Quarterly Results Preview

IDMSA DOM MAKLERSKI

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Energomontaż Południe

Sector: Construction
Fundamental rating: Hold (↓)
Market relative: Overweight (→)
Price: PLN 4.58
12M EFV: PLN 4.5 (↓)

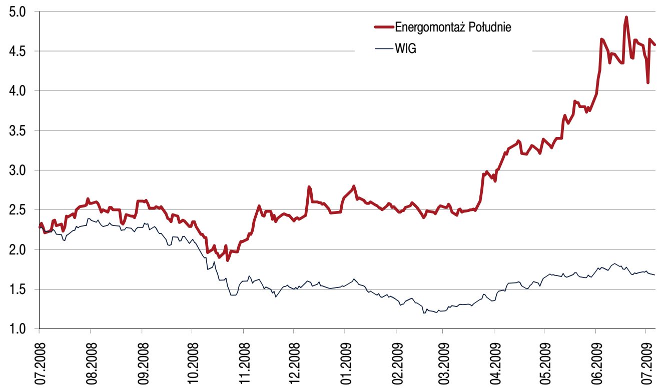
Market Cap.: US$ 69 m
Reuters code: EMPD.WA
Av. daily turnover: US$ 0.03 m
Free float: 61%
12M range: PLN 1.86-4.93

Key data

IFRS consolidated		2008	2009E	2010E	2011E
Sales	*PLN m*	239.8	311.1	331.4	367.8
EBITDA	*PLN m*	29.8	36.3	37.9	38.8
EBIT	*PLN m*	25.3	31.4	32.4	32.6
Net profit	*PLN m*	15.6	17.4	20.8	23.3
EPS	*PLN*	0.33	0.37	0.44	0.49
EPS yoy chng	*%*	16	11	19	12
Net debt	*PLN m*	63.2	-17.2	-6.9	-7.1
P/E	*x*	13.9	16.7	14.0	12.5
P/CE	*x*	10.8	13.0	11.0	9.8
EV/EBITDA	*x*	9.4	7.5	7.5	7.3
EV/EBIT	*x*	11.1	8.7	8.7	8.7
EV/Sales	*x*	1.2	0.9	0.9	0.8
Gross dividend yield	*%*	2.0	2.0	2.2	2.7
No. of shares (eop)	*ths.*	47,544	63,344	63,344	63,344

Source: Company, DM IDMSA estimates

Stock performance



Source: ISI

Upcoming events

1. Release of 1H09 results: August 31, 2009

Catalysts

1. Efficient expansion on the German market
2. Signing large contracts in the power segment
3. Synergies with Amontex and PBG

Risk factors

1. Inefficient expansion on the German market
2. Delays in the start of the investments in the power sector in Poland
3. Prolonging slowdown (which may lower demand on steel structures)
4. Falling prices of dwellings may entail fall of land prices
5. Possible lack of expected synergies with Amontex and PBG

- **Good 2Q09E financial posting.** Energomontaż Południe (EP) will release its 2Q09 financial results (in consolidated report for 1H09) on August 31. We expect the results to be good, with envisaged healthy yoy profits increase (for details please refer to *Figure 1* on the next page). Please note, however, that such quarterly financial posting should not constitute a major surprise for the investors community, in our view.

- **Flattish yoy quarterly sales.** We forecast the Company's quarterly sales to go up by only 3% yoy (to PLN 69.8 million), despite materially improved contract portfolio in recent times. The reason are the delays in launching the construction works in Germany (the Company won there a few lucrative contracts in recent times, yet the projects' kick-offs were postponed until 3Q09). Furthermore, we forecast poor quarterly sales of Amontex (the Company's subsidiary specializing in the production of steel structures), due to very low demand on its products and services (early-cyclical business).

- **One-off costs.** We forecast the Company's quarterly operating profit to be affected by one-off costs. Specifically, we envisage EP to recognize c. PLN 1 million costs related to arrangement of the office space ('Legnicka Park Popowice') for tenants. Please note, however, that it will be partially offset by envisaged c. PLN 0.9 million gain on leasing agreements (EP will recognize only c. 50% of profits from this activity in 2Q09, as the office space had not been fully adopted for tenants yet).

- **Healthy growth of profits.** We forecast EP to post a healthy yoy improvement as far as the 2Q09 profitability is concerned (we forecast the Company's EBIT margin at 6.6% in 2Q09 vs. 0.1% in the base quarter). In our opinion, the margin growth should stem from (i) better yoy quality of backlog, coupled with (ii) favorable sectoral trends (construction costs on decline), and (iii) better yoy performance of the production division (which reached its BEP in 3Q08). The margin improvement should translate into material yoy increase of the Company's operating and net profit in 2Q09, in our view, which we forecast at, respectively, PLN 4.6 million (versus EBIT of zero for the base period), and PLN 3.4 million (almost 100% yoy increase).

- **New shares issue for PBG.** The management of PBG has recently announced that it is in talks with EP concerning purchase of c. 25% equity stake in the latter (new issue of c. 15.8 million shares). PBG stated that the general terms of the transaction had been already agreed upon. According to unofficial sources, the shares will be issued at prices in the PLN 3.4-3.5 range.

- **Financial forecast – unchanged.** We keep our financial forecast for the Company intact. Please note, however, that we can not preclude some upgrade going forward. EP seems well positioned to be awarded some contracts by PBG (e.g. these related to the construction of stadiums), which would materially improve its contract portfolio. At the moment, however, we find it difficult to precisely estimate the probability of such development.

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

- **Valuation – diluted by the prospective share issue to PBG.** After incorporation of the prospective issue of 15.8 million new shares at PLN 3.45 per share (i.e. much below current share market price and our pre-issue per share value assessment) our 12M per share EFV for the Company declines moderately (by c. 10%) to PLN 4.5 per share (from PLN 5.0 per share previously).

- **LT fundamental rating downgraded.** Since the issuance of our Buy rating for EP's equities (on April 3, 2009), its share price rallied by 52% (outperforming the market by 33 pp) and markedly narrowed the valuation gap (further trimmed down by the prospective new issue to PBG); hence, our LT fundamental rating for the equities of EP goes one notch down to a Hold (from Buy). Nonetheless, we still perceive EP as a company with an appealing long term investment story (expected healthy pace of results improvement in the coming quarters (secured by the German expansion) and years (on the back of local power sector investments launch in 2011E)). Our ST market-relative Overweigh bias remains intact, given good results for 2Q09E and likely backlog improvement.

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

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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

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LT fundamental recommendation tracker

Recommendation		Issue date	Reiteration date	Expiry date	Performance	Relative performance	Price at issue/ reiteration (PLN)	12M EFV (PLN)	
Energomontaż Południe									
Hold	-	01.12.2008	-	03.04.2009	28%	30%	2.36	3.40	-
-	→	-	09.01.2009	-	-	-	2.65	4.00	↑
-	→	-	11.01.2009	-	-	-	2.65	4.00	→
-	→	-	08.02.2009	-	-	-	2.53	4.00	→
-	→	-	08.03.2009	-	-	-	2.47	4.00	→
Buy	↑	03.04.2009	-	06.07.2009	52%	33%	3.01	5.00	↑
-	→	-	05.04.2009	-	-	-	3.01	5.00	→
-	→	-	15.05.2009	-	-	-	3.59	5.00	→
-	→	-	17.05.2009	-	-	-	3.59	5.00	→
-	→	-	08.06.2009	-	-	-	4.50	5.00	→
Hold	↓	06.07.2009	-	Not later than 06.07.2010	-	-	4.58	4.50	↓

Market-relative recommendation tracker

Relative recommendation		Issue date	Reiteration date	Expiry date	Price at issue/ reiteration (PLN)	Relative performance
Energomontaż Południe						
Neutral	-	01.12.2008	-	Not later than 01.12.2009	2.36	30%
-	→	-	09.01.2009	-	2.65	-
-	→	-	11.01.2009	-	2.65	-
-	→	-	08.02.2009	-	2.53	-
-	→	-	08.03.2009	-	2.47	-
Overweight	↑	03.04.2009	-	Not later than 05.04.2010	3.01	33%
-	→	-	05.04.2009	-	3.01	-
-	→	-	15.05.2009	-	3.59	-
-	→	-	17.05.2009	-	3.59	-
-	→	-	08.06.2009	-	4.50	-
-	→	-	06.07.2009	-	4.58	-

Distribution of IDM's current recommendations

	Buy	Hold	Sell	Suspended	Under revision
Numbers	15	27	14	1	0
Percentage	26%	47%	25%	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	18	16	21	1	0
Percentage	32%	29%	38%	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	2	2	1	0
Percentage	29%	29%	29%	14%	0%

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