IDMSA DOM MAKLERSKI

Forecast Update

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Hydrobudowa Polska

Sector: General construction
Fundamental rating: Sell (↓)
Market relative: Underweight (↓)
Price: PLN 3.72
12M EFV: PLN 3.55 (↓)

Market Cap.: US$ 271 m
Reuters code: HBWL.WA
Av. daily turnover: US$ 0.50 m
Free float: 39%
12M range: PLN 3.12-6.09

Investment story & recommendation

Despite the management's recent signalling, the margins on stadium contracts (the Company's flagship investments, with >50% share in backlog) may come out tiny. First, due to unfavorable weather conditions in the past few weeks (temperature below zero), HBP incurred higher than previously envisaged construction costs in order to run the works in line with the schedules (cost-consuming technologies were applied). Second, on the back of recently signed agreements with subcontractors, the costs of some subcontracting works may prove way above the Company's initial assumptions and our projections. We expect the margins on stadiums to be lower than we previously anticipated and – consequently – we materially decrease our short- to mid-term profit forecast. With lowered 12M EFV (of PLN 3.55 per share) resting below the current share market price, we downgrade our LT fundamental rating for HBP's equities to Sell (from Buy). We also downgrade our ST market-relative bias to an Underweight (from Overweight).

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 decrease, however, our profit forecast for 2010 and onwards, on the back of much lower than previously envisaged expected margins on stadiums (these we forecast to be at 5% at the gross profit on sales level, versus 7% assumed previously). Please note that we see the risk of further margin forecast downward revision. The risk relates both to stadium contracts as well as new contracts that the Company may be awarded this year (HBP's backlog for 2011 is still tiny at the moment and – given tough competition in the environmental protection segment – we expect HBP to materially lower prices in order to boost the portfolio). For details regarding changes in our financial forecast for HBP, please see *Figure 1* below.

Valuation

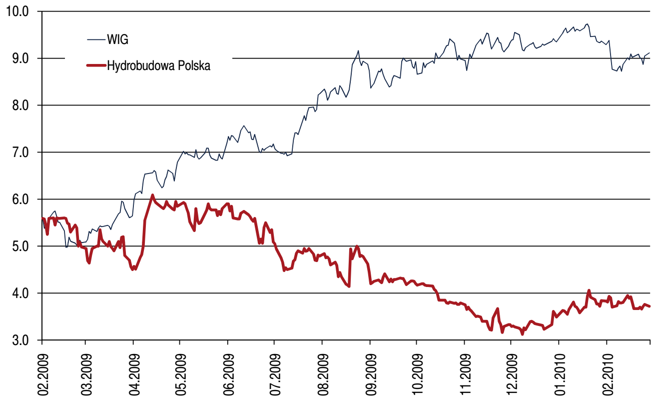
As a result of aforementioned financial forecast downgrade, our 12M EFV for HBP's equities goes down by 18% to PLN 3.55 per share (from PLN 4.32 per share previously). In the local peer-relative context HBP trades with premium to the averages (c. 24% on 2010E P/E multiple), which we deem unjustified given very low visibility of the Company's financial results this year and rather challenging further backlog improvement.

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	87.2	111.3
EBIT	*PLN m*	60.9	114.0	73.8	98.0
Net profit	*PLN m*	64.5	92.5	50.9	72.3
EPS	*PLN m*	0.31	0.44	0.24	0.34
EPS yoy chng	*%*	6	43	-45	42
Net debt	*PLN m*	230.9	66.7	131.7	126.7
P/E	*x*	12.1	8.5	15.4	10.8
P/CE	*x*	9.6	7.4	12.2	9.2
EV/EBITDA	*x*	12.9	6.7	10.5	8.2
EV/EBIT	*x*	16.7	7.5	12.4	9.3
EV/Sales	*x*	0.8	0.5	0.5	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 FY09 financial results: March 22, 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

Please note that the figures have been removed from this publication intentionally.

BASIC DEFINITIONS
A/R turnover (in days) = 365/(sales/average A/R))
Inventory turnover (in days) = 365/(COGS/average inventory))
A/P turnover (in days) = 365/(COGS/average A/P))
Current ratio = ((current assets – ST deferred assets)/current liabilities)
Quick ratio = ((current assets – ST deferred assets – inventory)/current liabilities)
Interest coverage = (pre-tax profit before extraordinary items + interest payable/interest payable)
Gross margin = gross profit on sales/sales
EBITDA margin = EBITDA/sales
EBIT margin = EBIT/sales
Pre-tax margin = pre-tax profit/sales
Net margin = net profit/sales
ROE = net profit/average equity
ROA = (net income + interest payable)/average assets
EV = market capitalization + interest bearing debt – cash and equivalents
EPS = net profit/ no. of shares outstanding
CE = net profit + depreciation
Dividend yield (gross) = pre-tax DPS/stock market price
Cash sales = accrual sales corrected for the change in A/R
Cash operating expenses = 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.

Banks
Net Interest Margin (NIM) = net interest income/average assets
NIM Adjusted = (net interest income adjusted for SWAPs)/average assets
Non interest income = fees&commissions + result on financial operations (trading gains) + FX gains
Interest Spread = (interest income/average interest earning assets)/ (interest cost/average interest bearing liabilities)
Cost/Income = (general costs + depreciation + other operating costs)/ (profit on banking activity + other operating income)
ROE = net profit/average equity
ROA = net income/average assets
Non performing loans (NPL) = loans in 'substandard', 'doubtful' and 'lost' categories
NPL coverrage ratio = loan loss provisions/NPL
Net provision charge = provisions created – 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.

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.

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*	-	*Not later than 01.03.2011*	-	-	3.72	3.55	↓

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*	-	*Not later than 01.03.2011*	3.72	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	22	31	13	1	0
Percentage	33%	46%	19%	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	1	5	0	1	0
Percentage	14%	71%	0%	14%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	23	28	15	1	0
Percentage	34%	42%	22%	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	4	1	1	0
Percentage	14%	57%	14%	14%	0%

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