23 March 2010

Special comment

BRE Bank Securities

Real-Estate Developers

Poland

Polnord

PND.PW; PNOR.WA

Buy

(Reiterated)

Maciej Stokłosa
(48 22) 697 47 41
maciej.stoklosa@dibre.com.pl

Q4 2009 Results Impacted By One-Offs

Current price: PLN 38.9; Target price PLN 46.8

Polnord's 2009 fourth-quarter results were impacted by a slew of one-time items, including provisions charged against gross profit (PLN 6.2m), and gains on property revaluations totaling PLN 64.5m (including a PLN 59.9m fair-value adjustment of a land lot in Dopiewiec purchased in March 2009 from Prokom). As a result of delivery of a larger-than-expected number of homes in the period (74 vs. 71), the home sales revenue exceeded our PLN 37.3m forecast at ca. PLN 41m. Unexpectedly for us, Polnord also sold homes in Russia for PLN 1.8m. The gross profit on homebuilding operations came in line with expectations, and SG&A expenses were PLN 3.7m higher than predicted. In all, the Q409 results came in line. We maintain that Polnord is a good investment pick, owing to a decent land bank, the fact that all new projects have financing in place, and based on its future building plans. Polnord may team up with GTC for a shopping-center project in Warsaw's Wilanów district, which could generate a profit margin as high as 30-35%. The first profits from the development could be booked in the first year of construction, that is possibly already in 2010. We are working on revisions to our financial forecasts for Polnord.

Polnord's Q4 2009 revenues exceeded our estimate by PLN 13.8m, of which PLN 3.7m came from higher-than-expected home sales. Moreover, sales of units in a housing development in Russia contributed PLN 1.8m to the quarter's topline, and settlements with major shareholder Prokom added another PLN 7.9m.

The gross profit fell short of our forecasts at PLN 5.4m (a gross margin of 10.6% also missed our 27.4% estimate) after being weighed down by COGS provisions in the amount of PLN 6.2m. PLN 5m of this amount was a provision related to an office project in Novosibirsk, Russia (Polnord's contracts with suppliers there provide that their compensation will be offices in the building, sold at a discount to the market value. Polnord expected the ratio of the selling price of the office spaces to construction costs to be favorable, but the costs have increased since the contracts were signed. Otherwise, the Novosibirsk project is expected to generate good margins). Further, Polnord booked a PLN 1.2m provision for a housing project in Łódź in which it charges almost PLN 1100 per square meter – quite a lot for Łódź where there is currently an oversupply of new homes. However, the project is still going to generate positive cash flows for the company.

The adjusted gross margin on real-estate operations (which generated a revenue of PLN 42.8m) was in line at ca. 27%. Fourth-quarter SG&A expenses were higher than our PLN 9.8m estimate at PLN 13.5m. Other net operating expenses amounted to PLN 0.2m, and property revaluations produced a PLN 64.5m gain, including a PLN 59.9m gain from the land in Dopiewiec whose per-square-meter value increased to PLN 244 from PLN 70 at the time of the purchase.

Polnord reported high other net financial expenses (PLN 11.5m vs. PLN 10.6m forecasted) in Q409, among others as a result of derivatives losses incurred by subsidiary Fadesa. An effective tax rate of 26.9% was higher than predicted. After unexpected minority losses of PLN 0.5m, the Q409 bottom-line profit came in at PLN 31.4m, ahead of our PLN 27.4m forecast.

If it had not been for revaluations of investment property and COGS provisions, Polnord would have reported a Q409 EBIT loss of 3m, and a net loss close to PLN 27m.

Reported vs. forecasted Q4 2009 results

(PLN m)	Q4 2009	Q4 2009F	difference	Q4 2008	change
Revenue	51.1	37.3	36.9%	46.9	8.9%
Gross profit	5.4	10.2	-47.1%	12.6	-57.3%
Gross margin	*10.6%*	*27.4%*	-	*27.0%*	-
Property revaluation gains	64.5	43.0	49.9%	0.0	-
EBIT	55.2	44.4	24.3%	-15.6	-
EBIT margin	*108.1%*	*119.1%*	-	*-33.2%*	-
Pre-tax income	43.7	33.8	29.3%	-11.5	-
Pre-tax margin	*85.6%*	*90.6%*	-	*-24.5%*	-
Net income	31.4	27.4	14.7%	-10.6	-
Net margin	*61.5%*	*73.4%*	-	*-22.5%*	-

Source: Polnord, F – forecasts by BRE Bank Securities

Michał Marczak tel. (+48 22) 697 47 38
Managing Director
Head of Research
michal.marczak@dibre.com.pl
Strategy, Telco, Mining, Metals, Media

Research Department:

Marta Jeżewska tel. (+48 22) 697 47 37
Deputy Director
marta.jezewska@dibre.com.pl
Banks

Analysts:

Kamil Kliszcz tel. (+48 22) 697 47 06
kamil.kliszcz@dibre.com.pl
Fuels, Chemicals, Energy, Retail

Piotr Grzybowski tel. (+48 22) 697 47 17
piotr.grzybowski@dibre.com.pl
IT, Media

Maciej Stokłosa tel. (+48 22) 697 47 41
maciej.stoklosa@dibre.com.pl
Construction, Real-Estate Developers

Jakub Szkopek tel. (+48 22) 697 47 40
jakub.szkopek@dibre.com.pl
Manufacturers

Sales and Trading:

Piotr Dudziński tel. (+48 22) 697 48 22
Director
piotr.dudzinski@dibre.com.pl

Marzena Łempicka-Wilim tel. (+48 22) 697 48 95
Deputy Director
marzena.lempicka@dibre.com.pl

Traders:

Emil Onyszczuk tel. (+48 22) 697 49 63
emil.onyszczuk@dibre.com.pl

Grzegorz Stępien tel. (+48 22) 697 48 62
grzegorz.stepien@dibre.com.pl

Tomasz Dudź tel. (+48 22) 697 49 68
tomasz.dudz@dibre.com.pl

Michał Jakubowski tel. (+48 22) 697 47 44
michal.jakubowski@dibre.com.pl

Tomasz Jakubiec tel. (+48 22) 697 47 31
tomasz.jakubiec@dibre.com.pl

Grzegorz Strublewski tel. (+48 22) 697 48 76
grzegorz.strublewski@dibre.com.pl

"Private Broker"

Jacek Szczepański tel. (+48 22) 697 48 26
Director
jacek.szczepanski@dibre.com.pl

Paweł Szczepanik tel. (+48 22) 697 49 47
Sales
pawel.szczepanik@dibre.com.pl

Dom Inwestycyjny
BRE Banku S.A.
ul. Wspólna 47/49
00-950 Warszawa
www.dibre.com.pl

List of abbreviations and ratios contained in the report.
EV *– net debt + market value (EV – economic value)*
EBIT *– Earnings Before Interest and Taxes*
EBITDA *– EBIT + Depreciation and Amortisation*
PBA *– Profit on Banking Activity*
P/CE *– price to earnings with amortisation*
MC/S *– market capitalisation to sales*
EBIT/EV *– operating profit to economic value*
P/E *– (Price/Earnings) – price divided by annual net profit per share*
ROE *– (Return on Equity) – annual net profit divided by average equity*
P/BV *– (Price/Book Value) – price divided by book value per share*
Net debt *– credits + debt papers + interest bearing loans – cash and cash equivalents*
EBITDA margin *– EBITDA/Sales*

Recommendations of BRE Bank Securities S.A.
A recommendation is valid for a period of 6-9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:
BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from –5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
Recommendations are updated at least once every nine months.

The present report expresses the knowledge as well as opinions of the authors on day the report was prepared. The opinions and estimates contained herein constitute our best judgement at this date and time, and are subject to change without notice. The present report was prepared with due care and attention, observing principles of methodological correctness and objectivity, on the basis of sources available to the public, which BRE Bank Securities S.A. considers reliable, including information published by issuers, shares of which are subject to recommendations. However, BRE Bank Securities S.A., in no case, guarantees the accuracy and completeness of the report, in particular should sources on the basis of which the report was prepared prove to be inaccurate, incomplete or not fully consistent with the facts.

This document does not constitute an offer or invitation to subscribe for or purchase any financial instruments and neither this document nor anything contained herein shall form the basis of any contract or commitment whatsoever. It is being furnished to you solely for your information and may not be reproduced or redistributed to any other person. This document nor any copy hereof is not to be distributed directly or indirectly in the United States, Australia, Canada or Japan.

Recommendations are based on essential data from the entire history of a company being the subject of a recommendation, with particular emphasis on the period since the previous recommendation.

Investing in shares is connected with a number of risks including, but not limited to, the macroeconomic situation of the country, changes in legal regulations as well as changes on commodity markets. Full elimination of these risks is virtually impossible.
BRE Bank Securities S.A. bears no responsibility for investment decisions taken on the basis of the present report or for any damages incurred as a result of investment decisions taken on the basis of the present report.

It is possible that BRE Bank Securities S.A. renders, will render or in the past has rendered services for companies and other entities mentioned in the present report.

BRE Bank Securities S.A., its shareholders and employees may hold long or short positions in the issuers' shares or other financial instruments related to the issuers' shares. BRE Bank Securities S.A., its affiliates and/or clients may conduct or may have conducted transactions for their own account or for account of another with respect to the financial instruments mentioned in this report or related investments before the recipient has received this report.

Copying or publishing the present report, in full or in part, or disseminating in any way information contained in the present report requires the prior written agreement of BRE Bank Securities S.A. Recommendations are addressed to all Clients of BRE Bank Securities S.A.
The activity of BRE Bank Securities S.A. is subject to the supervision of the Polish Financial Supervision Commission.

BRE Bank Securities S.A. serves as animator in relation to the shares of the following companies: Certyfikaty Skarbiec Nieruchomości, Erbud, Es-System, LW Bogdanka, Macrologic, Magellan, Mieszko, Mondi, Nepentes, Pemug, Polimex-Mostostal, Torfarm.
BRE Bank Securities S.A. receives remuneration from issuers for services rendered to the following companies: Agora, Ambra, Arkus, Bakalland, BRE Bank, Deutsche Bank, DZ Bank Polska, Elektrobudowa, Elzab, Energoaparatura, Energomontaż Północ, Erbud, Es-System, Farmacol, Ferrum, Fortis Bank, GTC, Intergroclin Auto, Koelner, Komputronik, LW Bogdanka, Magellan, Mennica, Mercor, Mieszko, Mostostal Warszawa, Nepentes, Odratrans, Pemug, PGF, PGNiG, Polimex-Mostostal, Polmos Lublin, Polnord, Prokom Software, Seco Warwick, Sfinks, Sokołów, Sygnity, Techmex, Torfarm, Unibep, WSiP, ZA Puławy.
In the last 12 months BRE Bank Securities S.A. has been an offering agent of the issuer's shares in a public offering for the following companies: Centrum Klima, LW Bogdanka.
Asseco Poland provides IT services to BRE Bank Securities.

Individuals who did not participate in the preparation of recommendations, but had or could have had access to recommendations prior to their publication, are employees of BRE Bank Securities S.A. authorised to access the premises in which recommendations are prepared, other than the analysts mentioned as the authors of the present recommendations.

Strong and weak points of valuation methods used in recommendations:
DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.
Comparative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.