Energomontaz Poludnie

Poland, Construction sector

Reuters: EMPD.WA Bloomberg: EPD PW

13 August 2012

Looking for solvency

Sell maintained, TP down to PLN 0.10

Energomontaz (EPD) has become the latest company in the PBG capital group to file for bankruptcy. We believe this arrangement is much more probable than in the case of Hydrobudowa Polska because EPD holds real estate assets that it could cash in. Moreover it is 100% exposed to investments in the power sector, the outlook for which is much more attractive than for road construction or general construction in which Hydrobudowa operates. On the other hand, however, the company has already spent a long time trying, unsuccessfully, to cash in on its properties, and the recent conflict with Alstom (a key client) bodes ill for cooperation (if any) in the future. With respect to the declared insolvency, we estimated the net value of the company's assets at PLN 0.1 per share and have decided, exceptionally, to base our Target Price on this calculation. As the current share price is above our Target, we are maintaining a Sell recommendation.

Motion for bankruptcy submitted. EPD's management filed to arrange bankruptcy, pointing to the aggressive activities undertaken by financial institutions and the hostile behaviour of Alstom (which was one of its largest clients) as the main reasons. The management proposed a restructuring option including the disposal of non-core assets and a haircut covering the repayment of 100% of debt of up to PLN 10ths, 80% of debt in the range PLN 10–100ths, and 61% of debt exceeding PLN 100ths. The final version of the restructuring plan will be a matter for negotiations with creditors, unless those representing 2/3 of claims agree on a restructuring option. Creditors have three months to present claims and then, one month later, a creditors meeting will vote on approving the arrangement, which means that the final ruling and the shape of the arrangement will not be known for a few months. In case a compromise cannot be reached, the court may decide on the company's liquidation.

We see chance for an arrangement. We see much better chances for any arrangement than in the case of Hydrobudowa. Firstly, EPD has 100% exposure to investments in the Polish power sector, which is expected to grow in the coming years. Secondly, it owns real estate, such as an office building in Wroclaw and a residential project in Katowice, that could be sold. On the other hand, however, the company has already spent a long time trying, unsuccessfully, to sell its properties, and the conflict with key client Alstom created risk of claims from this investor as well as does not bode well for cooperation with this client in the future.

Should EPD's bankruptcy have been expected? EPD's troubles were initiated by PBG's bankruptcy. Following the insolvency of a controlling shareholder, EPD simply lost credibility in the eyes of its debt holders and trade creditors. This quickly resulted in Alstom's withdrawal from subcontracting contracts and the termination of credit and lease contracts with banks. Nevertheless, EPD's financial standing was very tough. EPD reported a negative EBITDA of PLN 7.7m and PLN 19.4m in 2011 and 2010, respectively, and EBITDA was only PLN 1.6m in 1Q12.

Who are Energomontaz's debt holders? EPD's outstanding bank debt was PLN 112.8m as of 1Q12, and net debt was PLN 109.3m. EPD's LT interest bearing debt was PLN 44.2m, and solely related to leasing agreements. ST interest bearing debt totalled PLN 68.8m, of which credits and loans totalled PLN 59.9m, whereas leasing was PLN 8.7m. Peako was the EPD's largest creditor, with an outstanding debt of PLN 17.3m as of 2011-end. The other creditors were BRE (PLN 9.9m), BNP (PLN 9.2m), PKO (PLN 9.1m), Kredyt Bank (PLN 9m) and PBG (PLN 4m).

Valuation and recommendation. With respect to EPD' bankruptcy, we have estimated the net value of the company's assets and, exceptionally, decided to base our Target Price on this calculation. In accordance with haircuts proposed by management, we have attributed 61% of the BV of liabilities and 0–100% of the BV of assets. Because our downgraded TP of PLN 0.1 is below the market share price, we are maintaining a **SELL** recommendation. In our opinion, following the declaration of bankruptcy (with a restructuring option), the future shape of the company (execution potential, etc.) may be completely different once the bankruptcy process is complete. This is why **we have put our financial forecasts for EPD Under Revision,** waiting for news to come.

Energomontaz Poludnie: Financial summary

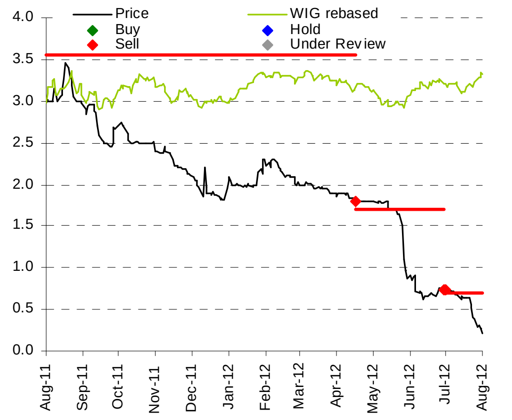
PLN in millions, unless otherwise stated

	2010	2011	2012E	2013E	2014E
Revenues	313.7	331.7	n.a.	n.a.	n.a.
EBITDA	-19.4	-7.7	n.a.	n.a.	n.a.
EBIT	-29.4	-16.6	n.a.	n.a.	n.a.
Net profit	-34.3	-17.7	n.a.	n.a.	n.a.
EPS	n.m.	n.m.	n.a.	n.a.	n.a.
P/E (x)	n.a.	n.a.	n.a.	n.a.	n.a.
EV/EBITDA (x)	n.a.	n.a.	n.a.	n.a.	n.a.

Source: Company data, DM BZ WBK estimates

Recommendation **Sell**

Price (PLN, 13 August 2012)	0.21
Target price (PLN, 12M)	0.10
Market cap. (PLN m)	15
Free float (%)	35%
Number of shares (m)	70.972
EURPLN	4.08
USDPLN	3.31



The chart measures performance against the WIG index. On 10/08/2012, the WIG index closed at 41,878.

Rec.	Date	Price		Price change	
		on issue date	12 month target	absolute	relative (p.p)
Sell	7-10-2012	0.74	0.70	-71.6%	-75.4
Sell	7-9-2012	0.73	0.70	1.4%	1.4
Sell	4-26-2012	1.80	1.70	-59.4%	-60.9

Main shareholders	
PBG	64.84%
Jan Jurkiewicz	6.93%
Maciej Zientara with Superkonstelacja	5.00%

Company description

Energomontaz Poludnie is a pure power sector contractor (renovation of heat and power units, installation of new power generating capacity) with over 50 years of market experience.

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Net assets value calculation

With respect to the submitted motion for the arrangement of bankruptcy, we have estimated the net value of the company's assets and, exceptionally, decided to base our Target Price on this calculation. In accordance with haircuts proposed by management, we have attributed 61% of the BV of liabilities (in fact, a 39% haircut will relate exclusively to liabilities exceeding PLN 100ths). It should be remembered that this is an initial proposition from the management and the final agreement might be different. For this reason we see both upside and downside risks to our TP. In the case of assets, we have attributed 40% of the BV of tangible assets, 85% of the BV of investment properties, 40% of the BV of receivables and inventories and 100% of cash.

Fig. 1. Energomontaz-Poludnie: Net assets value calculation
PLN in millions, unless otherwise stated

Assets and liabilities	BV as of 1Q12	% of BV attributed	Value attributed
Intangible assets	3	0%	0
Tangible assets	70	40%	28
Investment properties	83	85%	71
LT receivables	12	0%	0
LT deffered assets	16	0%	0
Inventories	70	40%	28
ST Receivables	122	40%	49
Cash & equivalents	4	100%	4
LT interest bearing debt	44	61%	27
Other LT liabilities	1	61%	0
Reserves	20	61%	12
ST interest bearing debt	69	61%	42
Other ST liabilities	147	61%	90
Value per share (PLN)			**0.10**

Source: Company data, DM BZ WBK estimates

Real estate is EPD's most valuable asset

Energomontaz has put its non-core real estate assets up for sale, but no transactions have been concluded so far. We estimate the total value of the company's real estate at c. PLN 71m, including an office building in Wroclaw, apartment projects in Katowice, and plots of land in Opole. The major property is an office building in Wroclaw, which we estimate to have a value of PLN 32.6 (assuming a 30% discount to fair value with respect to the time consuming disposal of such assets in the current climate). The building in question is subject to leasing with ING Lease. We assess the value of the dwellings in Katowice at PLN 31m (30% discount assumed to fair value), and the undeveloped plots of land at c. PLN 4m.

Fig. 2. Energomontaz-Poludnie: Fair value of office building in Wroclaw
PLN in millions, unless otherwise stated

Name of the project	Location	Describtion	Net rentable area (sq.m.)	Vacancy rate implied	Rate	EUR/PLN	Yearly Net Operating Income	Yield implied	Property value implied	Current value*
Legnicka Park Popowice	Wrocław	Office space	8.000	5%	11.500	4.0	4.2	9.00%	46.6	32.6

*Source: Company data, DM BZ WBK estimates, *30% discount implied*

Fig. 3. Energomontaz-Poludnie: Fair value of housing project in Katowice
PLN in millions, unless otherwise stated

Name of the project	Location	Describtion	Number of flats ready for sale*	Average dwelling size (sq.m)	Average price of dwelling per 1 sq.m	Value of housing stock (PLN m)	Current value**
Osiedle Ksiazece	Katowice	Apartments	180	60	4500	48.6	34

Source: Company data, DM BZ WBK estimates, estimates, * *30% discount implied*

Risks

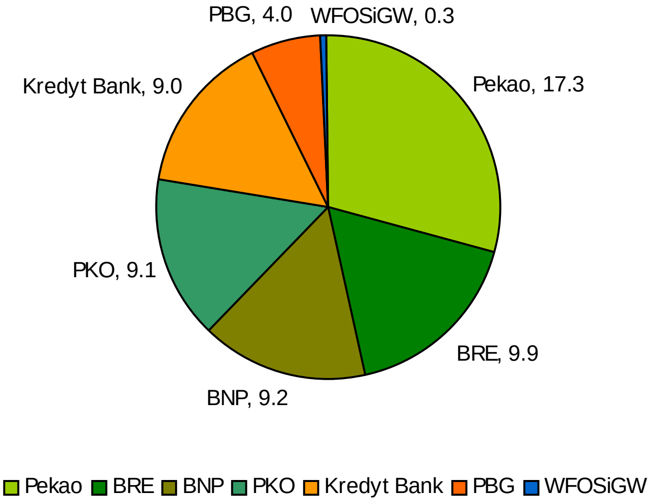
We see the **conflict with Alstom** as one of the most important risks for Energomontaz. Astom, the company's most important client (58% of EPD's revenues were generated from Alstom in 2011), recently terminated contracts with Energomontaz (EPD was Alsom's subcontractor). This may results in claims, the value of which are difficult to assess at the moment. Accounting for such claims would reduce our TP. Furthermore, the conflict bodes ill for future cooperation with this client (assuming an arrangement with creditors in concluded and the company continues in business).

The other risk factor relates to **guarantees made by EPD for bonds issued by PBG**. Following PBG's bankruptcy, EPD declared that this guarantee would not be effective – this case has not yet been solved. The value of EPD's conditional liabilities (chiefly the guarantees in question) was as much as PLN 981m as of 1Q12.

Debt breakdown

Regarding ST interest bearing liabilities as of 2011-end, EPD's biggest debt holder was Peako (PLN 17.3m). Four other banks, BRE, BNP, PKO and Kredyt Bank, held debt of c. PLN 9–10m each. LT interest bearing debt relates solely to leasing agreements, chiefly with ING Lease.

Fig. 4. Energomontaz Poludnie; Breakdown of ST loans as of 2011-end (in PLN m)



Source: Company

Financial statements and forecasts

Fig. 5. Energomontaz-Poludnie: Income statement forecasts
PLN in millions, unless otherwise stated

	2010	2011	2012E	2013E
Sales	**313.7**	**331.7**	**n.a.**	**n.a.**
COGS	**-319.3**	**-317.3**	**n.a.**	**n.a.**
Gross profit on sales	**-5.6**	**14.3**	**n.a.**	**n.a.**
Selling costs	-0.5	-0.4	n.a.	n.a.
General administration costs	-20.5	-20.1	n.a.	n.a.
Net profit on sales	**-26.6**	**-6.2**	**n.a.**	**n.a.**
Other operating income	21.2	11.6	n.a.	n.a.
Other operating costs	-24.0	-22.0	n.a.	n.a.
Others	0.0	0.0		
EBIT	**-29.4**	**-16.6**	**n.a.**	**n.a.**
Financial income	1.9	0.5	**n.a.**	**n.a.**
Financial costs	-6.3	-10.1	n.a.	n.a.
Others	0.0	0.0	n.a.	n.a.
Pre tax	**-33.8**	**-26.2**	n.a.	n.a.
Income tax	-0.5	8.6	**n.a.**	**n.a.**
Minority interest in net income	0.0	0.0	n.a.	n.a.
Net income	**-34.3**	**-17.7**	**n.a.**	**n.a.**

Source: Company data, DM BZ WBK estimates

Fig. 6. Energomontaz-Poludnie: Ratios

	2010	2011	2012E	2013E
Sales growth (y/y)	14%	6%	n.a.	n.a.
Gross profit growth (y/y)	n.m.	-356%	n.a.	n.a.
EBITDA growth (y/y)	n.m.	-60%	n.a.	n.a.
Operating profit growth (y/y)	n.m.	-43%	n.a.	n.a.
Net income growth (y/y)	n.m.	-48%	n.a.	n.a.
A/R turnover days	180	140	n.a.	n.a.
Inventory turnover days	104	111	n.a.	n.a.
A/P turnover days	134	138	n.a.	n.a.
Cash cycle	150	112	n.a.	n.a.
NWC/Sales	35%	26%	n.a.	n.a.
Gross margin	-1.8%	4.3%	n.a.	n.a.
EBITDA margin	-6.2%	-2.3%	n.a.	n.a.
EBIT margin	-9.4%	-5.0%	n.a.	n.a.
Pre-tax margin	-10.8%	-7.9%	n.a.	n.a.
Net margin	-10.9%	-5.3%	n.a.	n.a.
ROE	-24.0%	-16.9%	n.a.	n.a.
ROA	-7.6%	-4.3%	n.a.	n.a.
Current ratio	1.3	1.1	n.a.	n.a.
Quick ratio	0.8	0.7	n.a.	n.a.

Source: Company data, DM BZ WBK estimates

Fig. 7. Energomontaz-Poludnie: Balance sheet forecast
PLN in millions, unless otherwise stated

	2010	2011	2012E	2013E
Fixed assets	**171.9**	**182.6**	**n.a.**	**n.a.**
Intangibles	1.7	2.9	n.a.	n.a.
Goodwill	0.0	0.0	n.a.	n.a.
Tangible fixed assets	75.3	71.0	n.a.	n.a.
LT receivables	4.0	8.5	n.a.	n.a.
LT investments	83.9	83.1	n.a.	n.a.
LT deferred assets	6.6	17.1	n.a.	n.a.
Others	0.3	0.0	n.a.	n.a.
Current assets	**259.6**	**206.9**	**n.a.**	**n.a.**
Inventories	114.2	78.8	n.a.	n.a.
ST receivables	128.7	125.2	n.a.	n.a.
ST deferred assets	0.0	0.0	n.a.	n.a.
Cash & equivalents	13.6	2.9	n.a.	n.a.
Other assets	3.0	0.0	n.a.	n.a.
Total assets	**431.5**	**389.5**	**n.a.**	**n.a.**
Equity	**115.4**	**94.1**	**n.a.**	**n.a.**
Liabilities & reserves	**316.1**	**295.4**	**n.a.**	**n.a.**
Reserves	22.1	20.2	n.a.	n.a.
LT liabilities	59.9	52.3	n.a.	n.a.
Non-interest-bearing	3.8	3.6	n.a.	n.a.
Interest-bearing	56.1	48.6	n.a.	n.a.
ST Liabilities	193.5	181.4	n.a.	n.a.
Non-interest-bearing	130.6	113.7	n.a.	n.a.
Interest-bearing	62.9	67.7	n.a.	n.a.
Reserves	0.0	0.0	n.a.	n.a.
Deferred liabilities	40.6	41.6	n.a.	n.a.
Total liabilities and equity	**431.5**	**389.5**	**n.a.**	**n.a.**

Source: Company data, DM BZ WBK estimates

Fig. 8 Energomontaz-Poludnie: Cash flow forecast
PLN in millions. unless otherwise stated

	2010	2011	2012E	2013E
Pre - tax profit (loss)	-33.8	-26.2	n.a.	n.a.
Depreciation and amortization	10.0	8.9	n.a.	n.a.
NWC change:	52.4	50.1	n.a.	n.a.
Change in inventories	-62.3	35.5	n.a.	n.a.
Change in receivables	67.6	17.9	n.a.	n.a.
Change in payables	47.1	-3.3	n.a.	n.a.
Other	-34.0	-14.2	n.a.	n.a.
Operating cash flow	**-5.4**	**18.5**	**n.a.**	**n.a.**
Capital expenditures	-27.4	-6.5	n.a.	n.a.
Other	0.0	0.0	n.a.	n.a.
Investing cash flow	**-27.4**	**-6.5**	**n.a.**	**n.a.**
Change in interest-bearing debt	-28.5	-16.0	n.a.	n.a.
Dividends payment	0.0	0.0	n.a.	n.a.
Interest	-6.3	-7.7	n.a.	n.a.
Other	58.9	0.9	n.a.	n.a.
Financing cash flow	**24.1**	**-22.7**	**n.a.**	**n.a.**
Total cash flow	**-8.8**	**-10.7**	**n.a.**	**n.a.**

Source: Company data, DM BZ WBK estimates

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In preparing this document DM BZ WBK S.A. applied at least two of the following valuation methods:
1) discounted cash flows (DCF),
2) comparative,
3) mid-cycle,
4) dividend discount model (DDM).

The discounted cash flows (DCF) valuation method is based on expected future discounted cash flows. One advantage of the DCF valuation method is that it takes into account all cash streams reaching Issuer and the cost of money over time. Some disadvantages of the DCF valuation method are that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.
The comparative valuation method is based on the economic rule of "one price". Some advantages of the comparative valuation method are that the analyst need only estimate a small number of parameters; the valuation is based on current market conditions; the relatively large accessibility of indicators for companies being compared; and that there is an extensive knowledge of the comparative method among investors. Some disadvantages of valuation by the comparative method are the considerable sensitivity of the results of the valuation on the choice of companies to the comparative group; the method can lead to a simplification of the picture of the company which in turn can lead to omitting certain important factors (e.g. growth dynamics, extra-operational assets, corporate governance, the repeatability of results, differences in applied accounting standards); and the uncertainty of the effectiveness of a market valuation of companies being compared.
The mid-cycle valuation is based on long-term averages for the two-year forward consensus P/E and EV/EBITDA multiples for the members of the peer group. The methodology is aimed calculating a fair, through the cycle value of cyclical stocks. Among its shortfalls is that at peaks and/or troughs of the cycle, the implied fair value may deviate substantially from the market's value of an analysed stock as well as the methods' reliance on the quality of external data (we use Bloomberg consensus here). Simplicity and average through-cycle value allowing to capture over as well as under-valuation of a given stock are the main advantages of this methodology.
The dividend discount model (DDM) valuation is based on the net present value of the future dividends that are expected to be paid out by the company. Some advantages of the DDM valuation method are that it takes into account real cash flows to equity-owners and that the methodology is used in respect to companies with long dividend payout history. Main disadvantage of the DDM valuation method is that dividend payouts are based on a large number of parameters and assumptions, including dividend payout ratio.

Explanations of special terminology used in the recommendation:
EBIT – earnings before interest and tax
EBITDA – earnings before interest, taxes, depreciation, and amortization
P/E – price-earnings ratio
EV – enterprise value (market capitalisation plus net debt)
PEG - P/E to growth ratio
EPS - earnings per share
CPI – consumer price index
WACC - weighted average cost of capital
CAGR – cumulative average annual growth
P/CE – price to cash earnings (net profit plus depreciation and amortisation) ratio
NOPAT – net operational profit after taxation
FCF - free cash flows
BV – book value
ROE – return on equity
P/BV – price-book value

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