


**Property
Developers**

Poland

Dom Development Accumulate

DOMD.WA; DOM.PW

(Reiterated)

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Q2 2010: Business As Usual

Current price: PLN 46.0; Target price: PLN 50.1;

Dom Development reported better-than-expected results for the second quarter of 2010, but the difference accounts for just 0.49% of the company's market cap. The main reason behind the stronger-than-expected earnings were larger sizes of the upmarket apartments delivered in the period. The overall number of deliveries (and the gross margin) was in line with expectations. DOM plans to deliver only 240-270 homes in the second half of the year, suggesting a decline in Q3 and Q4 profits (in Q2, the company sold 180 flats and two commercial spaces). DOM's 2010 financial performance is a result of a lack of new development starts in 2008 and H1 2009. The projects started in late 2009 and 2010 will not start to contribute to earnings growth until mid-2011. The financial prospects for 2011 and 2012 should be the main measure of the company's attractiveness as an investment in our view. Even though Dom Development sold fewer homes in Q2 than in Q1 2010 (312 vs. 343 units), this should not be seen as a reason for concern, being mainly a base effect (the Q1 sales-to-inventory ratio was an impressive 29%). A sales/inventory ratio of 24% recorded in Q2 2010 still means that DOM can clear out its housing stock within a one-year period (the building cycle is 1.5 years). We stand by the timing and size projections (supported by the recent purchase of two new development sites) for DOM's future projects set out in the latest research update. We are reiterating an accumulate rating on DOM.

DOM's Q2 revenues exceeded our estimate by 16.8% on larger-than-predicted square-metres of upmarket home deliveries (the number of deliveries made in the period was in line at 180). The gross margin was just 0.5 ppt higher than expected. General expenses amounted to PLN 17.7m vs. our PLN 18.0m estimate. Other net operating expenses were higher than our PLN 0.75m forecast at PLN 1.6m. EBIT topped our estimate by 41.8%, thanks mainly to higher revenues.

Other net financial expenses proved lower than predicted (PLN 2.4m vs. PLN 4.4m), probably due to differences in assumed and actual project cost allocations (the financial costs of work in progress are capitalized, while costs related to finished projects are charged against profits). After an effective tax rate of 22.2%, the Q2 2010 net income was PLN 5.9m higher than predicted (the difference between our estimate and the actual bottom-line figure is substantial in percentage terms – which stems from the fact that DOM has been selling relatively few homes this year, and so has a high operating leverage – but the PLN 5.9m accounts for just 0.49% of the company's market cap).

Reported vs. forecasted Q2 2010 results

(PLN m)	Q2 2010	Q2 2010F	differ.	Consensus Estimates	differ.	Q2 2009	change
Revenues	142.8	122.2	16.8%	141.0	1.3%	192.0	-25.6%
Gross profit	38.3	32.2	19.0%	-	-	51.7	-25.9%
Gross margin	26.8%	26.3%	-	-	-	27.0%	-
EBIT	19.1	13.4	41.8%	17.1	11.5%	30.7	-37.9%
Pre-tax income	16.7	9.0	85.4%	-	-	28.3	-41.2%
Net income	13.2	7.3	81.1%	11.6	13.7%	22.6	-41.7%

Source: Dom Development, F - forecasts by BRE Bank Securities, Consensus estimates by PAP

Gross housing sales as percentage of average inventory

	Q2 2010	Q1 2010	Q4 2009	Q3 2009	Q2 2009	Q1 2009	Q4 2008	Q3 2008	Q2 2008
Average housing inventory	1 351	1 221	882	893	1 048	1 180	1 269	1 414	1 536
Gross sales	330	360	317	251	215	126	105	234	366
Gross sales / Inventory	24%	29%	36%	28%	21%	11%	8%	17%	24%

Source: Dom Development, BRE Bank Securities



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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

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