

# Hydrobudowa Polska

Sector: Construction  
Fundamental rating: Hold (→)  
Market relative: Underweight (↓)  
Price: PLN 0.88  
12M EFV: PLN 1.3 (→)

Market Cap.: US\$ 58 m  
Reuters code: HBWLWA  
Av. daily turnover: US\$ 0.46 m  
Free float: 37%  
12M range: PLN 0.70-3.38

## Investment story and recommendation

HBP's equities suffered a tremendous share market price decline in the last months. Valuation-wise, the stock is inexpensive, but in the absence of any positive triggers we maintain our LT fundamental Hold recommendation. Moreover, taking into account (i) feeble 3Q11E results, (ii) expected revision of management's FY11 guidance, and (iii) weak cash position, we lower our ST market-relative rating to Underweight (from Neutral). We might become more positive about HBP's equities if the Company shows positive effects of a restructuring process and pursues the announced strategy involving refocusing from the low-margin road and general construction to the construction works for power units and gas & oil.

## Restructuring and refocusing

According to Mr. Jerzy Wiśniewski, PBG's CEO, HBP should be merged with Aprivia and transformed into a subcontractor on PBG's oil & gas and power construction contracts. This may be beneficial for the Company in terms of volumes, although there is a risk of margin transfer to the PBG Group at the expense of HBP's minority shareholders. HBP is also undergoing a restructuring process (Miko-Tech spin-off, merging structures of HBP and Hydrobudowa 9, optimisation of the real estate utilisation) that, according to PBG's management, may reduce expenses by as much as PLN 20 million. Should this goal be attained, the downsizing (which is in our view inevitable because of the expected sales decline) may turn to be less detrimental to the HBP's results than previously expected.

## 3Q11 results' forecast

We expect HBP's 3Q11 results, due to be released on November 14, to come out decent in yoy terms, yet unimpressive taken into account the management's FY11 guidance.

**Sales.** We expect HBP to post PLN 430 million in sales (up 3% yoy) – we think that this figure was partially hit by poor weather conditions in July/August.

**Gross profit.** In our view, the 3Q11 gross margin on sales was rather weak standing at 5.0%, depressed mainly by low-margin road and stadium contracts.

**EBIT & net income.** We expect no significant one-offs, which leads us to our 3Q11E EBIT of PLN 10.5 million. The bottom line may be slightly hit because of the EUR appreciation – HBP has a naked long PLN forward position created to hedge profits from an EUR-denominated contract for a sewage system construction

## Guide to adjusted profits

FY11E net profit adjusted for non-recurring items.

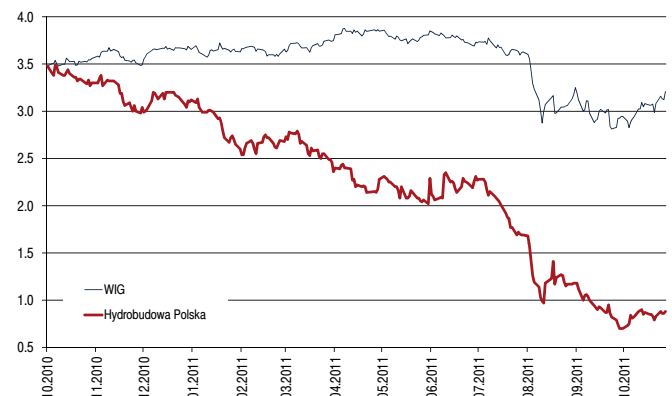
## Key data

IFRS consolidated		2010	2011E	2012E	2013E
Sales	PLN m	1,581.6	1,582.4	1,565.4	1,165.8
EBITDA	PLN m	63.2	77.0	84.1	68.9
EBIT	PLN m	44.6	56.3	60.3	42.7
Net profit	PLN m	8.1	43.0	31.6	22.0
Adj net profit	PLN m	8.1	34.9	31.6	22.0
Adj EPS	PLN m	0.04	0.20	0.15	0.10
Adj EPS yoy chng	%	-92	431	-26	-31
Net debt	PLN m	278.2	307.8	239.0	149.1
P/E	x	22.9	4.3	5.9	8.4
P/ICE	x	7.0	2.9	3.3	3.8
EV/EBITDA	x	7.3	6.4	5.0	4.9
EV/EBIT	x	10.4	8.8	7.0	7.8
Gross dividend yield	%	0.0	0.0	0.0	5.1
DPS	PLN	0.00	0.00	0.00	0.05
No. of shares (eop)	m	210.6	210.6	210.6	210.6

P/E and P/ICE multiples based on adjusted net profit.

Source: Company, DM IDMSA estimates

## Stock performance



Source: Bloomberg

## Upcoming events

1. Release of the 3Q11 results: November 14, 2011

## Catalysts

1. Successful restructuring
2. Successful refocusing

## Risk factors

1. Guidance revision
2. Weak profitability of underlying business
3. Weak cash position

in Bydgoszcz (where eventually the scope of work appeared to be smaller than expected).

**Cash position.** In 3Q11, we do not expect the cash position to exhibit any material improvement, but we think that it should show some signs of revival in 4Q11.

**Backlog.** We estimate HBP's backlog at the end of 3Q11 to stand at PLN 2.2 billion.

### Financial forecast

**Sales.** We expect the management's guidance (FY11 sales of over PLN 1.6 billion) to be met. Taking into account that the Company has already c. PLN 1.3 billion backlog for FY12, we expect this level of revenue to be maintained in the next year. However, we expect a significant slump thereafter, caused by the falling number of investment projects in road construction. As of FY14, the sales figures should improve due to the Company's participation in power construction contracts.

**EBIT.** We expect HBP's FY11 EBIT to amount to PLN 56.3 million. We think that it will be maintained in FY12, and then decline along with falling revenue.

**Net income.** In our view, the net profit guidance for FY11 (PLN 50 million) will not be met. In the coming years, we expect a significant drop in the net income, given that FY11 results were strongly supported by significant one-off items (which we estimate to stand at PLN 8.1 million after-tax).

### Valuation

We value HBP with the use of a 75%/20%/5% combination of DCF, domestic peers and foreign peers valuation. The peers valuation utilises EV/EBITDA and P/E multiples with equal weights. The 12M EFVs implied by the DCF and peer valuation are PLN 1.4 per share and PLN 1.1 per share, respectively. As a result, our 12M EFV remains unchanged at PLN 1.3.

## 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	-	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	-	06.06.2011	-39%	-47%	3.34	3.36	→
-	→	-	31.08.2010	-	-	-	3.48	3.36	→
-	→	-	12.10.2010	-	-	-	3.38	3.36	→
-	→	-	25.10.2010	-	-	-	3.30	3.36	→
-	→	-	15.11.2010	-	-	-	3.28	3.36	→
-	→	-	15.12.2010	-	-	-	3.20	3.36	→
-	→	-	02.01.2011	-	-	-	3.12	3.36	→
-	→	-	28.01.2011	-	-	-	2.65	3.36	→
-	→	-	01.03.2011	-	-	-	2.73	3.36	→
-	→	-	24.03.2011	-	-	-	2.55	3.36	→
-	→	-	19.04.2011	-	-	-	2.21	3.36	→
-	→	-	20.04.2011	-	-	-	2.20	3.36	→
-	→	-	16.05.2011	-	-	-	2.08	3.36	→
Under revision	-	06.06.2011	-	17.07.2011	-2%	1%	2.05	Under revision	-
-	→	-	20.06.2011	-	-	-	2.20	Under revision	-
Sell	-	17.07.2011	-	31.08.2011	-41%	-34%	2.01	1.70	-
-	→	-	25.07.2011	-	-	-	1.69	1.70	→
Hold	↑	31.08.2011	-	Not later than 31.08.2012	-	-	1.18	1.30	↓
-	→	-	03.10.2011	-	-	-	0.73	1.30	→
-	→	-	24.10.2011	-	-	-	0.88	1.30	→
-	→	-	27.10.2011	-	-	-	0.88	1.30	→

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	-	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	-	25.10.2010	3.34	-9%
-	→	-	31.08.2010	-	3.48	-
-	→	-	12.10.2010	-	3.38	-
Overweight	↑	25.10.2010	-	19.04.2011	3.30	-38%
-	→	-	15.11.2010	-	3.28	-
-	→	-	15.12.2010	-	3.20	-
-	→	-	02.01.2011	-	3.12	-
-	→	-	28.01.2011	-	2.65	-
-	→	-	01.03.2011	-	2.73	-
-	→	-	24.03.2011	-	2.55	-
Underweight	↓	19.04.2011	-	06.06.2011	2.21	-6%
-	→	-	20.04.2011	-	2.20	-
-	→	-	16.05.2011	-	2.08	-
Under revision	-	06.06.2011	-	17.07.2011	2.05	1%
-	→	-	20.06.2011	-	2.20	-
Underweight	-	17.07.2011	-	31.08.2011	2.01	-34%
-	→	-	25.07.2011	-	1.69	-
Neutral	↓	31.08.2011	-	27.10.2011	1.18	-25%
-	→	-	03.10.2011	-	0.73	-
-	→	-	24.10.2011	-	0.88	-
Underweight	↓	27.10.2011	-	Not later than 27.10.2012	0.88	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	24	40	8	1	0
Percentage	33%	55%	11%	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	2	2	1	1	0
Percentage	33%	33%	17%	17%	0%

Distribution of IDM's current market relative recommended weightings

	Overweight	Neutral	Underweight	Suspended	Under revision
Numbers	22	32	18	1	0
Percentage	30%	44%	25%	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	2	2	1	1	0
Percentage	33%	33%	17%	17%	0%

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