuation ratios

	2002*	2003*	2004	2005	2006e	2007e	2008e	2009e	2010e
ROE (%)		*47%*	*56%*	*43%*	*29%*	*29%*	*31%*	*31%*	*30%*
ROA (%)		*24%*	*40%*	*22%*	*22%*	*24%*	*26%*	*28%*	*28%*
ROIC (%)		*17.5%*	*37.7%*	*28.2%*	*19.6%*	*20.3%*	*22.2%*	*23.2%*	*23.6%*
WACC (%)	*9.5%*	*10.4%*	*10.0%*	*16.2%*	*8.0%*	*11.7%*	*9.5%*	*10.2%*	*9.5%*
EVA (%)		*7.1%*	*27.6%*	*12.1%*	*11.6%*	*8.6%*	*12.7%*	*13.0%*	*14.1%*
PER (x)		*65.3*	*20.1*	*17.8*	*22.0*	*19.6*	*16.0*	*13.3*	*11.3*
EV/EBITDA (x)	*86.8*	*36.4*	*15.0*	*16.1*	*14.2*	*12.5*	*10.5*	*9.1*	*7.9*
EV/FCF (x)		*107.6*	*129.5*	*88.7*	*29.0*	*38.3*	*37.6*	*35.8*	*35.8*
PBR (x)		*15.2*	*8.9*	*6.8*	*6.1*	*5.4*	*4.6*	*3.8*	*3.1*
PSR (x)	*8.3*	*7.6*	*4.2*	*2.9*	*2.7*	*2.4*	*2.2*	*2.0*	*1.8*
EV/S (x)	8.33	7.58	4.23	2.92	2.65	2.42	2.21	2.01	1.82
Dividend Yield (%)		0.00%	1.57%	2.80%	3.19%	3.67%	4.37%	5.02%	6.12%
PEG (x, 3 yr prospective)					4.27	1.08	0.79		

Source: Company data, Wood & Company estimates

Company Background Information

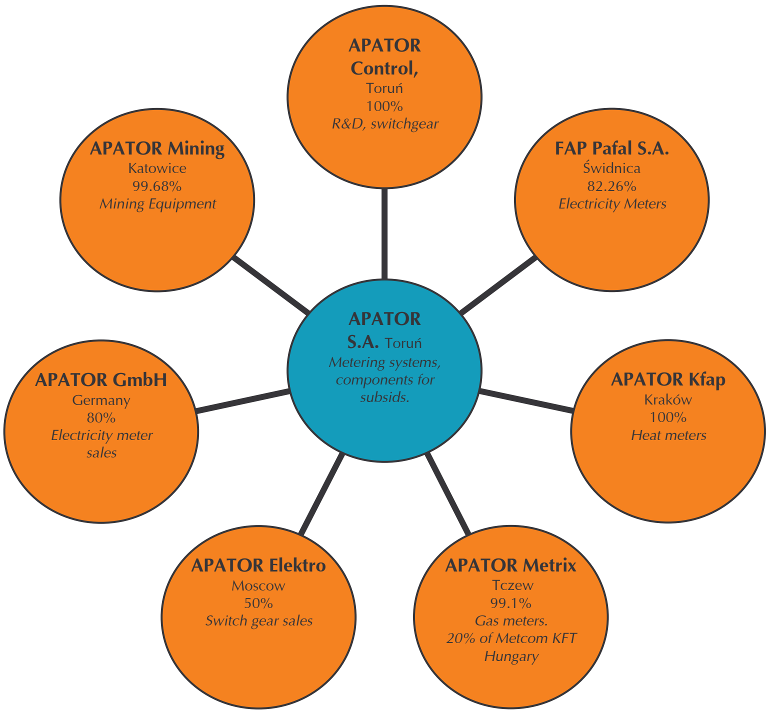
APATOR GROUP – History and Structure

Listed in Warsaw April 1997, there are offices in Germany and Hungary too.

Apator was founded in 1949 as a state-owned company producing electrical and mining equipment. In 1993 the company was privatized and in 1995 Apator Mining established as a wholly-owned subsidiary. The company listed on the Warsaw Stock Exchange in April 1997. Elektro and Control were established in 1998 and 2000. Apator bought FAP Pafal in April 2004, KFAP in October 2004 and Metrix in January 2005. Metrix has a 20% stake in Metcom Kft, effectively a Hungarian sales office. Apator GmbH, registered in October 2006 will sell Apator products, primarily electricity meters, into Germany.

Company split into discrete production units and sales offices, with Apator SA in charge of admin, coordination, strategy and some component production.

APATOR Group structure



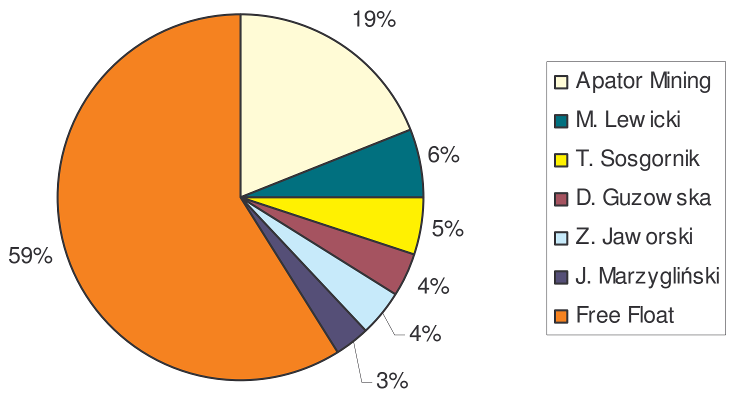
Source: Apator

Shareholder Structure

All named shareholders involved in running the business and have no plans to sell up.

All the named shareholders are members of the management or supervisory boards and all were employees of Apator when it was privatized. Apator Mining acquired it's 19% shareholding in 2000, when Apator was fighting off a hostile takeover bid from Prokom. The major shareholders have no plans to reduce their stakes or sell out. It is estimated that institutional investors hold around 15% of the freefloat, with 44% in the hands of individuals.

Shareholder structure diagram



Source: Apator

Apator group – product portfolio summary

Segment	Product	Use	Domestic Market Share	Client	Distribution	Export	Competition	Strategy
Metering Equipment	Electronic electricity meters	mainly residential, some industrial	64%	Electricity cos	direct sale	mainly W. Europe incl. Italy, Spain, Lithuania, Serbia & Montenegro, Israel, Hungary	Landis & Gyr, JM Tronic, Actaris	More efficient and cheaper versions which adapt to varying methods of remote reading
	Inductive electricity meters	mainly residential, some industrial	85%	Electricity cos	95% direct sale 5% wholesale	Germany (80%), Hungary, Columbia, Venezuela,	DZG, Actaris, Landys & Gyr	minimise manufacturing costs
	Prepay electricity meters	domestic, industrial, partic. rented apartments	95%	Electricity cos	direct sale	nascent, through establishment of German subsidiary	Landis & Gyr, Actaris	complex systems with variable payment methods
	Heat meters	residential, industrial	25%	Developers, housing associations, heating distributors	59% building contractors 34% wholesale and heat distribution cos, 7% housing associations and developers	Under development	Ista, Actaris, Techem, Kamstrup	new models with remote reading. Cost control. Pre-pay system
	Gas meters	residential, industrial	45%	6 national gas companies	98% national gas companies, 2% building contractors	Russia, Germany, Portugal, Ukraine, Hungary, Korea	Intergaz, Actaris	pre-pay; lower cost models for foreign markets.
	LEW Metering system	comprehensive credit/prepayment intelligent metering system	n/a	energy companies, developers	100% direct sale	nascent	Landis & Gyr, Actaris	several trial systems implemented. Catalyst deregulation of energy market in PL
Switchgear Equipment	Fuse box switch and circuit breakers	in junction boxes: domestic, industrial and housing estates	60%	Electricity cos	70% large wholesalers 30% electricity cos	Turkey, Ukraine, Belarus, Croatia, Russia, Romania, Bulgaria	10 European cos. Asian cos barred	remote monitoring; smaller, more attractive design.
	Switch disconnectors and circuit breakers	control of electrical motors	40%	Industry, agriculture, electrical installers	large wholesalers & special commissions	" ""	Spamel, Elektromet. Foreign firms largely excluded	n/a
	SPD (surge protector devices)	safety of electricity lines	15% - want 50%	Electricity cos	75% wholesale, 10% direct sale, 15% integrators	starting to export	ABB, Bezpol, Eti Polam	widen offer to include medium and low-voltage for buildings.
	Switchgears and drivers	control and safety of electrical machines	5%	Industry, agriculture, electrical installers	direct sale, building contractors	minimal	fragmented domestic market - tens of firms	get into big investment projects
	Mining equipment	control and safety of electrical mining equipment	30-70%, compressors 60%	coal mines	34% mines, 33% mining machinery makers; 33% distributors	minimal - aiming for 10%	E&H, Invertim, Carboautomatyka	improve safety

Source: Apator

Important disclosures

IMPORTANT DISCLOSURES

The Company hereby informs that if a specific investment recommendation does not contain all information required by the relevant legislation (i.e. Public Notice 114/2006 Coll. on the honest presentation of investment recommendations), then such information is freely available on the website of WOOD & Company Financial Services, a.s. at http://www.wood.cz/web/services/research/public_notice The Company recommends that the recipients of this announcement thoroughly review the appropriate sections of its website.

VALUATION & RISKS

The main risk to the recommendation in our report would be a sudden contraction in the Polish construction sector, leading to a severe cut in investment expenditure across the economy.

For details of the methodologies used to determine our price targets and risks related to the achievement of the targets refer to main body of report or at http://www.wood.cz/web/services/research/public_notice

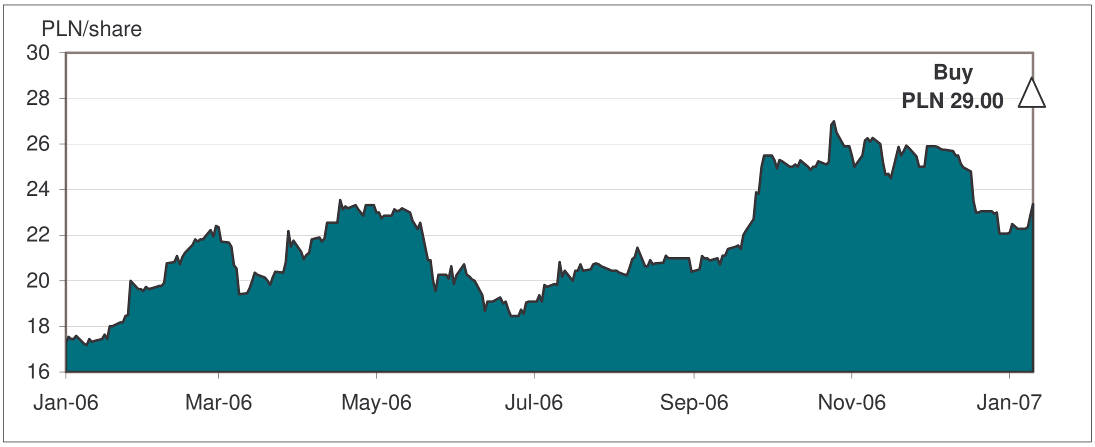
SECURITIES PRICES

Prices are taken as of the previous day's close on the home market unless otherwise stated. **Apator** closing price as of January 10, 2007.

CONFLICTS OF INTEREST POLICY

WOOD & Company Financial Services, a.s. manages conflict of interest arising as a result of the preparation and publication of research through its use of internal databases, notifications by the relevant employees and Chinese Walls as monitored by Compliance. For further details see our websites at http://www.wood.cz/web/services/research/public_notice

PRICE AND RATINGS CHART



	Current	Target	Recomm
January 15, 2007	22.89	**29.00**	BUY

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