

59/2023/GPW (126) December 19, 2023

This report is prepared for the Warsaw Stock Exchange SA within the framework of the Analytical Coverage Support Program 4.0.

Grodno

2Q23/24 financial results review	2
Growth via acquisitions.....	2
Recent events.....	2
Upcoming events.....	2
Financial forecast.....	3
Valuation	3
Recommended action.....	3
Catalysts	4
Risk factors	4
Competitive advantages.....	4
Disclaimer	5

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Analyst: Maciej Wewiórski

Sector: Construction materials
Fundamental rating: Hold (→)
Market relative: Neutral (→)
Price: PLN 10.98
12M EFV: PLN 11.8 (↓)

Market Cap: US\$ 43 m
Bloomberg code: GRN PW
Av. daily turnover: US\$ 0.03 m
12M range: PLN 9.50-15.66
Free float: 34.2%

Grodno

2Q23/24 financial results review

2Q23/24 financial results turned to be weaker than we expected due to tighter competition and cost pressure.

Lower interest of retail investors in PV installations coupled with falling prices of PV modules is responsible for a yoy decline of 2Q23/24 revenues to a great extent, though it should be noted that 1H23/24 sales grew 2% yoy on the contracting market. According to data collected by the Union of Electrotechnical Distribution Employers SHE, the electrotechnical wholesale sales fell by 4% at the same time. Investors curbed their projects which is corroborated by a low number of construction permits issued.

In 2Q23/24 a significant pressure on margins was observed along with the competition tightening that was caused by the electrotechnical market slowdown. Additional pressures on external services costs and other costs categories led to a considerable EBIT drop (down 54% yoy).

2Q23/24 financial costs proved to be higher than we expected which – with lower revenues – resulted in NI resting below our forecasts.

Growth via acquisitions

The growth pace of Grodno's revenues and profits accelerated with 11 acquisitions carried out to date. We consider the Company's takeover transactions as successful and value-adding and believe we may see more attractive acquisitions in the future given favorable pricing of smaller competitors. At the moment, Grodno's priority seems to be its market position's strengthening, albeit the pressure exerted by the competition is strong. Grodno estimates its market share at 12-13%. After the acquisition of TIM and Kaczmarek Electric the Würth Group's share in the Polish market reached c. 25%. Grodno intends to participate in the market consolidation taking advantage of the slowdown which should favor this

Guide to adjusted profits

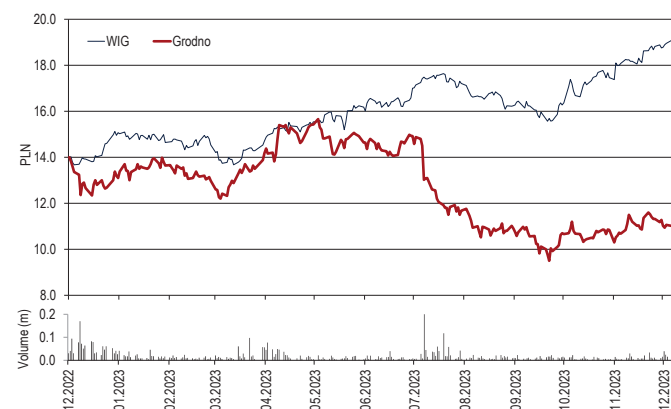
No factors necessitating adjustments.

Key data

IFRS consolidated		2022/23	2023/24E	2024/25E	2025/26E
Sales	PLN m	1,228.5	1,179.0	1,202.6	1,238.7
EBITDA	PLN m	42.5	28.7	35.1	45.9
EBIT	PLN m	34.0	20.0	26.5	37.2
Net income	PLN m	22.3	8.9	15.6	26.4
EPS	PLN	1.45	0.58	1.01	1.71
EPS yoy chg	%	-49.0	-60.3	76.0	68.9
Net debt	PLN m	104.1	90.4	81.2	67.0
P/E	x	7.6	19.0	10.8	6.4
P/CE	x	5.5	9.6	7.0	4.8
EV/EBITDA	x	6.4	9.0	7.1	5.1
EV/EBIT	x	8.0	12.9	9.5	6.3
EV/Sales	x	0.2	0.2	0.2	0.2
Gross dividend yield	%	7.7	0.0	2.1	4.6
DPS	PLN	0.84	0.00	0.23	0.51
No. of shares (eop)	m	15.4	15.4	15.4	15.4

Source: Company, DM BOŚ SA estimates

Stock performance



Source: Bloomberg

Recent events

1. Release of the financial report for 1H23/24: December 14, 2023

Upcoming events

1. Release of the financial report for 3Q23/24: February 15, 2024

kind of activities and help strengthen the Company's position in the future. The Company plans more acquisitions. There are quite a few enterprises on the market generating revenues below PLN 100 million and troubled by both, diminishing earnings and succession issues.

Fig. 1. Grodno; 2Q23/24 financial results

IFRS, consolidated (PLN m)	2Q23/24	2Q22/23	yoy chg	2Q23/24E DM BOŚ	1-2Q23/24	1-2Q22/23	yoy chg
Sales	306.3	317.9	-4%	306.1	597.1	584.3	2%
EBITDA	6.7	11.4	-41%	10.7	15.2	25.0	-39%
EBITDA margin	2.2%	3.6%	-	3.5%	2.5%	4.3%	-
EBIT	4.3	9.3	-54%	8.3	10.4	21.1	-51%
EBIT margin	1.4%	2.9%	-	2.7%	1.7%	3.6%	-
Net income	0.2	5.0	-95%	5.9	4.8	13.8	-65%
Net income margin	0.1%	1.6%	-	1.9%	0.8%	2.4%	-

Source: Company, DM BOŚ SA estimates

Financial forecast

Weak 1H23/24 figures made us cut our forecasts. The slowdown on the electrotechnical market is more severe than we assumed, hence we lower our sales expectations. Due to cost pressures and tighter competition we lower the EBIT margin for both, FY23/24E and FY24/25E from 3% and 3% expected earlier to 1.7% and 2.2%, respectively.

Valuation

The incorporation of the lower risk free rate and valuation horizon forward shift in time offsets the cut of our financial forecasts partially. Our 12M EFV

constituting a 50%–50% mix of the DCF FCFF method and peer-relative exercise, falls to PLN 11.8 per share. The DCF FCFF/peer-relative valuation yields PLN 15.1/ 8.5 per share (previously PLN 17.2/ 12.6 per share).

Recommended action

High volatility of product prices and disruptions in demand and supply do not support the stabilization of profitability. Hence, the visibility of Grodno's financial results in the upcoming quarters will not be high, we believe, and we maintain our neutral stance towards Grodno's equities.

Catalysts

1. Warehouse space optimization
2. Rising electricity prices for end-users
3. New support programs for the RES segment investors
4. Further acquisitions of peer companies (to-date Grodno has concluded 10 takeovers)
5. Automation of warehouse storage and distribution processes
6. Successful development of e-commerce channel in B2C and B2B segments

Risk factors

1. Rising generation costs of suppliers because of raw materials prices growth and lack of possibility to transfer the prices growth onto customers
2. Pressure on wages growth
3. Sales seasonality
4. Dependence on main suppliers
5. Insolvency of clients
6. Bad inventories management
7. IT system crashes
8. Impact of the majority shareholders controlling 79.3% of the votes on the GSA
9. Inability to reach strategic goals (annual growth of sales at 10% by 2024/25)
10. Withdrawal from/ limits imposed on the government support programs for the RES segment investors
11. Inability to continue further lucrative acquisitions of peer companies
12. COVID-19 pandemic (shortages of components necessary for the production or lack of goods due to broken supply chains)

Competitive advantages

1. Strong geographic diversification (one of the most extensively developed sales network among independent distributors of electrotechnical materials)
2. Exposure to the fast growing segments of the electrotechnical market (photovoltaics and heat pumps currently, earlier LED lighting)
3. Comprehensive offer including consulting services, design and construction
4. Numerous acquisitions all of which proved to be value accretive
5. A vast client base including households, SMES, local and regional government units, and industrial plants as well
6. Lack of dependence on one/few suppliers
7. Multiple points of sale (suppliers more willing to cooperate with the big partner with a well-developed logistic base)

BASIC DEFINITIONS

A/R turnover (in days) = $365/(\text{sales}/\text{average A/R})$
Inventory turnover (in days) = $365/(\text{COGS}/\text{average inventory})$
A/P turnover (in days) = $365/(\text{COGS}/\text{average A/P})$
Current ratio = $(\text{current assets} - \text{ST deferred assets})/\text{current liabilities}$
Quick ratio = $(\text{current assets} - \text{ST deferred assets} - \text{inventory})/\text{current liabilities}$
Interest coverage = $(\text{pre-tax profit before extraordinary items} + \text{interest payable})/\text{interest payable}$
Gross margin = $\text{gross profit on sales}/\text{sales}$
EBITDA margin = $\text{EBITDA}/\text{sales}$
EBIT margin = EBIT/sales
Pre-tax margin = $\text{pre-tax profit}/\text{sales}$
Net margin = $\text{net profit}/\text{sales}$
ROE = $\text{net profit}/\text{average equity}$
ROA = $(\text{net income} + \text{interest payable})/\text{average assets}$
EV = $\text{market capitalization} + \text{interest bearing debt} - \text{cash and equivalents}$
EPS = $\text{net profit}/\text{no. of shares outstanding}$
CE = $\text{net profit} + \text{depreciation}$
Dividend yield (gross) = $\text{pre-tax DPS}/\text{stock market price}$
Cash sales = $\text{accrual sales corrected for the change in A/R}$
Cash operating expenses = $\text{accrual operating expenses corrected for the changes in inventories and A/P, depreciation, cash taxes and changes in the deferred taxes}$

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

KEY TO INVESTMENT RANKINGS

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

Buy – fundamentally undervalued (upside to 12M EFV in excess of the cost of equity) + catalysts which should close the valuation gap identified;
Hold – either (i) fairly priced, or (ii) fundamentally undervalued/overvalued but lacks catalysts which could close the valuation gap;
Sell – fundamentally overvalued (12M EFV < current share price + 1-year cost of equity) + catalysts which should close the valuation gap identified.

This is a guide to expected relative price performance:

Overweight – expected to perform better than the benchmark (WIG) over the next quarter in relative terms
Neutral – expected to perform in line with the benchmark (WIG) over the next quarter in relative terms
Underweight – expected to perform worse than the benchmark (WIG) over the next quarter in relative terms

The recommendation tracker presents the performance of DM BOŚ S.A.'s recommendations. A recommendation expires on the day it is altered or on the day 12 months after its issuance, whichever comes first.

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

Distribution of DM BOŚ's current recommendations

	Buy	Hold	Sell	Suspended	Under revision	Not rated
Numbers	46	23	9	9	0	4
Percentage	51%	25%	10%	10%	0%	4%

Distribution of DM BOŚ's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision	Not rated
Numbers	26	39	13	9	0	4
Percentage	29%	43%	14%	10%	0%	4%

Banks

Net Interest Margin (NIM) = $\text{net interest income}/\text{average assets}$
Non interest income = $\text{fees\&commissions} + \text{result on financial operations (trading gains)} + \text{FX gains}$
Interest Spread = $(\text{interest income}/\text{average interest earning assets})/(\text{interest cost}/\text{average interest bearing liabilities})$
Cost/Income = $(\text{general costs} + \text{depreciation})/(\text{profit on banking activity} + \text{other net operating income})$
ROE = $\text{net profit}/\text{average equity}$
ROA = $\text{net income}/\text{average assets}$
Non performing loans (NPL) = loans in 'basket 3' category
NPL coverage ratio = $\text{loan loss provisions}/\text{NPL}$
Net provision charge = $\text{provisions created} - \text{provisions released}$

DM BOŚ S.A. generally values the covered banks via two methods: comparative method and fundamental target fair P/E and target fair P/BV multiples method. The advantage of the former is the fact that it incorporates the current market assessment of the value of the company's peers. The weakness of the comparative method is the risk that the valuation benchmark may be mispriced. The advantage of the fundamental target fair P/E and target fair P/BV multiples method is its independence of the current market valuation of the comparable companies. The weakness of this method is its high sensitivity to undertaken assumptions, especially those related to the residual value calculation. Assumptions used in valuation can change, influencing thereby the level of the valuation. Among the most important assumptions are: GDP growth, forecasted level of inflation, changes in interest rates and currency prices, employment level and change in wages, demand on the analysed company products, raw material prices, competition, standing of the main customers and suppliers, legislation changes, etc. Changes in the environment of the analysed company are monitored by analysts involved in the preparation of the recommendation, estimated, incorporated in valuation and published in the recommendation whenever needed.

Distribution of DM BOŚ's current recommendations for the companies which DM BOŚ has supplied with material investment services within the last 12 months

	Buy	Hold	Sell	Suspended	Under revision	Not rated
Numbers	8	4	1	1	0	3
Percentage	47%	24%	6%	6%	0%	18%

Distribution of DM BOŚ's current market relative recommended weightings for the companies which DM BOŚ has supplied with material investment services within the last 12 months

	Overweight	Neutral	Underweight	Suspended	Under revision	Not rated
Numbers	5	6	2	1	0	3
Percentage	29%	35%	12%	6%	0%	18%

LT fundamental recommendation tracker

Analyst	Recommendation	Report date	Reiteration date	Distribution date	Expiry date	Performance	Relative performance	Price at issue/reiteration*	EFV (12 months)
Grodno									
Maciej Wewiórski	Buy	31.08.2021	-	31.08.2021	16.08.2022	4%	30%	15.34	20.60 →
Maciej Wewiórski	-	-	31.08.2021	31.08.2021	-	-	-	15.86	20.60 →
Maciej Wewiórski	-	-	07.10.2021	07.10.2021	-	-	-	15.60	20.60 →
Maciej Wewiórski	-	-	01.11.2021	02.11.2021	-	-	-	15.96	20.39 ↓
Maciej Wewiórski	-	-	04.11.2021	04.11.2021	-	-	-	16.42	20.39 →
Maciej Wewiórski	-	-	16.11.2021	17.11.2021	-	-	-	16.82	23.30 ↑
Maciej Wewiórski	-	-	05.12.2021	06.12.2021	-	-	-	16.10	23.30 →
Maciej Wewiórski	-	-	16.01.2022	17.01.2022	-	-	-	17.24	23.30 →
Maciej Wewiórski	-	-	07.02.2022	07.02.2022	-	-	-	18.10	23.30 →
Maciej Wewiórski	-	-	28.02.2022	28.02.2022	-	-	-	15.50	23.30 →
Maciej Wewiórski	-	-	14.04.2022	14.04.2022	-	-	-	19.98	23.30 →
Maciej Wewiórski	-	-	24.04.2022	25.04.2022	-	-	-	19.80	26.60 ↑
Maciej Wewiórski	-	-	26.05.2022	26.05.2022	-	-	-	17.48	26.60 →
Maciej Wewiórski	-	-	07.06.2022	08.06.2022	-	-	-	17.28	26.60 →
Maciej Wewiórski	-	-	15.07.2022	15.07.2022	-	-	-	16.14	26.60 →
Maciej Wewiórski	-	-	08.08.2022	09.08.2022	-	-	-	15.16	26.60 →
Maciej Wewiórski	Buy	16.08.2022	-	16.08.2022	09.08.2023	-25%	-40%	15.74	26.60 →
Maciej Wewiórski	-	-	02.09.2022	02.09.2022	-	-	-	15.80	26.60 →
Maciej Wewiórski	-	-	07.10.2022	07.10.2022	-	-	-	15.12	26.60 →
Maciej Wewiórski	-	-	28.10.2022	28.10.2022	-	-	-	15.34	26.60 →
Maciej Wewiórski	-	-	14.11.2022	14.11.2022	-	-	-	16.28	24.30 ↓
Maciej Wewiórski	-	-	01.12.2022	01.12.2022	-	-	-	15.72	24.30 →
Maciej Wewiórski	-	-	04.12.2022	05.12.2022	-	-	-	15.18	24.30 →
Maciej Wewiórski	-	-	22.12.2022	23.12.2022	-	-	-	12.90	17.30 ↓
Maciej Wewiórski	-	-	13.01.2023	13.01.2023	-	-	-	13.38	17.30 →
Maciej Wewiórski	-	-	03.02.2023	03.02.2023	-	-	-	13.96	17.30 →
Maciej Wewiórski	-	-	10.02.2023	10.02.2023	-	-	-	13.64	17.30 →
Maciej Wewiórski	-	-	02.03.2023	02.03.2023	-	-	-	13.22	17.30 →
Maciej Wewiórski	-	-	10.03.2023	10.03.2023	-	-	-	12.98	17.30 →
Maciej Wewiórski	-	-	13.04.2023	13.04.2023	-	-	-	14.38	17.30 →
Maciej Wewiórski	-	-	29.05.2023	29.05.2023	-	-	-	14.76	17.30 →
Maciej Wewiórski	-	-	14.07.2023	14.07.2023	-	-	-	14.88	17.30 →
Maciej Wewiórski	Hold	09.08.2023	-	09.08.2023	Not later than 09.08.2024	-7%	-17%	11.82	14.90 ↓
Maciej Wewiórski	-	-	31.08.2023	31.08.2023	-	-	-	10.90	14.90 →
Maciej Wewiórski	-	-	12.10.2023	12.10.2023	-	-	-	10.70	14.90 →
Maciej Wewiórski	-	-	06.11.2023	06.11.2023	-	-	-	10.86	14.90 →
Maciej Wewiórski	-	-	04.12.2023	04.12.2023	-	-	-	11.60	14.90 →
Maciej Wewiórski	-	-	10.12.2023	11.12.2023	-	-	-	11.32	14.90 →
Maciej Wewiórski	-	-	19.12.2023	19.12.2023	-	-	-	10.98	11.80 ↓

* prices at issue/reiteration are the closing prices at the report or reiteration date

Market-relative recommendation tracker

Analyst	Relative Recommendation		Report date	Reiteration date	Distribution date	Expiry date	Price at issue/ reiteration*	Relative performance
Grodno								
Maciej Wewiórski	Overweight	←	31.08.2021	-	31.08.2021	16.08.2022	15.34	30%
Maciej Wewiórski	-	→	-	31.08.2021	31.08.2021	-	15.86	-
Maciej Wewiórski	-	→	-	07.10.2021	07.10.2021	-	15.60	-
Maciej Wewiórski	-	→	-	01.11.2021	02.11.2021	-	15.96	-
Maciej Wewiórski	-	→	-	04.11.2021	04.11.2021	-	16.42	-
Maciej Wewiórski	-	→	-	16.11.2021	17.11.2021	-	16.82	-
Maciej Wewiórski	-	→	-	05.12.2021	06.12.2021	-	16.10	-
Maciej Wewiórski	-	→	-	16.01.2022	17.01.2022	-	17.24	-
Maciej Wewiórski	-	→	-	07.02.2022	07.02.2022	-	18.10	-
Maciej Wewiórski	-	→	-	28.02.2022	28.02.2022	-	15.50	-
Maciej Wewiórski	-	→	-	14.04.2022	14.04.2022	-	19.98	-
Maciej Wewiórski	-	→	-	24.04.2022	25.04.2022	-	19.80	-
Maciej Wewiórski	-	→	-	26.05.2022	26.05.2022	-	17.48	-
Maciej Wewiórski	-	→	-	07.06.2022	08.06.2022	-	17.28	-
Maciej Wewiórski	-	→	-	15.07.2022	15.07.2022	-	16.14	-
Maciej Wewiórski	-	→	-	08.08.2022	09.08.2022	-	15.16	-
Maciej Wewiórski	Overweight	→	16.08.2022	-	16.08.2022	22.12.2022	15.74	-19%
Maciej Wewiórski	-	→	-	02.09.2022	02.09.2022	-	15.80	-
Maciej Wewiórski	-	→	-	07.10.2022	07.10.2022	-	15.12	-
Maciej Wewiórski	-	→	-	28.10.2022	28.10.2022	-	15.34	-
Maciej Wewiórski	-	→	-	14.11.2022	14.11.2022	-	16.28	-
Maciej Wewiórski	-	→	-	01.12.2022	01.12.2022	-	15.72	-
Maciej Wewiórski	-	→	-	04.12.2022	05.12.2022	-	15.18	-
Maciej Wewiórski	Neutral	↓	22.12.2022	-	23.12.2022	10.12.2023	12.90	-35%
Maciej Wewiórski	-	→	-	13.01.2023	13.01.2023	-	13.38	-
Maciej Wewiórski	-	→	-	03.02.2023	03.02.2023	-	13.96	-
Maciej Wewiórski	-	→	-	10.02.2023	10.02.2023	-	13.64	-
Maciej Wewiórski	-	→	-	02.03.2023	02.03.2023	-	13.22	-
Maciej Wewiórski	-	→	-	10.03.2023	10.03.2023	-	12.98	-
Maciej Wewiórski	-	→	-	13.04.2023	13.04.2023	-	14.38	-
Maciej Wewiórski	-	→	-	29.05.2023	29.05.2023	-	14.76	-
Maciej Wewiórski	-	→	-	14.07.2023	14.07.2023	-	14.88	-
Maciej Wewiórski	-	→	-	09.08.2023	09.08.2023	-	11.82	-
Maciej Wewiórski	-	→	-	31.08.2023	31.08.2023	-	10.90	-
Maciej Wewiórski	-	→	-	12.10.2023	12.10.2023	-	10.70	-
Maciej Wewiórski	-	→	-	06.11.2023	06.11.2023	-	10.86	-
Maciej Wewiórski	-	→	-	04.12.2023	04.12.2023	-	11.60	-
Maciej Wewiórski	Neutral	→	10.12.2023	-	11.12.2023	Not later than 10.12.2024	11.32	-5%
Maciej Wewiórski	-	→	-	19.12.2023	19.12.2023	-	10.98	-

* prices at issue/reiteration are the closing prices at the report or reiteration date

This report has been prepared by Dom Maklerski Banku Ochrony Środowiska SA registered in Warsaw (hereinafter referred to as DM BOŚ SA) and commissioned by the Warsaw Stock Exchange SA (hereinafter referred to as WSE SA) pursuant to the agreement on the research report preparation between DM BOŚ SA and WSE SA within the framework of the Analytical Coverage Support Program 4.0 described on the WSE SA website: <https://www.gpw.pl/gpwpa> (hereinafter referred to as the Agreement). DM BOŚ SA will receive a remuneration for the research report in accordance with the Agreement.

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The report is an investment research within the meaning of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

This report constitutes a recommendation within the meaning of Commission Delegated Regulation (EU) 2016/958 of 9 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the technical arrangements for objective presentation of investment recommendations or other information recommending or suggesting an investment strategy and for disclosure of particular interests or indications of conflicts of interest. This report is for information purposes only.

This report constitutes neither investment advice nor provides investment service as referred to in Article 76 of the Act on Financial Instruments Trading as of 29 July 2005 (Journal of Laws, 2018, Item 2286 as amended), hereinafter referred to as the Act on Trading; it does not constitute any legal or tax advice, neither does it constitute an indication whether an investment is suitable or appropriate in an individual situation of an investor. In particular this report is not a personal recommendation based on any individual needs or situation of any investor. DM BOŚ SA informs that the investment advice services exclusively consist in the preparation of a personal recommendation based on individual needs and situation of a given client and transferring it to them. To receive this type of a recommendation an agreement on providing investment advice services must be signed with an investments company offering these services.

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