

18/2009/RP (28) January 25, 2009

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# Hydrobudowa Polska

Sector: Construction  
Fundamental rating: Buy (→)  
Market relative: Neutral (↓)  
Price: PLN 5.8  
12M EFV: PLN 8.53 (→)

Market Cap.: US\$ 335 m  
Reuters code: HBWLWA  
Av. daily turnover: US\$ 0.10 m  
Free float: 39%  
12M range: PLN 5.25-9.40

## Investment opinion

Hydrobudowa Polska (HBP) is a highly specialized construction company, operating on the fast-growing and highly profitable environmental protection and hydroengineering construction market, where it is the market leader. We believe that huge spending on environmental protection in Poland (fueled by EU-funds inflow) and contracts related to EURO 2012 (stadiums) should constitute the key driving forces for the Company's financial results for at least next couple of years. Furthermore, high reliance on EU-financed contracts materially improves mid-term earnings visibility (low sensitivity of the Company's numbers to periodic swings of GDP) which undoubtedly constitutes a desirable trait in times of slowing economy, in our view. With all these being said, in the ST we draw the attention to the Company's 4Q08E results, which – due to non-cash items related to derivative financial instruments – are likely to bring in very feeble reported profits.

## Quarterly results corner; 4Q08E preview

We expect HBP's 4Q08 results to be weak (for details please refer to *Figure 1* below), with material yoy and qoq decreases of profits. We believe, however, that a rational market reaction to such quarterly financial posting should be neutral, given the fact that a non-cash (one-off) item will constitute the sole reason for the envisaged slump of reported profits.

Fig. 1 Hydrobudowa Polska; 4Q08 results' forecast

IFRS consolidated PLN m	4Q08E		4Q07		yoy change	realization of FY number in 4Q:	
	4Q08E	4Q07	2008E	2007			
Sales	394.2	238.7	65%	32%	42%		
Gross profit on sales	16.1	29.2	-45%	15%	54%		
Gross profit on sales margin	4.1%	12.2%	-	-	-		
EBIT	3.1	20.8	-85%	5%	59%		
EBIT margin	0.8%	8.7%	-	-	-		
Pre-tax profit	0.9	25.4	-96%	2%	72%		
Pre-tax margin	0.2%	10.6%	-	-	-		
Net profit	0.7	20.0	-96%	1%	50%		
Net margin	0.2%	8.4%	-	-	-		

Source: Company, DM IDMSA estimates

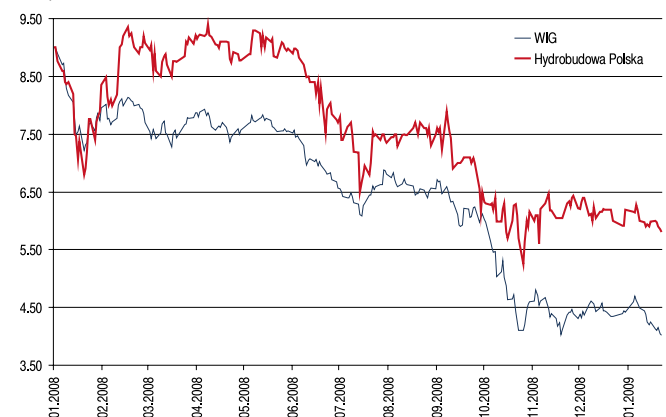
We forecast the Company's quarterly sales at PLN 394.2 million, which is 65% up yoy. We see the main reasons for such impressive yoy improvement in (i) continuously expanding environmental protection and specialist construction contract portfolio (the Company's current backlog stands at c. PLN 2 billion) and (ii) consolidation of Hydrobudowa 9.

## Key data

IFRS consolidated		2008E	2009E	2010E	2011E
Sales	PLN m	1,228.1	1,754.5	2,089.3	2,480.9
EBITDA	PLN m	78.9	166.7	220.8	270.6
EBIT	PLN m	65.0	147.1	198.2	245.5
Net profit	PLN m	55.7	113.9	145.5	187.6
EPS	PLN m	0.26	0.54	0.69	0.89
EPS yoy chng	%	-9	104	28	29
Net debt	PLN m	99.8	238.8	241.6	218.8
P/E	x	21.9	10.7	8.4	6.5
P/CE	x	17.6	9.1	7.3	5.7
EV/EBITDA	x	16.8	8.8	6.6	5.3
EV/EBIT	x	20.3	9.9	7.4	5.9
EV/Sales	x	1.1	0.8	0.7	0.6
Gross dividend yield	%	0.0	0.0	0.0	0.0
No. of shares (eop)	ths.	210,558	210,558	210,558	210,558

Source: DM IDMSA estimates

## Stock performance



Source: ISI

## Upcoming events

1. 4Q08 results release: February 2009

## Catalysts

1. Signing new large environmental protection contracts co-financed by EU (e.g. waste incineration plant in Poznań and Kraków for the value of c. PLN 1.1 billion)
2. Signing contracts related to EURO 2012 (stadiums)
3. Signing other specialist construction contracts

## Risk factors

1. FX exposure (most of environmental protection contracts are EUR-denominated)
2. Prolonging administrative procedures may negatively affect smooth absorption of EU funds' inflow by investors (public sector)
3. Non-cash derivative-valuation-driven feeble 4Q08E profits

As far as the Company's quarterly profits are concerned, however, we forecast material yoy and qoq decrease. The reason will be, in our view, c. PLN -32 million FX loss on open FX positions, stemming from material appreciation of EUR vs. PLN in 4Q08 (derivatives valuation as of the end of December 2008). Please note, however, that the projected FX loss will relate to standard forwards (not options) and it is likely to be non-cash.

The background behind the likely loss on FX forwards is as follows. HBP uses forwards in order to hedge cash flows on EUR-denominated contracts against fluctuation of EUR vs. PLN. Assuming appreciation of EUR vs. PLN at the moment of the contract settlement, positive effect in the form of larger cash inflows (in PLN terms) is being offset by cash outflows on closed forwards (at the same time projected cash flow on EUR-denominated contract is independent from fluctuation of EUR vs. PLN). In 2008 HBP signed two construction contracts of the value of EUR 55 million and following its hedging strategy, it purchased forwards in order to hedge its currency exposure. There was not any cash payments in 4Q08 (the contract settlement will fall in 2009 and 2010) related to these contracts, that is why HBP did not close any forward positions in that period. Given, however, strong appreciation of EUR vs. PLN in 4Q08, HBP was obliged by its auditor to value opened forwards as of the end of December 2008 and, consequently, to report a paper loss (in cash terms it should be offset by larger PLN cash inflows from these contracts in 2009-2010).

We estimate that the aforementioned item will lower the Company's quarterly gross profit on sales and operating profit to respectively PLN 16.1 million and PLN 3.1 million, translating into 45% and 85% yoy declines. If it had not been for this item, our forecast of HBP's 4Q08 gross profit on sales and EBIT would stand, respectively, at PLN 48.1 million (65% increase yoy) and PLN 35.1 million (69% rise yoy). Following aforementioned envisaged slump of the Company's reported operating profit, we also forecast material yoy decrease of HBP's 4Q08 bottom line (by 96%) to a mere PLN 0.7 million.

Summing up, we expect the Company's 4Q08 reported profits to be weak, but with a non-cash item being the main reason behind that. Please note that if it had not been for the expected FX forwards valuation in 4Q08, the management FY08 financial forecast (EBIT of PLN 97.3 million and NP of PLN 83.7 million) would, mostly likely, be met.

## Financial forecast

We have revised our financial forecast for HBP for 2008, incorporating our explicit expectations for 4Q08 (for details please refer to *Figure 2* below). Specifically, we decrease our FY08E sales by 3%, while EBIT and NP go down by 35% and 33%, respectively. We remind that the FY08E profit downgrade is driven by envisaged 4Q08 FX losses. We do not change our forecasts for 2009 and beyond.

*Fig. 2 Hydrobudowa Polska; Changes in IDM's forecast*

IFRS consolidated PLN m	2008E		
	current	previous	change
Sales	1,228.1	1,272.4	-3%
EBIT	65.0	100.3	-35%
NP	55.7	82.8	-33%

*Source: DM IDMSA estimates*

## Valuation

With intact post-2008 forecast, our 12M EFV for HBP continues to dwell at PLN 8.53 per share.

## Recommendation

We keep our LT fundamental Buy recommendation for HBP intact. However, expecting weak 4Q08 reported profits, we downgrade our ST market-relative bias for HBP from Overweight to Neutral (and remove it from our list of top potential outperformers (discussed on a recurring basis in our *Monthly research* report)), as we do not preclude that the market's first reaction to such a quarterly posting may be lukewarm at best.

### Financial statements (IFRS consolidated)

Fig. 3 Hydrobudowa Polska; Balance sheet

PLN m	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
<b>Fixed assets</b>	<b>80.0</b>	<b>151.9</b>	<b>177.6</b>	<b>183.6</b>	<b>186.7</b>	<b>189.8</b>	<b>192.8</b>	<b>195.9</b>	<b>198.9</b>	<b>202.0</b>	<b>205.1</b>	<b>208.2</b>	<b>212.3</b>
Intangibles	0.8	0.8	0.9	1.3	1.6	1.9	2.1	2.3	2.4	2.5	2.5	2.5	2.4
Goodwill	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Tangible fixed assets	70.1	142.0	167.5	173.2	176.0	178.7	181.6	184.5	187.4	190.4	193.5	196.6	200.8
LT receivables	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
LT investments	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
LT deferred assets	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Current assets</b>	<b>502.7</b>	<b>1,004.5</b>	<b>1,415.7</b>	<b>1,667.4</b>	<b>1,968.2</b>	<b>2,317.6</b>	<b>2,426.9</b>	<b>2,494.1</b>	<b>2,560.1</b>	<b>2,621.1</b>	<b>2,728.0</b>	<b>2,824.2</b>	<b>2,924.9</b>
Inventories	5.2	11.3	15.4	18.2	21.5	24.8	25.6	26.2	26.7	27.1	28.3	29.3	30.4
ST receivables	426.5	916.4	1,309.3	1,559.1	1,851.3	2,134.5	2,203.1	2,248.9	2,291.3	2,324.6	2,421.0	2,510.6	2,606.1
ST deferred assets	3.4	7.4	10.6	12.6	15.0	17.3	17.8	18.2	18.5	18.8	19.6	20.3	21.1
Cash & equivalents	48.3	50.2	61.2	58.4	61.2	121.9	161.2	181.6	204.3	231.4	239.8	244.7	248.1
Other assets	19.2	19.2	19.2	19.2	19.2	19.2	19.2	19.2	19.2	19.2	19.2	19.2	19.2
<b>Total assets</b>	<b>582.7</b>	<b>1,156.4</b>	<b>1,593.3</b>	<b>1,851.1</b>	<b>2,154.9</b>	<b>2,507.4</b>	<b>2,619.7</b>	<b>2,690.0</b>	<b>2,759.1</b>	<b>2,823.2</b>	<b>2,933.1</b>	<b>3,032.4</b>	<b>3,137.3</b>
<b>Equity</b>	<b>139.4</b>	<b>527.7</b>	<b>641.6</b>	<b>787.2</b>	<b>974.8</b>	<b>1,190.4</b>	<b>1,238.6</b>	<b>1,286.3</b>	<b>1,333.9</b>	<b>1,380.6</b>	<b>1,432.4</b>	<b>1,489.0</b>	<b>1,548.4</b>
<b>Liabilities &amp; reserves</b>	<b>443.4</b>	<b>628.7</b>	<b>951.7</b>	<b>1,063.9</b>	<b>1,180.1</b>	<b>1,317.0</b>	<b>1,381.1</b>	<b>1,403.7</b>	<b>1,425.1</b>	<b>1,442.5</b>	<b>1,500.7</b>	<b>1,543.4</b>	<b>1,588.9</b>
<b>Reserves</b>	<b>9.3</b>	<b>20.0</b>	<b>28.6</b>	<b>34.1</b>	<b>40.5</b>	<b>46.6</b>	<b>48.1</b>	<b>49.1</b>	<b>50.1</b>	<b>50.8</b>	<b>52.9</b>	<b>54.9</b>	<b>56.9</b>
LT liabilities	67.3	84.6	114.6	104.6	84.6	84.6	114.6	114.6	114.6	114.6	124.6	124.6	124.6
Non-interest-bearing	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Interest-bearing	62.7	80.0	110.0	100.0	80.0	80.0	110.0	110.0	110.0	110.0	120.0	120.0	120.0
ST Liabilities	364.4	519.1	801.4	916.8	1,045.0	1,174.1	1,206.4	1,227.8	1,248.1	1,264.5	1,310.1	1,350.3	1,393.2
Non-interest-bearing	213.7	449.1	611.4	716.8	845.0	974.1	1,006.4	1,027.8	1,048.1	1,064.5	1,110.1	1,150.3	1,193.2
Interest-bearing	150.7	70.0	190.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0	200.0
Reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Deferred liabilities	2.3	5.0	7.1	8.4	10.0	11.6	11.9	12.2	12.4	12.6	13.1	13.6	14.1
<b>Total liabilities and equity</b>	<b>582.7</b>	<b>1,156.4</b>	<b>1,593.3</b>	<b>1,851.1</b>	<b>2,154.9</b>	<b>2,507.4</b>	<b>2,619.7</b>	<b>2,690.0</b>	<b>2,759.1</b>	<b>2,823.2</b>	<b>2,933.1</b>	<b>3,032.4</b>	<b>3,137.3</b>

Source: Company, DM IDMSA estimates

Fig. 4 Hydrobudowa Polska; Income statement

PLN m	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
<b>Sales</b>	<b>571.5</b>	<b>1,228.1</b>	<b>1,754.5</b>	<b>2,089.3</b>	<b>2,480.9</b>	<b>2,860.4</b>	<b>2,952.3</b>	<b>3,013.7</b>	<b>3,070.5</b>	<b>3,115.2</b>	<b>3,244.4</b>	<b>3,364.4</b>	<b>3,492.4</b>
<b>COGS</b>	<b>-517.5</b>	<b>-1,121.5</b>	<b>-1,538.1</b>	<b>-1,808.8</b>	<b>-2,138.0</b>	<b>-2,469.4</b>	<b>-2,552.3</b>	<b>-2,607.1</b>	<b>-2,659.1</b>	<b>-2,701.4</b>	<b>-2,818.2</b>	<b>-2,921.5</b>	<b>-3,031.7</b>
<b>Gross profit on sales</b>	<b>54.1</b>	<b>106.6</b>	<b>216.4</b>	<b>280.5</b>	<b>343.0</b>	<b>391.0</b>	<b>400.0</b>	<b>406.6</b>	<b>411.4</b>	<b>413.8</b>	<b>426.2</b>	<b>442.9</b>	<b>460.7</b>
Selling costs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
General administration costs	-21.3	-45.5	-69.3	-82.3	-97.5	-112.3	-115.7	-117.9	-119.9	-121.5	-126.6	-131.3	-136.3
<b>Net profit on sales</b>	<b>32.8</b>	<b>61.1</b>	<b>147.1</b>	<b>198.2</b>	<b>245.5</b>	<b>278.7</b>	<b>284.3</b>	<b>288.7</b>	<b>291.5</b>	<b>292.3</b>	<b>299.6</b>	<b>311.6</b>	<b>324.5</b>
Other operating income	9.6	11.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other operating costs	-7.2	-7.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>EBIT</b>	<b>35.2</b>	<b>65.0</b>	<b>147.1</b>	<b>198.2</b>	<b>245.5</b>	<b>278.7</b>	<b>284.3</b>	<b>288.7</b>	<b>291.5</b>	<b>292.3</b>	<b>299.6</b>	<b>311.6</b>	<b>324.5</b>
Financial income	15.8	17.4	5.9	6.0	6.2	7.2	8.9	9.9	10.7	11.6	12.3	12.6	12.9
Financial costs	-16.7	-24.2	-18.4	-24.0	-19.1	-18.5	-19.5	-20.5	-20.5	-20.5	-20.8	-21.1	-21.1
Others	16.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Pre tax</b>	<b>50.4</b>	<b>58.3</b>	<b>134.6</b>	<b>180.3</b>	<b>232.5</b>	<b>267.4</b>	<b>273.7</b>	<b>278.2</b>	<b>281.8</b>	<b>283.5</b>	<b>291.1</b>	<b>303.1</b>	<b>316.3</b>
Income tax	-10.2	-2.5	-20.2	-34.2	-44.2	-50.8	-52.0	-52.9	-53.5	-53.9	-55.3	-57.6	-60.1
Minority interest in net income	0.0	-0.1	-0.5	-0.5	-0.7	-1.0	-1.0	-1.1	-1.2	-1.3	-1.3	-1.4	-1.5
<b>Net income</b>	<b>40.2</b>	<b>55.7</b>	<b>113.9</b>	<b>145.5</b>	<b>187.6</b>	<b>215.7</b>	<b>220.7</b>	<b>224.2</b>	<b>227.0</b>	<b>228.4</b>	<b>234.5</b>	<b>244.1</b>	<b>254.7</b>

Source: Company, DM IDMSA estimates

Fig. 5 Hydrobudowa Polska; Cash flow

PLN m	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Pre-tax profit (loss)	50.4	58.3	134.6	180.3	232.5	267.4	273.7	278.2	281.8	283.5	291.1	303.1	316.3
Depreciation and amortization	5.1	13.8	19.6	22.6	25.2	26.2	28.0	29.9	31.9	34.2	35.6	37.1	40.9
NWC change:	-74.7	-260.7	-234.7	-147.1	-167.3	-157.4	-37.1	-25.1	-22.7	-17.3	-52.0	-50.4	-53.7
Change in inventories	4.5	-6.1	-4.2	-2.7	-3.3	-3.3	-0.8	-0.6	-0.5	-0.4	-1.2	-1.0	-1.1
Change in receivables	-164.0	-489.9	-392.8	-249.8	-292.3	-283.1	-68.6	-45.9	-42.4	-33.3	-96.4	-89.6	-95.5
Change in payables	84.8	235.3	162.3	105.4	128.3	129.1	32.3	21.4	20.3	16.5	45.5	40.3	42.9
Other	-37.0	62.1	3.5	-7.7	-21.9	-30.6	-36.5	-37.8	-39.3	-40.6	-41.1	-43.4	-46.0
<b>Operating cash flow</b>	<b>-56.1</b>	<b>-126.5</b>	<b>-77.0</b>	<b>48.0</b>	<b>68.4</b>	<b>105.7</b>	<b>228.1</b>	<b>245.2</b>	<b>251.8</b>	<b>259.8</b>	<b>233.6</b>	<b>246.5</b>	<b>257.4</b>
Capital expenditures	-31.1	-85.7	-45.3	-28.6	-28.2	-29.3	-31.0	-32.9	-35.0	-37.3	-38.7	-40.2	-45.0
Other	57.0	0.0	1.8	1.8	1.8	2.7	4.2	5.1	5.8	6.5	7.1	7.3	7.4
<b>Investing cash flow</b>	<b>26.0</b>	<b>-85.7</b>	<b>-43.5</b>	<b>-26.8</b>	<b>-26.4</b>	<b>-26.6</b>	<b>-26.8</b>	<b>-27.8</b>	<b>-29.2</b>	<b>-30.7</b>	<b>-31.7</b>	<b>-33.0</b>	<b>-37.6</b>
Change in interest-bearing debt	64.2	-63.4	150.0	0.0	-20.0	0.0	30.0	0.0	0.0	0.0	10.0	0.0	0.0
Dividends payment	0.0	0.0	0.0	0.0	0.0	0.0	-172.5	-176.5	-179.4	-181.6	-182.7	-187.6	-195.3
Interest	-8.7	-15.2	-18.4	-24.0	-19.1	-18.5	-19.5	-20.5	-20.5	-20.5	-20.8	-21.1	-21.1
Other	-0.8	292.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<b>Financing cash flow</b>	<b>54.7</b>	<b>214.0</b>	<b>131.6</b>	<b>-24.0</b>	<b>-39.1</b>	<b>-18.5</b>	<b>-162.0</b>	<b>-197.0</b>	<b>-199.8</b>	<b>-202.1</b>	<b>-193.5</b>	<b>-208.7</b>	<b>-216.4</b>
<b>Total cash flow</b>	<b>24.6</b>	<b>1.8</b>	<b>11.1</b>	<b>-2.8</b>	<b>2.8</b>	<b>60.7</b>	<b>39.3</b>	<b>20.5</b>	<b>22.7</b>	<b>27.0</b>	<b>8.5</b>	<b>4.9</b>	<b>3.4</b>

Source: Company, DM IDMSA estimates

Fig. 6 Hydrobudowa Polska; Ratios

PLN m	2007	2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Sales growth (yoy)	115%	115%	43%	19%	19%	15%	3%	2%	2%	1%	4%	4%	4%
Gross profit growth (yoy)	154%	97%	103%	30%	22%	14%	2%	2%	1%	1%	3%	4%	4%
EBITDA growth (yoy)	314%	96%	111%	32%	23%	13%	2%	2%	2%	1%	3%	4%	5%
Operating profit growth (yoy)	493%	85%	126%	35%	24%	14%	2%	2%	1%	0%	2%	4%	4%
Net income growth (yoy)	280%	39%	104%	28%	29%	15%	2%	2%	1%	1%	3%	4%	4%
A/R turnover days	218	200	232	251	251	254	268	270	270	270	267	268	267
Inventory turnover days	5	3	3	3	3	3	4	4	4	4	4	4	4
A/P turnover days	110	104	123	132	131	133	140	141	141	141	139	140	140
Cash cycle	113	98	112	122	123	125	132	133	133	133	131	131	131
NWC/Sales	37%	39%	40%	41%	41%	41%	41%	41%	41%	41%	41%	41%	41%
Gross margin	9.5%	8.7%	12.3%	13.4%	13.8%	13.7%	13.5%	13.5%	13.4%	13.3%	13.1%	13.2%	13.2%
EBITDA margin	7.1%	6.4%	9.5%	10.6%	10.9%	10.7%	10.6%	10.6%	10.5%	10.5%	10.3%	10.4%	10.5%
EBIT margin	6.2%	5.3%	8.4%	9.5%	9.9%	9.7%	9.6%	9.6%	9.5%	9.4%	9.2%	9.3%	9.3%
Pretax margin	8.8%	4.7%	7.7%	8.6%	9.4%	9.3%	9.3%	9.2%	9.2%	9.1%	9.0%	9.0%	9.1%
Net margin	7.0%	4.5%	6.5%	7.0%	7.6%	7.5%	7.5%	7.4%	7.4%	7.3%	7.2%	7.3%	7.3%
ROE	34.4%	16.7%	19.5%	20.4%	21.3%	19.9%	18.2%	17.8%	17.3%	16.8%	16.7%	16.7%	16.8%
ROA	8.5%	6.4%	8.3%	8.4%	9.4%	9.3%	8.6%	8.4%	8.3%	8.2%	8.1%	8.2%	8.3%
Current ratio	1.4	1.9	1.8	1.8	1.9	2.0	2.0	2.0	2.1	2.1	2.1	2.1	2.1
Quick ratio	1.4	1.9	1.7	1.8	1.9	2.0	2.0	2.0	2.0	2.1	2.1	2.1	2.1

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** =  $\text{EBIT}/\text{sales}$

**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	-	Not later than 30.11.2009	-10%	-1%	6.43	8.53	→
-	→	-	11.01.2009	-	-	-	6.00	8.53	→
-	→	-	25.01.2009	-	-	-	5.80	8.53	→

**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	-	Not later than 25.01.2010	5.80	-

**Distribution of IDM's current recommendations**

	Buy	Hold	Sell	Suspended	Under revision
Numbers	21	22	7	1	0
Percentage	41%	43%	14%	2%	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	3	0	1	0
Percentage	33%	50%	0%	17%	0%

**Distribution of IDM's current market relative recommended weightings**

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	19	16	15	1	0
Percentage	37%	31%	29%	2%	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	4	0	1	0
Percentage	17%	67%	0%	17%	0%

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