

# Hydrobudowa Polska

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**Sector:** General construction  
**Fundamental rating:** Sell (→)  
**Market relative:** Underweight (→)  
**Price:** PLN 3.55  
**12M EFV:** PLN 3.36 (↓)

**Market Cap.:** US\$ 257 m  
**Reuters code:** HBWLWA  
**Av. daily turnover:** US\$ 0.50 m  
**Free float:** 39%  
**12M range:** PLN 3.12-5.93

**Quarterly  
Results Preview**

## Investment opinion & recommendation

With some fundamental downside to our 12M EFV (lowered by 5% to PLN 3.36 per share, chiefly on the back of higher than previously envisaged forward net debt and slightly higher NWC financing needs) we maintain our LT fundamental Sell recommendation for HBP's equities. The quality of the Company's backlog seems poor as it was boosted in the times of tight competition and price war among contractors. Furthermore, the Company incurred much higher than previously envisaged construction costs in the winter season (in order to run works in line with the schedules) and – consequently – we expect the margins on stadium contracts (the Company's flagship investments, with >50% share in backlog) to be tiny (we forecast >40% yoy slump of the Company's net profit in 2010). True, we project yoy rebound of Hydrobudowa's earnings in 2011 (envisaged c. 40% yoy net profit increase), but the downside risk to our forecast seems material given feeble post-2010 contract portfolio and our belief that further backlog development might prove challenging (lack of large environmental protection or engineering contracts on the horizon, while the Company's share in road contracts (a few such contracts are to be shortly signed by the consortium of PBG) will be, probably, minor). On the back of envisaged miserable posting for 1Q10, we also maintain our ST Underweight market-relative stance towards HBP's shares.

## 1Q10 results' forecast

Hydrobudowa Polska will publish 1Q10 financial results on May 17. In spite of envisaged one-off gain of approx. PLN 8 million helping the Company' quarterly profits, we forecast 44% yoy slump of HBP's EBIT, which may – in our view – spur some negative market reaction. The key reason for envisaged feeble quarterly posting are low margins on stadium contract.

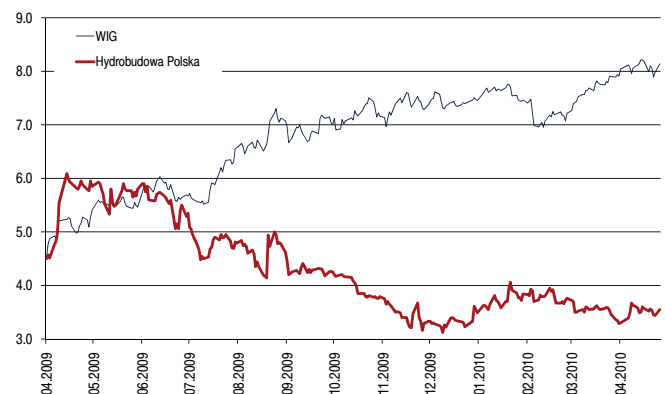
Despite severe and protracted winter we forecast material yoy increase of the Company's quarterly sales. Specifically, we project Hydrobudowa to post 1Q10 revenues of PLN 310 million (48% up yoy), on the back of large stadium contracts in the portfolio. As we expect the margins related to the construction of stadiums to be tiny, we forecast the gross profit on sales margin in 1Q10 at mere 4% (vs. 12% in 1Q09), triggering approx. 50% yoy decrease of Hydrobudowa's gross profit on sales. We expect the Company to recognize a one-off gain of c. PLN 8 million (cash item) on the back of recently reached consensus settlement with municipal waterworks office (following the dispute regarding proper contract completion). This extra gain brings our quarterly EBIT projection to PLN 8.4 million, which is >40% lower yoy. We forecast >100% yoy increase of the Company's pre-tax profit, due to much lower

### Key data

IFRS consolidated		2009	2010E	2011E	2012E
Sales	PLN m	1,675.6	1,996.2	2,204.1	2,078.7
EBITDA	PLN m	133.0	93.2	118.8	107.9
EBIT	PLN m	115.2	73.8	98.0	85.8
Net profit	PLN m	97.9	51.7	72.3	63.1
EPS	PLN m	0.47	0.25	0.34	0.30
EPS yoy chng	%	52	-47	40	-13
Net debt	PLN m	243.5	134.9	114.8	23.2
P/E	x	7.6	14.5	10.3	11.8
P/C/E	x	6.5	10.5	8.0	8.8
EV/EBITDA	x	7.4	9.5	7.3	7.1
EV/EBIT	x	8.6	12.0	8.8	9.0
EV/Sales	x	0.6	0.4	0.4	0.4
Gross dividend yield	%	0.0	0.0	0.0	0.0
No. of shares (eop)	m	210.6	210.6	210.6	210.6

Source: Company, DM IDMSA estimates

### Stock performance



Source: ISI

### Upcoming events

1. Release of 1Q10 financial results: May 17, 2010

### Catalysts

1. Signing new large environmental protection contracts co-financed by EU (e.g. waste incineration plant)
2. Signing other specialist construction contracts

### Risk factors

1. Management of stadium contracts
2. Prolonging administrative procedures may negatively affect smooth absorption of EU funds' inflow by investors (public sector)
3. Growing construction costs
4. Weaker yoy 1Q10E and FY10E financial results

yoy financial costs projected for 1Q10 (the hike in financial costs in 1Q09 stemmed from FX translation losses booked by HBP after the appreciation of EUR vs. PLN), yet this dynamics is spurious due to very low base of 1Q09. However, assuming quarterly effective CIT rate at a statutory level in 1Q10 (vs. net tax asset recognition in the base quarter of 1Q09), we forecast HBP's quarterly net profit at PLN 7.6 million, broadly flat yoy.

## 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** =  $\text{EBIT}/\text{sales}$   
**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 IDM 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 IDMSA'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.

## Banks

**Net Interest Margin (NIM)** =  $\text{net interest income}/\text{average assets}$   
**NIM Adjusted** =  $(\text{net interest income adjusted for SWAPs})/\text{average assets}$   
**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** =  $(\text{general costs} + \text{depreciation} + \text{other operating costs})/(\text{profit on banking activity} + \text{other operating income})$   
**ROE** =  $\text{net profit}/\text{average equity}$   
**ROA** =  $\text{net income}/\text{average assets}$   
**Non performing loans (NPL)** = loans in 'substandard', 'doubtful' and 'lost' categories  
**NPL coverage ratio** =  $\text{loan loss provisions}/\text{NPL}$   
**Net provision charge** =  $\text{provisions created} - \text{provisions released}$

DM IDM 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.

LT fundamental recommendation tracker

Recommendation		Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/reiteration (PLN)	12M EFV (PLN)	
<b>Hydrobudowa Polska</b>									
Hold	-	01.07.2008	-	30.11.2008	-16%	25%	7.70	8.50	-
-	→	-	06.07.2008	-	-	-	7.40	8.40	↓
-	→	-	05.08.2008	-	-	-	7.50	8.40	→
-	→	-	31.08.2008	-	-	-	7.30	8.40	→
-	→	-	28.09.2008	-	-	-	7.00	8.40	→
-	→	-	13.10.2008	-	-	-	5.99	8.48	↑
-	→	-	29.10.2008	-	-	-	6.00	8.48	→
-	→	-	09.11.2008	-	-	-	6.20	8.53	↑
Buy	↑	30.11.2008	-	27.04.2009	-10%	-13%	6.43	8.53	→
-	→	-	11.01.2009	-	-	-	6.00	8.53	→
-	→	-	25.01.2009	-	-	-	5.80	8.53	→
-	→	-	08.02.2009	-	-	-	5.59	8.53	→
-	→	-	08.03.2009	-	-	-	4.95	8.53	→
-	→	-	05.04.2009	-	-	-	4.51	8.53	→
Hold	↓	27.04.2009	-	13.10.2009	-30%	-48%	5.79	6.14	↓
-	→	-	17.05.2009	-	-	-	5.50	6.14	→
-	→	-	08.06.2009	-	-	-	5.58	6.14	→
-	→	-	08.07.2009	-	-	-	4.48	6.14	→
-	→	-	02.08.2009	-	-	-	4.79	6.14	→
-	→	-	25.08.2009	-	-	-	4.95	5.20	↓
-	→	-	31.08.2009	-	-	-	4.62	5.20	→
-	→	-	12.10.2009	-	-	-	4.15	5.20	→
Sell	↓	13.10.2009	-	07.01.2010	-13%	-19%	4.08	3.39	↓
-	→	-	14.12.2009	-	-	-	3.39	3.39	→
Hold	↑	07.01.2010	-	31.01.2010	8%	10%	3.55	3.50	↑
Buy	↑	31.01.2010	-	01.03.2010	-3%	0%	3.84	4.32	↑
-	→	-	03.02.2010	-	-	-	3.93	4.32	→
Sell	↓	01.03.2010	-	Not later than 01.03.2011	-5%	-15%	3.72	3.55	↓
-	→	-	29.03.2010	-	-	-	3.36	3.55	→
-	→	-	26.04.2010	-	-	-	3.55	3.36	↓

Market-relative recommendation tracker

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/reiteration (PLN)	Relative performance
<b>Hydrobudowa Polska</b>						
Neutral	-	01.07.2008	-	29.10.2008	7.70	15%
-	→	-	06.07.2008	-	7.40	-
-	→	-	05.08.2008	-	7.50	-
-	→	-	31.08.2008	-	7.30	-
-	→	-	28.09.2008	-	7.00	-
-	→	-	13.10.2008	-	5.99	-
Overweight	↑	29.10.2008	-	25.01.2009	6.00	7%
-	→	-	09.11.2008	-	6.20	-
-	→	-	30.11.2008	-	6.43	-
-	→	-	11.01.2009	-	6.00	-
Neutral	↓	25.01.2009	-	13.10.2009	5.80	-54%
-	→	-	08.02.2009	-	5.59	-
-	→	-	08.03.2009	-	4.95	-
-	→	-	05.04.2009	-	4.51	-
-	→	-	27.04.2009	-	5.79	-
-	→	-	17.05.2009	-	5.50	-
-	→	-	08.06.2009	-	5.58	-
-	→	-	08.07.2009	-	4.48	-
-	→	-	02.08.2009	-	4.79	-
-	→	-	25.08.2009	-	4.95	-
-	→	-	31.08.2009	-	4.62	-
-	→	-	12.10.2009	-	4.15	-
Underweight	↓	13.10.2009	-	31.01.2010	4.08	-11%
-	→	-	14.12.2009	-	3.39	-
-	→	-	07.01.2010	-	3.55	-
Overweight	↑	31.01.2010	-	01.03.2010	3.84	0%
-	→	-	03.02.2010	-	3.93	-
Underweight	↓	01.03.2010	-	Not later than 01.03.2011	3.72	-15%
-	→	-	29.03.2010	-	3.36	-
-	→	-	26.04.2010	-	3.55	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	22	29	16	1	0
Percentage	32%	43%	24%	1%	0%

Distribution of IDM's current recommendations for companies that were within the last 12M IDM customers in investment banking

	Buy	Hold	Sell	Suspended	Under revision
Numbers	2	4	0	1	0
Percentage	29%	57%	0%	14%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	22	28	17	1	0
Percentage	32%	41%	25%	1%	0%

Distribution of IDM's current market relative recommended weightings for the companies that were within the last 12M IDM customers in investment banking

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	1	2	3	1	0
Percentage	14%	29%	43%	14%	0%

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