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Special comment

**Construction**

Poland

**Rafako**

RAFA.WA; RFK.PW

**Hold**

(Reiterated)

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## Rafako Reports Strong Q409 Core Earnings

**Current price: PLN 13.3, Target price: PLN 13.5**

**Rafako changed the way it presents financial information, and its approach to accounting for certain P&L items, and we had to make a number of adjustments to obtain comparable Q4 2009 earnings results which included a PLN 2.5m higher-than-expected recurring EBIT figure. The company's new accounting policy is factored in our financial forecasts for 2010 and beyond, as presented in the recent Power-Engineering Industry Update. We maintain that Rafako stands to be the biggest beneficiary of the upcoming investment boom in the Polish power industry. In spite of these prospects, the its shares are priced fairly high at a FY10E P/E of 17.6. We expect a series of value-enhancing developments toward the end of the year (when Rafako has a chance of capturing two major power-plant construction orders). For the time being, we are reiterating a neutral rating on Rafako.**

As reported in the FY2009 financial statements, Rafako's Q4 2009 revenue was 11% lower than predicted, probably due to delays in the launch of some contracts. The gross margin also fell short of expectations at 4.7% (we expected 9.2%) because of warranty-repair allowances and provisions for contract losses totaling PLN 12.4m; the adjusted margin amounts to 9.3%.

SG&A expenses amounted to PLN 15.2m (we expected PLN 15.4m), and other operating income of PLN 11.6m beat our expected loss of PLN 0.3m (thanks mainly to reversals of provisions for liquidated damages in the amount of PLN 5.8m). After all this, the Q409 EBIT came in at PLN 8.7m, falling short of our PLN 11.7m estimate. Other net financial income of PLN 10.5m beat our PLN 3.5m forecast, probably as a result of the changed accounting policy.

Before the adoption of a new accounting approach in Q4 2009, Rafako booked bank fees under "other financial expenses." Now, it recognizes these fees under "costs of goods sold." Rafako made adjustments to its reported 2008 results which resulted in an increase in other net financial expenses by PLN 5.9m, and a reduction in gross profit by PLN 4.7m. Based on comparable year-over-year revenue levels, we concluded that the adjustments in FY2008 accounts were made in line with the new accounting policies applied to FY2009 financials. Accordingly, we assume that the PLN 7m difference between reported and forecasted financial expenses included an amount of about PLN 5m resulting from the policy change. The PLN 5m added to other net financial income, and at the same time to COGS. After adjustment for these accounting movements, and for provisions, the Q409 gross margin expands from 9.3% to 11.2% – a level that can be considered recurring. With gross margin at 11.2%, the recurring fourth-quarter gross profit rises to PLN 29.6m, which is PLN 2.3m more than our estimate. Recurring EBIT would have been 2.5m ahead of forecasts.

The 2009 fourth-quarter tax was in line, while minority interests were lower than predicted (PLN -0.3m vs. PLN 0.45m). All in all, Rafako made a solid Q4 2009 showing.

### Reported vs. forecasted Q4 2009 results

(PLNm)	Q4 2009	Q4 2009F	difference	Consensus	difference	Q4 2008	change
Revenue	264.5	297.4	-11.0%	254.0	4.1%	305.7	-13.5%
Gross profit	12.3	27.4	-55.0%	-	-	60.5	-79.7%
Gross margin	4.7%	9.2%	-	-	-	19.8%	-
EBIT	8.7	11.7	-25.6%	7.3	18.7%	32.2	-73.0%
EBIT margin	3.3%	3.9%	-	2.9%	-	10.5%	-
Pre-tax income	19.2	15.2	26.4%	-	-	-46.6	-141.1%
Pre-tax margin	7.2%	5.1%	-	-	-	-15.2%	-
Net income	16.8	11.8	41.6%	7.1	136.9%	-22.6	-174.2%
Net margin	6.3%	4.0%	-	2.8%	-	-7.4%	-

Source: Rafako, F – forecasts by BRE Bank Securities, Consensus estimates by PAP

**Adjustments to 2008 financials: FY2008 vs. FY2009 financial data**

(PLN m)	FY2008 Report	FY2009 Report	Change
Revenue	1125.6	1125.7	0.2
Gross profit	120.4	115.7	-4.7
<i>Gross margin</i>	10.7%	10.3%	-
SG&A expenses	40.5	57.0	16.4
Other net operating expenses	-19.1	-2.9	16.2
EBIT	60.8	55.9	-4.9
<i>EBIT margin</i>	5.4%	5.0%	-
Net financial income	-11.9	-6.0	5.9
Net income	-11.6	-11.2	0.4
<i>Net margin</i>	-1.0%	-1.0%	-

Source: Rafako, BRE Bank Securities

**Q/Q changes in Q409 provisions**

Provision	Q4/Q3 change	Q409	Q309
Warranty repairs	8.3	13.2	4.9
Construction contracts	4.1	5.4	1.3
Liquidated damages & other	-5.8	8.4	14.3
Incl. COGS	12.4	18.6	6.2
Incl. other operating expenses	-5.8	8.4	14.3

Source: Rafako, 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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**HOLD** – we expect that the rate of return from an investment will range from -5% to +5%  
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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 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.