



Developers

Poland

Dom Development Suspended

DOM.WA; DOM.PW

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Second-Quarter Results

Current Price: PLN 42.50

Dom Development posted solid second-quarter results achieved in a slumping property market. Net income was 51.5% higher than in the first quarter and 25.6% higher than in Q207 at PLN 68.7m. EBIT amounted to PLN 83.3m (after a 58% increase from Q108 and a 26.4% rise from Q207), on revenues of PLN 267.9m (up 42.9% q/q and 16.5% y/y). Bottom-line income exceeded analysts' consensus (PLN 60.4m) by 14%, and, at PLN 69m, was the highest in DD's history. Gross margin also achieved a record level of 41.5%. EBIT was 11% ahead of consensus (PLN 83.3m vs. PLN 75.2m), and revenues exceeded the analysts' estimate (PLN 254m) by 5.5% after increasing 17% from Q207 to PLN 268m. Given the current decline in prices and margins due to rising prices of land, we predict that DD will not be able to continue to grow earnings at the same robust rate going forward.

Overview of quarterly results (PLN m)

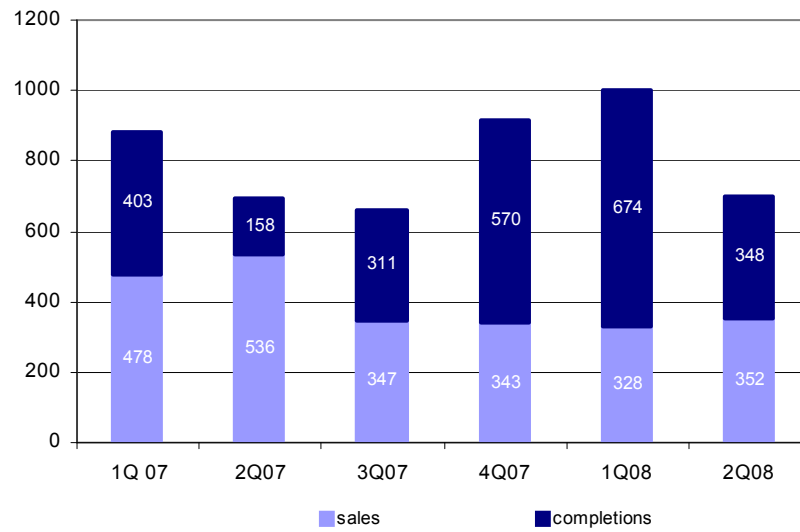
	1Q 07	2Q07	3Q07	4Q07	1Q08	2Q08	1H08	1H07	Q/Q	Y/Y
Sales revenues	171.9	230.0	272.7	204.2	187.5	267.99	455.5	401.9	42.9%	16.5%
Gross profit	63.0	88.4	103.2	78.5	75.1	111.1	186.2	151.4	48.0%	25.7%
<i>Gross profit margin</i>	36.7%	38.4%	37.8%	38.4%	40.0%	41.5%	40.9%	37.7%		
EBIT	44.0	65.9	78.7	52.3	52.7	83.3	136.0	109.9	58.0%	26.4%
<i>EBIT margin</i>	25.6%	28.7%	28.9%	25.6%	28.1%	31.1%	29.9%	27.3%		
Pre-tax income	46.6	68.1	81.3	54.4	56.5	85.6	142.1	114.7	51.4%	25.7%
Net income	37.4	54.7	65.4	43.1	45.4	68.7	114.1	92.1	51.5%	25.6%
<i>Net margin</i>	21.7%	23.8%	24.0%	21.1%	24.2%	25.6%	25.0%	22.9%		

Source: BRE Bank Securities, Dom Development

An analysis of DD's balance sheet shows a significant drop in liquidity – cash has decreased 72% in the last six months, from PLN 275.5m to PLN 77.7m, as the company tapped its cash base to buy land for future developments. The ratio of cash to market cap is currently 7%, and the ratio of debt to equity stands at 0.34, suggesting a significant potential for continued investments. DD has available investment resources of PLN 420m (cash and credit line). Inventories (the land bank and developments in their early stages) increased by over PLN 92m compared to the first quarter, reflecting the company's belief in a market rebound. In turn, the value of work in progress fell ("work in progress" is defined as dwellings nearing completion) to PLN 304.9m in Q2, in line with market trends, meaning that sales are likely to decline in the coming quarters.

The trend that stands out most in DD's second-quarter release are consistently high margins, which is an important strength given the current trends in the real-estate market and looking at the falling margins of the company's main rival, JWC. In our view, this strength is supported by recognition in Q2 of developments started at lower costs at a time when the housing boom was at its peak (H107). DD's management predict that the housing slump will continue for at least 1.5-2 more years, and this belief was the premise for postponement of several completions until the second half of 2010. In the last few months, selling prices in the low-end housing segment have declined 1.6%, and prices of "low end+" dwellings have decreased 1.1%, as developers devise more and more incentives to attract more buyers. In the high-end segment, prices have increased by ca. 4%.

Dwellings sold vs. completed



Source: BRE Bank Securities, Dom Development

As shown in the diagram above, Dom Development completed 348 homes in the second quarter (fewer than in the two preceding quarters), and sold 352 dwellings. After two very successful periods in Q1 and Q2, sales of new homes stabilized at 330-350 units. DD's management stress that, even though there will be a smaller number of completions going forward, prices and margins are going to remain intact. Further, the company's strategy provides for a reasonable land-purchase policy (do not buy too much at once) to keep pace with market developments. Dom Development's land bank is estimated at 7819 dwellings with a total living space of 507,000 square meters, worth approximately PLN 4.1 billion. Most of the investments are set to start in late 2009 and 2010.



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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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