

# Construction sector

Energomontaż Południe, Budimex, Hydrobudowa Polska, Polimex-Mostostal, Trakcja-Tiltra

Poland, General construction

Initiation of coverage

27 July 2011

## No light in the tunnel

**Despite an underperformance of the WIG-Construction index vs. WIG (WIG Construction slid by 26% vs. marginal 1% decrease of WIG since the beginning of the year), construction stocks may remain beyond the interest of investors. We believe an unfavourable market environment remains the greatest difficulty for construction companies, which is producing a gloomy mid-term sales and profits outlook including 1) large building projects connected to EURO 2012 coming to an end, 2) expected lower absorption of EU funding, 3) likely investment slowdown beginning next year and 4) extremely tough competition resulting in pressure on margins. Unless the outlook improves (which seems unlikely in the near future) the poor sentiment toward WSE-listed construction companies will probably remain unchanged. Furthermore, we project uninspiring financial results for construction companies for 2Q2011, which may become another burden on their market share prices. Consequently, we recommend to underweight the entire sector.**

The outlook for construction companies remains dull. Large contracts connected to EURO 2012 are coming to an end, which, together with a lower absorption of EU funds, may result in a significant slowdown in the sector from 2012. This development may hit the sales of contractors in the Polish market. It is true that there is some light at the end of the tunnel in the form of the power sector, which is on the verge of a large investment program, but the scale of investments and their timing is still in question. Furthermore, only a narrow group of construction companies might benefit from planned investments.

Tough competition in the construction market during 2009–10 has taken its toll (many foreign players entered the Polish construction scene in this period, which produced a price war between contractors). In our opinion, 2Q2011 will be another quarter in which margin contraction can be expected. Consequently, in spite of expected y/y aggregate sales expansion in 2Q2011, we project some y/y fall in aggregate profits.

In this report we initiate our coverage of general construction sector with four Sell recommendations (Energomontaż Południe, Polimex-Mostostal, Hydrobudowa Polska, Trakcja-Tiltra) and the sole Hold (Budimex). Below, we present a summary of DCF-derived 12M fair value assessments and recommendations.

### Summary; 12M fair value assessments and recommendations

Company	12M TP	Recommendation
Energomontaż Południe	3.56	Sell
Budimex	91.3	Hold
Polimex-Mostostal	2.74	Sell
Hydrobudowa Polska	1.59	Sell
Trakcja-Tiltra	2.52	Sell

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# Hydrobudowa Polska

## (Not)wanted!?

Although the threat of huge penalties related to the construction of the National Stadium in Warsaw has been addressed (the consortium has signed an appendix changing the completion date), we still expect extra costs related to this project for 2Q–3Q2011 stemming from contract delays and construction faults. Consequently, we forecast a net profit of PLN 47.8 million in FY2011, i.e. slightly below the management target. In the longer term, we cannot rule out difficulties for the company in finding new contracts (extremely high dependence on projects related to EURO 2012, which are coming to an end) and see unfavourable changes in the sales mix (growing share of low-margin sales in the road sector), for which we predict a flattish NP for 2012–13. On the back of: (i) a no-growth equity story for HBP; and (ii) our DCF derived 12M TP of PLN 1.59 per share suggesting a downside, we initiate our coverage of HBP with a fundamental **Sell** rating.

We expect HBP to post feeble results for 2–3Q11. This is because of expected extra costs (of at least PLN 8–10m) related to problems completing the contract for the construction of the new stadium in Warsaw. Consequently, we forecast a net profit of PLN 47.8 for FY2011 (31% up y/y), i.e. slightly below the management target of PLN 50 million.

Hydrobudowa had been developing its order book by winning road construction contracts (for example stretches of the A1 and A4 motorways), which have turned out to be extremely low-margin projects (gross profit on sales at a mere 2% in 2010). Note that road contracts constitute as much as 44% of the Company's backlog, which is why we expect growing sales from road projects in the sales mix within the next two years (from 8% in 2010 to 42% in 2011 and 52% in 2012), which in turn may result in HBP's total gross profit on sales decreasing.

Furthermore, we expect the company to run into gigantic difficulties filling its order book due to its high historical dependence on projects co-financed by EU funds and related to EURO 2012 (water contracts, roads, stadiums), which are coming to an end (Hydrobudowa is probably the most dependant on such projects among stocks we cover). Based on these factors, we forecast negative net profit CAGR during 2012–14.

### Hydrobudowa Polska; Financial summary

PLN in millions, unless otherwise stated

	2009	2010	2011E	2012E	2013E
Revenues	1 673,9	1 581,6	1 604,5	1 315,7	1 142,1
EBITDA	131,3	68,8	93,2	84,8	77,9
EBIT	113,5	50,2	72,7	62,2	53,8
Net profit	96,2	36,5	47,8	45,1	45,6
EPS	0,46	0,17	0,23	0,21	0,22
P/E (x)	3,8	9,9	7,6	8,0	7,9
EV/EBITDA (x)	4,6	9,3	7,2	4,9	4,7

Source: Company data, DM BZ WBK estimates

Recommendation	Sell
Price (PLN, 26 June 2011)	1.72
Target price (PLN, 12-month)	1.59
Market cap. (PLN m)	362
Free float (%)	37.0
Number of shares (m)	210.6
EURPLN	4.00
USDPLN	2.76



The chart measures performance against the WIG index. On 26/07/2011, the WIG index closed at 47,186.

Main shareholders	
PBG SA	63.05%
ING OFE	11.04%
Other	25.91%

### Company description

Hydrobudowa is a multi-specialized company. It has a strong position in water infrastructure construction (sewerage) and hydro-engineering objects. The company has also developed competences in the construction of roads and specialist projects such as tunnels and stadiums.

### Stock triggers

1. Conquering new business segments (e.g. power engineering).
2. Winning upcoming hydro-engineering contracts (Raciborz reservoir, etc.).
3. Winning new contracts for the construction of waste material incineration plants.

### Risk factors

1. FY2011 NP below management target.
2. High dependence on projects co-financed by EU and related to EURO 2012 (risk of difficulties with further order book expansion).
3. Risk of penalties related to the stadium in Gdańsk.
4. Sales and profit contraction once large stadium and road contracts are completed (2012 and onward).
5. Rise in construction material costs (aggregates).
6. Decrease in expenditure on roads for 2012–13.
7. Little experience in road construction.
8. Losing the case with Martifer.

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