

Hydrobudowa Polska

Sector: General construction
Fundamental rating: Buy (↑)
Market relative: Overweight (↑)
Price: PLN 3.84
12M EFV: PLN 4.32 (↑)

Market Cap.: US\$ 278 m
Reuters code: HBWLWA
Av. daily turnover: US\$ 0.50 m
Free float: 39%
12M range: PLN 3.12-6.09

Investments story & recommendation

We believe that Hydrobudowa Polska has probably already addressed the majority of potential risk factors related to the stadium contracts (the Company's flagship investments, with >50% share in backlog). For example, the Company has already subcontracted over 80% of construction works related to these constructions (fixing costs at the same time), which materially enhanced the visibility of its financial results this year (we expect the margins on stadiums to be higher than we previously anticipated and – consequently – we materially increase our short-to mid-term profits forecast). Furthermore, we find the potential risk of penalty payments (embedded in the stadium contracts) to be insignificant at the moment, as the construction works (despite unfavorable weather conditions in the past few weeks) progress in line with the schedule. On the back of double-digit fundamental upside to our upgraded 12M EFV (of PLN 4.32 per share) and our conviction that the discount that the Company's equities are being traded vs. the peers is too deep (HBP is the cheapest contractor in our coverage), we upgrade our LT fundamental recommendation for HBP's equities to a Buy (from Hold) and our ST market-relative bias to an Overweight (from Underweight).

Financial forecast

Our 2009 financial forecast for HBP remains unaltered (sales, EBIT and NP at – respectively – PLN 1,775.3 million, PLN 114 million and PLN 92.5 million), staying close to the management's guidance. We increase, however, our profit forecast for 2010 (and onwards, albeit in a much smaller extent), on the back of (i) higher than previously envisaged expected margins on stadiums (these we forecast to be above 7% at the gross profit on sales level) and (ii) decreased financial costs (lowered net debt going forward). For details regarding changes in our financial forecast for HBP, please see *Figure 1* on the next page.

Valuation

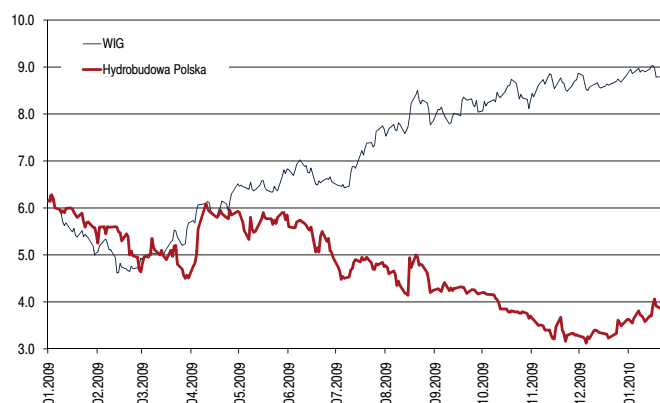
As a result of aforementioned financial forecast upgrade and lowered 2010E-eop net debt, our 12M EFV for HBP's equities goes up by 23% to PLN 4.32 per share (from PLN 3.5 per share previously). In the local peer-relative context HBP trades with visible discounts to the averages (respectively c. 24% and 14% on 2010E and 2011E P/E multiples), which in the wake of diminishing risk factors relating to the Company's key constructions (stadiums), seem excessive to us.

Key data

IFRS consolidated		2008	2009E	2010E	2011E
Sales	PLN m	1,225.5	1,775.3	1,996.2	2,204.1
EBITDA	PLN m	78.4	126.8	132.5	131.1
EBIT	PLN m	60.9	114.0	119.1	117.8
Net profit	PLN m	64.5	92.5	82.8	81.8
EPS	PLN m	0.31	0.44	0.39	0.39
EPS yoy chng	%	6	44	-10	-1
Net debt	PLN m	230.9	306.3	283.8	256.8
P/E	x	12.5	8.7	9.8	9.9
P/CE	x	9.9	7.7	8.4	8.5
EV/EBITDA	x	13.3	8.8	8.2	8.1
EV/EBIT	x	17.1	9.8	9.2	9.0
EV/Sales	x	0.8	0.6	0.5	0.5
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 4Q09 financial results: March 1, 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

4Q09E results forecast

HBP's 4Q09 financial results (to be released on March 1) should be strong (for details please refer to *Figure 2* on the next page). On the back of well developed contract portfolio last year, we forecast the Company's quarterly sales at PLN 725.6 million, marking >80% yoy growth (we estimate c. 45% share of sales from stadium constructions in the Company's quarterly top line). At the operating profit line level, we expect HBP to show PLN 42.6 million

(EBIT margin at 5.9%) vs. operating loss in the base quarter of 4Q08, which stemmed from losses on FX transaction (hedging) after significant appreciation of EUR vs. PLN. As we expect the Company to show net financial costs in 4Q09 (vs. net financial income

of PLN 7.6 million in 4Q08, driven by translation gains on the back of aforementioned EUR vs. PLN strengthening), we project the Company's net profit to go up from PLN 6 million in 4Q08 to PLN 31.7 million in 4Q09.

Fig. 1 Hydrobudowa Polska; Changes in IDM's forecasts

IFRS consolidated PLN m	2009E			2010E			2011E		
	current	previous	change	current	previous	change	current	previous	change
Sales	1,775.3	1,775.3	0%	1,996.2	1,996.2	0%	2,204.1	2,204.1	0%
EBIT	114.0	114.0	0%	119.1	100.2	19%	117.8	114.3	3%
NP	92.5	92.4	0%	82.8	64.7	28%	81.8	74.0	10%

Source: DM IDMSA estimates

Fig. 2 Hydrobudowa Polska; 4Q09 results forecast

IFRS consolidated PLN m	4Q09E	4Q08	yoy change
Sales	725.6	384.0	89%
EBIT	42.6	-6.4	n.m.
EBIT margin	5.9%	-1.7%	-
Pre-tax profit	35.6	1.0	n.m.
Pre-tax margin	4.9%	0.3%	-
Net profit	31.7	6.0	426%
Net margin	4.4%	1.6%	-

Source: DM IDMSA estimates

Fig. 3 Hydrobudowa Polska; DCF valuation

PLN m	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	>2019E
Sales	1,775.3	1,996.2	2,204.1	2,143.7	2,120.2	2,102.5	2,139.3	2,174.5	2,222.3	2,271.8	2,323.0	
yoy change	45%	12%	10%	-3%	-1%	-1%	2%	2%	2%	2%	2%	
EBIT margin	6.4%	6.0%	5.3%	5.7%	5.9%	6.0%	6.0%	6.1%	6.3%	6.3%	6.3%	
EBIT	114.0	119.1	117.8	122.7	124.8	125.8	129.4	132.6	139.3	143.0	146.9	
yoy change	87%	5%	-1%	4%	2%	1%	3%	2%	5%	3%	3%	
Effective cash tax rate (T)	4%	19%	19%	19%	19%	19%	19%	19%	19%	19%	19%	
EBIT * (1-T)	109.0	96.5	95.5	99.4	101.1	101.9	104.8	107.4	112.9	115.9	119.0	
yoy change	72%	-11%	-1%	4%	2%	1%	3%	2%	5%	3%	3%	
EBITDA	126.8	132.5	131.1	135.8	137.8	139.6	144.1	148.3	156.0	160.8	165.8	
yoy change	62%	5%	-1%	4%	1%	1%	3%	3%	5%	3%	3%	
EBITDA margin	7.1%	6.6%	5.9%	6.3%	6.5%	6.6%	6.7%	6.8%	7.0%	7.1%	7.1%	
Depreciation	12.8	13.4	13.3	13.1	13.0	13.8	14.7	15.7	16.7	17.8	18.9	
EBIT * (1-T) + D	121.8	109.8	108.7	112.5	114.1	115.7	119.5	123.1	129.5	133.6	137.9	
yoy change	51%	-10%	-1%	3%	1%	1%	3%	3%	5%	3%	3%	
Capex	-13.9	-14.8	-14.6	-13.7	-13.4	-14.3	-15.1	-16.0	-17.0	-18.1	-19.8	
Change in WC	-7.8	-59.5	-53.9	14.1	5.3	25.2	-10.5	-10.0	-14.2	-13.7	-14.2	
Equity issue proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Free cash flow	100.1	35.6	40.1	112.9	106.0	126.7	93.9	97.1	98.3	101.9	103.9	
Cost of equity												
Risk free rate (nominal)	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	5.0%
Equity risk premium	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
Unlevered beta	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Beta adjusted for leverage	1.46	1.32	1.27	1.20	1.19	1.17	1.15	1.13	1.12	1.11	1.10	1.10
Required rate of return	12.6%	11.9%	11.7%	11.4%	11.4%	11.3%	11.2%	11.1%	11.0%	11.0%	10.9%	9.9%
Cost of debt												
Cost of debt (pre-tax)	7.5%	7.0%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%	6.5%
Effective tax rate	4%	19%	19%	19%	19%	19%	19%	19%	19%	19%	19%	19%
After-tax cost of debt	7.2%	5.7%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
WACC												
Weight of debt	33%	28%	25%	20%	19%	17%	16%	14%	13%	12%	11%	11%
Weight of equity	67%	72%	75%	80%	81%	83%	84%	86%	87%	88%	89%	89%
Cost of equity	12.6%	11.9%	11.7%	11.4%	11.4%	11.3%	11.2%	11.1%	11.0%	11.0%	10.9%	9.9%
After-tax cost of debt	7.2%	5.7%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%	5.3%
WACC	10.8%	10.2%	10.1%	10.2%	10.2%	10.2%	10.2%	10.3%	10.3%	10.3%	10.3%	9.4%
Discount multiple	1.00	1.00	1.09	1.20	1.33	1.46	1.61	1.78	1.96	2.16	2.39	
Discount factor	1.00	1.00	0.92	0.83	0.75	0.68	0.62	0.56	0.51	0.46	0.42	
PV of free cash flow	-	-	36.7	93.8	79.9	86.6	58.3	54.6	50.1	47.1	43.6	
Sum of FCFFs PVs												550.7
Weight of debt in the residual period												11%
Weight of equity in the residual period												89%
Average cost of equity in the definite period												11.4%
Average WACC in the definite period												10.3%
WACC in the residual period												9.4%
Residual growth of FCFFs, base-case scenario												2.5%
Residual value												1,535.8
Present value of the residual value												643.5
Value of HBP's operations												1,194.3
Cash and equivalents, eop 2010E												76.2
Interest-bearing debt, eop 2010E												360.0
Equity value												910.4
No. of shares (m)												210.6
12-month forward per share EFV (PLN)												4.32

Source: DM IDMSA estimates

Financial statements (IFRS consolidated)
Fig. 4 Hydrobudowa Polska; Balance sheet

PLN m	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Fixed assets	252.3	253.4	254.9	256.2	256.8	257.2	257.7	258.1	258.5	258.8	259.1	260.0
Intangibles	2.2	2.3	2.6	3.0	3.2	3.5	3.6	3.8	3.8	3.9	3.8	3.8
Goodwill	37.2	37.2	37.2	37.2	37.2	37.2	37.2	37.2	37.2	37.2	37.2	37.2
Tangible fixed assets	160.6	161.6	162.7	163.7	164.0	164.2	164.5	164.8	165.1	165.4	165.7	166.7
LT receivables	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7	9.7
LT investments	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
LT deferred assets	37.4	37.4	37.4	37.4	37.4	37.4	37.4	37.4	37.4	37.4	37.4	37.4
Other	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Current assets	957.4	1,170.8	1,253.6	1,383.3	1,389.1	1,401.4	1,394.8	1,408.2	1,421.6	1,441.6	1,462.1	1,503.1
Inventories	12.3	16.1	18.1	20.2	19.5	19.3	19.1	19.4	19.7	20.1	20.5	21.0
ST receivables	857.3	1,011.9	1,137.9	1,256.3	1,221.9	1,208.5	1,177.4	1,198.0	1,217.7	1,244.5	1,272.2	1,300.9
ST deferred assets	12.6	18.3	20.5	22.7	22.0	21.8	21.6	22.0	22.4	22.8	23.4	23.9
Cash & equivalents	74.3	123.7	76.2	83.2	124.7	151.0	175.8	167.9	160.9	153.3	145.1	156.4
Other assets	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Total assets	1,209.8	1,424.2	1,508.5	1,639.5	1,645.9	1,658.7	1,652.5	1,666.3	1,680.1	1,700.5	1,721.3	1,763.1
Equity	228.8	321.4	404.2	486.0	574.1	595.5	615.6	638.5	661.8	688.6	714.3	740.5
Liabilities & reserves	980.9	1,102.9	1,104.3	1,153.5	1,071.8	1,063.2	1,036.9	1,027.8	1,018.3	1,011.9	1,007.0	1,022.7
Reserves	10.8	15.6	17.6	19.4	18.9	18.7	18.5	18.9	19.2	19.6	20.0	20.5
LT liabilities	95.0	90.2	90.2	90.2	90.2	90.2	90.2	90.2	90.2	90.2	90.2	90.2
Non-interest-bearing	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2	10.2
Interest-bearing	84.8	80.0	80.0	80.0	80.0	80.0	80.0	80.0	80.0	80.0	80.0	80.0
ST Liabilities	870.0	989.5	988.1	1,034.6	953.7	945.3	919.3	909.7	899.8	892.7	887.2	902.2
Non-interest-bearing	488.9	639.5	708.1	774.6	753.7	745.3	739.3	749.7	759.8	772.7	787.2	802.2
Interest-bearing	381.1	350.0	280.0	260.0	200.0	200.0	180.0	160.0	140.0	120.0	100.0	100.0
Deferred liabilities	5.2	7.5	8.4	9.3	9.0	8.9	8.8	9.0	9.1	9.3	9.6	9.8
Total liabilities and equity	1,209.8	1,424.2	1,508.5	1,639.5	1,645.9	1,658.7	1,652.5	1,666.3	1,680.1	1,700.5	1,721.3	1,763.1

Source: Company, DM IDMSA estimates

Fig. 5 Hydrobudowa Polska; Income statement

PLN m	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Sales	1,225.5	1,775.3	1,996.2	2,204.1	2,143.7	2,120.2	2,102.5	2,139.3	2,174.5	2,222.3	2,271.8	2,323.0
COGS	-1,103.5	-1,605.6	-1,814.1	-2,016.7	-1,952.9	-1,927.6	-1,909.1	-1,940.8	-1,971.5	-2,010.9	-2,055.0	-2,100.6
Gross profit on sales	122.0	169.7	182.1	187.4	190.8	192.6	193.4	198.5	203.0	211.4	216.8	222.4
General administration costs	-49.1	-65.8	-63.0	-69.5	-68.1	-67.8	-67.6	-69.0	-70.4	-72.0	-73.8	-75.5
Net profit on sales	72.9	103.9	119.1	117.8	122.7	124.8	125.8	129.4	132.6	139.3	143.0	146.9
Other operating income	14.3	15.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other operating costs	-26.3	-5.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EBIT	60.9	114.0	119.1	117.8	122.7	124.8	125.8	129.4	132.6	139.3	143.0	146.9
Financial income	27.6	9.8	7.1	6.2	6.7	7.4	7.9	8.2	8.3	8.3	8.4	8.6
Financial costs	-25.4	-26.8	-23.7	-22.8	-20.2	-18.2	-17.6	-16.3	-15.0	-13.7	-12.4	-11.7
Pre tax income	63.1	97.0	102.5	101.3	109.2	114.0	116.2	121.4	125.9	134.0	139.1	143.8
Income tax	2.4	-4.3	-19.5	-19.2	-20.8	-21.7	-22.1	-23.1	-23.9	-25.5	-26.4	-27.3
Minority interest in net income	-1.1	-0.2	-0.2	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-0.6	-0.6
Net income	64.5	92.5	82.8	81.8	88.1	91.9	93.6	97.8	101.5	108.0	112.1	115.9

Source: Company, DM IDMSA estimates

Fig. 6 Hydrobudowa Polska; Cash flow

PLN m	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Gross income (loss)	63.1	97.0	102.5	101.3	109.2	114.0	116.2	121.4	125.9	134.0	139.1	143.8
Depreciation and amortization	17.5	12.8	13.4	13.3	13.1	13.0	13.8	14.7	15.7	16.7	17.8	18.9
NWC change:	-244.5	-7.8	-59.5	-53.9	14.1	5.3	25.2	-10.5	-10.0	-14.2	-13.7	-14.2
Change in inventories	2.3	-3.7	-2.1	-2.0	0.6	0.3	0.2	-0.3	-0.3	-0.4	-0.4	-0.5
Change in receivables	-267.2	-154.7	-125.9	-118.5	34.4	13.4	31.1	-20.6	-19.7	-26.7	-27.7	-28.7
Change in payables	20.4	150.6	68.5	66.5	-20.9	-8.3	-6.1	10.4	10.1	12.9	14.5	15.0
Other	-28.8	14.0	3.1	2.6	-2.7	-6.0	-7.5	-9.8	-11.8	-14.6	-16.7	-18.3
Operating cash flow	-192.8	116.0	59.5	63.2	133.8	126.3	147.7	115.8	119.8	121.9	126.4	130.2
Capital expenditures	-45.0	-13.9	-14.8	-14.6	-13.7	-13.4	-14.3	-15.1	-16.0	-17.0	-18.1	-19.8
Other	0.1	4.1	1.5	1.2	1.6	2.1	2.5	2.6	2.5	2.4	2.2	2.3
Investing cash flow	-44.9	-9.8	-13.3	-13.4	-12.1	-11.4	-11.8	-12.5	-13.6	-14.7	-15.8	-17.5
Change in interest-bearing debt	-14.6	-35.8	-70.0	-20.0	-60.0	0.0	-20.0	-20.0	-20.0	-20.0	-20.0	0.0
Dividends payment	0.0	0.0	0.0	0.0	0.0	-70.5	-73.5	-74.9	-78.3	-81.2	-86.4	-89.7
Interest	-26.1	-26.8	-23.7	-22.8	-20.2	-18.2	-17.6	-16.3	-15.0	-13.7	-12.4	-11.7
Other	313.5	5.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financing cash flow	272.8	-56.9	-93.7	-42.8	-80.2	-88.7	-111.1	-111.2	-113.2	-114.9	-118.8	-101.4
Total cash flow	35.2	49.3	-47.5	7.0	41.5	26.3	24.8	-7.9	-7.0	-7.6	-8.2	11.3

Source: Company, DM IDMSA estimates

Fig. 7 Hydrobudowa Polska; Ratios

	2008	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Sales growth (yoy)	114%	45%	12%	10%	-3%	-1%	-1%	2%	2%	2%	2%	2%
Gross profit growth (yoy)	126%	39%	7%	3%	2%	1%	0%	3%	2%	4%	3%	3%
EBITDA growth (yoy)	94%	62%	5%	-1%	4%	1%	1%	3%	3%	5%	3%	3%
Operating profit growth (yoy)	73%	87%	5%	-1%	4%	2%	1%	3%	2%	5%	3%	3%
Net income growth (yoy)	60%	44%	-10%	-1%	8%	4%	2%	4%	4%	6%	4%	3%
A/R turnover days	191	192	197	198	211	209	207	203	203	202	202	202
Inventory turnover days	3	3	3	3	4	4	4	4	4	4	4	4
A/P turnover days	96	103	113	114	122	121	121	119	119	119	119	119
Cash cycle days	98	93	87	88	93	92	90	87	87	87	87	87
NWC/Sales	30%	21%	22%	22%	22%	22%	21%	21%	21%	22%	22%	22%
Gross margin	10.0%	9.6%	9.1%	8.5%	8.9%	9.1%	9.2%	9.3%	9.3%	9.5%	9.5%	9.6%
EBITDA margin	6.4%	7.1%	6.6%	5.9%	6.3%	6.5%	6.6%	6.7%	6.8%	7.0%	7.1%	7.1%
EBIT margin	5.0%	6.4%	6.0%	5.3%	5.7%	5.9%	6.0%	6.0%	6.1%	6.3%	6.3%	6.3%
Pre-tax margin	5.1%	5.5%	5.1%	4.6%	5.1%	5.4%	5.5%	5.7%	5.8%	6.0%	6.1%	6.2%
Net margin	5.3%	5.2%	4.2%	3.7%	4.1%	4.3%	4.5%	4.6%	4.7%	4.9%	4.9%	5.0%
ROE	35.0%	33.6%	22.8%	18.4%	16.6%	15.7%	15.5%	15.6%	15.6%	16.0%	16.0%	15.9%
ROA	7.2%	7.0%	5.6%	5.2%	5.4%	5.6%	5.7%	5.9%	6.1%	6.4%	6.6%	6.7%
Current ratio	1.1	1.2	1.3	1.3	1.5	1.5	1.5	1.5	1.6	1.6	1.6	1.7
Quick ratio	1.1	1.2	1.3	1.3	1.4	1.5	1.5	1.5	1.6	1.6	1.6	1.6

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	-	Not later than 31.01.2011	-	-	3.84	4.32	↑

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	-	Not later than 31.01.2011	3.84	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	21	31	11	1	0
Percentage	33%	48%	17%	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	3	3	0	1	0
Percentage	43%	43%	0%	14%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	24	26	13	1	0
Percentage	38%	41%	20%	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	2	3	1	1	0
Percentage	29%	43%	14%	14%	0%

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