

77/2010/RP (117) July 25, 2010

Analyst: Adrian Kyrzcz, a.kyrzcz@idmsa.pl, +48 (22) 489 94 74

Hydrobudowa Polska

Sector: General construction
Fundamental rating: Hold (↑)
Market relative: Neutral (↑)
Price: PLN 3.34
12M EFV: PLN 3.36 (→)

Market Cap.: US\$ 224 m
Reuters code: HBWLWA
Av. daily turnover: US\$ 0.46 m
Free float: 37%
12M range: PLN 3.01-5.00

Investment opinion & recommendation

We upgrade our LT fundamental recommendation for HBP to a Hold (from Sell), as the Company's share market price closed the valuation gap to our 12M EFV (of PLN 3.36 per share). We also upgrade our ST market-relative bias to Neutral (from Underweight), due to two main reasons. First, in our opinion, the Company's 2Q10 posting may add credibility to Hydrobudowa's ability to attain FY10 net profit in line with, or even slightly above, our expectations (in other words, proving that the stadium contracts are profitable projects). Second, thanks to recent award of contracts worth PLN 2.9 billion (of which approx. PLN 1.1 billion should belong directly to Hydrobudowa), the Company materially increased its backlog which, in our view, should ease investors' concerns regarding the visibility of the Company's FY11 financial results and, consequently, improve the market's sentiment towards the stock.

Quarterly results corner; 2Q10E preview

Hydrobudowa Polska will publish its 2Q10 financial results on August 31 (within the framework of 1H10 semi-annual report). On the back of fat backlog including large stadium contracts (National Stadium in Warsaw, stadiums in Poznań and Gdańsk), we forecast 32% yoy increase of the Company's quarterly sales, up to PLN 450 million (regarding the details please refer to *Figure 1* on the next page). As we expect slightly lower yoy margins to be recognized on pending constructions, we forecast 'only' flat yoy operating profit, and >40% yoy decrease at the bottom line level. Although the envisaged quarterly net profit contraction looks uninspiring at the first sight, we do not preclude that the market reaction to such posting may actually prove even slightly positive. First, the quarterly net profit close to PLN 21 million would imply that stadium projects do not constitute a significant burden for the Company's financial results (which, in our view, was one of the market's concerns). Second, such quarterly showing would confirm Hydrobudowa's ability to meet (or possibly even exceed) our FY10 profit projections.

Financial forecast

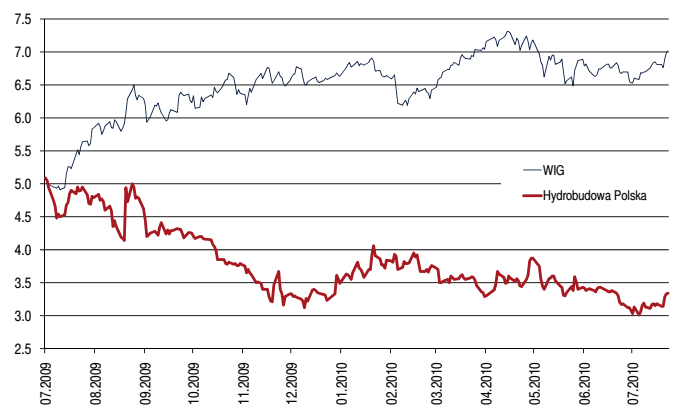
Our financial forecast for Hydrobudowa remains unchanged at the moment (our FY10 NP forecast stands at PLN 51.9 million, which is in line with the Company's representatives recent signaling (net profit above PLN 40 million this year)).

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	7.2	13.6	9.7	11.1
P/CE	x	6.1	9.9	7.6	8.2
EV/EBITDA	x	7.1	9.0	6.9	6.7
EV/EBIT	x	8.2	11.4	8.3	8.5
EV/Sales	x	0.6	0.4	0.4	0.3
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 2Q10 financial results: August 31, 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

Valuation

Our 12M EFV assessment for HBP's shares continues to stand at PLN 3.36 per share.

Fig. 1 Hydrobudowa Polska; 2Q10 and 1H10 results' forecast

IFRS consolidated PLN m	yoy change			yoy change			Realisation of FY figures in 2Q:		Realisation of FY figures in 1-2Q:	
	2Q10E	2Q09		1-2Q10E	1-2Q09		2010E	2009	2010E	2009
Sales	450.0	341.5	32%	772.7	551.0	40%	23%	20%	39%	33%
EBIT	26.4	26.4	0%	38.0	41.3	-8%	36%	23%	51%	36%
<i>EBIT margin</i>	5.9%	7.7%	-	4.9%	7.5%	-	-	-	-	-
Pre-tax profit	26.2	36.4	-28%	37.6	40.0	-6%	41%	32%	59%	39%
<i>Pre-tax margin</i>	5.8%	10.7%	-	4.9%	7.3%	-	-	-	-	-
Net profit	21.2	37.3	-43%	30.1	44.3	-32%	41%	38%	58%	45%
<i>Net margin</i>	4.7%	10.9%	-	3.9%	8.0%	-	-	-	-	-

Source: Company, DM IDMSA estimates

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 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)	
Hydrobudowa Polska									
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	-	25.07.2010	-10%	-17%	3.72	3.55	↓
-	→	-	29.03.2010	-	-	-	3.36	3.55	→
-	→	-	26.04.2010	-	-	-	3.55	3.36	↓
-	→	-	17.05.2010	-	-	-	3.45	3.36	→
-	→	-	14.06.2010	-	-	-	3.39	3.36	→
-	→	-	19.07.2010	-	-	-	3.14	3.36	→
Hold	↑	25.07.2010	-	Not later than 25.07.2011	-	-	3.34	3.36	→

Market-relative recommendation tracker

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/reiteration (PLN)	Relative performance
Hydrobudowa Polska						
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	-	25.07.2010	3.72	-17%
-	→	-	29.03.2010	-	3.36	-
-	→	-	26.04.2010	-	3.55	-
-	→	-	17.05.2010	-	3.45	-
-	→	-	14.06.2010	-	3.39	-
-	→	-	19.07.2010	-	3.14	-
Neutral	↑	25.07.2010	-	Not later than 25.07.2011	3.34	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	26	29	12	1	0
Percentage	38%	43%	18%	1%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	20	31	16	1	0
Percentage	29%	46%	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	3	2	0	1	0
Percentage	50%	33%	0%	17%	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	2	1	0
Percentage	17%	33%	33%	17%	0%

Institutional sales

Director – **Dariusz Wareluk**
tel.: +48 (22) 489 94 12
d.wareluk@idmsa.pl

Leszek Mackiewicz

tel.: +48 (22) 489 94 23
l.mackiewicz@idmsa.pl

Maciej Bąk

tel.: +48 (22) 489 94 14
m.bak@idmsa.pl

Bartosz Zieliński

tel.: +48 (22) 489 94 13
b.zielinski@idmsa.pl

Research

Sobiesław Pająk, CFA
(IT, Media, Equity strategy)

tel.: +48 (22) 489 94 70
s.pajak@idmsa.pl

Sylwia Jaśkiewicz, CFA

(Construction materials, Retail, Mid-caps)
tel.: +48 (22) 489 94 78
s.jaskiewicz@idmsa.pl

Maciej Wewiórski

(Commodities, Construction, Real estate)
tel.: +48 (22) 489 94 62
m.wewiorski@idmsa.pl

Michał Sobolewski, CFA

(Banks)
tel.: +48 (22) 489 94 77
m.sobolewski@idmsa.pl

Jakub Viscardi

(Telco, Retail)
tel.: +48 (22) 489 94 69
j.viscardi@idmsa.pl

Adrian Kyrzcz

(Construction)
tel.: +48 (22) 489 94 74
a.kyrzcz@idmsa.pl

Lukasz Prokopiuk

(Chemicals)
tel.: +48 (22) 489 94 72
l.prokopiuk@idmsa.pl

Marek Kaźmierczak

(Associate)
tel.: +48 (22) 489 94 64
m.kazmierczak@idmsa.pl

This report is for information purposes only. Neither the information nor the opinions expressed in the report constitute a solicitation or an offer to buy or sell any securities referred herein. The opinions expressed in the report reflect independent, current judgement of DM IDM S.A. Securities. This report was prepared with due diligence and scrutiny. The information used in the report is based on all public sources such as press and branch publications, company's financial statements, current and periodic reports, as well as meetings and telephone conversations with company's representatives prior to the date of report's release. We believe the above mentioned sources of information to be reliable, however we do not guarantee their accuracy and completeness. All estimates and opinions included in the report represent our judgment as of the date of the issue. The legal entity supervising DM IDM S.A. is Financial Supervision Commission in Warsaw (KNF in Polish abbreviation).

IDM does not take any responsibility for decisions taken on the basis of this report and opinions stated in it. Investors bear all responsibility for investment decisions taken on the basis of the contents of this report. The report is intended exclusively for private use of investors – customers of IDM. No part or excerpt of the report may be redistributed, reproduced or conveyed in any manner or form written or oral without the prior written consent of IDM. This report is released to customers the moment it is issued and the whole report is made available to the public one month after the issuance.

The analyst(s) responsible for covering the securities in this report receives compensation based upon the overall profitability of IDM which includes profits derived from investment banking activities, although the analyst compensation is not directly related thereto.

IDM releases analytical reports via mail or electronic mail to selected clients (professional clients).

Apart from mentioned above, there are no ties of any kind between DM IDM S.A., the analyst/analysts involved in the preparation of the report and his/her relatives and the company/companies analyzed in this publication, especially in the form of: i) offering of financial instruments in the primary market or/and Initial Public Offer within 12 months preceding the issue of this report, ii) purchasing and selling of financial instruments for own account due to tasks connected with organization of the regulated market, iii) purchasing and selling of financial instruments due to underwriting agreements and iv) the role of a market maker for securities analysed by IDM. The analysed company/companies does/do not possess DM IDM S.A. shares.

IDM has not signed with the company/companies any contracts for recommendation writing. Investors should assume that DM IDM S.A. is seeking or will seek business relationships with the company/companies described in this report. No excerpts from this research report were shown to the analyzed company/companies before the distribution of the report to clients.