Ceramic Producers

6 October 2005

Tile Wars

Using DCF we arrive at fair value at 123.0 PLN per share of Cersanit and 47.6 PLN per share of Opoczno which is respectively 5.4% below and 11.0% above the current market price. We rate Cersanit REDUCE and Opoczno ACCUMULATE.

The 50% excess production capacity of the Polish ceramic tiles industry led to market war on the domestic market and to increasing dependence on the uncertain export. While we believe the fierce price war will continue to negatively impact the margins in the coming years it will also enable the three top producers to consolidate the market at cost of smaller players.

After the disappointing 1H financial results we expect much stronger second half of the year. The good results of the construction industry and increasing demand for mortgage loans may foreshadow the increasing demand for the materials for building finishing.

Given the overcapacity in Poland the key to future growth are the planned investments in Russia, Ukraine or South-East Europe. Their delay is disappointing as it demonstrates the actual difficulties in building the presence on the emerging CEE markets. Since the potential projects are in very initial phase and their impact on shareholders value is unclear we did not include them in our financial projections and valuations.

Our main long-term concern is the emergence of large low-cost production capacity in Russia which will have a severe impact on the Polish export efforts to the Eastern Europe. Moreover we assume that in 3 years the trade flow can change direction and the domestic market in Poland will be affected by competitive import from EE countries.

In our opinion the operational and strategic advantages of Cersanit and the expected very good 3Q results are already included in its price. Given the moderate growth opportunities the 29% market premium to other industrial stocks seems excessive.

In the coming years Opoczno will have low capital expenditure needs thanks to its very modern production plants. On a growing market excess production capacity can surprisingly become an asset and secure the leading position. Despite pressure on margins Opoczno will be a cash cow which makes its DCF valuation attractive.

Ceramic producers: BZ WBK coverage summary
PLN, unless otherwise stated

Company	Ticker	Price	Current fair value	12-mTarget Price	Upside to target (%)	Rating	P/E(x) 2004	P/E(x) 2005E	P/E(x) 2006E	EV/EBITDA(x) 2004	EV/EBITDA(x) 2005E	EV/EBITDA(x) 2006E
Opoczno	OPO PW	42.90	47.6	52.0	21.2	Accumulate	9.2	12.1	12.1	6.3	6.2	6.4
Cersanit	CST PW	130.0	123.0	134.3	3.3	Reduce	16.6	15.2	15.1	10.9	10.1	9.9

Source: Company data, DM BZ WBK estimates, Financial results of Opoczno adjusted for impact of incentive schemes and write-off of badwill.

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Throughout this report we use share prices as of October 5, 2005.

Investment summary

The investment enthusiasm in 2004-2005 led to 50% production overcapacity of ceramic tiles industry leading to a price war

After the exceptionally good 2004 majority of the Polish tile producers kept investing in the production capacity. In 2004 and 2005 several very modern plants were opened producing the edge-technology ceramic tiles and several new pretenders tried to repeat the success story of Cersanit. Unfortunately this over-enthusiasm was not matched by the marketing power so in 2005 the Polish ceramic tile producers are under exceptional market pressure due to excess capacity and increasing competition.

After the domestic war for domination a threat of low-cost EE producers will emerge

After the excellent 2004 financial results it will be very difficult to maintain high profitability in the coming years. Fighting with the much more expensive imports from Italy, Spain and Germany was relatively easy. The current struggle between domestic players for domination is much harder. But the really tough times we expect in some 3 years when the low-cost production capacities in Eastern Europe, especially Russia, will cover the internal demand there and the export flow will change direction towards Poland.

We assume Opoczno will strengthen its leadership position. The price is attractive despite major long term risks

Opoczno with its excess capacity is directly exposed to the volatility of ceramic tiles market. While we believe the competitive pressure will deteriorate operating margins further, in our opinion Opoczno will gain market share at cost of weaker market players. The company has also potential for overhead cost optimisation, especially after the change in shareholders structure. The share price was severely penalized for the weak 1H2005 and incorporates the uncertainty of future performance. In our DCF model we accounted for the identified major long-term risk risks and we arrived at the target price (12-months) of PLN 52.0 per share which gives 11% upside potential. In expectation for good 2H2005 results we rate Opoczno ACCUMULATE.

Cersanit is fundamentally much safer, but overvalued

Cersanit is much safer fundamentally thanks to product diversification. The ceramic tiles production capacity is tailored to the marketing power so the margins are partially protected from the impact of the market price war. On the other hand there is little room for improvement for the already optimised operations. The limited production capacity means relatively flat revenues even if the market expands. Cersanit will be a great cash-cow in the coming years, but actually a quite expensive one. Based on 2005-2007 forecasts Cersanit is traded at considerable 35% premium to Opoczno and 29% premium to group of domestic industrial peers. The DCF target price (12 months) of 134.3 PLN is only 3.3% above the current price, thus implying the REDUCE rating.

Investment concerns/opportunities

Price war will continue to cut margins of ceramic tiles producers

A prolonged price war on the domestic market will continue to exert pressure on margins as the potential savings on the production cost side are likely to saturate. In our opinion in the long-term such a situation will increase the market consolidation by a series of acquisitions or even more likely by divestments of weaker players. But even then, due to relatively low entry barriers, the settlement of a high-margin oligopoly market is rather unlikely. We expect the operational margins on domestic sales to decrease - in the case of Opoczno in 2005 on average by 4.1pp vs. 2004, and our bottom-up estimations indicate a further decrease of 2.5pp in 2006, also due to pressure from the cost side factors like gas price and wages demands.

The opportunity window for export to EE countries will start to close soon

Exports to Eastern European countries will soon meet the same problems as the EU 15 producers faced in Poland in 2001-2004. Modern production capacities are being added quickly all across this region, especially in the upper quality segment that has traditionally been covered by imports. In EE countries, like Russia, production of tiles is ca. 30% cheaper than in Poland due to lower labour, gas and electricity costs. Actually the growth of the Polish tile exports to EE countries has already begun to decelerate. We expect growth of only 20% in 2005 (strong growth in Ukraine, but a decline in exports to Russia) followed by 15% in 2006. In the following years a slow decline of Polish exports is the most likely scenario, partially also due to cannibalisation caused by production potentially relocated from Poland to low-cost locations. This can negatively impact utilization of tile production capacity installed in Poland and hurt the profitability of investments made over the past few years.

We assume the low-cost EE ceramic tiles producers will start to target the Polish market in 3 years

Actually in all probably, the export flow between Poland and Russia could change direction quite quickly, just like what happened to the ceramic tile trade between Poland and the Czech Republic (just within 3 years, 2002-2005, Poland changed from a heavy importer to a net exporter). We believe that the bulk of imports to Poland from non-EU Europe (in the first wave) will originate from the production plants of key Polish players (with an established distribution network in Poland) who will decide to move production to these low-cost locations. But the presence of other huge new low-cost capacities in Eastern Europe create in the long term a substantial threat of new competitive entrants to the Polish market.

The Chinese ceramics imports while not devastating will exert pressure on EU markets

The market share of Chinese ceramic tiles is still minimal (ca. 2% of imports to EU countries in 2004 in value terms), but since 2001 China has increased its presence on the European market at a CAGR of 177%. While the quality of the Chinese products is still perceived as very low, they present a direct competitive threat to Polish producers focusing on cost-oriented consumers. Due to relatively high transportation costs, the Chinese competition is not as deadly as for example to the textile industry, but we assume that the import of off-European low-cost producers will gradually increase in importance on the EU market, hampering the export efforts of Polish producers. This can be even more important for the future of the sanitary ceramics as the high unit costs (implying relatively lower importance of transport costs) expose the market to trans-continental import.

Construction market recovery foreshadows increasing demand for ceramic tiles

Strong construction industry output dynamics in 2005 may foreshadow an intensification of demand for ceramic tiles in the coming quarters as the time approaches to finish the new dwellings. The boom in mortgage loans in 2005 is another indicator of increased demand for housing. Whether this demand is for newly built or second hand apartments is a secondary issue, as both segments of the real estate market lead to demand for ceramic tiles (new finishing and renovations). After 8 months of 2005 the number of newly built houses is flat on 2004 but every month the trend dynamics improves. In coming years we expect the growth of the domestic ceramic tiles market to be driven by private housing and exceed 4%.

We expect volume of ceramic tiles market to increase at GDP growth rate driven by private housing

The impact of the recent introduction of VAT reimbursement for construction materials on the construction industry is debatable. But in any case it leads to lowering of the effective price for some of the private consumers, especially for those utilizing the "renovation part" of the VAT relief. This may trigger some additional domestic demand, but of course not even close to the demand levels in 1H2004 caused by the VAT rate change.

There is a limited in time opportunity of taking advantage of the recovery of the EE economies

The opportunity exists to take advantage of the promising Eastern European markets. The Russian market has already recovered from the severe economic crisis of 1998, and the other markets are also performing well despite some political turbulence. These expanding markets are still not fully covered by domestic production, which allows for some good export opportunities at attractive prices. As said, we expect this export window to close within 3 years in the case of Russia and 5 years in the case of Ukraine. But till then it will be skimming time.

Potential relocation of production to EE countries would give operating savings, but it would substantially increase business risk

Potential CEE acquisitions will take place in a competitive environment targeted by strongest players

Opoczno and Cersanit are both considering launching a production unit in South or East Europe via capital acquisitions. Such a move can lead to cost savings on manufacturing, transport and custom duties and this can help to maintain some long-term position in those emerging markets. On the other hand, the companies will be exposed to higher business risk due to operations in foreign countries with a quite different business culture. This refers not only to higher general country risk reflected in low-grade debt ratings and economical freedom ratings (manually steered economy, bureaucracy), but also very general risk of entering a new market (different customer needs, management of local human resources, etc.). In our opinion it is difficult to assess at present if the potential future rewards of capital involvement outweigh the increase in risk perception for these companies wishing to create value for shareholders. This is particularly true due to the fact that the potential projects are still in the very initial phases and possible bids for capital acquisitions in most interesting markets, like Russia or Romania, will take place in a competitive environment (other foreign investors like Austrian Lasselberger or Italian Marazzi already are building their presence there).

Valuation

Our valuation is based solely on discounted cash flows based on the financial projections until 2014.

General market assumptions are as follows:

- We did not incorporate into our forecast any additional M&A projects in the ceramic tiles industry that the companies are considering, as none of them have ventured beyond the initial stages.
- Given the excess production capacity of Opoczno and no expansion plans of Cersanit we assume only maintenance/modernization capex gradually replacing the existing fixed assets. An average useful lifespan of machinery of 8 years is assumed.
- We expect the volume of the domestic ceramic tile market to increase by 5% in 2006 and 2007 due to recovery in the housing market. In the following years we assume the volume of the domestic tile market will expand at the GDP growth rate.

Fig. 1. Macroeconomic assumptions

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
GDP real growth	4.4%	4.8%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
CPI/PPI	2.3%	1.9%	2.2%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
PLN/USD	3.25	3.21	3.21	3.21	3.21	3.21	3.21	3.21	3.21	3.21
PLN/EUR	4.07	3.99	3.95	3.90	3.90	3.90	3.90	3.90	3.90	3.90
Polish tile market volume dynamics	4.2%	5.0%	5.0%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
Change in average tile price Poland (PLN)	-7.5%	-5.0%	1.1%	1.3%	1.3%	1.3%	1.3%	1.3%	1.3%	1.3%

Source: DM BZ WBK estimates

- Due to the price war we expect the average tile prices on Polish market to decrease by 7.5% in 2005 and 4.5% in 2006. We assume the price will escalate at 50% of the CPI rate starting from 2007. Due to appreciation of PLN vs. USD in 2H2004 the annual average tile price in exports will drop in 2005 by 9.4% in PLN terms. The trend of average price for individual companies will vary depending on the shift of their product mix and export exposure.

Fig. 2. Operating costs trend assumptions

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Change in raw material price (domestic)	2.3%	1.9%	2.2%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Change in raw material price (EUR import)	-8.1%	-0.1%	1.2%	1.2%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Electricity price	2.3%	1.9%	2.2%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Natural Gas price	7.5%	4.0%	2.2%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%	2.5%
Real increase in wage costs	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	0.0%	0.0%

Source: DM BZ WBK estimates

- We assume the prices of raw materials for ceramic tile manufacturing to escalate at the PPI rate. Any eventual manufacturing process improvements will be offset by shift to higher quality products, increasing quality requirements of customers. We assume 25% of the cost of raw materials for tile production to be denominated in EUR on average.
- We assume the natural gas price will increase by 7.5% in 2005 and by 4% in January 2006. In the following years we estimate the gas price will escalate at the PPI rate.
- We assume the total electric energy price (energy + distribution fees + taxes) to move in line with PPI, despite possible fluctuations in 2006-2007 triggered by full market liberalization.

- The manufacturing payroll cost will follow the path of inflation. The average remunerations will rise in real terms by a factor close to GDP growth, but we assume this will be offset by increasing efficiency of human resources.
- Due to the fight for the market share (sales force) and due to increase in oil prices (logistics) we expect the commercial unit cost to increase by 5% in 2005 and 2006.
- In the next 3 years we assume the market share of Opoczno on the Polish market to increase due to market concentration and pushing out of imports. Market share of Cersanit will be constrained by the limited capacity (we assume the capacity to increase only by GDP growth factor representing increasing production efficiency). Starting from 2009 we expect market share losses to imports from low-cost countries.

Fig. 3. Market share projections

Company	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Opoczno	24.0%	25.8%	27.2%	28.6%	28.0%	27.3%	26.6%	26.0%	25.3%	24.7%
Cersanit	19.0%	18.1%	18.1%	18.1%	17.7%	17.3%	16.9%	16.5%	16.0%	15.6%
Paradyż	23.0%	23.7%	25.0%	26.2%	25.6%	25.0%	24.4%	23.8%	23.2%	22.6%
Other	22.0%	20.3%	18.7%	17.0%	16.6%	16.2%	15.8%	15.4%	15.0%	14.6%
Imports	13.0%	12.0%	11.0%	10.0%	12.1%	14.2%	16.3%	18.3%	20.4%	22.5%

Source: DM BZ WBK estimates

- In our DCF valuation we use risk free rate of 4.70% (the yield on 10YR Polish government bonds and equity risk premium of 4.50%. A unlevered beta of 0.66 (Damodaran: Emerging Markets Ceramic Products) for both Opoczno and Cersanit is used. This translates into levered beta of 1.01 for Opoczno and 0.99 for Cersanit.

Fig. 4. WACC calculation

	Cersanit	Opoczno
Risk free rate (10-year Polish T-bond yield)	**4.70%**	**4.70%**
Unlevered beta	0.66	0.66
Levered beta	0.99	1.01
Equity risk premium	4.5%	4.5%
Cost of equity	**9.2%**	**9.2%**
Risk free rate (10-year Polish T-bond yield)	4.7%	4.7%
Debt risk premium	1.0%	2.0%
Tax rate	19%	19%
After tax cost of Debt	**4.62%**	**5.43%**
%D	36%	40%
%E	64%	60%
WACC	**7.5%**	**7.7%**

Source: DM BZ WBK estimates

Fig. 5. Opoczno: DCF valuation

	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Revenues	**426**	**467**	**512**	**560**	**605**	**625**	**641**	**656**	**682**	**709**	**737**
EBIT (adjusted)	94	82	84	95	111	108	103	99	91	88	87
Cash taxes on EBIT	18	16	15	18	21	20	19	19	17	17	17
NOPAT	**75**	**66**	**69**	**77**	**90**	**87**	**83**	**80**	**74**	**72**	**70**
Depreciation	37	47	47	46	38	42	44	44	51	54	55
Change in operating WC	10	39	15	16	15	6	5	5	9	9	9
Capital expenditure	**46**	**52**	**25**	**27**	**30**	**49**	**52**	**52**	**60**	**63**	**52**
Net investment	19	44	-7	-2	6	14	13	13	18	18	7
Free cash flow	**56**	**22**	**76**	**79**	**84**	**73**	**70**	**67**	**56**	**53**	**64**
WACC (2005-2012)		7.7%									
PV FCF 2005-2012		435									
Terminal growth		2.0%									
Terminal Value (TV)		1 048									
PV TV		497									
Total EV		**932**									
Net debt		205									
Equity value (1 Jan 2005)		**727**									
Month		10									
Current equity value		**783**									
Number of shares (m)		16.45									
Value per share		**47.6**									
Target price (12 months)		52.0									
Revenue growth	16.1%	9.7%	9.6%	9.3%	8.1%	3.2%	2.6%	2.4%	3.9%	3.9%	3.9%
EBIT growth	38.0%	-12.7%	2.8%	12.7%	17.6%	-3.3%	-4.6%	-3.2%	-7.9%	-3.4%	-1.6%
NOPAT growth	58.1%	-12.2%	3.7%	11.8%	17.6%	-3.3%	-4.6%	-3.2%	-7.9%	-3.4%	-1.6%
FCF growth	-26.7%	-60.3%	240%	4.4%	5.9%	-12.3%	-4.7%	-3.5%	-16.4%	-5.9%	20.0%
EBIT margin	22.0%	17.5%	16.4%	16.9%	18.4%	17.2%	16.0%	15.1%	13.4%	12.5%	11.8%
NOPAT margin	17.7%	14.2%	13.4%	13.7%	14.9%	14.0%	13.0%	12.3%	10.9%	10.1%	9.6%
Capex/Revenues	10.8%	11.2%	4.8%	4.9%	4.9%	7.9%	8.1%	7.9%	8.8%	8.9%	7.0%
Change in WC/Revenues	2.3%	8.3%	2.9%	2.9%	2.5%	1.0%	0.8%	0.8%	1.3%	1.3%	1.3%
Change in WC/Change in revenues	16.7%	93.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%

Source: DM BZ WBK estimates

Fig. 6. Cersanit: DCF valuation

	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Revenues	**583**	**655**	**687**	**705**	**730**	**748**	**770**	**793**	**817**	**842**	**868**
EBIT	134	140	140	139	139	137	137	136	136	150	156
Cash taxes on EBIT	10	15	15	15	14	14	14	14	14	29	30
NOPAT	**124**	**126**	**125**	**124**	**125**	**123**	**123**	**122**	**121**	**122**	**126**
Depreciation	44	53	56	60	64	69	75	81	87	79	79
Change in operating WC	38	39	10	5	8	5	7	7	7	8	8
Capital expenditure	**134**	**85**	**62**	**66**	**71**	**76**	**81**	**88**	**90**	**90**	**90**
Net investment	128	71	16	11	14	12	13	14	10	19	19
Free cashflow	**-4**	**55**	**109**	**113**	**111**	**111**	**109**	**108**	**111**	**102**	**107**
WACC (2003-2012)		7.5%									
PV FCF 2003-2012		699									
Terminal growth		2.0%									
Terminal Value (TV)		2,000									
PV TV		1,040									
Total EV		**1,739**									
Net debt		218									
Equity value (PLN, 1 Jan 2005)		**1,521**									
Number of shares (m)		13.30									
Value per share (PLN, 1 Jan 2005)		114.4									
Month		10									
Current value per share (PLN)		**123.0**									
Target price (12 months)		**134.3**									
Revenue growth	12.6%	12.4%	4.9%	2.5%	3.7%	2.4%	3.0%	3.0%	3.0%	3.1%	3.1%
EBIT growth	35.0%	4.3%	-0.2%	-0.9%	0.5%	-1.5%	-0.1%	-0.5%	-0.5%	10.6%	3.7%
NOPAT growth	46.0%	1.0%	-0.6%	-0.6%	0.7%	-1.6%	-0.2%	-0.5%	-0.6%	0.1%	3.7%
FCF growth	nm	nm	99.7%	3.3%	-1.8%	0.3%	-1.6%	-1.1%	2.6%	-7.8%	4.7%
EBIT margin	23.1%	21.4%	20.4%	19.7%	19.1%	18.3%	17.8%	17.2%	16.6%	17.8%	17.9%
NOPAT margin	21.3%	19.2%	18.2%	17.6%	17.1%	16.4%	15.9%	15.4%	14.9%	14.4%	14.5%
Capex/Revenues	23.0%	13.0%	9.0%	9.4%	9.7%	10.1%	10.5%	11.1%	11.1%	10.7%	10.4%
Change in WC/Revenues	6.5%	6.0%	1.4%	0.8%	1.1%	0.7%	0.9%	0.9%	0.9%	0.9%	0.9%
Change in WC/Change in revenues	58.1%	54.1%	30.8%	30.8%	30.8%	30.8%	30.8%	30.8%	30.8%	30.8%	30.8%

Source: DM BZ WBK estimates

Market Multiples Valuation

Fig. 7. Comparable valuation – mid-cap industrials

Company	Price	Market Cap	P/E			2003-07EPS	EV/EBITDA		
	(PLN)	(PLN m)	2005E	2006E	2007E	CAGR	2005E	2006E	2007E
Grajewo	28.0	1,389	14.5	11.0	9.4	24.3%	7.6	6.6	5.8
Mondi	40.0	2,000	13.2	12.6	11.0	5.5%	6.1	6.0	5.8
Kęty	133.5	1,232	12.5	11.9	11.0	12.7%	8.3	7.5	7.0
Groclin	93.9	516	13.8	13.8	11.8	6.1%	9.1	7.8	6.6
Average			**13.5**	**12.3**	**10.8**	**12.1%**	**7.8**	**7.0**	**6.3**
Opoczno	**42.90**	**706**	**12.6**	**11.6**	**9.6**	**12.%**	**7.1**	**7.0**	**6.5**
Market premium (discount)			-6%	-6%	-11%		-9%	-0%	+2%
Cersanit	**130.00**	**1,728**	**15.2**	**15.1**	**14.6**	**12.7%**	**10.1**	**9.9**	**9.8**
Market premium (discount)			12%	23%	35%		29%	42%	55%

Source: DM BZ WBK estimates

Compared to other mid-cap industrial companies listed on WSE Cersanit is trading at considerable 29% premium. This is quite excessive in our opinion given no particularly good long-term prospects of the ceramic tiles industry. Opoczno is traded at tiny 8% PE-based discount and almost-none 2% EV/EBITDA-based discount. Given different long-term value drivers of the listed peers we did not include comparable valuation to our fair value estimation of the ceramic tiles producers.

Fig. 8. Comparable valuation – small ceramic tiles producers

Company	Price	Market Cap	P/E		EV/EBITDA	
	(PLN)	(PLN m)	2004	2005E	2004	2005E
Polcolorit	2.36	179	20.1	11.6	5.2	na
Nowa Gala	4.25	157	12.6	21.8	7.4	7.7
Average			**16.4**	**17.0**	**6.3**	**7.7**

Source: Polcolorit, Nowa Gala official company guidance

The results of the other 2 ceramic tiles producers listed on WSE are shown just for reference as their small size does not allow for direct comparison. After the recent drastic reduction of forecasted earnings (Polcolorit and Nowa Gala revised their 2005 earning guidance in August) the small domestic ceramic tiles producers are currently traded at relatively high ratios.

Opoczno vs. Cersanit

While there are four ceramic tile producers listed on the WSE, Opoczno and Cersanit are the most interesting due to their size and market position. Opoczno is the traditional leader of the ceramic tile industry in Poland. Cersanit is a very successful newcomer that started to produce tiles only six years ago, but quickly won the number three spot on the market thanks to a strong position in sanitary ceramic ware and the established sales network. While Opoczno still holds a strong number one spot in ceramic tiles, Cersanit's competitive position is very similar because:

- The difference in effects of scale on the manufacturing costs of both companies are minimal. Production capacity of Opoczno in Poland is ca. 50% higher (28 million m^2 vs. 19 million m^2). Both capacities do not fit under one roof and require multiple production lines in multiple plants.
- Market penetration is almost the same. The three main producers in Poland (Opoczno, Paradyż and Cersanit) effectively cover the whole territory of Poland and are present in DIY networks and in almost all other important points of sale. Their negotiation power with the wholesalers and other distributors is practically the same.
- Both Opoczno and Cersanit focus their production on low-priced products, but gradually are entering the higher market segments. This process is more dynamic in the case of Cersanit, whose initial strategy of market entry and brand recognition building concentrated on low-end products. Currently the product mix of Opoczno and Cersanit ceramic tiles is almost the same. Even the new higher-quality designs look very similar and are far from unique.
- Both producers offer similar brand strengths. Opoczno's brand is broadly associated with ceramic tiles thanks to an established market presence. Cersanit utilizes the synergy effect of a strong brand earned in the bathroom ceramics market, where the brand recognition plays a much more important role than in the case of ceramic tiles.

The main strategic difference between the companies, and in our opinion the main competitive advantage of Cersanit, is its complete "Everything for the bathroom" product line. It includes the high margin sanitary ceramics, but also plastic sanitary ware like bathtubs or shower trays as well as bathroom furniture. Such a broad offer fits into the needs of customers of bathroom boutiques that have started to buy the total bathroom concepts of which ceramic tile is only one component. Such a market trend is also noticeable even by DIY customers. A complete product offer gives a huge potential for obvious synergies on the sales side and gives selling/marketing cost savings too. It also enhances brand recognition which may allow further broadening of the product assortment in the future.

For financial investors, diversification of Cersanit is also welcomed as it makes the company less exposed to the volatility of the market situation in individual segments, like the current price war in the ceramic tiles segment.

The strong point for Opoczno is the expertise gathered currently thanks to acquisition of Dvarcioniu Keramika. The Lithuanian market albeit potentially quite profitable is small and the value of the project is primarily in its bridgehead and testing ground position facing other CEE markets.

Fig. 9. Opoczno vs. Cersanit: Quick comparison

	Opoczno	Cersanit
Exposure to Ceramic Tiles Market (%of revenues coming from sale of tiles)	97%	55.1% (1H 2005)
Ceramic Tiles Production Capacity	31m m^2 (28m m^2 in Poland, 3m m^2 in Lithuania)	19m m^2
Plants	3 plants located in Opoczno; 1 in Lithuania: "Mazowsze" plant: capacity of 10m m2, of which 4m m2 (glazed porcelain); opened in May 2005 "Śląsk" plant: capacity 6m m^2 (porcelain and clay stoneware) "Pomorze" plant: capacity 12m m^2 (clay stoneware); currently under retooling that will allow to switch between various tile types Dvarcioniu Keramika (Lithuania): 3m m^2	1 plant located in Wałbrzych (Cersanit III subsidiary)
Location	Łódź district (Central Poland) => short distance to main markets in Poland (Warsaw and Silesia)	Wałbrzych district (South-West Poland) => longer distance to Warsaw and Eastern Europe, easier access to Germany and Czech Republic
Tax relief	no	Plant located in special economical zone, CIT relief for up to 50% of capex
Sales volume 2004	20.4 million m^2	14.7 million m^2
Sales volume (1H'2005)	ca 12m m^2	ca 8.5m m^2
Market share in Poland as of 1H'2005	24%	18%
Export share in revenues	22.5%	34.2% (1H 2005)
Product Mix	47.9% porcelain tiles (1H2005; up from 37% in 2004)	ca. 35% porcelain tiles
Number of product lines ("collections" consisting products designed around a decorative pattern or leitmotiv)	79 collections of wall tiles; 11 collections of floor tiles; 24 collections of glazed porcelain; 4 collections of salt&pepper unglazed porcelain; 7 collections of high-quality unglazed porcelain	63 collections of wall tiles; 23 collections of floor tiles; 14 collections of glazed porcelain; 22 collections of high-quality unglazed porcelain; 11 types of technical gres tiles
Brands	Opoczno brand (54% of sales volume); remaining production is bottom-shelf brands like Primacer, GresTeQ, Cedomix and "no-name brands" dedicated for DIYs	Cersanit brand only; even the low-quality products for DIYs
Distribution mix	25% DIYs/75% wholesalers	40% DIYs/60% wholesalers
Employment	1,181 total; 866 production	880 (Cersanit III)
Revenues on tiles 2004 [PLN million]	340.6	264.2 (Cersanit III)
Revenues on tiles 1H2005 [PLN million]	189.9	Ca. 156
Gross margin on sales 2004 (IAS)	41.6%	47.4% (whole Cersanit Group)
EBITDA margin 2004	21.7%	30.5% (whole Cersanit Group)
Average selling price (estimate for 2004) [PLN/m^2]	20.3	18.8

Source: Company data; DM BZWBK estimates

The future expected operational margins of Cersanit are much better as:

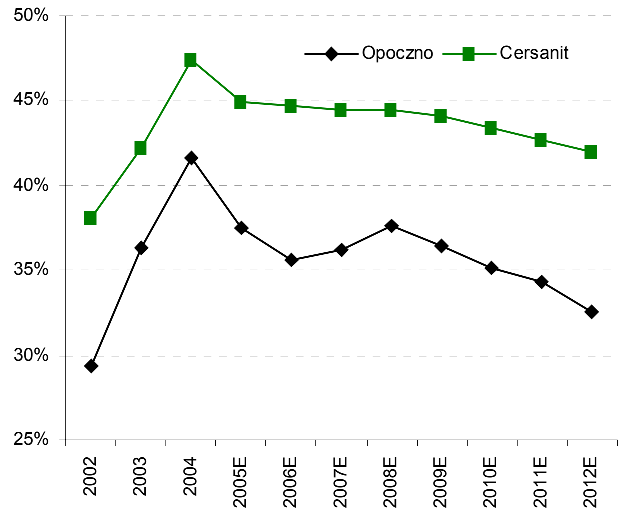
· The margins on other production segments are much better than on the ceramic tiles market and are expected to deteriorate less quickly

· The synergies between products give savings on sales and marketing costs

· Production capacity tailored to the marketing power means Cersanit will be able to focus on high margin segments. Opoczno will continue price war struggling to increase market share to utilize its excess production capacity

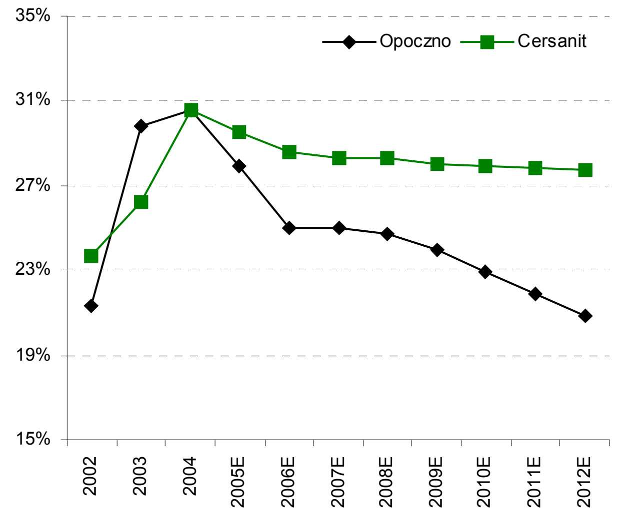
Mr. Michał Sołowow is dedicated to run Cersanit as the main asset in his financial group. Conversely, Enterprise Investors funds are dedicated to sell its stock in Opoczno as the duration of this investment exceeds the usual time span of venture capital projects. Acquisition/merger of Opoczno and Cersanit is possible, but since such a move does not create substantial synergies the different price expectations can be the main obstacle.

Fig. 10. Opoczno vs. Cersanit: Gross margin on sales



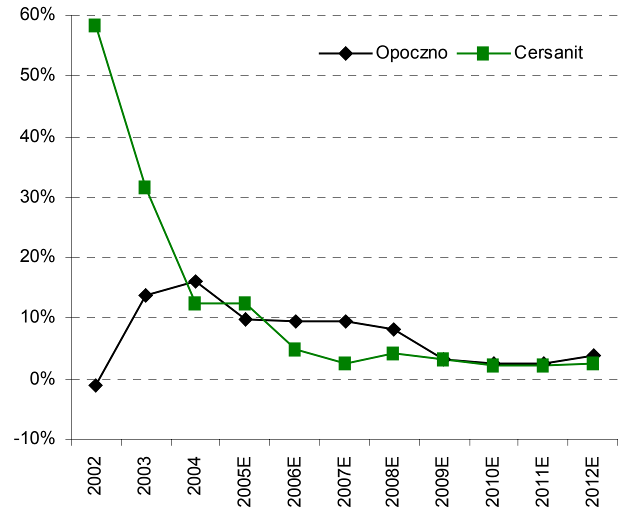
Source: DM BZWBK estimates

Fig. 11. Opoczno vs. Cersanit: EBITDA margin



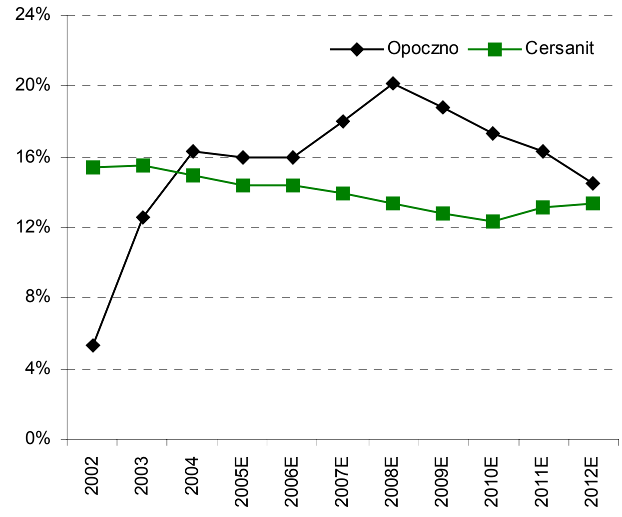
Source: DM BZWBK estimates

Fig. 12. Opoczno vs. Cersanit: Revenue growth



Source: DM BZWBK estimates

Fig. 13. Opoczno vs. Cersanit: EBIT/Assets



Source: DM BZWBK estimates

Ceramic Tiles Market Environment

Global market

The global growth is driven only by emerging markets

The global ceramic tile production increased by a factor of 3.2 over the last 13 years (9.4% CAGR). But in the last 5 years the growth has been much slower and is driven only by emerging countries like Brazil, India, Indonesia, Mexico, Iran or Vietnam producing mainly for their expanding domestic markets. The largest world producer (32% of global production) is China, which also produces mainly for it huge market and export to Asia, yet it also has started its presence on European markets.

Fig. 14. Ceramic tiles production
In sqm , unless otherwise stated

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	CAGR 12y
Spain	225	228	261	281	320	400	424	485	564	602	621	638	651	624	8.2%
Italy	447	432	435	459	510	562	554	572	589	606	632	638	606	603	2.3%
Rest of EU 15	214	199	205	206	197	198	188	194	202	203	200	188	190	192	-0.8%
EU 15	886	859	901	946	1,027	1,160	1,166	1,251	1,355	1,411	1,453	1,464	1,447	1,419	3.7%
World	1,923	2,048	2,284	2,616	3,280	4,023	4,517	4,698	5,013	4,994	5,462	5,614	5,883	6,192	9.4%

Source: "Ceramic World Review"

Europe

The EU15 market is stagnant

Over the last 5 years in the "old" European Union production has remained stable, which means a 6pp loss in the global market share.

Spain and Italy are traditionally the main producers in Europe

By far the most important producers are Spain and Italy and they remain also the top exporters, placing some 56% of their exports in Europe, the rest mainly in Near East countries and USA. The Italian tile industry is heavily diversified as the sector has 253 companies.

The Turkish producers are the most concentrated

The third key player in Europe is Turkey which is also a heavy exporter. The strength of Turkish tile producers is in the concentration of their market – 24 producers have a total capacity of ca. 250 million m^2. Kale, Toprak, and Ege are among the largest manufacturers in the world and Kale Group, with a capacity of 60 million m^2, is reportedly the largest plant in the world carrying out integrated manufacturing under a single roof. Turkish exports are placed mainly in Germany, but Turkish producers also try to expand into the other EU markets, also by acquisitions of local producers.

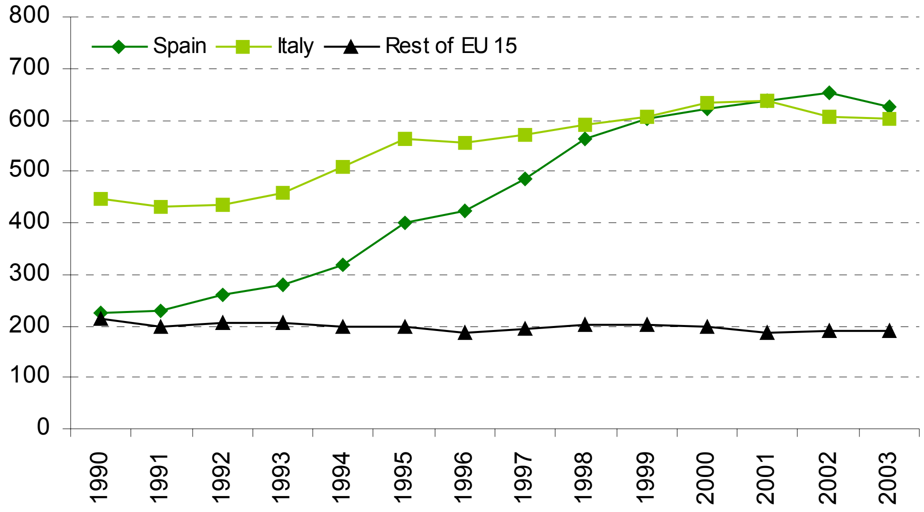
The production in Russia and Poland is expanding fastest

Russia and Poland are respectively the 4th and 5th European tile producers – these countries have radically increased their production in the past 5 years and have surpassed Germany (with Poland becoming a net exporter). German producers are having tough times mostly due to weakness of their domestic market and some like Villeroy&Boch are reducing their tile production capacity.

Austrian Lasselberger is the key player in CEE Europe

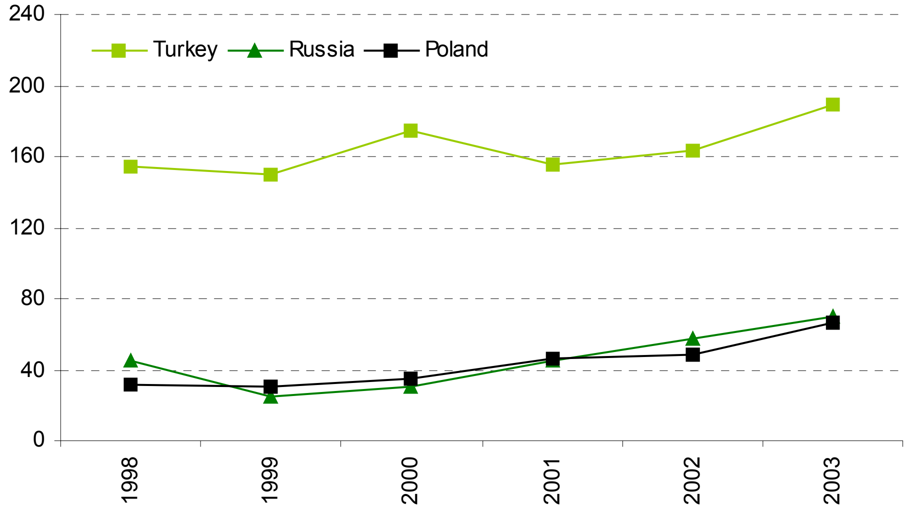
Another important player in the region is the Austrian Lasselberger Group that consolidated the ceramic tile industry in Czech Republic, Hungary and Romania and with its 16 production plants has 55 million m^2 in production capacity. It is by far the strongest player in Central and Eastern Europe and one of the main competitors in the region for the acquisition plans of Polish tile producers.

Fig. 15. Ceramic tiles production in EU15
In sqm , unless otherwise stated



Source: "Ceramic World Review"

Fig. 16. Ceramic tiles production in Turkey, Russian and Poland
In sqm , unless otherwise stated



Source: "Ceramic World Review"

The volume and market shares on the European market are stable, but not set in stone. Spain has managed to surpass Italy in production, but Italy remains by far the most important exporter on the EU market. Turkey, China and Poland report really fast growth of sales and while these countries are still far from threatening the dominant position of traditional players, there is still a lot of room to grow.

Fig. 17. Export to EU countries
In EUR millions, unless otherwise stated

Exporting country	1999	2000	2001	2002	2003	2004
Italy	1,789	1,787	1,789	1,714	1,764	1,768
Spain	721	827	744	799	796	793
Other EU15	499	491	460	489	503	530
Czech Republic	68	79	79	77	74	62
Poland	4	5	7	16	25	33
Other new EU member states	26	29	27	23	26	27
Turkey	115	129	129	131	158	183
China	1	1	3	13	35	66
Other Countries	103	109	130	105	123	129
TOTAL	**3,326**	**3,456**	**3,368**	**3,368**	**3,502**	**3,592**

Source: Eurostat, DM BZ WBK estimates

The EU market for sanitary ware and ceramic tiles is not protected by quantitative restrictions for imports. The low custom duty tariffs leave the window open for the import from developing countries.

Fig. 18. Custom Duty Tariffs for sanitary ware and ceramic tiles applied in the EU

Product	Tariff
Sanitary ware made of plastics	6.5%
Unglazed ceramic tiles	5.0%
Glazed ceramic tiles	0.0%
Sanitary ceramics	7.0%

Source: EU Commission

Domestic market

Fig. 19. Production Capacity of Ceramic Tile Producers in Poland
In sqm millions, unless otherwise stated

	2000	2001	2002	2003	2004	2005E
Wall tiles	30	35	41	40	44	47
Floor tiles	15	15	17	18	21	23
Gres Tiles	12	26	29	30	40	51
TOTAL	**56**	**77**	**87**	**89**	**104**	**121**

Source: "Wokół płytek ceramicznych" 2005/1

Fig. 20. Polish Ceramic Tiles Market
In sqm millions, unless otherwise stated

	2000	2001	2002	2003	2004
Domestic production	34	44	57	70	73
Export	3	6	10	16	26
Import	36	33	17	19	18
Supply for the domestic market	68	71	64	73	66

Source: "Wokół płytek ceramicznych" 2005/1

The production capacity of domestic players almost doubled in the last 5 years, most probably exceeding 120 million m2 annually in 2005. During the same time, domestic demand was quite stable, oscillating around 70 million m2. In the years 2000-2003 the share of imports in sales in Poland dropped from ca. 50% to (depending on sources) to 20%-27% and is still on the decrease.

Fig. 21. Import of ceramic tiles to Poland
In EUR millions, unless otherwise stated

Producer	1999	2000	2001	2002	2003	2004	CAGR 2004/ 1999	1H2004	1H2005	1H2005/ 1H2004
Spain	69.5	69.7	55.1	42.3	36.7	33.9	-13.4%	19.8	14.2	-28%
Italy	107.1	113.2	93.5	65.0	55.4	47.8	-14.9%	25.1	19.8	-21%
Germany	23.6	24.5	23.5	19.5	17.4	18.4	-4.8%	9.7	8.6	-11%
Czech Republic	18.4	21.8	16.1	11.6	8.9	8.9	-13.5%	4.4	3.7	-17%
Slovakia	3.6	4.2	3.6	2.3	1.7	1.7	-14.1%	0.9	0.4	-55%
Other UE countries	12.0	11.7	9.6	8.1	5.2	6.8	-10.7%	3.1	2.5	-18%
Turkey	1.5	4.2	3.7	3.2	5.6	3.8	20.5%	2.6	1.5	-43%
China	0.0	0.0	0.0	0.1	1.0	3.6	490.2%	1.5	1.4	-6%
Other non EU countries	0.4	1.5	1.8	0.9	0.4	0.2	-15.8%	0.1	0.2	138%
TOTAL	**236**	**251**	**207**	**153**	**132**	**125**	**-11.9%**	**67**	**52**	**-22%**

Source: Eurostat

Simultaneously to beating the foreign competition in the domestic market, Polish producers have started fighting over their share in foreign markets. In fact in the last 5 years the export of ceramic tiles has increased very rapidly (ca. 8 times due to a low base) and in 2004 Poland became a net ceramic tiles exporter.

Fig. 22. Production of Ceramic Tiles in Poland

	2000	2001	2002	2003	2004
Production volume [sqm million]	47,575	46,186	61,496	75,409	90,332
y/y dynamics	x	-3%	33%	23%	20%
Domestic production sold [PLN m]	795	982	1,201	1,473	1,759
y/y dynamics	20%	24%	22%	23%	19%

Source: GUS Statistical Office

The year 2004 was particularly good for the Polish tile industry. Revenues of most producers climbed to a record-high with very good profitability. The 22% CAGR of revenues of the Polish tile producers in 2000-2004 triggered a quite enthusiastic outlook for the future.

In that situation most producers decided to continue their extensive capital expenditure program boosting the production capacity of the sector. We estimate that in 2005 facilities having production capacity of ca. 18-20 million m^2 were or will be launched, most of them in the high-margin gres tiles sector.

Fig. 23. New capacity of the Polish ceramic tile industry 2005

Company	Capacity	Commission	Investment	Product
Paradyż	9.0m m^2	June 2005	New plant (Tomaszów)	Porcelain
Opoczno	6.0m m2	April 2005	2 new production lines in the "Mazowsze" plant	Porcelain
Stargres	3.0m m2	July 2005	New plant (Końskie)	Floor porcelain
Nowa Gala	2.0m m2	1Q2005	New plant (Końskie)	Porcelain
Polcolorit	2.2m m2	2Q2006	New plant (Piechowice) under construction	Monocottura

Source: Company data

In 2005 the total production capacity exceeds the domestic needs by more than 50%. The saturation of the domestic market causes:

- Pressure on selling margins due to increasing competition. In fact the market players report a “price war” and a drop in prices of ca. 6-8% in 2005.
- Increasing dependence on exports.

Domestic demand outlook

Long-term increase in demand for ceramic tiles will be driven by the deficit in housing and office space

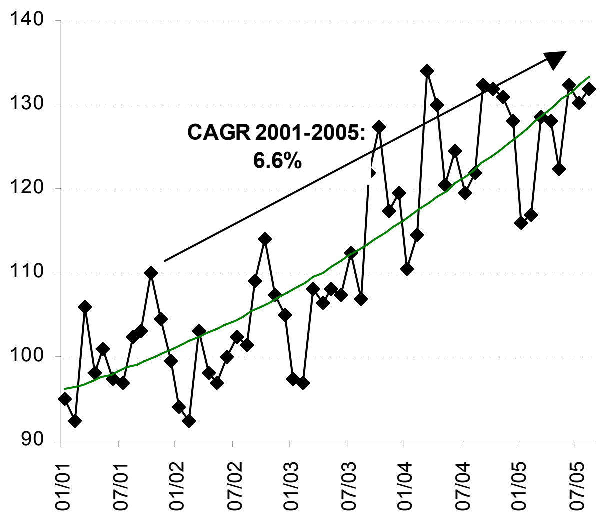
Domestic demand for tiles in long term is driven by the construction industry, especially housing and office space construction. In both segments Poland is at a deficit compared to EU standards, but convergence to these standards can be quite a lengthy process. In our forecasts we expect the volume of demand for ceramic tiles in Poland to expand at the forecasted real GDP growth level (4.3% in 2006; 4.5% in subsequent years).

Output of the construction industry increases in value at 6.6% CAGR since 2000. Despite the slow start due to long winter the trend continues in 2005.

The construction industry recovers quickly after the sharp decline in 1990's

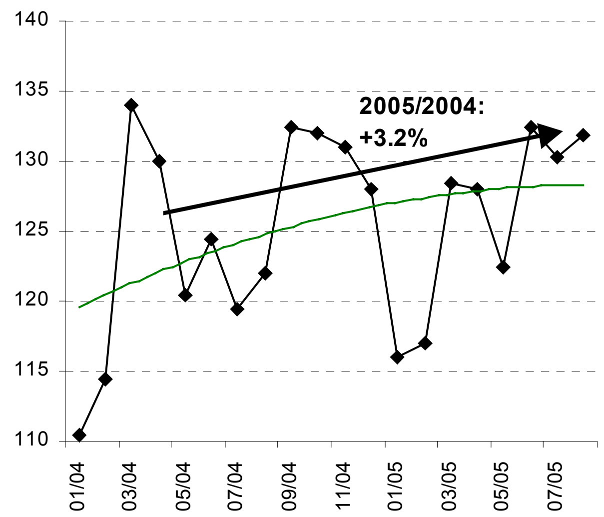
The number of new constructed dwellings declined dramatically in 1990-1996 (the number was cut in half) and while it has recovered at a 7.2% CAGR since then, it still is ca. 30% below the 1990 level. After the very good 2003, constructed dwelling output returned in 2004 to the long-trend levels. In 2005 the housing construction dynamics is flat on 2004 due to weak 1H2005, but strong data for the summer months predict continuation of good overall y/y dynamics.

Fig. 24. Construction industry – long term trend
100 = average monthly output 2000



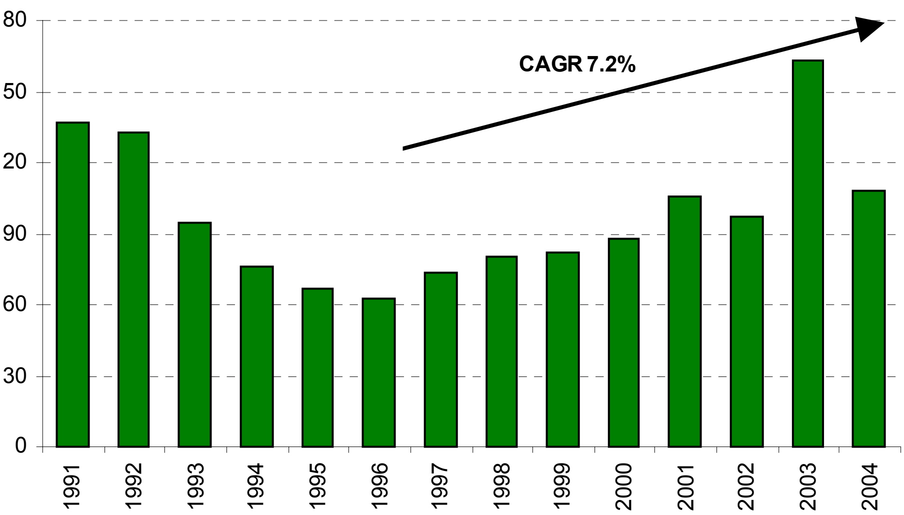
Source: GUS statistical office

Fig. 25. Construction industry – short term trend
100 = average monthly output 2000



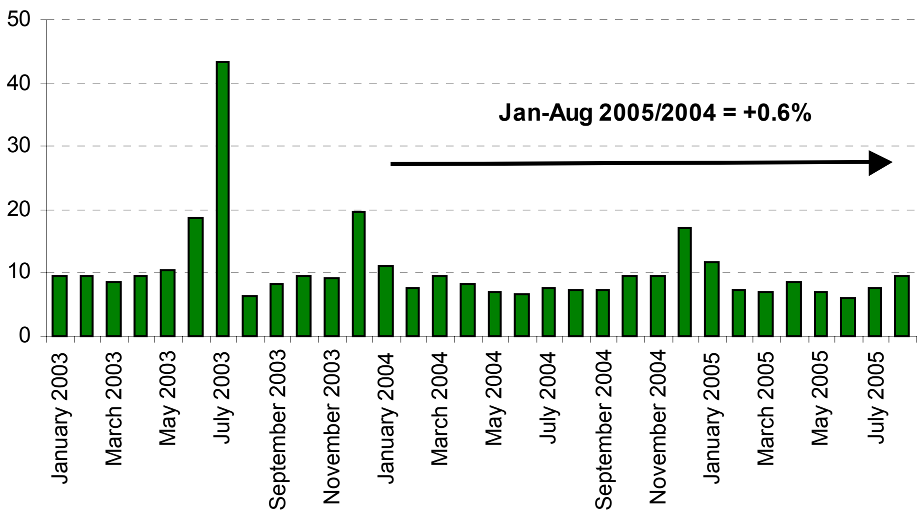
Source: GUS statistical office

Fig. 26. New household completed – long term trend
In thousands



Source: GUS statistical office

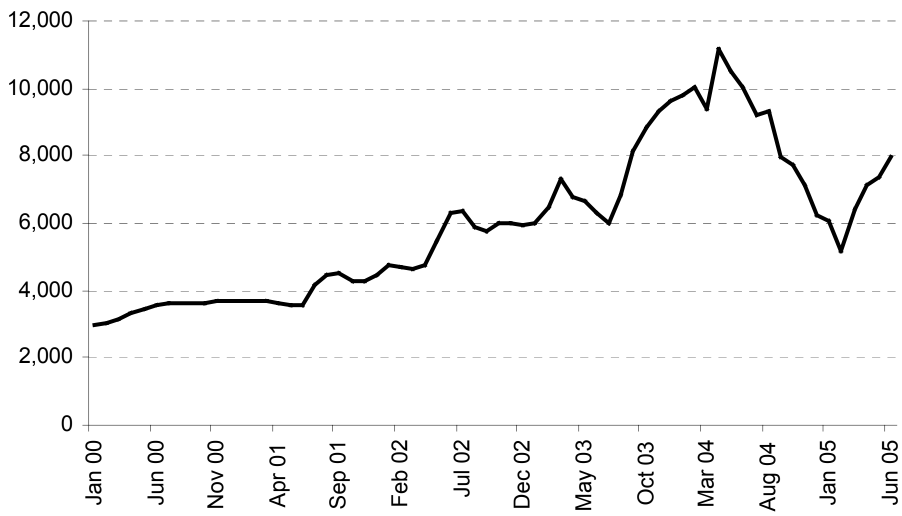
Fig. 27. New household completed – short term trend
In thousands



Source: GUS statistical office

The increase of housing loans was impressive in recent years and especially in 2003-2005. Easier access to mortgage loans may support a further increase in housing construction in the upcoming years.

Fig. 28. Housing loans – y/y increase
In PLN millions



Source: NBP, DM BZWBK calculation

Export markets

Fig. 29. Export of ceramic tiles from Poland
EUR in millions unless, otherwise stated

Market	1999	2000	2001	2002	2003	2004	1H 2004	1H 2005	1H 05/ 1H 04
Germany	0.5	0.6	0.5	1.0	1.7	2.8	1.3	1.5	15.6%
Italy	0.0	0.1	0.1	0.2	0.7	1.3	0.6	0.7	20.7%
Other EU 15 countries	0.7	0.2	0.3	0.4	0.8	1.1	0.4	1.2	187.6%
Czech Republic	0.3	0.3	0.3	1.8	4.2	8.4	3.8	5.8	53.5%
Lithuania	2.3	2.4	3.6	5.5	6.0	7.4	3.5	4.5	26.6%
Latvia	0.3	1.5	1.0	2.4	3.2	4.0	1.8	1.9	5.4%
Slovakia	0.6	0.9	1.4	2.0	3.2	4.4	1.8	2.7	48.9%
Hungary	0.0	0.0	0.4	1.5	2.3	3.9	1.4	2.7	82.9%
Other EU countries	0.5	0.4	0.5	1.1	1.2	1.8	0.9	1.1	23.6%
Russia	2.5	4.1	9.6	13.5	16.6	18.8	8.9	8.3	-6.5%
Ukraine	2.7	2.4	4.1	6.2	8.3	11.0	4.5	6.1	35.4%
Belarus	0.5	0.8	0.5	0.9	2.6	3.5	1.2	1.7	42.5%
Romania	0.1	0.2	0.4	0.6	0.7	1.0	0.5	1.1	133.9%
USA	0.1	0.2	0.1	0.3	0.9	1.3	0.5	0.6	21.5%
Other non EU countries	0.4	0.4	1.0	1.7	2.9	4.2	1.9	2.4	27.7%
TOTAL	**11.4**	**14.5**	**23.9**	**39.1**	**55.3**	**74.9**	**33.1**	**42.4**	**28.1%**
y/y growth of total Export	na	27%	65%	64%	41%	35%			

Source: SITC

Polish ceramic tile exports increases at 46% CAGR over the last 5 years

Polish ceramic tile exports increased at a stunning 46% CAGR over the last 5 years and were the second most important growth factor for the domestic producers. Mainly due to transportation costs, but also due to the quite early stage, marketing efforts of exports is focused on the neighboring countries. The four main markets include Eastern Europe (especially Russia and Ukraine), Central Europe (Czech Republic, Slovakia, and Hungary), Baltic States (especially Lithuania) and Western Europe (especially Germany).

The exports to Russia starts to decelerate

Exports to Russia and Ukraine were the first to grow rapidly and still account for more than one third of the export revenues. While Ukraine still gives nice growth potential, exports to Russia have started to slow down due to increasing (in volume and quality) production of Russian producers. Actually in 1H the value of the export to Russia dropped due to weak USD which is the functional currency in EE trade.

While tile exports to Baltic states are still expanding at a decent rate, these markets are limited in size. The acquisition of Dvarcioniu Keramika by Opoczno gives additional access to its distribution network, but in the long-term the export stream from Poland most probably will suffer from increasing domestic production.

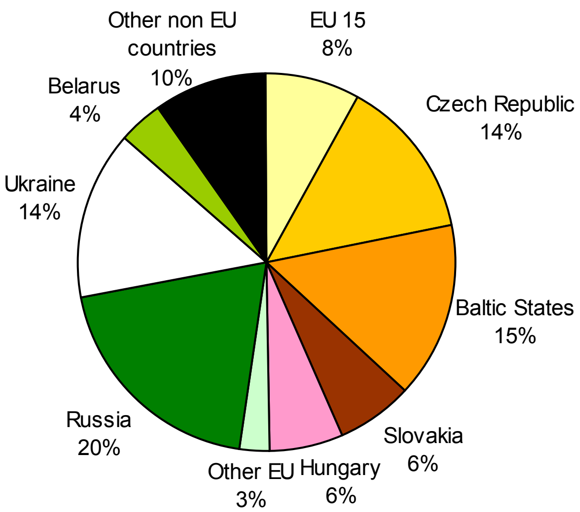
Export to CE markets expands fastest

Exports to Central European markets are most rapidly expanding and account for ca. 30% of export revenues. Within the last 5 years the trade stream between Poland and Czech Republic has altered direction. The traditional import of Czech tiles to Poland was cut by 50% and in 2005 was surpassed by exports from Poland to the Czech Republic (being practically non-existent until 2002).

Export to Western Europe plays minor role but is also rapidly expanding

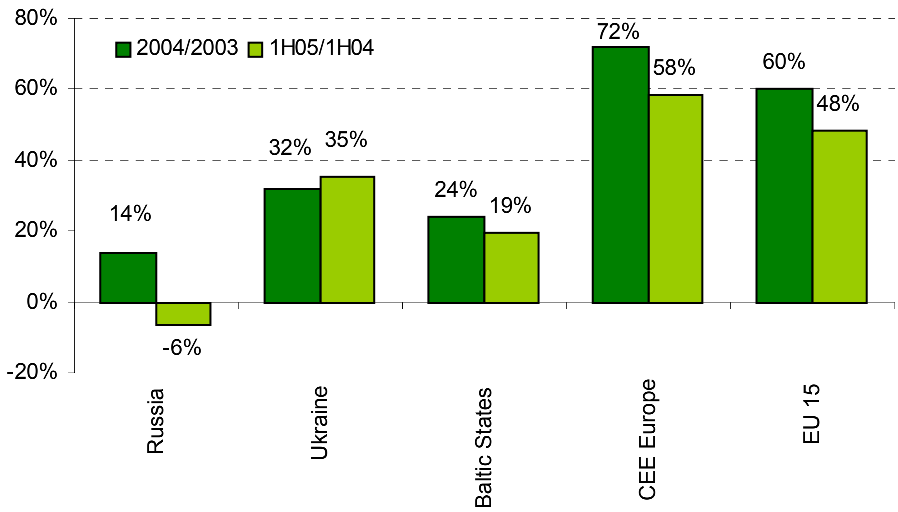
The potentially most lucrative market, Western Europe, accounts for only 8% of export revenues. The market there is quite settled and protected and additionally Polish exporters struggle there with other low-cost exporters (like Turkey and increasingly China). But the reported growth of export from Poland is immense, also due to a low base.

Fig. 30. Poland: Export of ceramic tiles in 1H 2005
In %



Source: Eurostat; DM BZWBK calculations

Fig. 31. Dynamics of segments of the Polish tile exports (Value terms EUR denominated)
In %



Source: Eurostat; DM BZWBK calculations

Russia

Russia still remains the main export market

Despite rapid expansion of other export markets and strong bureaucracy affecting economic freedom of transactions, Russia remains the most important market for Polish exporters.

The market in Russia expands at 21% after the collapse during the 1998 crisis

After the collapse during the 1998 crisis the Russian tile market recovered and continues to expand at a CAGR of 21%, unthinkable for a mature market. The market in Russia in 2004 was ca. 124 million m^2 (up ca. 16% on 2003), covered by 104.2 million m^2 of local production (up 27% on 2003) and 24 million m^2 in imports (down 9.5% on 2003). Imports come mainly from CIS states, including 4 million m2 in imports from Belarus. The export volume from Russia is only 4 million m^2 (a 14% increase on 2003).

The rapid expansion of demand positively impacted the prices at least in the higher priced segments traditionally targeted by imports. In fact in recent years (2003-2004) the Russian market offered the best prices for exporters in Europe.

Fig. 32. Italian Ceramic Tiles Export in 2004

Target market	Volume [sqm million]	Volume variation (2004/2003)	Value [EUR million]	Average price [EUR/ sqm]
UE 15	203.2	-0.7%	2,037.9	10.03
- incl. Germany	63.3	-6.7%	568.5	8.98
Europe - extra EU 15	74.7	-3.1%	555.2	7.43
- incl. Russia	5.0	5.1%	76.6	**15.21**
- incl. Poland	4.4	-19.7%	39.0	8.84
- incl. Hungary	8.0	-9.3%	55.6	6.90
USA	73.1	3.4%	750.1	10.26
Other countries	61.5	-1.8%	512.8	8.34
TOTAL	**412.5**	**-1.2%**	**3,856.0**	**9.35**

Source: Assopiastrelle (Italian ceramic tiles producers association)

The production is more dispersed than in Poland

There are about 38 tile producers in Russia and the market is not as concentrated as in Poland. The largest in terms of production volumes are Welor (15 million m^2 in 2003), Sokol (11 million m^2), Strojfactor (9 million m^2) and Lira Keramika (8 million m^2). Despite the rapid increase in production in 2004, a lot of companies announced substantial additional new investments in capacity increases in 2005.

We expect the production capacity to increase quickly to fully cover the domestic demand in 3 years

We expect the trend of increasing production to continue. This means pressure on prices, diminishing of imports to Russia to look for export opportunities. Just as a parallel comparison to the Polish market few years ago we forecast Russian production to cover the domestic demand in 3 years. At that time, thanks to low manufacturing costs, we expect the Russian producers to aggressively target the EU market.

Fig. 33. Competitive cost advantage of Russian producers

	Cost of production of unglazed porcelain tiles			
	Russia [USD/sqm]	Italy [USD/sqm]	Difference [USD/sqm]	Difference [%]
Raw materials	1.75	3.24	-1.49	-46%
Packaging	0.27	0.34	-0.07	-20%
Natural Gas and Energy	0.42	1.70	-1.29	-75%
Maintenance and repairs	0.86	0.81	0.05	6%
Labor	0.37	1.65	-1.28	-78%
Depreciation	0.99	0.98	0.02	2%
Total direct production costs	**4.65**	**8.71**	**-4.06**	**-47%**
Freight (Italy to Russia)	0.00	2.00	-2.00	n.m.
Tax and duty (Russia)	0.00	1.10	-1.10	n.m.
Direct costs of placing the product on the Russian market	**4.65**	**11.81**	**-7.16**	**-61%**

Source: Marazzi Group; Assopiastrelle; Exchange rate EUR/USD = 1.3

Russian producers have huge advantage due to very low natural gas and human resource cost

The cost advantage of very low natural gas prices (extracted locally) and very low human resource costs (the latter translating also into low prices of raw materials from the local mineral mining industry) is very deep and long lasting.

Foreign players already have started production in Russia

The potentially very lucrative market is attracting increased interest of foreign investors in acquisition of Russian producers. The largest producer ZAO Welor (together with its largest distribution network Kerama) was already taken over by Italian Marazzi Group for USD 103 million. Additionally, in the second half of 2005, Marazzi opened another large-scale greenfield plant in Malino (Moscow area). Several other West European and Turkish producers announced potential interest in direct entry into Russia.

Western Europe

EU15 remains the largest market potential in Europe

In the "old" counties of the European Union (EU 15) there is expected modest growth in the building industry, especially in the residential (new and renovation) segment which is mainly triggered by negative demographic trends. But despite the lack of market growth, the EU15 will remain the largest market potential for the ceramic tile producers in the region.

Fig. 34. Exporters to EU countries
EUR in millions, unless otherwise stated

Exporters	1999	2000	2001	2002	2003	2004
Italy	1,789	1,787	1,789	1,714	1,764	1,768
Spain	721	827	744	799	796	793
Other EU15	499	491	460	489	503	530
Czech Rep.	68	79	79	77	74	62
Poland	**4**	**5**	**7**	**16**	**25**	**33**
Other new EU member states	26	29	27	23	26	27
Turkey	115	129	129	131	158	183
China	1	1	3	13	35	66
Other Countries	103	109	130	105	123	129
TOTAL	**3,326**	**3,456**	**3,368**	**3,368**	**3,502**	**3,592**

Source: Eurostat

Poland accounts for only 1% of tile exports in EU

Poland accounts for only 1% of tile exports to the European Union countries. While this gives an enormous growth potential, the fight for western European markets will be tough and most certainly not very lucrative.

EU15 markets are protective and difficult to enter for new players

EU markets seem somewhat protective and difficult to enter for producers from developing countries. The main problem is access to the wholesaler distribution channel that requires national quality standards, strong brands, and generally tends to limit suppliers. To successfully target the distribution network Polish producers have to employ local intermediaries (agents) and lower prices (as they are perceived as "no-name brands"). So despite the relatively higher retail prices in West Europe's markets, margins for the Polish exporters are low (at least during the initial years of building a market presence). So in recent years the EU 15 has been of secondary importance to the domestic market and exports to East Europe were easier and more profitable. As the domestic market becomes tougher we expect Western Europe to be more aggressively targeted in future.

Low-margin distribution channels will dominate in the export efforts to EU15

For the Polish producers we find the main chance in two distribution channels:

- Do-It-Yourself markets: can be targeted directly by importers, put less emphasis on quality standards and national brands.
- Foreign manufacturers that are not capable of producing the full product range themselves but do want to have a full product range to offer to their clients. This gives direct access to established distribution channels, but limits the brand presence. Opoczno has already entered into a cooperation agreement with Villeroy&Boch (Villeroy&Boch is partially divesting its loss-making ceramic tiles division).

Both distribution channels will yield rather low margins for the Polish exporters, but they allow for a increase in market presence without huge outlays on distribution and service network.

Ceramic tiles: main cost-affecting factors

Raw materials

Raw materials for the ceramic industry include plastic and non-plastic minerals like clay, kaolin, technical sands, limestone, feldspar, as well as decoration colors, pigments, other colorants and glazing materials.

The "bulk" material costs is very comparable between various tile types

In Poland on average the "bulk" minerals account for ca. 2.9-3.2 PLN/m^2 manufacturing costs (or ca. 60-70% of the raw material costs on average). Bodies of high-quality tiles have a higher content of kaolin clays that affects the plasticity, absorptivity, expandability and the final color of the product. The mineral material mix is also slightly different for porcelain stoneware and for clay earthenware. But generally the "bulk" raw material cost is very comparable between various tile types.

For production of standard-quality tiles, the vast majority of the raw materials comes from the domestic mineral resources mining industry, only some like kaolin are partially imported, mainly from the Czech Republic, Ukraine and Germany. Conversely, the raw materials used in production of the high-class porcelain gres tiles are imported due to much higher requirements for homogeneity and purity. Despite a huge increase in demand, the price of mineral raw minerals remain relatively stable due to a readily available supply. Opoczno SA owns 2 clay deposits mined by a third party contractor that cover ca. 42% of plastic materials utilized by this company (red clay and vitrified clay).

The main differences in manufacturing costs come from colorant and surface quality

The main differences in manufacturing costs between various types of tiles come from coloring and surface quality. While in the low-priced segment the colorants play a relatively low role in the top (richly decorated) segment, they can account for the majority of raw material costs. This is especially important for gres tiles that are not only surface-colored but volume-colored.

On average 25% of raw materials is imported from EUR-based markets

The glazing materials and colorants come mainly from Italy and Spain and other EUR-based countries. This is the main foreign-currency exposure factor on the cost-side for the Polish manufacturers.

Energy and Gas

Natural gas accounts for ca. 10% of manufacturing costs. Electric energy for 3-4%.

Production of ceramic tiles is relatively highly energy consuming as on average, the manufacture of 1m2 of tiles requires roughly 2.5 m3 of methane gas and 30kWh of electric energy (the average consumption of the ceramic tile industry in Italy, which is consistent with a few Polish examples where data was available). In Poland electric energy accounts approximately for ca. 3-4% and natural gas for ca. 9-10% of operating costs of ceramic tile producers. In the case of Opoczno SA electric energy adds into manufacturing costs 0.6 PLN/m2 (electricity) and 1.6 PLN/m2 (methane gas) as of 1H2005.

Gas prices increased by 3.5% in June and by 4% in October 2005. We expect another increase by 5% in January 2006.

The ceramic tile production facilities (ovens) are gas-fired. The price of natural gas in Poland is regulated and all the tile producers are exposed to changes in the gas tariffs of the national gas distribution company PGNiG. Imports account for 68% of gas consumption in Poland and the gas prices have a long term tendency to follow changes in the world oil prices with a lag of few months. Gas tariffs are set yearly, but in case of a large fluctuation of import price they can be adjusted on a quarterly basis. In June 2005 the gas fuel tariffs for large industrial consumers increased by 3.5% and the recent escalation of the gas price on the world market will triggered another increase on the next tariff update in October by another 4%. In 1H2006 we expect the gas price to rise another 5% and escalate with PPI in the subsequent years.

The gas tariffs differ slightly among the regions in Poland in the distribution-cost component, but these differences are minor compared to the total (fuel+distribution) gas price. The total gas price for Cersanit located in Walbrzych region is only ca. 2% higher than for the majority of the Polish tile industry located in the Łódź region and such a minor difference does not affect the relative cost competitiveness.

The electric energy market is partially liberalized in Poland and industrial consumers are allowed to choose suppliers after paying an additional transmission fee to the local distribution company. This means there is no more exposure to the tariffs of local utilities, but instead exposure to the volatility of the energy market. There are a number of factors that affect the future of the electric energy market in Poland (end of long-term contracts of large power plants; introduction of a CO_2 emission trading system; green energy requirements; as well as an excise tax). For the purpose of this report we assume that electric energy will follow the PPI path, but certainly there is a risk (threat or opportunity) connected to the future escalation of this cost factor.

CO_2 emission allowances trading system will have a minor impact on operational results if the producers maintain their production levels

Another potentially uncertain factor is connected to the CO_2 emission allowances trading system. Companies are still waiting for the official allocation of emissions for the 2005-2007 period. In June 2005 there was a general reduction of emission quotas granted to Poland and therefore the companies will receive much lower limits than set previously (in the "National Plan for CO2 Emission Allowances" from July 2004). It seems that the companies will receive allocations at the level very similar to 2004 actual emissions with additional amounts for new production facilities planned to be launched (like the Mazowsze plant of Opoczno SA). So despite the really high prices of the allowances on the European market (15-20 EUR/t currently; 10 EUR/t expected after the Poland's entry to the trading system) the impact of CO_2 trading will be limited unless companies decide to change production levels.

Fig. 35. CO2 emissions allocation 2005-2007
In thousands tones

Company	Allocation
Opoczno S.A. (sum of allocation for plants)	138,000
Cersanit III	96,300
Paradyż (sum of allocation for plants)	91,600
Tubądzin	43,300

Source: Project of Ministry of Environment, September 2005

Manufacturing wage cost

Due to increasing automatization of the production process, the human resources factor in manufacturing costs generally decreases over time.

All the main tile producers have located their production plants in regions with relatively high unemployment. In both the Łódź region (Opoczno, Paradyż, and Tubądzin) and Wałbrzych region, the average remuneration is ca. 20% lower than the country average, while quite beneficial for the tile producers, does not impact their relative competitiveness. Most probably the wage cost will increase over time due to wage-pressure in the recovering regions, but this will be a quite lengthy process and that will be partially offset by increasing efficiency.

Selling expenses

These include the costs of marketing and distribution, of the field sales force, advertising and logistics costs. We expect this factor to increase in relation to sales, especially due to wage-pressures (sales force) and increased transportation costs (fuel).

Taxation

Plants located in "special economic" zones enjoy the possibility of CIT relief up to 65% of their capital expenditure. This gives advantage to the players including Cersanit (Walbrzych plant) and Paradyż (Tomaszów Mazowiecki plants).

DOM MAKLERSKI BZ WBK

Opoczno

Poland, Consumer goods

Reuters: OPOC.WA Bloomberg: OPO PW

6 October 2005

Leadership at cost of margins

Initiate coverage with ACCUMULATE. Fair value at 47.6 PLN

Despite declining profitability the leadership position on the tough but expanding market and modern production capacity will secure decent cash flows in the coming years. Due to negative sentiment after disappointing 1H the stock price dropped to an attractive level. In expectation for much better 2H we rate Opoczno ACCUMULATE.

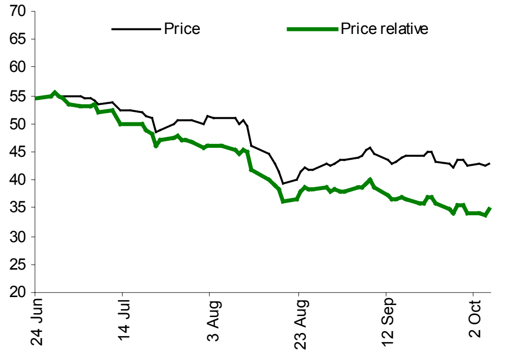
In 2005 Opoczno was forced to enter a price war to repel the new pretenders to secure leadership on the Polish market. While overcapacity of the tiles industry means deteriorating margins we expect Opoczno to increase its market share at cost of smaller players by 4pp over the next 4 years and to be one of the main beneficiaries of the expected growth of the Polish construction market in the coming years.

After exceptionally good 1H2004 the financial results of Opoczno in 2005 are substantially weaker due to tough battle on domestic market and much lower profitability of export to CIS countries. We expect significantly better 2H 2005 due to seasonality. The acquisition of Dvarcioniu Keramika will enable Opoczno to maintain 20% volume growth in 2005, but due to drop in average price by 9% the top line will increase by 10% only.

In our forecasts we did not include the acquisitions Opoczno is considering in CEE markets as the potential projects are still in a very initial phase. Capital commitment in emerging EE countries can provide substantial costs savings and opportunities for expansion, but it would substantially increase the business risk.

Excess modern production capacity means absorption of market growth and increase in market share will be possible without substantial capital expenditures. Therefore the DCF valuation is particularly favourable and the 12-month target price of 52.0 PLN means a 21% upside potential. The 2005-2007 market multiples represent 35% discount to Cersanit.

Recommendation	Accumulate
Price (PLN, 5 October 2005)	42.9
Fair value (PLN, current)	47.6
Target price (PLN, 12-months)	52.0
Market cap. (PLN m)	705
Free float (%)	51.6
Number of shares (m)	16.45
Average daily 3m turnover (shares)	31,5k
EURPLN	3.92
USDPLN	3.28



The price relative chart measures performance against the WIG 20 index. On 05/10/05 the WIG 20 index closed at 2508.90.

Main shareholders	% of capital
CSFB CP (Enterprise Investors)	48.4

Company description

Opoczno is the largest in Poland and the second largest in Central Europe producer of ceramic tiles

Fig. 36. Opoczno: Financial summary
PLN in millions, unless otherwise stated

	2004	2005E	2006E	2007E	2008E
Revenues	426	467	512	560	605
EBITDA	130	129	131	141	150
EBIT	94	82	84	96	111
Net Profit	76	56	61	74	89
EPS (PLN)	4.62	3.39	3.69	4.47	5.39
P/E (x)	9.6	12.6	11.6	9.6	8.0
EV/EBITDA (x)	6.9	7.1	7.0	6.5	6.1

Source: Company data, DM BZ WBK estimates; Financial results adjusted for one-offs

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1H 2005 results and outlook for 2H 2005

Fig. 37. Opoczno: 1H 2005 results review and outlook for 2H 2005
PLN in millions, unless otherwise stated

	1H 2004 IAS	2H 2004 IAS	1H 2005 consolidated (Opoczno S.A. + Dvarcioniu Keramika)	1H 2005 Opoczno S.A. parent only	1H 2005 Dvarcioniu consolidation starting from April 22, 2005	2H 2005E	2005E*	2005F*	1H2005/ 1H2004	2H2005/ 2H2004
Revenues	**230**	**196**	**198.2**	**189.9**	**8.3**	**269**	**467**	**473**	**-14%**	**37%**
COGS	133	116	127.1	123.5	3.6	165	292	na	-4%	42%
Gross profit	**97**	**80**	**71.1**	**66.4**	**4.7**	**111**	**182**	**na**	**-27%**	**39%**
Selling expenses	11	9	13.7	12.3	1.4	22	35	na	26%	138%
Administrative expenses	30	31	29.6	28.3	1.4	33	63	na	0%	8%
Other operating income	3	3	8.3	1.5	6.7	7	16	na	nm	nm
Other operating costs	4	5	11.1	11.1	0.0	3	14	na	nm	nm
Impact of one-time items	*0*	*0*	*-2.5*	*-8.4*	*5.9*	*5.8*	*3.3*	*na*	*nm*	*nm*
- IPO costs	*0*	*0*	*-8.0*	*-8.0*	*0.0*	*0.0*	*-8.0*	*na*	*nm*	*nm*
- badwill write off	*0*	*0*	*5.9*	*0.0*	*5.9*	*0.0*	*5.9*	*na*	*nm*	*nm*
- CSFB incentive plan	*0*	*0*	*4.6*	*4.6*	*0.0*	*8.8*	*13.4*	*na*	*nm*	*nm*
- Opoczno option plan	*0*	*0*	*-5.0*	*-5.0*	*0.0*	*-3.0*	*-8.0*	*na*	*nm*	*nm*
EBITDA reported	**74**	**56**	**45.6**	**36.3**	**9.3**	**82**	**128**	**110**	**-39%**	**47%**
EBITDA adjusted	**74**	**56**	**48.1**	**44.7**	**3.4**	**76**	**125**	**120**	**-35%**	**37%**
Depreciation	19	18	20.7	19.4	1.2	26	47	na	10%	48%
EBIT reported	**55**	**38**	**24.9**	**16.9**	**8.0**	**59**	**83**	**na**	**-55%**	**53%**
EBIT adjusted**	**55**	**38**	**27.4**	**25.3**	**2.1**	**53**	**80**	**na**	**-50%**	**38%**
Financial Income/Costs net	2	-1	-4.9	-2.4	-2.5	-7	-12	na	nm	nm
Profit before CIT reported	**57**	**37**	**20.0**	**14.5**	**5.5**	**52**	**72**	**na**	**-65%**	**39%**
CIT	11	7	3.8	3.9	-0.1	10	14	na	nm	43%
Net Income reported	**46**	**30**	**16.4**	**10.7**	**5.8**	**42**	**58**	**49**	**-64%**	**37%**
Net Income adjusted	**46**	**30**	**18.9**	**19.1**	**-0.1**	**36**	**55**	**59**	**-59%**	**18%**
Assets	445	478	563	488	75	603	603	na	27%	26%
Net debt	-87	-85	205	148	58	116	116	na	nm	nm
Inventory	65	65	98	77	22	98	98	na	52%	52%
Gross margin	42%	41%	36%	35%	56%	41%	39%	na	-6.4pp	0.5pp
Adjusted EBITDA margin	32%	28%	24%	24%	41%	28%	27%	25%	-8.1pp	-0.1pp
Adjusted EBIT margin	24%	19%	14%	13%	26%	20%	17%	na	-10.3pp	0.2pp
Adjusted net margin	20%	15%	10%	10%	-2%	13%	12%	12%	-10.4pp	-2.1pp
Net Debt/Assets	-20%	-18%	37%	30%	77%	19%	19%	na	nm	nm
Inventory turnover [days]	89	102	141	113	nm	109	123	na	+52 days	+7 days

F=official forecast of Opoczno S.A.; E= DM BZ WBK estimates, ** Adjustments to EBIT in 1H2005 include write-off of badwill; change in fair value of CSFB CP incentive plan, change in fair value of option plan; IPO costs, * Fair value of CSFB CP incentive plan estimated for the share price of 42.4 PLN (as of Sept, 30 2005)*

After the exceptionally good 1H2004 the 1H 2005 financial results are weak. Mainly due to:

- decreasing volume (as compared to the 1H2004 when the sales were unnaturally boosted by the VAT rate change)
- decreased average price on the Polish market (price war)
- weak USD and decreased income from USD-denominated sales on EE markets (delayed-action of the PLN/USD appreciation in 2H2004)

Additionally the financial statements of Opoczno are impacted by one time costs and revenues that can hinder the proper understating and have to be adjusted for:

- **IPO costs:** In 1H 2005 Opoczno SA incurred one-off costs connected to the IPO in the amount of PLN 8.0 million allocated to “other operating costs” and G&A costs.

- **Dvarcioniu Keramika acquisition:** Starting from April, 22 2005, Opoczno started to consolidate the financial reports with Dvarcioniu Keramika. The PLN 5.905 million write-off of badwill on Dvarcioniu acquisition boosted the consolidated EBIT line (“other operating revenue”). Additionally the operations of Dvarcioniu Keramika in the consolidation period improved the consolidated revenues by PLN 8 million and EBIT by PLN 2.1 million. Due to high financial costs Dvarcioniu generated PLN 0.2 million net loss for Opoczno SA group. The relatively high (ca. 4 months) inventories of Dvarcioniu were the main cause of increase in average inventory turnover period for Opoczno.
- **Selling shareholders’ (CSFB CP) incentive schemes**: they represent a transaction between the selling shareholder (CSFB Ceramic Partners) and the entitled persons from the management. Once CSFB CP sells the Opoczno shares (below the 10% level), it will pay cash to the entitled persons calculated as the difference between the selling price and bonus unit face value. As CSFB did not sell all his stock during the IPO, this obligation is (under new IFRS accounting regulations) still reported by Opoczno. While this obligation does not require any cash outflow from the company, Opoczno has to charge its P&L with changes in its fair value. As the IPO was below the implied (expected) price EBIT of Opoczno SA was “artificially” boosted in 1H by 4.6m PLN. After the sharp decline of share price (from PLN 55.0 on June, 30 to PLN 42.4 on September, 30) a PLN 8.84m impact is to be expected in 3Q2005.

Fig. 38. Fair value of incentive plan of main shareholder
PLN in thousands, unless otherwise stated

Description	Quantity	Face value (PLN)	Fair value as of 31 Dec 2004	Fair value as of 31 Mar 2005	Fair value as of 30 Jun 2004 at 55.0 PLN/share	Estimated fair value at 40.0 PLN/share	Estimated fair value at 42.4 PLN/share	Estimated fair value at 45.0 PLN/share	Estimated fair value at 50.0 PLN/share
Shareholders plan "2000"	508.5k	22,16	27,149	33,823	16,472	9,226	10,385	11,641	14,057
Shareholders plan "2005"	230.0k	26,30	173	3,721	6,271	2,994	3,518	4,086	5,179

Source: DM BZ WBK estimates

Fig. 39. Opoczno: Impact of main shareholder (CSFB CP) incentive plans on EBIT
PLN in thousands, unless otherwise stated

Description	1Q2005	2Q2005	1H Total	3Q2005E
Shareholders plan “2000”	-6,674	+17,351	+10,677	+6,087
Shareholders plan “2005”	-3,547	-2,550	-6,097	+2,753
TOTAL	-10,221	+14,801	+4,580	+8,840

Source: DM BZ WBK estimates, 3QE at 42.4 PLN per share

- **The incentive scheme of the Opoczno SA**: includes the issue of 304k convertibles for 0.01 PLN face value for entitled persons, convertible into C (in 2006) and D (in 2007) series-shares at the conversion price of PLN 62.0 and 68.2 per share, representing 1.8% dilution. In 1H2005 EBIT (G&A costs) was charged PLN 5.0m to this option plan.

Fig. 40. Opoczno: Expected charges to company option plan
PLN in millions, unless otherwise stated

	1Q’05	2Q’05	2H’05	1H’06	2H’06
Charges to EBIT connected to Company incentive plan	3.5	1.5	3.0	3.0	1.0

Source: DM BZ WBK estimates

We expect a much stronger 2H 2005 than the first part of the year mainly due to seasonality. We arrive on sales forecast slightly lower than the official company guidance. Despite the increase of natural gas tariffs in October 2005 the operational margins will be slightly better than in 1H due to effects of scale and end of the IPO-related G&A costs.

Fig. 41. Opoczno: 3Q'05 and 4Q'05 forecasts
PLN in millions, unless otherwise stated

	3Q'05	4Q'05	2H'05
Revenues	147	122	269
EBITDA reported	50	35	85
EBIT reported	36	22	59
Net Income reported	28	14	42
Impact of CSBF incentive plan	*8.8*	*0.0*	*8.8*
Impact of Opoczno option plan	*-1.5*	*-1.5*	*-3.0*
EBITDA adjusted	42	37	79
EBIT adjusted	29	24	53
Net income adjusted	20	16	36

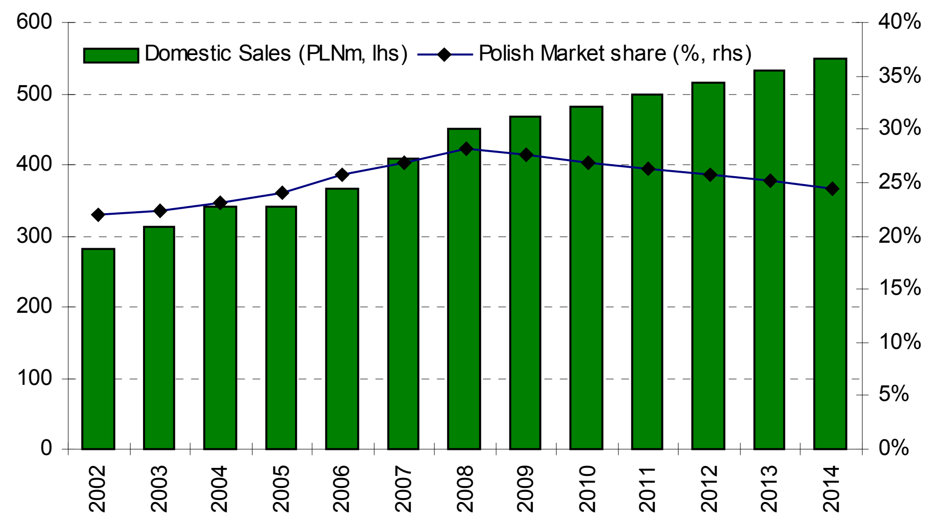
Source: DM BZ WBK estimates

Long-term assumptions

Our long-term financial forecast assumes following market development:

a) During the market war till 2008 Opoczno will gain additional 3% of the domestic market share by pushing out smaller players. Starting from 2009 the market share will drop systematically due to increased pressure of import from low-cost countries.

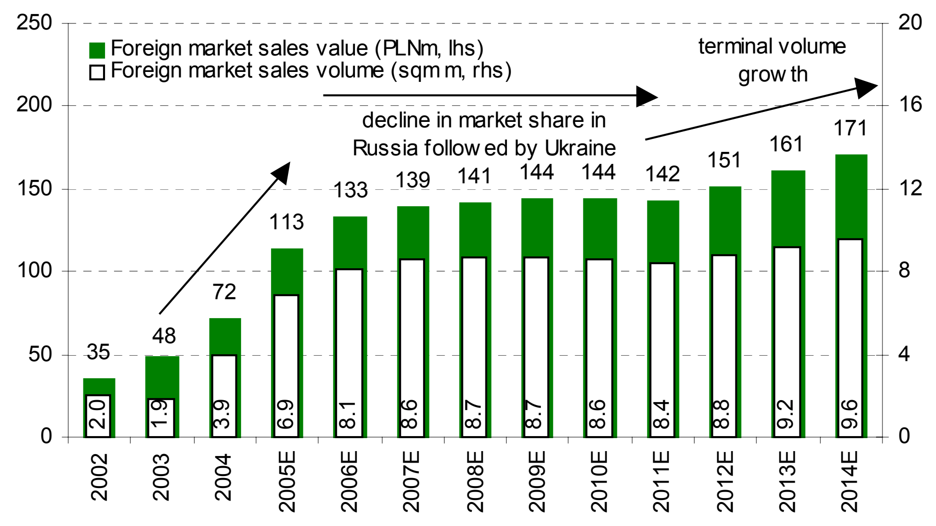
Fig. 42. Revenues of Opoczno on the Polish market



Source: DM BZ WBK estimates

b) Opoczno will benefit from expanding markets in CIS countries. As the exports to Russia already shows signs of deceleration we expect moderate market success there. Ukraine will become the main market, but we expect the export window to start to close in 2007 already. The export to Germany and other EU15 countries will increase at 40% CAGR, but due to low base it will play a more significant role (1-2% of revenues) only after 2010.

Fig. 43. Revenues of Opoczno on the export markets



Source: DM BZ WBK estimates

After the decline in 2005 and 2006 the EBITDA and gross margin will stabilize in 2007-2009 on the levels slightly higher than in early 2000's. As the capex will be limited only to maintenance Opoczno will be a cash-cow. Free cash flow will decrease after 2009 as the low cost imports will exert pressure on margins again and time will come to gradually upgrade/replace the machinery acquired during the 1999-2004 modernization program.

Financial statements

Fig. 44: Opoczno: Consolidated P&L account summary and forecasts
PLN in millions, unless otherwise stated

	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Revenues	**426**	**467**	**512**	**560**	**605**	**625**	**641**	**656**	**682**	**709**	**737**
COGS, o/w	249	292	330	357	378	397	415	431	460	485	509
Depreciation	37	47	47	46	38	42	44	44	51	54	55
Gross profit	177	175	182	203	227	227	225	225	222	224	228
Costs of sales	20	31	35	39	42	43	44	45	47	49	51
G&A expenses	61	63	63	69	74	77	79	81	84	87	91
Other operating income, net	-3	2	-3	-1	0	0	0	0	0	0	0
Operating profit	**94**	**83**	**81**	**95**	**111**	**108**	**103**	**99**	**91**	**88**	**87**
EBITDA	**130**	**131**	**128**	**140**	**150**	**149**	**147**	**143**	**142**	**142**	**141**
Net interest income	1	0	0	0	0	0	0	0	0	0	0
Interest expense	1	10	10	5	1	0	0	0	0	0	0
Other financial income, net	1	-2	0	0	0	0	0	0	0	0	0
Extraordinary gains, net	-0	0	0	0	0	0	0	0	0	0	0
Goodwill amortisation	0	0	0	0	0	0	0	0	0	0	0
Profit before income tax	**94**	**72**	**71**	**90**	**110**	**108**	**103**	**99**	**91**	**88**	**87**
Income tax	18	14	14	17	21	20	19	19	17	17	17
Income from associates	0	0	0	0	0	0	0	0	0	0	0
Minority interests	0	0	0	0	0	0	0	0	0	0	0
Net profit	**76**	**58**	**58**	**73**	**89**	**87**	**83**	**80**	**74**	**72**	**70**
Gross margin	42%	38%	36%	36%	38%	36%	35%	34%	33%	32%	31%
EBITDA margin	31%	28%	25%	25%	25%	24%	23%	22%	21%	20%	19%
Operating margin	22%	18%	16%	17%	18%	17%	16%	15%	13%	12%	12%
Pretax margin	22%	15%	14%	16%	18%	17%	16%	15%	13%	12%	12%
Tax rate	19%	19%	19%	19%	19%	19%	19%	19%	19%	19%	19%
Net margin	18%	12%	11%	13%	15%	14%	13%	12%	11%	10%	10%
Sales growth	16%	10%	10%	9%	8%	3%	3%	2%	4%	4%	4%
Gross profit growth	33%	-1%	4%	11%	12%	0%	-1%	0%	-1%	1%	2%
EBITDA growth	19%	0%	-2%	10%	7%	0%	-2%	-2%	-1%	0%	0%
Operating profit growth	38%	-11%	-3%	17%	18%	-3%	-5%	-3%	-8%	-3%	-2%
Pretax profit growth	46%	-24%	0%	26%	23%	-2%	-5%	-3%	-8%	-3%	-2%
Net profit growth	65%	-24%	0%	26%	23%	-2%	-5%	-3%	-8%	-3%	-2%

Source: Company data, DM BZ WBK estimates

Fig. 45: Opoczno: Consolidated Balance Sheet summary and forecasts
PLN in millions, unless otherwise stated

	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Current assets	**232**	**278**	**243**	**233**	**248**	**262**	**274**	**286**	**294**	**304**	**327**
cash and equivalents	9	90	38	8	4	10	16	22	20	19	31
other short term investments	76	0	0	0	0	0	0	0	0	0	0
accounts receivable	82	90	98	108	116	120	123	126	131	136	142
inventories	65	98	108	118	127	131	135	138	143	149	155
prepaid expenses	0	0	0	0	0	0	0	0	0	0	0
Fixed assets	**244**	**321**	**298**	**280**	**271**	**279**	**286**	**294**	**303**	**312**	**310**
PPE	244	320	298	280	271	279	286	294	303	312	310
long-term investments	0	0	0	0	0	0	0	0	0	0	0
intangibles	0	0	0	0	0	0	0	0	0	0	0
goodwill	0	0	0	0	0	0	0	0	0	0	0
long-term receivables	1	1	0	0	0	0	0	0	0	0	0
Long-term deferred charges	2	2	2	2	2	3	3	3	3	3	3
Total assets	**478**	**601**	**544**	**515**	**521**	**543**	**563**	**583**	**600**	**619**	**640**
Current liabilities	**56**	**142**	**118**	**104**	**90**	**82**	**84**	**86**	**90**	**93**	**97**
bank debt	0	81	51	31	11	0	0	0	0	0	0
accounts payable	29	31	34	38	41	42	43	44	46	48	49
other current liabilities	27	30	33	36	39	40	41	42	44	45	47
Deferred income	0	0	0	0	0	0	0	0	0	0	0
Long-term liabilities	**2**	**129**	**74**	**23**	**2**	**2**	**2**	**2**	**2**	**2**	**2**
bank debt	0	127	72	21	0	0	0	0	0	0	0
other long-term liabilities	2	2	2	2	2	2	2	2	2	2	2
Provisions	0	0	0	0	0	0	0	0	0	0	0
Equity	**420**	**320**	**339**	**374**	**415**	**445**	**463**	**481**	**494**	**510**	**527**
share capital	165	165	165	165	165	165	165	165	165	165	165
capital reserves	54	54	54	54	54	54	54	54	54	54	54
revaluation reserve	1	1	1	1	1	1	1	1	1	1	1
shares held in treasury	0	0	0	0	0	0	0	0	0	0	0
other reserve capital, incl. undistributed loss	124	41	62	82	107	138	160	181	201	220	237
net income	76	59	58	73	89	87	83	80	74	72	70
Minority Interest	**0**	**13**	**13**	**13**	**13**	**13**	**13**	**13**	**13**	**13**	**13**
Negative goodwill	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Total liabilities and equity	**478**	**604**	**544**	**514**	**521**	**542**	**562**	**582**	**599**	**619**	**639**
Net debt	-8	118	86	44	7	-10	-16	-22	-20	-19	-30
Net debt/Equity	-2%	37%	25%	12%	2%	-2%	-3%	-5%	-4%	-4%	-6%

Source: Company data, DM BZ WBK estimates

Fig. 46: Opoczno: Consolidated Cash Flow account summary and forecasts
PLN in millions, unless otherwise stated

	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Cash flow from operations	**101**	**81**	**90**	**102**	**112**	**122**	**122**	**119**	**116**	**116**	**116**
Net profit	76	59	58	73	89	87	83	80	74	72	70
Depreciation and amortisation	37	47	47	46	38	42	44	44	51	54	55
Minorities	0	13	0	0	0	0	0	0	0	0	0
Changes in WC, o/w	-19	-39	-15	-16	-15	-6	-5	-5	-9	-9	-9
inventories	-6	-33	-9	-10	-10	-4	-3	-3	-5	-6	-6
receivables	-12	-8	-9	-9	-9	-4	-3	-3	-5	-5	-5
payables	0	3	3	3	3	1	1	1	2	2	2
Other, net	-3	0	0	0	0	0	0	0	0	0	0
Cash flow from investment	**-32**	**26**	**-21**	**-24**	**-27**	**-48**	**-51**	**-51**	**-58**	**-62**	**-50**
Additions to PPE	-46	-52	-25	-27	-30	-49	-52	-52	-60	-63	-52
Additions to intangibles	0	0	0	0	0	0	0	0	0	0	0
Change in investments	12	76	0	0	0	0	0	0	0	0	0
Other, net	3	2	3	3	3	1	1	1	2	2	2
Cash flow from financing	**-80**	**-26**	**-120**	**-108**	**-88**	**-68**	**-65**	**-62**	**-60**	**-56**	**-54**
Change in short-term borrowing	-16	81	-30	-20	-20	-11	0	0	0	0	0
Change in long-term borrowing	-63	69	-55	-51	-21	0	0	0	0	0	0
Change in equity and profit distribution	1	0	0	0	0	0	0	0	0	0	0
Dividends paid	0	-172	-38	-38	-47	-58	-65	-62	-60	-56	-54
Other, net	-4	-3	3	1	0	0	0	0	0	0	0
Net change in cash and equivalents	**-12**	**81**	**-52**	**-30**	**-3**	**6**	**6**	**6**	**-2**	**-1**	**12**
Beginning cash and equivalents	20	9	90	38	8	4	10	16	22	20	19
Ending cash and equivalents	9	90	38	8	4	10	16	22	20	19	31

Source: Company data, DM BZ WBK estimates

Cersanit

Poland, Consumer goods

Reuters: CRSA.WA Bloomberg: CST PW

6 October 2005

Excellence at deluxe prices

Downgrade to REDUCE. Fair value at 123.0 PLN

Cersanit is one of the flagships of the Polish industry with an impressive growth track record and lucrative operational efficiency. But after the recent stock appreciation and due to the expected slowdown of growth it become overvalued. REDUCE.

We expect the 2H revenues and EBITDA to be strongest in the company's history. As the company runs at full capacity and it postponed any additional capex we expect the revenues to expand at moderate rate in coming years.

As the company does not want to increase the production capacity in Poland we assumed the company will be a cash-cow. It may however use its strong financial position to acquire disinvesting weaker market players or seek investment opportunities to broaden its product range.

Our view on the potential acquisition of controlling stake of Opoczno from Enterprise Investors would is positive if traded at the current attractive prices. But as the production profile of both companies is very similar the potential synergies are quite limited given overcapacity of the ceramic tiles industry.

The key of future growth are the potential future investments in other CEE countries. The most probable project, a planned greenfield sanitary ceramic plant in Ukraine will be not operational before the end of 2006. Given the very initial phase of potential projects and undetermined scope we did not include them in our financial projections.

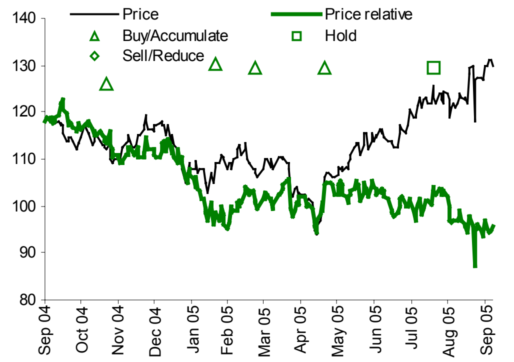
Full capacity utilization means Cersanit will be not devoted to fight aggressively for the market share on the ceramic tiles market. Settled oligopoly ceramic sanitary market means the operational margins of Cersanit are fundamentally much safer than those of Opoczno. The only identified long term threat is the increasing EU import of ceramic ware from low cost emerging countries like China.

Fig. 47. Cersanit: Financial summary
PLN in millions, unless otherwise stated

	2004	2005E	2006E	2007E	2008E
Revenues	583	655	687	705	730
EBITDA	178	193	196	199	204
EBIT	134	140	140	139	139
Net Profit	104	114	114	119	122
EPS (PLN)	7.84	8.55	8.60	8.93	9.18
P/E (x)	16.6	15.2	15.1	14.6	14.2
EV/EBITDA (x)	10.9	10.1	9.9	9.8	9.6

Source: Company data, DM BZ WBK estimates

Recommendation	Reduce
Price (PLN, 5 October 2005)	130.0
Fair value (PLN, current)	123.0
Target price (PLN, 12-months)	134.3
Market cap. (PLN m)	1,451
Free float (%)	51.1
Number of shares (m)	11.63
Average daily turnover 3M (shares)	5.9k
EURPLN	3.92
USDPLN	3.28



The price relative chart measures performance against the WIG 20 index. On 05/10/05 the WIG 20 index closed at 2508.90.

Main shareholders	% of voting rights
Michał Sołowow	48.9
ING NN pension fund	6.9
PZU pension fund	5.2

Company description

The largest producer of sanitary ceramics and the 3rd largest producer of ceramic tiles in Poland. Cersanit produces also other bathroom equipment and furniture.

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2005 results review and forecast

Fig. 48: Cersanit: Consolidated P&L account summary and forecasts
PLN in millions, unless otherwise stated

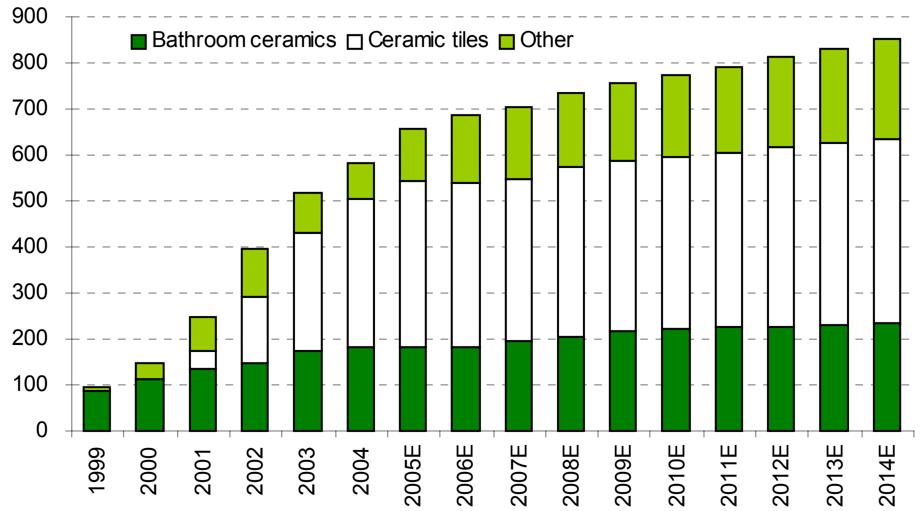
	1H2003	1H2004	1H2005	2H2003	2H2004	2H2005E	2005E
Revenues	**225.4**	**291.1**	**283.0**	**292.3**	**291.9**	**362.2**	**655.2**
COGS	135.2	152.7	151.6	146.5	154.8	361.1	361.1
Gross profit	**68.9**	**90.3**	**132.0**	**149.7**	**186.4**	**162.2**	**294.1**
Selling expenses	34.8	51.5	48.5	48.6	47.8	64.8	113.3
Administrative expenses	13.9	18.3	20.0	18.2	20.2	20.3	40.4
Other operating income net	-1.5	-0.9	-0.2	-2.0	-3.5	0.0	-0.2
EBITDA	**57.3**	**87.4**	**89.5**	**78.7**	**90.7**	**103.8**	**193.3**
Depreciation	17.3	19.7	26.3	19.1	24.0	26.7	53.0
EBIT	**40.0**	**67.7**	**63.2**	**59.6**	**66.7**	**77.1**	**140.3**
Financial Income/Costs net	-9.5	-5.8	-0.7	-23.5	-23.3	-14.7	-15.4
Profit before CIT	30.5	61.9	62.5	45.6	49.2	62.4	124.9
CIT	5.4	0.0	5.6	2.6	6.8	5.6	11.2
Net Income	**27.5**	**56.5**	**56.9**	**40.6**	**47.8**	**56.8**	**113.6**
Inventory	80,3	92	137	88	119	134	134
Gross margin	31%	31%	47%	51%	64%	45%	45%
EBITDA margin	25%	30%	32%	27%	31%	29%	30%
EBIT margin	18%	23%	22%	20%	23%	21%	21%
Net margin	12%	19%	20%	14%	16%	16%	17%

Source: Company data, DM BZ WBK estimates

The company runs at full production capacity and we expect the 2H revenues and EBITDA to be strongest in the company's history. The stockpiled additional inventories (as of end of 1H 2005) will help 3Q revenues that is traditionally the best quarter for the producers building materials.

As Cersanit the postponed any major additional capex in production capacity in Poland we expect the revenues to expand at moderate rate in coming years. Full capacity utilization means Cersanit will be not devoted to fight aggressively for the market share and its operational margins will be maintained. We assumed the company will be a cash-cow, but it may use its strong financial position to acquire disinvesting weaker market players or seek investment opportunities to broaden its product range.

Fig. 49. Cersanit: Revenues growth
PLN in millions, unless otherwise stated

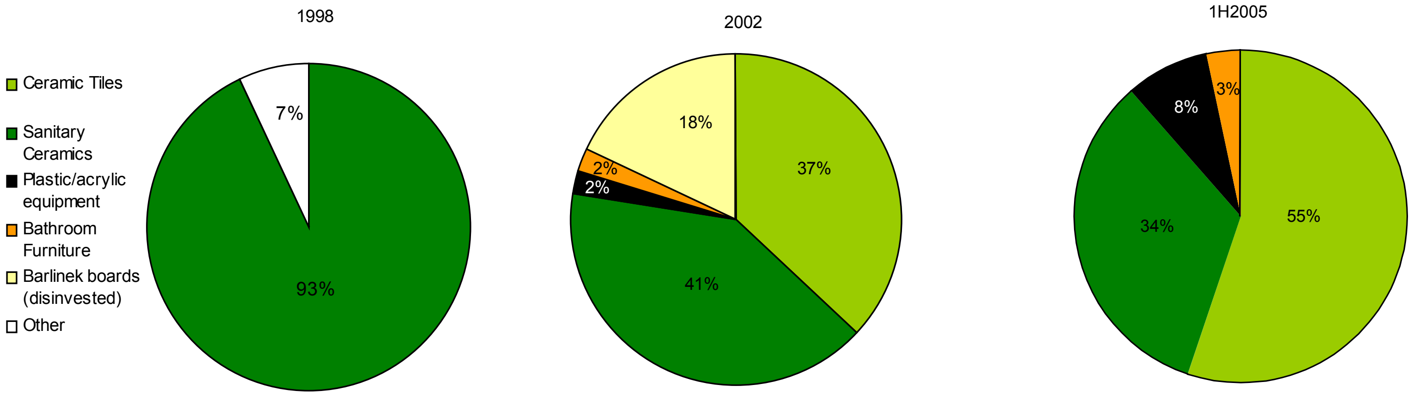


Source: DM BZ WBK estimates

For 2006 we do not assume any investments in additional production capacity and in the long perspective only maintenance capex enabling expansion of production capacity just to preserve the share on the growing market (volume escalating with GDP). Cersanit will run at full production capacity utilization.

Market segments of Cersanit

Fig. 50. Cersanit: Revenues segment split



Source: Company data

After only five years on the market, ceramic tiles have become the stronger leg of Cersanit. In 1H 2005, 55.1% of the group's revenues were generated by the Cersanit III tile subsidiary. Mirosław Jędrzejczyk, who become CEO in January 2005, has a ceramic tile background. He has lead Cersanit III since 2003 and prior to that he held managerial positions in Cersanit III and Paradyż Group.

But even now the diversified product offer remains the main strength of Cersanit. This is in line with the market tendency to perceive the bathroom as an integrated system of sanitary ceramics, plastic and steel accessories, ceramic wall and floor tiles and furniture. The business model of the major players on the "bathroom market" like Sanitec, Roca or Villeroy&Boch assumes coverage of all the connected with equipping bathrooms with the broadest possible offer - vertically to bathtubs, showers, bathroom furniture, steel/iron accessories (taps), heaters, etc.

Fig. 51. Cersanit: Market segments

Market segment	Annual Production capacity	Market share	Market place	Main Competition
Ceramic Tiles	19m m^2	19%	3	Opoczno, Paradyż
Sanitary Ceramics	2.2m pieces	35-40%	1	Sanitec Group, Roca
Shower cubicles	120ths pieces	20-25%	2-3	Sanplast, Kabi, Ravak
Acrylic products (Bath tubes, shower trays)	120ths pieces	15%	3	Sanitec Group, Roca (Poolspa), Ravak
Bathroom furniture	200ths pieces	12%	n/a	Sanitec Group (Koło); small manufacturers (market is very dispersed)

Source: Cersanit SA, DM BZ WBK estimates

The sanitary ceramics operations are run by the Cersanit I subsidiary located in Krasnystaw (Eastern Poland). The plant was thoroughly modernized after 2000 and now has production capacity of 2.2m of bathroom ceramics (washbasins, bidets, lavatory bowls, WC suits). The plant runs at full capacity.

The plastic/acrylic equipment (bathtubs, shower cubicles, shower trays) is produced by the Cersanit II subsidiary in Starachowice (Central-Eastern Poland). Additionally in 2001 the company launched production of bathroom furniture and in 2005 a new plant was added increasing the annual furniture production capacity to 200,000 pieces. Starachowice plant is located in a special economical zone – thus Cersanit II enjoys the CIT tax relief.

The main competitors include:

- Sanitec Group with 4 production facilities in Koło, Włocławek, Mińsk Mazowiecki and Ozorków. This company offers full spectrum of bathroom ceramics, bathtubs, shower cubicles and trays and bathroom furniture under domestic Koło and Panda brands. Distribution of other Sanitec Group brands like Keramag, Koralle and Albatros.
- Largest European producer of bathroom equipment Roca with 55 plants worldwide. In Poland Roca runs sanitary ceramic production plant in special economical zone in Gliwice (0.5m pieces capacity) and acrylic/iron bathtubs/equipment production plant Poolspa. Roca is expanding its ceramic production capacity to 1.3m pieces expected next year.
- Sanplast (Strzelno), the largest low-cost producer of shower cubicles and trays in Central Europe. The company produces also acrylic bathtubs. Sanplast started to build a broad product offer by acquisition in March 2004 of porcelain tiles producer Ceramika Gres and in June 2005 of Hoesch a German producer of high bathtubs.

The sanitary ceramic market tends to be very concentrated and the 3 main players (Cersanit, Sanitec, Roca) control ca. 80% of the market. The main players have dedicated product lines for each price segment and tend to avoid price wars. This means an oligopoly market characterized by relatively high margins. The other segments are more dispersed, but the obvious synergies on the sale side keep the profitability high even for furniture.

The main threat for the producers of bath ceramics and equipment is the potential flood of low-cost imported ware, especially from China. The Chinese imports already accounts for ca. 10% of the market limited to the low-price segment. The most affected are the products with relatively low transportation costs, like steel equipment, but the pressure is also exerted on ceramics. The perceived quality of Chinese goods is still very inferior, but it is reported to improve quickly. Given low custom duties and lack of import quotas to EU the low-cost importers are likely in long run to take control of the lower priced segment and to exert pressure on the margins in the mid-price segment.

Investment in Ukraine?

In March 2005 Cersanit announced it will construct new production plants in Russia or Ukraine. Since then no details nor progress reports were revealed. According to Ukrainian sources since July Cersanit is negotiating acquisition of a building site for the production plant in Vinnitsya (Central Ukraine), most probably at the site of the airplane producer “Vinnitskiy Avicionniy zavod”. If the project materializes it will be the key to the growth of Cersanit as the investments promised to the local authorities are impressive:

Fig. 52. Status of the Cersanit Ukraine project

Status of the project	Negotiations with the local authorities (district governor). Applied for the agreement of the Ukrainian Ministry of Industry for the site acquisition.
Next expected milestone	November 2005: establishing the Special Purpose Vehicle “Cersanit Ukraine”
1st phase investment	Sanitary ware plant for EUR 40m. Expected commission date: end of 2006
Expected total capex	USD 100m till 2010
Target employment	1,500

Source: Internet Site of Vinnitsya city; “Delovaya nedelya” July 2005

As the project is at very premature phase and since there are no official announcements on scope/time frame we did not include it into our forecast and valuation.

Financial forecast

Fig. 53: Cersanit: Consolidated P&L account summary and forecasts
PLN in millions, unless otherwise stated

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Revenues	**518**	**583**	**655**	**687**	**705**	**730**	**748**	**770**	**793**	**817**	**842**	**868**
COGS, o/w	299	306	361	380	392	410	424	440	458	477	481	494
Depreciation	36	44	53	56	60	64	69	75	81	87	79	79
Gross profit	219	277	294	307	312	321	324	330	335	340	361	374
Costs of sales	83	99	113	123	128	134	138	142	147	151	156	161
G&A expenses	32	39	40	44	46	48	49	50	52	54	55	57
Other operating profit/loss, net	(4)	(4)	(0)	0	0	0	0	0	0	0	0	0
Operating profit	**100**	**134**	**140**	**140**	**139**	**139**	**137**	**137**	**136**	**136**	**150**	**156**
EBITDA	**136**	**178**	**193**	**196**	**199**	**204**	**206**	**212**	**217**	**223**	**229**	**235**
Financial income/cost, net	(23)	(23)	(15)	(13)	(7)	(4)	(3)	(3)	(3)	(2)	(2)	(2)
Profit before income tax	**76**	**111**	**125**	**127**	**132**	**136**	**134**	**134**	**134**	**133**	**148**	**154**
Income tax	8	7	11	13	13	14	14	14	14	14	28	29
Net profit	**68**	**104**	**114**	**114**	**119**	**122**	**120**	**120**	**120**	**120**	**120**	**125**
EBITDA margin	26%	31%	30%	29%	28%	28%	28%	27%	27%	27%	27%	27%
Operating margin	19%	23%	21%	20%	20%	19%	18%	18%	17%	17%	18%	18%
Pretax margin	15%	19%	19%	18%	19%	19%	18%	17%	17%	16%	18%	18%
Tax rate	11%	6%	9%	10%	10%	10%	10%	10%	10%	10%	19%	19%
Net margin	13%	18%	17%	17%	17%	17%	16%	16%	15%	15%	14%	14%
Sales growth	32%	13%	12%	5%	3%	4%	2%	3%	3%	3%	3%	3%
EBITDA growth	46%	31%	9%	2%	1%	2%	1%	3%	3%	3%	3%	3%
Operating profit growth	54%	35%	4%	0%	-1%	0%	-2%	0%	0%	-1%	11%	4%
Pretax profit growth	91%	46%	12%	2%	4%	3%	-1%	0%	0%	0%	11%	4%
Net profit growth	94%	53%	9%	1%	4%	3%	-1%	0%	0%	0%	0%	4%

Source: Company data, DM BZ WBK estimates

Fig. 54: Cersanit: Consolidated Balance Sheet summary and forecasts
PLN in millions, unless otherwise stated

	2003	2004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Current assets	**314**	**413**	**389**	**417**	**444**	**472**	**499**	**526**	**552**	**583**	**605**	**630**
cash and equivalents	82	136	81	94	112	129	147	163	179	199	210	222
accounts receivable	143	156	173	181	186	193	197	203	209	216	222	229
inventories	88	119	134	140	144	149	153	157	162	167	172	177
other assets	1	2	2	2	2	2	2	2	2	2	2	2
Fixed assets	**377**	**448**	**497**	**503**	**509**	**515**	**522**	**528**	**535**	**538**	**550**	**561**
property, plant and equipment	375	444	494	500	506	513	519	526	533	536	547	558
intangible assets	0	1	0	0	0	0	0	0	0	0	0	0
investments	1	3	3	3	3	3	3	3	3	3	3	3
Total assets	**691**	**861**	**886**	**920**	**953**	**987**	**1 020**	**1 054**	**1 087**	**1 121**	**1 155**	**1 191**
Current liabilities	**243**	**307**	**300**	**305**	**308**	**312**	**315**	**318**	**322**	**326**	**330**	**334**
Interest–bearing liabilities	119	194	194	194	194	194	194	194	194	194	194	194
Accrued expenses and other payables	106	113	105	110	113	117	120	123	127	131	135	139
Other current liabilities	18	1	1	1	1	1	1	1	1	2	2	2
Non-current liabilities	**160**	**161**	**81**	**81**	**81**	**81**	**81**	**81**	**81**	**81**	**81**	**81**
Interest–bearing liabilities	160	161	81	81	81	81	81	81	81	81	81	81
Other long-term liabilities	0	0	0	0	0	0	0	0	0	0	0	0
Equity	**288**	**392**	**506**	**534**	**564**	**594**	**624**	**654**	**684**	**714**	**744**	**775**
Common stock	13	13	13	13	13	13	13	13	13	13	13	13
Retained earnings	206	274	379	407	432	459	491	521	551	582	611	638
Net profit	68	104	114	114	119	122	120	120	120	120	120	125
Total liabilities and equity	**691**	**861**	**886**	**920**	**953**	**987**	**1 020**	**1 054**	**1 087**	**1 121**	**1 155**	**1 191**

Source: Company data, DM BZ WBK estimates

Fig. 55: Cersanit: Consolidated Cash Flow summary and forecasts
PLN in millions, unless otherwise stated

	2 003	2 004	2005E	2006E	2007E	2008E	2009E	2010E	2011E	2012E	2013E	2014E
Cash flow from operations	**66**	**92**	**128**	**161**	**173**	**178**	**184**	**188**	**194**	**199**	**191**	**196**
Net profit	68	104	114	114	119	122	120	120	120	120	120	125
Depreciation and amortisation	36	44	53	56	60	64	69	75	81	87	79	79
Changes in WC, o/w	-45	-38	-39	-10	-5	-8	-5	-7	-7	-7	-8	-8
inventories	-22	-31	-15	-7	-4	-5	-4	-5	-5	-5	-5	-5
receivables	-25	-13	-16	-8	-5	-7	-5	-6	-6	-6	-7	-7
payables	2	7	-8	5	3	4	3	4	4	4	4	4
Other, net	6	-18	0	0	0	0	0	0	0	0	0	0
Cash flow from investment	**-77**	**-116**	**-102**	**-62**	**-66**	**-71**	**-76**	**-81**	**-88**	**-90**	**-90**	**-90**
Additions to PPE	-77	-113	-103	-62	-66	-71	-76	-81	-88	-90	-90	-90
Additions to intangibles	0	0	0	0	0	0	0	0	0	0	0	0
Change in long-term investments	-1	-1	0	0	0	0	0	0	0	0	0	0
Other, net	0	-1	0	0	0	0	0	0	0	0	0	0
Cash flow from financing	**82**	**76**	**-80**	**-86**	**-89**	**-91**	**-90**	**-90**	**-90**	**-90**	**-90**	**-93**
Change in long-term borrowing	-29	1	-80	0	0	0	0	0	0	0	0	0
Change in short-term borrowing	51	75	0	0	0	0	0	0	0	0	0	0
Change in equity and profit distribution	60	0	0	0	0	0	0	0	0	0	0	0
Dividends paid	0	0	0	-86	-89	-91	-90	-90	-90	-90	-90	-93
Other, net	0	0	0	0	0	0	0	0	0	0	0	0
Net change in cash and equivalents	**70**	**52**	**-55**	**13**	**18**	**16**	**18**	**17**	**16**	**19**	**11**	**12**
Beginning cash and equivalents	13	84	136	81	94	112	129	147	163	179	199	210
Ending cash and equivalents	84	136	81	94	112	129	147	163	179	199	210	222

Source: Company data, DM BZ WBK estimates

Appendix 1: Ceramic Tiles market overview

Products & Technologies

Ceramic tiles are building materials used for finishing floors (interior house floors, exterior floors (terraces), floors of public buildings, factory floors, and swimming pools) and wall facings (interior facing of houses, especially bathrooms and kitchens, and exterior facings). Multitudes of uses means there is no “universal” product. This gives a substantial advantage to the large-scale manufacturers that are able to cover all the market needs with a variety of products.

Basically there are 2 sets of product requirements affecting customer choice:

- Required mechanical abrasion/scratch resistance, water absorption, frost resistance, adhesion, and stain/detergent resistance, etc. For each tile application the importance of mechanical properties is different and emphasis is placed differently. Usually floor tiles have dense bodies, low water absorption and high mechanical abrasion resistance. Wall tiles tend to have porous body, higher water absorption, relatively high wear resistance, but more interesting colorings. For the exterior floor tiles, frost resistance and adhesion play the key role. Kitchen tiles usually are smaller in size and have high chemical stain resistance.
- The decorative aspect is the key marketing factor, at least in the medium and higher price segments of the market. Depending on customer preferences and fashion trends, the products vary in coloring, decoration, size and surface finish. Producers are forced to run a multitude of “collections” to fit exactly into various customer tastes – the more product lines, the larger is potential market penetration. Distinctive and innovative products (like tiles with unique decorations or exceptionally large face) are sold at much better prices, but this premium is usually short-lived as successful ideas are copied (within months) as the relatively simple technology allows for quick adaptations. Colorings and surface finish are also the main factors that differentiate the manufacturing costs of tiles.

As a product, ceramic tiles are basically a fusion of mineral plastic and non-plastic materials formed (usually by pressing) into tiles and then fired (depending on technology) at temperatures of 900-1400 Celsius. Depending on technological advancement, ceramic tiles range from commodities that don’t differ much from glazed basic bricks to unique polished natural stone imitations with superior mechanical and esthetic characteristics.

There is a variety of products of the ceramic tiles industry depending on the mix of raw materials and technology used. The most common tile types include:

Glazed double fired tiles (Bicottura): a “traditional” technology of two separate firings, the first firing of body (bisque) alone, the second firing of the tile body after the glaze or decoration has been applied. This is technology that has been used most extensively worldwide for decades thanks to its ease of production of richly decorated or colorful tiles. Due to high water absorption levels and relatively high wear characteristics, bicottura tiles are used primarily for wall tiles (known also as Majolica as a typical traditional Italian product) or for floors with very little foot traffic.

Glazed single-fired tiles: technologies developed in the 1980s of a single-firing of the tile leading to the fusion of the clay body with the glaze. The term Monocottura refers mainly to single-fired floor tiles while Monoporosa has become the main production technology of uni-colour wall tiles (especially those with very large faces). While both double-firing and single-firing methods can produce tiles of similar quality, single firing is a more efficient and easier-to-automate process, which in turn results in production cost reductions.

Clay stoneware floor tiles: a quite broad group of dense-body tiles (as compared to porous-body wall tiles) with low water absorption and high mechanical abrasion resistance. Most floor tiles are glazed with scratch-resistant glazes produced in a single-firing or triple firing process. But there are multiple variations, e.g. terracotta (cotto) which is an unglazed, quite porous floor tile made from a selection of red clays popular for its rustic look.

Ceramic decorations: richly decorated tiles, produced mainly in multiple-firing technology (each coloring fired separately). These tiles are supplementary to the main product lines ("collections"), but due to their very high unit cost they account for ca. 10%-15% of total revenues of tile producers on average.

Porcelain stoneware (gres porcelanato): innovative technology variation of dry-dust-pressing mineral materials (selected clays, kaolinitic minerals, quartz and feldspar) then firing it at a relatively high temperature of ca. 1250 degrees Celsius. This technology results in a uniform dense tile with a smooth finish and high mechanical strength and much better (very low) water absorption. Similar to "standard" tile ceramics, porcelain tiles are produced for a variety of purposes (interior and exterior floors and walls) and in various surface finish types (glazed, non-glazed matt, polished, and semi-polished). Three general porcelain gres quality standards include:

- "Salt-and-pepper" granular structure gres. Due to its rough structure and spotted coloring it is the easiest to manufacture and therefore it is a low-margin product. Almost exclusively used as a mechanically-superior and cost effective (retail prices in DIYs range from 15-20 PLN/m2) substitute for "typical" floor/paving/terrace ceramic tiles.
- Standard-class: non-glazed (various surface types) and glazed tiles with higher quality and interesting colorings for outdoor and indoor purposes. Typical retail for these products range from 40-60 PLN/m2, as compared to 25-50 PLN/m2 for domestic medium-quality ceramic tiles.
- High-class porcelanato: unglazed polished natural stone imitations or glazed, richly decorated large-face tiles. Another high-priced sub-segment are the technical gres tiles with superior mechanical properties used for industrial applications.

Dry-pressed porcelain tile is the product of the moment, radically increasing its market share at the expense of other technologies. Especially the floor tiles are cannibalized by gres tiles due to superior mechanical properties of the latter. The Polish producers, with their relatively modern production capacities, have an extraordinary high share of porcelain gres tiles production capacity which seem to be an apparent asset in the fight for the European market. On the other hand the modern advanced ceramic ovens offer quite a broad range of firing temperatures – this means retooling the production lines from one type of tile to another (clay stoneware to porcelain and vice versa) is a relatively fast and easy process.

It is important to stress that despite the differences in technology and raw material mix, the manufacturing cost of various tile body types do not differ very much. The main difference in the manufacturing cost of tiles does not come from the "body" of the tile but from the surface (glazing, colouring, polishing). In particular, the production of porcelain tiles is only slightly more expensive than clay stoneware tiles of comparable decorative properties.

Fig. 56. Italy 2003: ceramic tiles manufacturing cost
In EUR/sgm

Type	Average cost
Glazed porcelain	5.64
Unglazed porcelain	5.92
Average ceramic tile	5.25

Source: Assopiastrelle (Italian ceramic producers association)

The price difference on the retail market between the tile types comes mainly from the high margins on the porcelain tiles and large-face tiles obtainable thanks to the premium on new and superior products. But as the technologies of production are wide-spread and easy-to-upgrade, this premium diminishes over time.

The technology of ceramic tiles is relatively uncomplicated and does not require exceptionally unique competencies. At the beginning of Poland's economic transition in the late 1980s, the domestic know-how of technology was basically limited to Opoczno. Since then several new production companies have been founded by Opoczno's high and middle management (incl. its main competitor Ceramika Paradyż) and the know-how uniqueness gradually diluted. The production is scalable and the cost of a new small-sized production facility is not a barrier impossible to overcome for a small business. So basically there is no major entry barrier for new production concerns. Actually according to some sources up to 20% of the domestic demand (especially in the lower prices segment) is satisfied by very small producers.

Market segmentation (prices)

The cheaper, lower-quality and small faced (20x25cm wall tiles and 30x30cm floor tiles) cost the end consumer around 15-20 PLN/m2. This is a typical DIY merchandize and it accounts for the majority of sales volume on the Polish ceramic tiles market. The competition here is tough as all the major domestic players offer very similar products. Surprisingly in DIY there are relatively many really cheap Italian tiles (especially floor tiles), and some imports from other countries (such as Turkey or the Czech Republic).

The majority of "collections" of the Polish tile producers is targeted toward the medium market segment at 35-45 PLN retail price range. This region is almost exclusively populated by Polish producers, with a broad range of products and interesting decorations.

The upper segment belongs to polished porcelain, in which the Italian and Spanish imports hold the ground but the segment is aggressively targeted by Polish producers trying to take advantage of this high-margin segment. Very high prices (PLN 60-200+/m2) are achieved also by some "traditional" ceramic tiles and mosaics, but exclusively by the best designs of Western European producers, especially the top brands like Villeroy&Boch.

Fig. 57: Examples of ceramic tiles pricing on the polish retail market

Retail prices incl. VAT	Low price segment	Medium price segment	High price segment
Wall tiles	Ceramika Color: “Atis” 20x25cm; PLN 15.95 PLN/m^2 Opoczno (Primacer): “Pink cheap”; 20x25cm; 19.95 PLN/m^2	Opoczno: “Diuna Orange”; 22.5x30cm; PLN 38.95 PLN/m^2 Ceramika Końskie: “Temida” ; 20x25cm; 32.95 PLN/m2 Cersanit: “Pallada Azul”; 25x35cm; 42.95 PLN/m^2	Aparici (Spain): “Tropica Naranja”; 25x36cm; 100 PLN/m2 Villeroy&Boch: “White glossy”; 32x58cm; 233.45 PLN/m^2 Jasba (Germany): “Feather Grey Glossy” mosaics; 440 PLN/m^2
Floor tiles	Opoczno: “Itaka Turkus”; Floor Glazed; 40x40cm; PLN 14.95 PLN/m^2 Ceramiche Di Sassuolo (Italy): “Fire Grigio“ glazed Monocottura red body; 30x30cm; 14.95 PLN/m^2	Tubądzin: “Kaledonia 2”; Floor glazed; low water absorption; 33x33cm; PLN 44.95 PLN/m^2 Paradyż: “Delta beige”; 33x33cm: PLN 41.95 PLN/m^2 Cersanit: “Selena Verde”; 33x33cm; PLN 37.95 PLN/m^2	Aparici (Spain): “Saltilo Naranja”; terracotta 36x36cm; 92 PLN/m2 Jasba (Germany): “Centino foggy grey” floor tile; 30x40cm; 162 PLN/m^2
Gres tiles	Cersanit: “Agros” salt&pepper unglazed floor porcelain; 30x30cm; PLN 14.95 PLN/m^2	Cersanit: “Sicilia” Porcelain Floor 45x45cm; PLN 45 PLN/m^2 Opoczno: “Kastor” Porcelain Glazed Floor 30x30cm; PLN 36.95 PLN/m2 Ceramika Gala: “Terra Prato”; Porcelain Glazed; 33x33cm; PLN 34.90 PLN/m	Italgraniti (Italy): “Indian White” polished porcelain; 30x30cm; 187 PLN/m^2 Nowa Gala: “OR02” polished porcelain; 73 PLN/m^2 Opoczno: “Saturn Malachit” polished porcelain; 45x45cm; PLN 117 PLN/m^2

Source: DM BZWBK; prices from selected retail stores, Warsaw September 2005

Distribution

While the production of ceramic tiles is relatively simple, the art of effectively selling them is much tougher and is effectively the main entry barrier for potential newcomers. In Poland direct retail sales by factory outlets and exposition centers is minimal. Distribution of ceramic tiles basically follows 3 different paths:

“Traditional” distribution: involving wholesalers acquiring the tiles directly at plants’ warehouses. Wholesalers distribute the tiles to specialty retail shops or sell them directly to end consumers at their warehouse stores. The exposition furniture (“expositors”) is provided by the producers – actually this is the main marketing effort and marketing cost of the tile producers. In Opoczno’s case, the number of expositors amounts to 10 thousand. Retail shops often take the form of “bathroom boutiques” offering the whole spectrum of products and accessories for bathrooms (tiles, sanitary ceramics, plastic and steel sanitary ware, and furniture). The retail distribution network is very dispersed: 2 thousand companies having 2.5 shops.

DIY market: large shopping chains are supplied directly by producers. In this case producers are responsible for logistics and are directly exposed to the transportation costs. Generally DIY put less emphasis on quality standards and brand products and offer lower prices to customers.

Institutional customers are served by a dedicated sales force (regional representatives) of the production companies.

As in all other markets, large producers have an advantage of a stronger bargain position with distributors. The wholesalers tend also to cooperate with a limited number of suppliers to minimize overhead costs. There are some additional specific factors that enhance the tendency to concentrate the ceramic tile market:

- Small retailers do not have enough exposition space to cover more than the few top producers.
- DIY's require stable and quick deliveries – this is easier and cheaper to optimize for large producers with larger logistics resources.
- The producer-owned exhibition showrooms are very helpful in assisting sales efforts. Customers of ceramic tiles require to "see and touch" the product before reaching a decision. Even more important are the visits of retailers that have to carefully select the products for their limited shopping space. Exhibition showrooms are a quite costly infrastructure (including "boxes" – imitations of bathrooms to show full decorative aspect of a given tile collection).

Appendix 2: Ceramic tiles industry in Poland at glance

Name	ownership	Capacity [million m² p.a.]	Plants	Year of launching	Revenues on Tiles 2003 [PLN mln]	Revenues on Tiles 2004 [PLN mln]	Employment	Export share	Products	Additional Info
Opoczno	public listed complany	28.0	Opoczno	1883	361	425	1181	17% (2004)	whole spectrum of wall, floor, and gres tiles	In April 2005 2 new production lines were opened in the "Mazowsze" plant increasing the maximum capacity by 6 mln m^2 to ca. 28 mln m^2. In total PLN 234 mln invested in 2000-2005 for plant modernizations.
Ceramika Paradyż	private company (Andrzej Wodzyński + Barbara Kazimierska)	32.0	5 production facilities: Opoczno (mozaics, decorations, small face tiles) , Paradyż (standard tiles), 3 plants in Tomaszów Mazowiecki (gres, large face tiles, floor tiles)	1993	239	402	na	40% (1H2005)	whole spectrum of wall, floor, and gres tiles	In June 2005 a new (fifth) production plant was opened in Tomaszów adding capacity of 9 mn m^2 large-face gres tiles at the cost of ca. 120 PLN million. Tomaszów Mazowiecki plants are located in the special economicial zone (Łódź)
Cersanit (Cersanit III)	public listed complany	19.0	Wałbrzych	2001	212	320	880	28% (2004)	whole spectrum of wall, floor, and gres tiles	Started in 2001 with bottom-shelf products and since then constantly shifts its product mix upwards. Decleared full utilization of ceramic tiles capacity in 2005; no plans to increase capacity in tile sector; Company produces also sanitary ceramics and other bathroom accessories;
Ceramika Tubądzin	private company	7.6	2 production facilities (Tubądzin, Ozorków)	1987	na	180	700	27% (2004)	whole spectrum of wall, floor, and gres tiles	
"Grupa Końskie"	group of connected private companies	6.2	Mniszków (Cer-Rol); Końskie (Ceramika Końskie; Stargres)	1990; 1996; 2005	91	na	na	na	bicottura; gres	New production plant of Stargres company was launched in July 2005 with target capacity of 3 mn m^2 floor gres tiles.
Ceramika Gres	Sanplast (96%) - private company owned by Podraza family	5.0	Kopaniny (Końskie)	2001	59	na	210	na	only floor tiles (teracotta and non-glazed gres)	Plans to launch production of glazed gres tiles. Sanplast (leading Polish producer of shower enclosures and trays) acquired 96% of the shares from Innova Capital private equity fund in March 2004 after severe financial losses in 2002 and 2003.
Ceramika Nowa Gala	public listed complany	4.7	Końskie	1995	65	88.7	279	28% (1H2005)	gres tiles only	2,1 mn m^2 ceramic tiles sold in 2003. New plant (capacity 2.0m m^2 for PLN 27m) was launched in 1Q2005 financed by 2004 IPO. Plans for another plant upgrade (PLN 70m) were postponed due to tough market situation
Polcolorit	public listed complany; controlled (69% votes) by Marconi family	4.5	Piechowice (Jelenia Góra)	1984	77	92	250	30% (2004)	bicottura; gres	In May 2005 the construction of new plant in Piechowice has begun. In the first stage capacity of 2,25 mn m^2 gres tiles at the cost of ca. 56 PLN million is to be commissioned in 2Q2006. Target new capacity 4,5 mn m^2 increasing the future capacity of the Polcolorit - Ceramica Marconi Group to 9mn m^2.
ZP Jopex	private company (Franciszek Jopek)	2.5	Zabrze	1989	48	na	na	na	porcelain wall and floor tiles	company produces also sanitary ceramics
ZPiWS Ceramika Pilch	Private: Edward Pilch family	2.0	Jasienica (Bielsko Biała)	1989	44	na	na	na	bicottura wall and floor tiles	company produces also sanitary ceramics
Ceramika Kopaniny		1.5	Kopaniny (Końskie)	1994	na	na	na	na	bicottura wall tiles	
Ceramika Eva		1.5	Wyry (Katowice)	1998	na	na	na	na	bicottura and monocottura	
Cerkolor; Ceramika Avanti		1.5	Parczówek (Opoczno region); Czeladź	1999	64	na	200	na	wall/floor tiles + decorated/strip tiles for kitchens and bathroom	bulk of production capacity comes from the plant launched in 2000

Source: Company Data; IPO Prospecti of Polcolorit, Nowa Gala, Opoczno; "Wokół Płytek Ceramicznych"; "Rzeczpospolita"; Monitor Polski B; DM BZ WBK estimates

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In preparing this document Dom Maklerski BZ WBK S.A. made use of the following valuation methods:
1) discounted cash flows ("DCF"); and
2) comparative.
The DCF valuation method is based on expected future discounted cash flows. One advantage of the DCF valuation method is that it takes into account all cash streams reaching the Issuer and the cost of money over time. Some disadvantages of the DCF valuation method are that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The comparative valuation method is based on the economic rule of "one price". Some advantages of the comparative valuation method are that the analyst need only estimate a small number of parameters; the valuation is based on current market conditions; the relatively large accessibility of indicators for companies being compared; and that there is an extensive knowledge of the comparative method among investors. Some disadvantages of valuation by the comparative method are the considerable sensitivity of the results of the valuation on the choice of companies to the comparative group; the method can lead to a simplification of the picture of the company which in turn can lead to omitting certain important factors (e.g. growth dynamics, extra-operational assets, corporate governance, the repeatability of results, differences in applied accounting standards); and the uncertainty of the effectiveness of a market valuation of companies being compared.

Explanations of special terminology used in the recommendation:
EBIT – earnings before interest and tax
EBITDA – earnings before interest, taxes, depreciation, and amortization
P/E – price-earnings ratio
EV – enterprise value (market capitalisation plus net debt)

PEG - P/E to growth ratio
EPS - earnings per share
CPI – consumer price index
WACC - weighted average cost of capital
CAGR – cumulative average annual growth
P/CE – price to cash earnings (net profit plus depreciation and amortisation) ratio
NOPAT – net operational profit after taxation
FCF - free cash flows
BV – book value
ROE – return on equity

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