

5 November 2009

Update


Real Estate Developers
 Poland

Current price	PLN 44.0
Target price	PLN 50.1
Market cap	PLN 1.08bn
Free float	PLN 0.26bn
Avg daily trading volume (3M)	PLN 1.47m

Shareholder Structure

Dom Development B.V.	63.15%
Jarosław Szanajca	7.06%
Grzegorz Kielpsz	5.66%
Others	24.13%

Company Profile

Dom Development is a real-estate developer operating solely in the residential segment in Warsaw. Previously, the company focused on high-end apartments; currently, it is primarily offering affordable apartments.

Dom Development Accumulate

DOM.PW; DOMD.WA

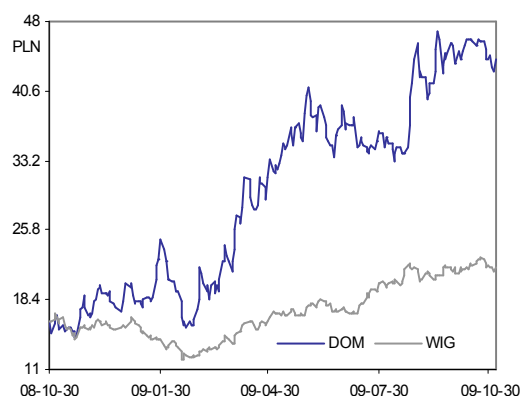
(Reiterated)

Real-Estate Market On the Mend

The situation in the Polish real-estate market is improving. In Q3 2009, Dom Development (DOM) sold 230 flats net- and 251 gross of cancellations, compared to 215 (gross) in Q2 2009. The company improved its sales effectiveness, measured as a ratio of sales to available housing stock, relative to Q2 2008 when the housing market has already slowed, but the financial crisis has not hit yet. As expected, DOM decided to start seven new housing projects with 1233 flats that can be listed for sale at any time the Management decides. Financing will be available when needed. To adjust our financial projections for DOM to market reality, we made revisions in our cost and income assumptions, which led us to reduce expected construction costs for the two latest projects, the 'Derby 9' and 'Saska Kępa' residential complexes in Warsaw, by PLN 200/sqm. Construction on other new projects is not likely to start earlier than in spring 2010. Dom Development's Q3 2009 results missed expectations due to high finance expenses which will decrease in future periods as the company launches new projects (these expenses will be recognized under costs related to the development projects, and will be booked after the projects are completed). After adjustment for these expenses, the actual 2009 third-quarter results come much closer to our estimates. The considerable gap between forecasted and actual profit margins on development projects prompted downward revisions to expected 2009 and 2010 profits, while reduced construction costs led to upward revisions to 2011 and 2012 profit forecasts. Summing up, we think that the premium to NAV at which Dom Development is trading is fully deserved. We expect the developer to grow its business to a scale which will ultimately enable it to sell at least 2000 homes a year. We are reiterating an accumulate rating on DOM.

Justified premium to book value

We believe that the premium in Dom Development's share price over its book value is justified for the following reasons: During the housing boom, most real-estate developers overinvested in new projects, taking advantage of the then-prevailing financing model under which banks required just 10% down-payments compared to 40% today. While large developers are mostly able to secure the necessary capital and continue to conduct business as usual, many smaller firms are not. And Dom Development enjoys very strong liquidity compared to competition. Further, DOM deserves a premium for its good organization, recognized name, and good relations with banks. Real-estate development is a high-margin business. As for scale, a liquid firm like DOM is able to expand, and to increase its asset turnover and ROE. Such expansion will be supported by a PLN 100-150m allocation toward land purchases, aimed at diversifying the existing land bank and facilitating a greater number of projects in the future.

Dom Development vs. WIG

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(PLN m)	2007	2008	2009F	2010F	2011F
Revenue	878.8	698.2	634.5	497.3	798.1
EBITDA	243.2	168.1	100.9	39.7	123.7
<i>EBITDA margin</i>	27.7%	24.1%	15.9%	8.0%	15.5%
EBIT	241.0	165.7	98.5	37.3	121.3
Net income	200.6	136.9	75.0	27.3	97.7
P/E	5.4	7.9	14.4	39.6	11.1
P/CE	5.3	7.8	14.0	36.3	10.8
P/BV	1.6	1.6	1.5	1.4	1.3
EV/EBITDA	4.5	8.0	13.5	31.6	7.7
DYield	0.3%	4.6%	1.8%	0.6%	2.3%



Q3 2009 Results

Dom Development's Q309 earnings figures missed expectations. In spite of higher revenues, a 17% gross profit on home sales fell short of our estimate of 24% and the consensus estimate of 26%. The company recognized revenues from single-family house completions against which it had set up a provision in Q309 accounts. As a result, the provision was charged against COGS (PLN 3m) and transferred from other finance expenses (PLN 3m) to other operating income. In effect, Q309 other net operating income amounted to PLN 1.1m, in line with our estimated PLN 1m.

After adjustment for the provision, the gross profit comes close to our estimate at PLN 25.5m. The adjusted gross margin is 19.3%, that is still less than expected.

Dom Development delivered more low-priced flats in its development in Warsaw's Białołęka district than we had expected (175 vs. 135). Overall, the company sold 296 homes in Q3 2009 compared to our expected 240. For Q4 2009, we predict that the company will deliver about 300, mostly affordable flats and houses, generating similar revenues and profits as in the previous quarter.

At PLN 15.5m, DOM's third-quarter SG&A expenses were about PLN 0.5m lower than forecasted. Other operating gains were offset by other net finance expenses of PLN 3.2m (we expected a PLN 1.7m finance gain). The effective tax rate was high at 24%. After all this, the bottom-line figure fell short of our expectations and the consensus estimate. The finance expenses that caused the gaps between our estimates and actual figures are going to disappear in future periods; as DOM starts new projects, these costs will be recognized under the COGS attributable to these projects upon delivery of the flats to buyers.

Q3 2009 results

(PLN m)	Actuals	Our Estimates	Differ.	Consensus Estimates	Differ.
Revenue	132.1	104.9	25.9%	124.0	6.6%
Gross profit*	22.5	25.2	-10.7%	-	32.1 *
%	17.0%	24.0%	-	-	25.9% *
EBIT	7.0	9.1	-23.3%	16.6	-57.8%
%	5.3%	8.7%	-	13.4%	-
Pre-tax income	6.0	9.8	-38.8%	-	-
Net income	4.5	8.0	-43.3%	12.7	-64.5%
%	3.4%	7.6%	-	10.2%	-

Source: BRE Bank Securities., PAP, Dom Development; * gross profit calculated as forecasted EBIT + actual SG&A expenses

Sales Efficiency

We measure the efficiency of Dom Development's sales as a ratio of gross sales (i.e. pre-cancellations) to housing inventory available during a quarter. Interestingly, this ratio was higher in Q3 2009 than in Q2 2008, when the real-estate market was slower, but far from suffering a crisis.

Quarterly sales efficiency (gross sales / available inventory)

	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008
Average available inventory	893	1048	1180	1269	1414	1536
Gross home sales	251	215	126	105	234	366
Sales efficiency ratio	28%	21%	11%	8%	17%	24%

Source: BRE Bank Securities

DOM's available inventory is set to increase thanks to new projects (in Q1 2010, the company will have more than 2000 flats listed for sale). If the developer succeeds in maintaining its efficiency ratio above 25%, this will translate to sales of 2000 units a year, and 500 per quarter, starting in Q4 2010 / Q1 2011.

Revisions to Valuation and Financial Forecasts

Dom Development's Q3 2009 results prompted small downward revisions to expected margins from existing projects. In turn, forecasted margins on future projects were raised to account for lower costs of construction services. The per-square-meter cost of the most recently launched



“Saska Kępa” development was reduced to ca. PLN 3400 from PLN 3600, and the per-square-meter cost of the “Derby 9” residential complex was lowered to PLN 3000 from PLN 3200. We did not change our expectations with respect to the selling prices of the homes, leaving ourselves room to be pleasantly surprised.

Forecasts and Valuation

Based on DCF analysis, we set the per-share price target on Dom Development at PLN 50.1.

DCF model assumptions:

- Home prices (including discounts) expected to decrease by 3% to 5%.
- Return on capital greater than WACC in FY2014 and beyond.
- Construction costs expected to increase by 3% annually starting in 2011.
- Home prices expected to increase by 3% annually starting in 2011.
- Risk-free rate = 6.2% (based on yields on 10Y T-bonds).
- New projects to be developed on the existing land bank until 2013.
- No expansion into new cities until 2012.
- Land purchases predicted in 2010, 2011, and 2017, and every year thereafter.



DCF Valuation Model

(PLN m)	2009F	2010F	2011F	2012F	2013F	2014F	2015F	2016F	2017F	2018F	2018+
Revenue	634.5	497.3	798.1	763.6	783.9	823.1	861.8	899.7	933.9	966.6	
<i>change</i>	-9.1%	-21.6%	318.6%	-4.3%	2.7%	5.0%	4.7%	4.4%	3.8%	3.5%	
EBITDA	100.9	39.7	123.7	107.6	96.8	101.3	107.2	112.9	117.7	122.1	
<i>EBITDA margin</i>	15.9%	8.0%	15.5%	14.1%	12.3%	12.3%	12.4%	12.5%	12.6%	12.6%	
Amortiz. & deprec.	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4	
EBIT	98.5	37.3	121.3	105.1	94.4	98.9	104.8	110.5	115.3	119.7	
<i>EBIT margin</i>	15.5%	7.5%	15.2%	13.8%	12.0%	12.0%	12.2%	12.3%	12.3%	12.4%	
Tax rate on EBIT	18.7	7.1	23.0	20.0	17.9	18.8	19.9	21.0	21.9	22.7	
NOPLAT	79.7	30.2	98.2	85.2	76.4	80.1	84.9	89.5	93.4	97.0	
CAPEX	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4	-2.4	
Working capital	253.8	81.4	235.8	41.7	33.7	-26.2	-24.9	-23.8	-21.7	-20.7	
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
FCF	333.6	111.5	334.0	126.9	110.2	53.9	60.0	65.7	71.7	76.3	78.6
<i>WACC</i>	10.1%	10.5%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	10.6%	
<i>discount factor</i>	98.4%	89.1%	80.1%	72.0%	64.8%	58.3%	52.4%	47.1%	42.4%	38.3%	
PV FCF	328.3	99.4	267.5	91.4	71.4	31.4	31.4	30.9	30.4	29.2	
WACC	10.1%	10.5%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	10.6%	
Cost of debt	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	7.4%	6.8%	
Risk-free rate	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%	5.6%	
Credit risk premium	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	
Net debt / EV	20%	14%	0%	0%	0%	0%	0%	0%	0%	0%	
Cost of Equity	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%	10.6%	
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	
FCF growth after the forecast horizon		3.0%									
Terminal value		1 034.0									
Present value of the terminal value (PV TV)		396.1									
Present value of FCF in the forecast horizon		1 011.3									
Equity value (EV)		1 407.3									
Net debt		272.1									
Land liquidation value		0.0									
Minority interests		0.0									
Equity value		1 135.3									
Number of shares (millions)		24.6									
Equity value per share (PLN)		46.2									
Cost of equity (9M)		8.3%									
Target Price		50.1									
EV/EBITDA('09) for the target price		11.3									
P/E('09) for the target price		16.4									
TV to EV		28%									

Sensitivity Analysis

FCF growth in perpetuity

	2.0%	2.5%	3.0%	3.5%	4.0%
WACC -1.0ppt	48.0	49.0	50.2	51.5	53.0
WACC -0.5ppt	48.0	49.0	50.2	51.5	53.0
WACC	47.9	49.0	50.1	51.4	52.9
WACC +0.5ppt	47.9	48.9	50.1	51.4	52.9
WACC +1.0ppt	47.8	48.9	50.0	51.3	52.9

**Income Statement**

(PLN m)	2006	2007	2008	2009F	2010F	2011F	2012F
Revenue	729.8	878.8	698.2	634.5	497.3	798.1	763.6
<i>change</i>	35.9%	20.4%	-20.6%	-9.1%	-21.6%	60.5%	-4.3%
COGS	496.9	545.7	429.0	468.4	391.6	605.1	584.9
Gross profit	232.9	333.1	269.1	166.1	105.7	193.0	178.7
<i>gross margin</i>	31.9%	37.9%	38.5%	26.2%	21.3%	24.2%	23.4%
Selling expenses	-21.7	-22.4	-30.0	-21.9	-20.5	-21.5	-22.2
General and administrative expenses	-41.3	-57.7	-61.9	-41.7	-44.0	-46.2	-47.5
Other net operating income/loss	-5.0	-12.1	-11.5	-4.0	-4.0	-4.0	-3.8
EBIT	165.0	241.0	165.7	98.5	37.3	121.3	105.1
<i>change</i>	130.7%	46.1%	-31.2%	-40.6%	-62.1%	225.4%	-13.3%
<i>EBIT margin</i>	22.6%	27.4%	23.7%	15.5%	7.5%	15.2%	13.8%
Profit on financing activity	2.8	9.4	7.2	-5.8	-3.5	-0.7	29.5
Extraordinary gains/losses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax income	167.8	250.4	173.0	92.6	33.7	120.6	134.7
Tax	-32.6	-49.7	-36.0	-17.6	-6.4	-22.9	-25.6
Minority interests	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income	135.2	200.6	136.9	75.0	27.3	97.7	109.1
<i>change</i>	-	48.4%	-31.7%	-45.2%	-63.6%	257.5%	11.7%
<i>margin</i>	18.5%	22.8%	19.6%	11.8%	5.5%	12.2%	14.3%
Amortization and depreciation	1.6	2.2	2.4	2.4	2.4	2.4	2.4
EBITDA	166.5	243.2	168.1	100.9	39.7	123.7	107.6
<i>change</i>	127.3%	46.0%	-30.9%	-40.0%	-60.7%	211.7%	-13.0%
<i>EBITDA margin</i>	22.8%	27.7%	24.1%	15.9%	8.0%	15.5%	14.1%
Shares at year-end (millions)	22.3	24.6	24.6	24.6	24.6	24.6	24.6
EPS	6.1	8.2	5.6	3.1	1.1	4.0	4.4
CEPS	6.1	8.3	5.7	3.2	1.2	4.1	4.5
ROAE	43.2%	33.8%	19.9%	10.6%	3.6%	12.3%	12.6%
ROAA	17.9%	18.4%	9.1%	4.6%	1.9%	6.5%	6.8%

**Balance Sheet**

(PLN m)	2006	2007	2008	2009F	2010F	2011F	2012F
ASSETS	923.9	1 252.1	1 764.6	1 519.1	1 424.2	1 564.7	1 623.8
Fixed assets	17.0	21.9	20.9	20.9	20.9	20.9	20.9
Intangible assets	0.7	0.7	1.4	1.4	1.4	1.4	1.4
Equity in associates	0.8	1.0	1.1	1.1	1.1	1.1	1.1
Property, plant and equipment	5.5	6.5	6.8	6.8	6.8	6.8	6.8
Deferred income tax assets	7.5	10.6	8.4	8.4	8.4	8.4	8.4
Other	2.4	3.0	3.3	3.3	3.3	3.3	3.3
Current assets	906.9	1 230.2	1 743.7	1 498.2	1 403.3	1 543.8	1 602.9
Inventories	594.9	862.4	1 458.1	1 222.7	1 028.7	831.3	786.6
Receivables	60.8	65.9	55.5	50.5	47.7	76.5	73.2
Other current assets	23.7	26.4	6.3	6.3	6.3	6.3	6.3
Cash and cash equivalents	227.5	275.5	223.7	218.7	320.5	629.5	736.7
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(PLN m)	2006	2007	2008	2009F	2010F	2011F	2012F
LIABILITIES	923.9	1 252.1	1 764.6	1 519.1	1 424.2	1 564.7	1 623.8
Equity	491.9	696.1	683.5	738.8	759.3	832.6	898.0
Minority interests	0.0	0.0	-0.2	-0.2	-0.2	-0.2	-0.2
Long-term liabilities	154.8	330.4	462.9	460.9	460.9	460.9	460.9
Loans, finance leases	102.2	241.8	433.3	433.3	433.3	433.3	433.3
Reserves	52.6	88.6	29.6	27.7	27.7	27.7	27.7
Short-term liabilities	277.2	225.5	618.4	319.5	204.1	271.3	264.9
Loans and bonds	98.9	37.0	62.5	62.5	62.5	62.5	62.5
Trade creditors	143.8	121.0	145.5	158.8	123.4	190.6	184.3
Other	34.5	67.5	410.4	98.2	18.2	18.2	18.2
Debt	201.1	278.8	495.8	495.8	495.8	495.8	495.8
Net debt	-26.4	3.3	272.1	277.1	175.3	-133.8	-240.9
(Net debt / Equity)	-5.4%	0.5%	39.8%	37.5%	23.1%	-16.1%	-26.8%
(Net debt / EBITDA)	-0.2	0.0	1.6	2.7	4.4	-	-
BVPS	22.0	28.3	27.8	30.1	30.9	33.9	36.6

**Cash Flows**

(PLN m)	2006	2007	2008	2009F	2010F	2011F	2012F
Cash flows from operating activities	-30.3	-22.3	-215.0	22.9	114.6	336.6	123.7
Net income	135.2	200.6	136.9	75.0	27.3	97.7	109.1
Amortization and depreciation	1.6	2.2	2.4	2.4	2.4	2.4	2.4
Working capital	-211.8	-295.7	-245.5	253.8	81.4	235.8	41.7
Other	44.8	70.6	-108.8	-308.4	3.5	0.7	-29.5
Cash flows from investing activities	-1.8	-3.6	-3.5	-2.4	-2.4	-2.4	-2.4
CAPEX	-1.4	-3.6	-3.5	-2.4	-2.4	-2.4	-2.4
Capital investments	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Cash flows from financing activities	185.8	73.9	166.7	-25.5	-10.4	-25.1	-14.1
Stock offering	220.5	0.0	0.0	0.0	0.0	0.0	0.0
Debt	-34.8	77.6	216.8	0.0	0.0	0.0	0.0
Dividend / buy-back	0.0	-3.7	-50.1	-19.6	-6.8	-24.4	-43.6
Other	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in cash	153.7	48.0	-51.8	-5.0	101.8	309.0	107.1
Cash at end of period	227.5	275.5	223.7	218.7	320.5	629.5	736.7
DPS (PLN)	0.0	0.2	2.0	0.8	0.3	1.0	1.8
FCF				333.6	111.5	334.0	126.9
(CAPEX / Sales)	0.2%	0.4%	0.5%	0.4%	0.5%	0.3%	0.3%

Market multiples

	2006	2007	2008	2009F	2010F	2011F	2012F
P/E	7.3	5.4	7.9	14.4	39.6	11.1	9.9
P/CE	7.2	5.3	7.8	14.0	36.3	10.8	9.7
P/BV	2.0	1.6	1.6	1.5	1.4	1.3	1.2
P/S	1.3	1.2	1.5	1.7	2.2	1.4	1.4
FCF/EV	0.0%	0.0%	0.0%	24.6%	8.9%	35.3%	15.1%
EV/EBITDA	5.7	4.5	8.0	13.5	31.6	7.7	7.8
EV/EBIT	5.8	4.5	8.2	13.8	33.7	7.8	8.0
EV/S	1.3	1.2	1.9	2.1	2.5	1.2	1.1
DYield	0.0%	0.3%	4.6%	1.8%	0.6%	2.3%	4.0%
Price (PLN)	44.0						
Shares at year-end (millions)	22.3	24.6	24.6	24.6	24.6	24.6	24.6
MC (PLN m)	981.8	1080.6	1080.6	1080.6	1080.6	1080.6	1080.6
Minority interests (PLN m)	0.0	0.0	-0.2	-0.2	-0.2	-0.2	-0.2
EV (PLN m)	955.4	1 083.9	1 352.6	1 357.6	1 255.8	946.7	839.6



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**List of abbreviations and ratios contained in the report:**

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
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

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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%
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Comparative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

Previous recommendations issued for Dom Development

Rating	Hold	Sell	Sell	Suspended	Accumulate
Date	2009-03-25	2009-05-06	2009-06-15	2009-09-04	2009-09-28
Price on rating date	23.00	32.45	38.99	42.70	44.59
WIG on rating date	24443.51	29777.06	32362.67	36009.43	38214.58