

## Stalexport Autostrady SA

Bloomberg Ticker:	STX:PW	Closing Price (3/10/17):	PLN4.30
6 Month Avg. Daily Vol. (USD mn):	0.13	Market Cap (USD mn):	262
Estimated Annualized Return:	10.5%		

March 11, 2017

### INVESTMENT THESIS

Stalexport Autostrady holds a concession on a 61-kilometer stretch of the A4 in Poland between Katowice and Kraków. The concession ends in 2027. The company's management has done an excellent job of improving operations since taking over in 2006 growing toll revenue at 11.8% over the past ten years. Despite the growth in the business, and inherent operating leverage in running a toll motorway, the current market valuation is 19% below a zero growth intrinsic value making Stalexport an attractive investment opportunity. If the company is able to grow revenues at half of its historic rate, there is 67% upside to its intrinsic value. If the company is able to continue to grow its revenues at its historic rate, there is 131% upside. Given the stability of the company's revenue and the expected return of 10.5%, we recommend a starting position of 2.0%.

### COMPANY DESCRIPTION

#### History

Stalexport Autostrady started operations on January 1, 1963 as Przedsiębiorstwo Handlu Zagranicznego "Stalexport". It specialized in exporting and importing steel products as well as importing raw materials for the Polish steel industry. In 1993, the Polish government privatized the company with shares listing on the Warsaw Stock Exchange in October 26, 1994. In 1997, Stalexport won a 30-year concession to construct, adapt, and operate a 61 km toll road on the A4 motorway between Katowice and Kraków.

The motorway was secondary to the steel business until 2006, when the Atlantia Group, then Autostrade S.p.A., an Italian infrastructure company, acquired 50%+1 share of Stalexport for €67 million or PLN200 million. By Polish regulation, Atlantia was forced to launch a public tender offer for up to 66% of Stalexport's share capital. It increased its share to 56.24% at the time of the acquisition. To complete the acquisition, Atlantia required Stalexport to increase its share capital with all new shares going directly to Atlantia. It also mandated the sale of the steel business. Prior to obtaining Atlantia as a strategic investor, Stalexport was dealing with potential bankruptcy for a number of years with its auditor, BDO, issuing a statement of the going concern nature of the company in its opinion statement. Atlantia manages a network of 5,000 km of toll motorways in Italy, Brazil, Chile, India, and Poland. It is a leader with respect to automatic motorway toll collections systems.



In 2011, Stalexport reduced its share capital to PLN185.45 million to reflect the change of the of the organization and capital requirements as the company was solely an operator of a toll road.

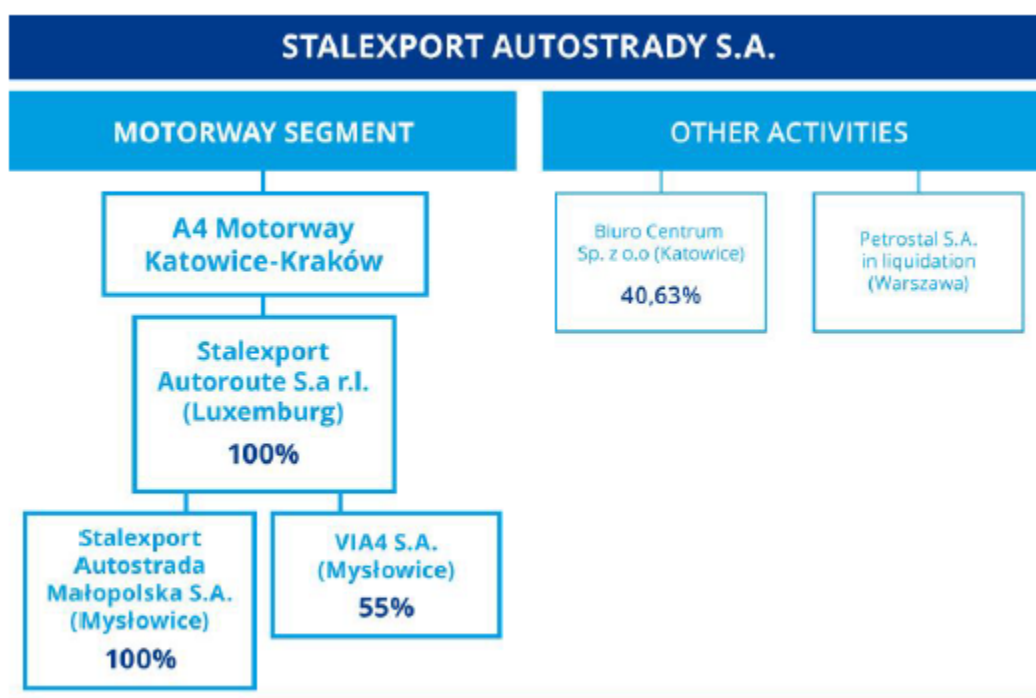
Shareholder Structure	2008	2009	2010	2011	2012	2013	2014	2015	2016
Atlantia	56.24%	56.24%	56.24%	60.63%	60.63%	60.63%	60.63%	60.63%	61.20%
Others	43.76%	43.76%	43.76%	39.37%	39.37%	39.37%	39.37%	39.37%	38.80%
Shares held by Atlantia, million	139.06	139.06	139.06	149.92	149.92	149.92	149.92	149.92	151.32

Source: Company data

Since the acquisition, Atlantia increased its shareholding to 61.20%. Post-acquisition, its first increase came in to 2011 with a purchase of 10.86 million shares increasing its stake to 60.63%. In 2016, the company purchased another 1.4 million shares increasing its stake to 61.20%. Management has an insignificant shareholding with Emil Wasacz, President of the Management Board, holding 59,000 shares.

## Organizational Structure

Organisational chart of Stalexport Autostrady Group as at 31 December 2016



Source: Internal study

Stalexport Autostrady S.A. focuses on the upgrade and expansion of motorway infrastructure. In 1997, it was the first Polish company to be granted a concession to operation, upgrade, and maintain a toll motorway winning the concession on the A4 motorway between Katowice and Kraków section. In 2004, the concession was transferred to Stalexport Autostrada Małopolska S.A.

Stalexport Autoroute S.à r.l. was established on December 30, 2005. The entity does not conduct any operational activities apart from holding shares in SAM as well as in VIA4. The entity was established as a prerequisite to obtain a loan for a consortium of banks.

Stalexport Autostrada Małopolska S.A. (SAM) SAM was established on December 19, 1997 as a special purpose vehicle to manage the A4 motorway between Katowice and Kraków. The motorway concession was transferred to from the group to SAM on July 28, 2004. After the transfer, SAM was authorized to collect lease fees and tolls for using the above-mentioned motorway section. As stated by the concession agreement, the entity is obliged to provide ongoing maintenance of the motorway and continue other necessary investment tasks.

VIA4 (formerly Stalexport Transroute Autostrada S.A.) was established on 14 May 1998. VIA4's only customer is SAM. Its main tasks are ongoing operation and maintenance of the A4 toll motorway section, which includes operation of the toll collection system, management of motorway traffic, and comprehensive renovation and maintenance of the motorway. VIA4 also carries out tasks related to safety and road traffic. VIA4 is 55% owned by Stalexport and 45% owned by Egis Road Operation S.A., a French company with expertise in all of aspects of motorway management.

Biuro Centrum was established on June 9, 1994. The main business of Biuro Centrum consists in management and maintenance of the office and conference building in Katowice at ul. Mickiewicza 29 co-owned by Stalexport Autostrady (40.47%) and Węglokoks S.A. (59.53%).

Selected Financial Data 12/31/16, PLN mn	Stalexport			
	Autostrady Group	Stalexport Autostrady	SAM	VIA4
Current assets	387	311	69	14
Non-current assets	1,060	79	1,041	9
Current liabilities	177	1	176	7
Non-current liabilities	688	1	681	5
Total equity	582	388	254	11
Net debt	(315)	(300)	(9)	6
Revenue	293	4	288	21
Gross profit	252	(0)	230	21
EBITDA	263	(3)	231	18
EBIT	218	(3)	210	16
Net profit (loss)	171	181	149	13
EBIT margin	74%	-92%	73%	78%
ROE	29%	47%	59%	115%

Source: Company data

98% of the consolidated company's revenues and 96% of EBIT are from SAM, the entity that collects the lease fees and tolls from the motorway.

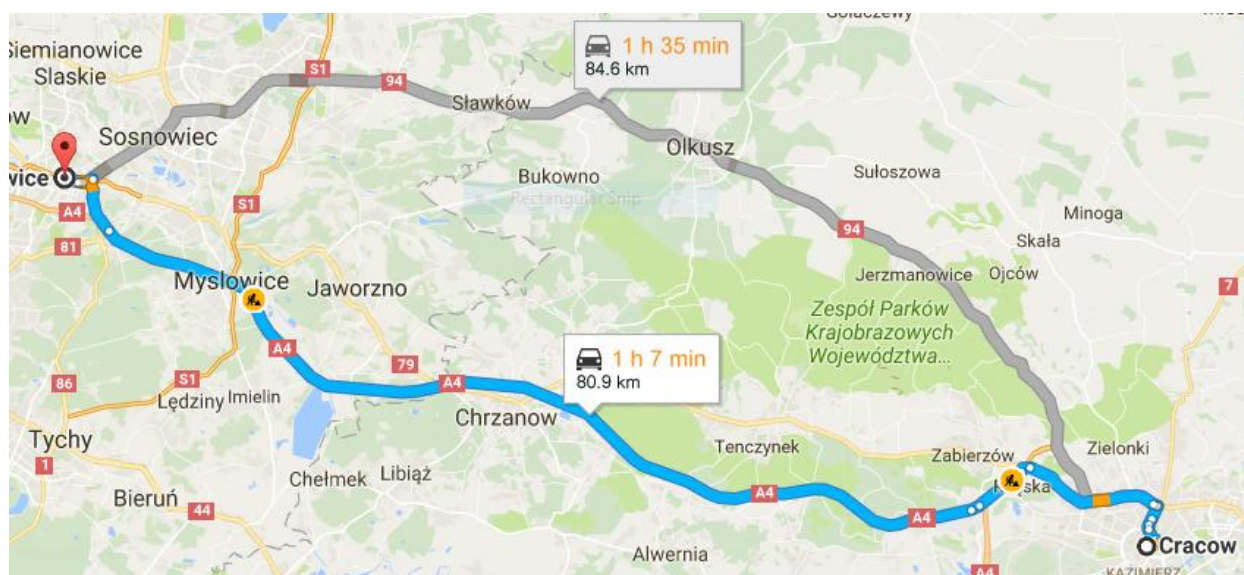
Given the importance of the toll road, we focus our attention on this business. The A4 toll motorway between Katowice and Kraków is 61-kilometer toll road. It is part of the A4, which is one of the major motorways in Poland and one of the



two motorways planned to stretch from the eastern border Poland to the western border of Poland by 2022 along with the A2 in central Poland.



The A4 from Katowice to Kraków is an open system, where money is paid at tollbooths stretching across the road based on the vehicle type. The open system is relative cheap but forces commuters to stop at each tollbooth decreasing the capacity of the motorway. The other system is a closed system where there are tolls at each interchange when entering and exiting the motorway the toll is paid based on the vehicle and the distance traveled.



According to Google Map driving directions, the A4 is the quickest way from Katowice to Kraków beating the 94 by 28 minutes. As mentioned, the only major competition to cross Poland is the A2 in central Poland. The decision is based on your starting and ending point and the quickest route of travel so in many instances there is no competition. The A4 is a fastest way to travel particularly if you are driving across southern Poland from east to west or west to east and there are very few alternatives. It would be very difficult for a competing toll road to be built over the next 10 years allowing the A4 to generate steady revenue with very little investment requirements. Additionally, if another road were to be built to compete with the A4, it would cannibalize government revenue, as the A4 from Katowice to Kraków will be handed over to the government at the end of the concession in 2027. Toll roads also have barriers to entry in the form of habitual behavior. When commuters have a road travelled on a daily basis a habit is formed as the road is travelled without any thought creating a habit that is difficult to break.

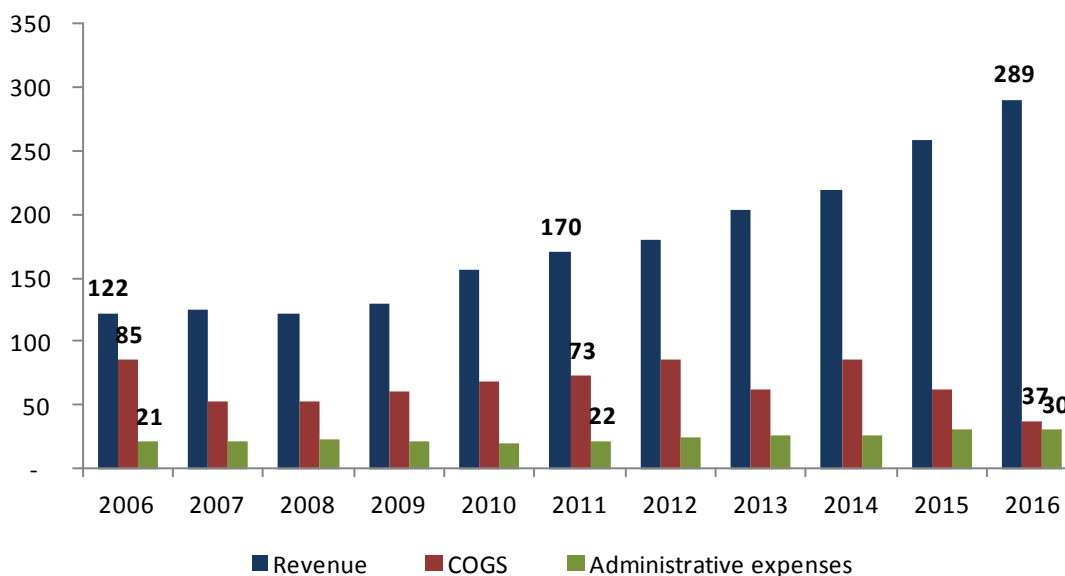
For the consolidated entity, since 2008, toll revenue increased by 11.6% per year with passenger vehicle toll revenue increasing by 11.4% per year and heavy goods vehicle toll revenue increasing by 11.9% per year. Average daily traffic increased by 4.5% per year with passenger vehicle traffic increasing by 5.7% per year and heavy goods traffic decreasing by 0.6% per year. The average toll increased by 6.8% per year with the average toll for passenger vehicles increasing at 5.4% per and heavy goods vehicles increasing by 12.5% per year.

Average Daily Traffic	2008	2009	2010	2011	2012	2013	2014	2015	2016	08-16 CAGR
Passenger cars	21,794	22,457	23,189	24,568	23,979	26,596	28,513	30,922	34,069	5.7%
Heavy goods vehicles	6,876	6,146	6,809	6,053	4,651	5,050	5,488	5,988	6,614	-0.5%
<b>Total</b>	<b>28,670</b>	<b>28,603</b>	<b>29,997</b>	<b>30,621</b>	<b>28,630</b>	<b>31,646</b>	<b>34,001</b>	<b>36,910</b>	<b>40,683</b>	<b>4.5%</b>
Toll Revenues (PLN mn)	2008	2009	2010	2011	2012	2013	2014	2015	2016	08-16 CAGR
Passenger cars	84	89	109	115	121	140	150	178	200	11.4%
Heavy goods vehicles	36	39	47	54	58	62	68	80	88	11.9%
<b>Total</b>	<b>120</b>	<b>128</b>	<b>155</b>	<b>169</b>	<b>179</b>	<b>202</b>	<b>218</b>	<b>258</b>	<b>288</b>	<b>11.6%</b>
Average Toll (PLN)	2008	2009	2010	2011	2012	2013	2014	2015	2016	08-16 CAGR
Passenger cars	10.6	10.9	12.8	12.8	13.9	14.4	14.4	15.8	16.1	5.4%
Heavy goods vehicles	14.3	17.3	18.8	24.6	33.9	33.8	33.9	36.4	36.6	12.5%
<b>Total</b>	<b>11.4</b>	<b>12.2</b>	<b>14.2</b>	<b>15.2</b>	<b>17.1</b>	<b>17.5</b>	<b>17.6</b>	<b>19.1</b>	<b>19.4</b>	<b>6.8%</b>

Source: Company data



Despite the growth in revenues, Stalexport’s cost of goods sold have decreased from PLN85 million in 2006 to PLN37 million in 2016. 2006 and 2012 were the two years with the highest cost of goods sold at PLN85 million. Cost of goods sold is very dependent on road works during the year, which creates a bit of lumpiness and no correlation with revenues. 2016 saw lower road works leading to much lower cost of goods sold. Since 2006, cost of goods sold averaged PLN66 million.



Source: Company data, PLN mn

Administrative expenses have increased steadily from PLN21 million in 2006 to PLN30 million in 2016, equal to a 3.8% annual increase, well below the rate of change in toll revenue.

Atlantia has done a good job of growing revenues while decreasing expenses as a percentage of revenues. The biggest driver of decreasing costs relative to expenses was eliminating inefficiencies from having too many subsidiaries.

The A4 concession expires in 2027. Upon expiry, the A4 will be transferred to Poland’s Treasury. If Stalexport is to grow, it will come from the existing asset. There are other potential PPP projects but it would be speculative to assume any growth from these projects as the company has not indicated there are any potential projects in the pipeline. The company has also been selective in the past and passed on projects where prospective returns were not attractive enough.

Internal growth will come from traffic growth and growth in the average toll. In 2016, Stalexport implemented its own A4Go on-board units after not being able to coordinate with the viaToll system used elsewhere in Poland. The A4Go unit allows for electronic payment at the tolls decrease traffic at tollbooths. The A4Go was implemented in only 6 months and went online in July 2016. By the end of the year, roughly 10% of morning traffic used the A4Go system. The decrease in traffic at tollbooths decreases the travel time for commuters making the A4 a more attractive route for existing and potential users.



## VALUATION

Given the barriers to entry and the predictability of revenue, we value Stalexport using a DCF until 2026 the year before the company has to hand operations back to the treasury. We assume no cash flows in 2027 for conservatism.

We vary sales growth to get an estimated intrinsic value under different scenarios. Under the most conservative scenario, we assume no growth in sales. Sales growth is then assumed to increase by 3% as scenarios become more aggressive and we reach the most aggressive scenario of 12%, which assumes sales growth will continue at roughly the pace it has over the past ten years (11.8%).

The last ten years saw significant variability in the cost of goods sold but the variability was within a well-defined range. We assume an average of the last ten years with no inflation.

Administrative expenses have increased steadily over the past 10 years at a rate of 3.8% per year. We assume administrative expenses continue increasing at 4.0% per year. We also assume a tax rate of 20% roughly in-line with the effective tax rate of 19.8% over the past ten years.

Since 2008, the company's average change in working capital to revenue rate is 6.3% meaning every zloty of revenue generates 6.3 grosz of positive free cash flow due to negative working capital requirements. Despite the negative working capital generating free cash flow, we assume there is no cash flow generated from working capital and there are no investments in working capital.

Also since 2008, the company has spent 26.1 grosz on capital expenditures for every 1 zloty of revenue just above the depreciation rate of 19.1 grosz for every 1 zloty of revenue. Over the past four years, the capex to depreciation rate averaged 0.8 meaning the company is spending less on capex than depreciation. The recent trend of capex below depreciation leads us to assume capex equals depreciation therefore there are no additional fixed capital requirements other than the maintenance capex.

The company has a net cash position just over PLN315 million and a share in property investments with an estimated value of PLN10 million.

We place a probability on each of the 5 revenue growth scenarios to get a blended intrinsic value of PLN7.21 per share, which has 67.6% upside from the current price.



Scenario	Intrinsic value per share		
		Upside	Probability
0% revenue growth	5.12	19.1%	10%
3% revenue growth	6.03	40.2%	20%
6% revenue growth	7.09	65.0%	40%
9% revenue growth	8.35	94.2%	20%
12% revenue growth	9.83	128.6%	10%
<b>Blended intrinsic value</b>	<b>7.21</b>	<b>67.6%</b>	

Source: Reperio Capital Research estimates

Under the most conservative scenario of zero revenue growth still leads to an upside of 19% illustrating the downside protection at current prices.

## RISKS

Stalexport's biggest risk is regulatory risk. While a toll motorway concession is a contract, the authorities are most likely least concerned with the owner of the toll motorway and more concerned with other stakeholders such as commuters. In Poland, Stalexport was sued by the Polish government for anti-competitive practices due to high toll rates. In 2008, the company had to pay a PLN1.5 million fine. In India, populism led to abolition of tolls for an extended period. Countries may also change their previous position to void contracts.

Any new motorway running parallel to the A4 would create additional supply impacting Stalexport's ability to attract traffic and raise toll rates.

Traffic particularly heavy goods vehicles is dependent on economic growth. Slowing macroeconomic growth could hurt traffic growth.

The company has more related party transactions than what we would like and there is potential for some corporate governance risks. The main related party transactions are with companies owned by Atlantia, which complete roadworks on the motorway.

Related Party Transactions	2008	2009	2010	2011	2012	2013	2014	2015	2016
Receivables	0.9	0.0	0.0	0.0	0.0	0.0	0.1	0.1	1.7
Payables	11.3	29.1	9.9	34.1	5.4	2.9	13.3	2.9	2.2
Guarantees and suspended amounts	-	-	0.6	0.5	14.5	8.8	12.3	10.8	7.2
Revenue	1.1	1.0	0.1	0.2	0.4	0.5	0.6	0.7	1.9
COGS	(0.1)	(0.1)	(0.0)	(0.9)	(4.1)	(4.0)	(4.4)	(4.7)	(4.3)
Capex and resurfacing works	(33.0)	(106.9)	(38.5)	(54.7)	(51.1)	(18.6)	(45.3)	(11.0)	(41.7)
Remuneration	7.8	9.7	6.8	4.8	3.9	4.0	4.0	3.9	3.3
Remuneration % of operating income	20.4%	25.8%	11.8%	7.0%	6.2%	3.6%	3.9%	2.4%	1.5%

Source: Company data

Management remuneration has decreased substantially as a percentage of operating income. Management may increase its salaries and extract greater value in the future.





There is a risk of the company tendering for new concession and overpaying hurting returns on future projects. The company was disciplined enough to pass on past projects that did not meet the parameters needed for attractive returns.



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