



Property Developers

Poland

J.W. Construction

Buy

JWC.PW; JWCA.WA

(Reiterated)

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Higher Revenue = Higher Earnings

Current price PLN 13.18; Target price PLN 14.0;

JWC's earnings outperformed our expectations, but this is a consequence of the fact that more homes were delivered to buyers (1940 in FY 2009, where we expected 1737). Margins on the development business were in line with expectations (27.0% vs. 27.1%). The Company's earnings in other segments were slightly disappointing, but the scale of the business here is limited. Compared to the preceding quarters, general and administrative expenses increased. All in all, we reiterate our view that these earnings are of historical importance; the key factors are new project starts and current home sales. In FY 2010, unlike its competitors, JWC will see its earnings grow y/y. There are still some 3,000 homes remaining to be recognized in the earnings of the coming quarters. Due to the 6M delay in its construction cycle vs. peers, JWC will not start new residential projects until H2'10. It will therefore start getting revenue from them in 2012. In 2011, a gap may occur, in consequence of the fact that the Company will only recognize sales of individual unsold homes from old projects, and the valuation of work-in-progress. Another factor that might lead to the delay in the start of new projects are delayed cash flows. Because some of its clients were unable to finalize their purchases (of homes sold in the 10/90 system in the Górczewska Park project), the developer's stock of homes for sale currently comprises as many as 1,500 units. Fortunately, these homes are in line with the current preferences of the buyers (small apartments, 35-55 m2 in size). We reiterate a positive rating.

J.W. Construction generated revenue 26.7% ahead of our expectations. The source of this discrepancy is the real-estate development sector, with more homes than we had assumed sold in Q4 2009 (altogether in FY 2009: 1940 vs. 1737 expected). Gross margin was below expectations (24.6% vs. 26.9%), but this discrepancy is solely a consequence of below-expectations earnings in the other segments (hotels, TBS (social housing association), eliminations). The gross margin on the development business was in line with expectations (27.1% vs. 27%). In TBS and in the hotel business (considered jointly) the margin was 12.2%, while we had expected 21.8%. This decline in margins is a temporary phenomenon without impact on the future. The TBS business comes with much lower capitalization rates (3%) compared to the market value of comparable apartments. The introduction of regulations allowing TBS homes to be sold at market prices would significantly boost the value of JWC's shares.

Q4 2009 actuals vs. forecast

| (PLN m) | Q4 2009 | Q4 2009F | Difference | PAP consensus | Difference | Q4 2008 | Change |
|----------------|---------|----------|------------|---------------|------------|---------|--------|
| Sales revenue | 222.2 | 175.4 | 26.7% | 187.0 | 18.8% | 267.9 | -17.0% |
| Gross profit | 54.6 | 47.2 | 15.7% | - | - | 62.4 | -12.5% |
| % margin | 24.6% | 26.9% | - | - | - | 23.3% | - |
| EBIT | 42.0 | 36.1 | 16.2% | 39.5 | 6.3% | 38.1 | 10.3% |
| % margin | 18.9% | 20.6% | - | 21.1% | - | 14.2% | - |
| Pre-tax margin | 35.3 | 32.5 | 8.6% | - | - | 24.9 | 41.9% |
| % margin | 15.9% | 18.5% | - | - | - | 9.3% | - |
| Net profit | 31.0 | 26.3 | 17.9% | 26.9 | 15.4% | 13.5 | 130.4% |
| % margin | 14.0% | 15.0% | - | 14.4% | - | 5.0% | - |

Source: BRE Bank Securities, J.W. Construction

Q4 2009 by segment vs. forecasts

| (PLN m) | Property development | Hotels, TBS | Other |
|-----------------|----------------------|-------------|-------|
| Q4 2009 | | | |
| Revenue | 215.5 | 6.7 | 0.0 |
| Gross profit | 58.3 | 0.8 | -4.5 |
| % margin | 27.0% | 12.2% | - |
| Q4 2009F | | | |
| Revenue | 167.8 | 7.6 | 0.0 |
| Gross profit | 45.5 | 1.7 | 0.0 |
| % margin | 27.1% | 21.8% | - |

Source: BRE Bank Securities, J.W. Construction

Q4 2009 vs. Q3 2009 and H1 2009 by segment

| (PLN m) | Property development | Hotels | TBS | Construction | Other | Adjustments, eliminations |
|----------------|----------------------|--------|-------|--------------|-------|---------------------------|
| Q4 2009 | | | | | | |
| Revenue | 215.5 | 3.8 | 2.9 | 86.6 | -11.7 | -74.9 |
| Gross profit | 58.3 | 0.0 | 0.8 | 13.7 | -1.2 | -17.1 |
| % margin | 27.0% | 0.2% | 27.6% | 15.8% | 10.1% | 22.8% |
| Q3 2009 | | | | | | |
| Revenue | 146.2 | 4.3 | 2.5 | 109.5 | 4.0 | -106.5 |
| Gross profit | 38.8 | 0.5 | 1.2 | 2.2 | 1.0 | -2.1 |
| % margin | 26.5% | 12.3% | 49.1% | 2.0% | 23.8% | 2.0% |
| H1 2009 | | | | | | |
| Revenue | 302.9 | 7.5 | 6.1 | 82.6 | 17.9 | -85.9 |
| Gross profit | 86.7 | -0.2 | 3.1 | 6.9 | 0.5 | -7.7 |
| % margin | 28.6% | -2.8% | 50.0% | 8.3% | 2.9% | 9.0% |

Source: BRE Bank Securities, J.W. Construction

General expenses were higher than expected at PLN 15.8m (we forecasted PLN 10.5m). In Q3 2009, general expenses figured to PLN 10.0m, and in Q2 2009 to PLN 9.8m. The reason for their increase remains to be explained. We believe it may have been caused by the disbursement of bonuses at the end of the year or accounting reclassifications in the FY report. Other net operating income was PLN 3.2m, ahead of the PLN 0.5m loss we expected.

Other finance expected were higher than expected as well at PLN 6.7m (we expected PLN 3.6m). The difference is probably a consequence of higher-than-expected interest expenses. Developers recognize the cost of loans used to finance projects in their COGS. However, loans used for the TBS business, or for the expansion of the Czarny Potok center, end up with other finance expenses. We have updated our forecast accordingly. We believe the discrepancy may stem from the delay in loan repayment following the completion of some projects (after the sale of the homes, the cost of the unrepaid portion of the loan is no longer classified with COGS).

Effective tax rate was 12%, and the net profit PLN 31.0m (vs. PLN 26.3m we expected). One thing worth noting in Q4 2009 earnings is the fact that net debt did not decrease significantly. We are not concerned by this, however. Changes in construction contract assets and liabilities suggest that most of the events in Q4 2009 were delivery of homes pre-sold the proportional system and/or construction work on selected projects. We expect a bigger improvement in working capital in 2010.

Changes in key balance-sheet items, Q4 2009 vs. Q3 2009

| (PLN m) | Q4 2009 | Q3 2009 | Q/Q change |
|------------------------------------|---------|---------|------------|
| Assets: construction contracts | 916.2 | 990.5 | -74.3 |
| Liabilities construction contracts | 346.5 | 412.5 | -66.0 |
| Cash and equivalents | 27.2 | 20.2 | 7.0 |
| Long-term loans | 113.4 | 203.5 | -90.1 |
| Short-term loans | 276.7 | 208.9 | 67.8 |

Source: BRE Bank Securities, J.W. Construction

New projects under planning: commercial projects

| Project | Type | Space in m2 | Expected start | Description |
|---------------------|-------------------------|-------------|----------------|---|
| Jerozolimskie Point | Office building | 4157 | started | - |
| Pileckiego | Office building / hotel | 16838 | H2'10 | Interested buyer changes building concept |
| Nowa Dana | Office/retail | 28712 | Q3 2010 | Demolition work scheduled for June 2010 |

Source: BRE Bank Securities, J.W. Construction

**New projects under planning: residential projects**

| Project | Space m2 | Homes | Planned start | Description |
|-------------------------|----------|-------|---------------|--------------------------------------|
| Zielona Dolina. S1 | 29265 | 597 | Q3 2010 | Tender appeals under consideration |
| Zielona Dolina. S1 | 43285 | 883 | 2011 | - |
| Światowida | 13000 | 196 | H2 2010 | |
| Łódź Tymienieckiego S1 | 6942 | 120 | H2 2010 | |
| Katowice (Uroczysko) S1 | 4015 | 100 | H2 2010 | |
| Ożarów Mazowiecki - S1 | 1920 | 12 | started | Display homes. 12 under construction |
| Antoniewska | 13863 | 220 | 2011 | Expecting zoning decision |
| Lewandów Park III | 33179 | 787 | 2011 | |
| Berensona | 9350 | 170 | 2011 | |
| Ożarów Mazowiecki - S2+ | 9600 | 60 | 2011+ | |

Source: BRE Bank Securities, J.W. Construction



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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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