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Construction & Real Estate: October 2018

Construction & Property Developers, Poland

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Construction

- The **WIG-Construction** index has held its ground in October, outperforming the WIG broad market benchmark for the first time since April.
- As the **2018 Q3 earnings season** kicks off, we predict that rated construction firms will report 15% revenue growth for the quarter, coupled with a 10% drop in EBITDA. In some cases, the contraction versus Q3 2017 will be mitigated by positive base effects. This is true for the equipment suppliers Ulma and Herkules, and for the railway builders Trakcja, Torpol, and ZUE, though in their case any acceleration in profits will most likely be overshadowed by worsened balance-sheet positions.
- Erbud (ERB)** has seen its shares rebound 15% since the mid-August profit warning, and it is set for continued outperformance going forward even if Q3 results are shown to have worsened year over year.
- We would buy **Unibep (UNI)** as soon as its stock dives back under 5 zlotys.
- Torpol (TOR)**, **Trakcja (TRK)**, and **ZUE (ZUE)** have been the worst performers this month, with their values wiped by a string of cancelled public tenders and reports of increasing debt.
- Budimex (BDX)** has regained some of the ground lost in recent months, but it does not offer any more upside potential in our view. Europe's top construction stocks have taken a 14% plunge in October (see page 6). Consequently, giants like Strabag and Porr, both with a meaningful presence in Poland, are currently trading at over-30% discounts to Budimex on 2019E P/E and EV/EBITDA ratios even though the Polish firm has plans for a big hiring push in 2019 amid rising labor costs.
- TOP PICKS: OVERWEIGHT ERB, UNI, ELB, UNDERWEIGHT TRK**

Property Developers

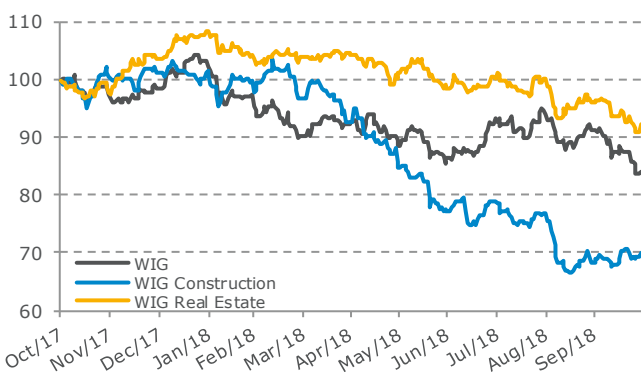
- Residential developers are a much better choice at the moment than any construction stock, with their **earnings prospects undervalued at 0.6x median price-to-book and 6.5x 2018-2019E P/E**.
- New home sales** in Poland's six largest metropolitan markets fell 19% in Q3 2018 relative to the same year-ago period, with ytd sales to September down 10% on the year. Our **top-rated companies (1AT, ARH, DOM, LCC, LKD)** registered much slower sales falls in the period (-13% and -6%, respectively), and their earnings prospects for 2018 and 2019 are intact, with an implied **2019E PE/ ratio of 6.0x and DYield of 12%**.
- The **sales prices** of new homes were 6.4% higher in Q3 2018 than in Q3 2017 according to REAS market research which puts the hikes in listing prices at nearly 10%, an estimate backed by Home Broker & Open Finance (see page 3). Homebuilders seem to have no trouble passing the rising construction costs onto the buyers, which means their sales profits will stay high next year.
- Shares of **Archicom (ARH)** and **Echo (ECH)** have hit this year's lows after falling for no legitimate reason. Echo did post a 54% drop in residential sales in Q3, but investors should take note of the fact that the Developer generates 75% of its earnings from commercial real estate.
- TOP PICKS: OVERWEIGHT LCC, ARH, 1AT, LKD, ECH, DOM, UNDERWEIGHT PND**

1M* & YTD Performance

Construction	MoM	YTD
Erbud	+12.7%	-44%
Budimex	+9.5%	-40%
Herkules	+2.7%	-17%
Elbudowa	-0.3%	-49%
Ulma	-2.1%	+4%
Unibep	-2.2%	-49%
Elektrotim	-4.5%	-54%
ZUE	-12.3%	-20%
Trakcja	-15.2%	-59%
Torpol	-26.7%	-54%
WIG Con.	+0.9%	-31%
WIG	-8.9%	-15%
Developers	MoM	YTD
BBi Dev.	+19.6%	-14%
Dom Dev.	+4.0%	-13%
JWC	+3.0%	-34%
P.A. Nova	+1.1%	-22%
Polnord	+1.1%	-2%
LC Corp	-2.8%	-2%
Lokum Dew.	-4.0%	+2%
Capital Park	-6.0%	-14%
Atal	-6.1%	-25%
GTC	-7.8%	-18%
Ronson	-9.3%	-29%
Archicom	-10.2%	-21%
Echo Inv.	-10.7%	-3%
i2 Dev.	-13.4%	+1%
WIG Real Est.	-4.6%	-11%
WIG	-8.9%	-15%
Foreign Indices	MoM	YTD
DE Real Est.	-2.7%	+5%
DAX	-8.8%	-12%
AT Real Est.	-6.6%	-1%
ATX	-8.9%	-10%
EU Real Est.	-4.2%	-6%
EU Con.	-8.4%	-10%
EU Equity	-10.2%	-13%

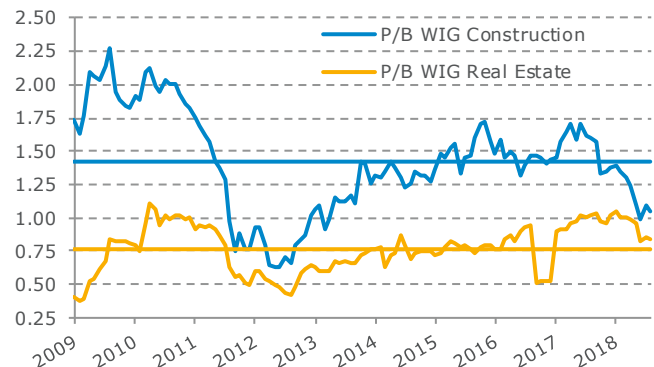
*Sep. 27 - Oct. 29

WIG Construction and WIG Real Estate vs. WIG



Source: Bloomberg

P/B ratios for WIG Construction and WIG Real Estate



EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
EBIT/EV – operating profit to economic value
EBITDA/EV – EBIT + Depreciation and Amortisation to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
MCap – current market capitalization
Monthly price change (MoM price change) – change in the price of a stock since the date of the previous publication or in the course of the past month

ATX – Austrian Traded Index of all companies listed in Austria
DAX – German Stock Index of 30 selected blue chip stocks traded on the Frankfurt Stock Exchange
EPRA Index – FTSE EPRA Global Real Estate Index
FDA06 Index (EU Equity) – FTSE Developed Europe Index
GDBR10 Index – German Generic Government Bonds 10 Year Yield

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for the companies discussed in this publication in the 12 months prior to this publication

Archicom

Rating	overweight	overweight	overweight
Rating date	6/22/2018	4/26/2018	1/25/2018
Target price (PLN)	-	-	-
Price on rating day	15.00	15.30	15.75

Atal

Rating	buy	accumulate	accumulate	accumulate
Rating date	7/4/2018	6/22/2018	4/6/2018	2/2/2018
Target price (PLN)	42.86	42.86	47.00	49.20
Price on rating day	36.40	37.30	43.40	42.40

BBI Development

Rating	neutral	neutral
Rating date	4/26/2018	2/2/2018
Target price (PLN)	-	-
Price on rating day	0.66	0.70

Budimex

Rating	hold	hold	accumulate	buy
Rating date	8/2/2018	6/6/2018	4/6/2018	2/2/2018
Target price (PLN)	125.00	163.00	216.39	246.00
Price on rating day	122.60	153.00	215.00	197.80

Capital Park

Rating	buy	buy
Rating date	4/6/2018	2/2/2018
Target price (PLN)	8.35	8.42
Price on rating day	5.95	5.95

Dom Development

Rating	buy	accumulate	buy	buy
Rating date	8/2/2018	6/22/2018	3/20/2018	2/2/2018
Target price (PLN)	87.80	87.80	103.10	103.00
Price on rating day	72.80	85.80	85.80	82.00

Echo

Rating	buy	buy	buy
Rating date	4/6/2018	2/2/2018	10/2/2017
Target price (PLN)	5.63	6.31	6.42
Price on rating day	5.23	5.05	5.19

Elektrobudowa

Rating	buy	hold	buy	buy
Rating date	9/26/2018	6/6/2018	4/6/2018	2/2/2018
Target price (PLN)	45.00	71.00	116.00	113.00
Price on rating day	32.80	69.00	96.40	81.20

Elektrotim

Rating	neutral	neutral	overweight	underweight
Rating date	9/27/2018	5/28/2018	11/16/2017	10/24/2017
Target price (PLN)	-	-	-	-
Price on rating day	4.20	5.80	7.61	9.76

Erbud

Rating	buy	buy	accumulate	buy	buy	buy	buy
Rating date	9/3/2018	6/6/2018	5/9/2018	4/6/2018	3/5/2018	12/15/2017	11/3/2017
Target price (PLN)	14.40	22.00	23.10	29.60	29.40	28.70	29.80
Price on rating day	9.60	14.90	19.40	21.60	21.30	20.60	24.70

GTC

Rating	hold	accumulate	hold	hold
Rating date	4/6/2018	3/5/2018	2/2/2018	1/5/2018
Target price (PLN)	9.60	9.70	9.70	10.00
Price on rating day	9.39	8.64	9.67	9.90

Herkules

Rating	neutral	neutral
Rating date	1/25/2018	10/24/2017
Target price (PLN)	-	-
Price on rating day	3.67	3.60

i2 Development

Rating	neutral	neutral	overweight
Rating date	6/22/2018	5/28/2018	1/12/2018
Target price (PLN)	-	-	-
Price on rating day	15.40	17.30	14.90

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JWC

Rating	neutral	underweight	neutral
Rating date	6/22/2018	3/29/2018	1/25/2018
Target price (PLN)	-	-	-
Price on rating day	3.48	4.16	4.41

LC Corp

Rating	buy	buy	buy
Rating date	6/22/2018	4/6/2018	2/2/2018
Target price (PLN)	3.58	3.50	3.74
Price on rating day	2.39	2.70	3.10

Lokum Deweloper

Rating	overweight	overweight	overweight
Rating date	6/22/2018	3/29/2018	1/25/2018
Target price (PLN)	-	-	-
Price on rating day	18.80	17.80	18.00

PA Nova

Rating	neutral	neutral	neutral
Rating date	3/29/2018	2/28/2018	11/27/2017
Target price (PLN)	-	-	-
Price on rating day	22.30	23.30	24.00

Polnord

Rating	underweight	neutral	neutral
Rating date	6/22/2018	2/2/2018	12/27/2017
Target price (PLN)	-	-	-
Price on rating day	9.04	10.50	8.70

Ronson

Rating	neutral	neutral	underweight	underweight
Rating date	6/22/2018	4/3/2018	3/29/2018	2/2/2018
Target price (PLN)	-	-	-	-
Price on rating day	1.09	1.32	1.32	1.45

Torpol

Rating	neutral	neutral	neutral	neutral	neutral	neutral	neutral
Rating date	9/27/2018	5/28/2018	3/29/2018	2/2/2018	1/25/2018	11/27/2017	10/24/2017
Target price (PLN)	-	-	-	-	-	-	-
Price on rating day	5.18	6.40	7.50	7.98	8.16	8.55	10.93

Trakcja

Rating	underweight	underweight	neutral	neutral	neutral	underweight	underweight
Rating date	9/27/2018	5/18/2018	3/29/2018	2/2/2018	1/25/2018	11/27/2017	10/24/2017
Target price (PLN)	-	-	-	-	-	-	-
Price on rating day	3.47	3.65	6.75	7.24	7.56	7.69	10.30

Ulma

Rating	neutral	neutral	neutral
Rating date	5/28/2018	3/29/2018	11/27/2017
Target price (PLN)	-	-	-
Price on rating day	73.00	66.50	73.90

Unibep

Rating	buy	buy	accumulate	buy
Rating date	4/6/2018	2/2/2018	1/5/2018	11/3/2017
Target price (PLN)	10.10	10.80	10.80	14.00
Price on rating day	7.50	8.60	9.76	9.90

ZUE

Rating	neutral	neutral	neutral	neutral	neutral	underweight
Rating date	9/27/2018	5/28/2018	3/29/2018	2/2/2018	1/25/2018	11/27/2017
Target price (PLN)	-	-	-	-	-	-
Price on rating day	5.56	5.86	6.12	6.18	6.44	6.89

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