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Trakcja – Financial Standing Markedly Worsens In Q1

Rating: underweight | current price: PLN 3.44

TRK PW | Construction, Poland

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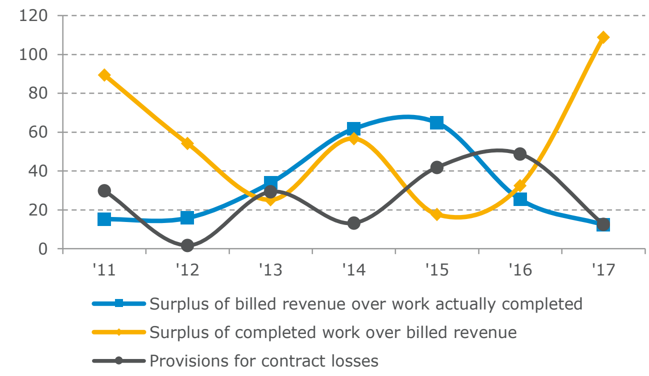
Trakcja's final financial statements for the first quarter of FY2018, released yesterday, in terms of P&L were a reiteration of the preliminary estimates issued over a week ago, with a higher-than-expected net loss attributed in equal parts to the Polish business and the Lithuanian business. When it comes to the balance sheet, however, the final report revealed an unexpectedly large negative cash flow, and a worrying discrepancy in the amount of billed revenue, which markedly exceeds the work actually completed. The high debt reported at the end of March further adds to the unexpected deterioration in Trakcja's financial standing, especially if we look at the challenging market conditions where intense competition forces railway builders to bid low profit margins while construction costs rise. The risk to the future profitability of jobs currently on offer is further exacerbated by delays in administrative procedures, which draw out the period from bid placement to contract award. To account for the deterioration in Trakcja's financial health, we have cut our 2018-2020 net profit forecasts for the Company by 70% today, and we downgrade its stock from neutral to overweight.

2018 Q1 Recap

- Trakcja's final Q1 2018 financials confirmed a higher-than-forecast quarterly **net loss** of PLN 22m.
- The Company reported that its **backlog** at 31 March was PLN 1,958m, representing an increase of 10% from December 2017 and a **45% rebound** from March 2017. This after the acquisition of new bookings totaling PLN 431m during the first quarter, twice the amount acquired in the same period a year ago.

Valuation of Trakcja's construction contracts



Source: Trakcja, Dom Maklerski mBanku

- **Net debt** was **PLN 165m** in March 2018 versus PLN 20m in the same month last year.
- **Operating cash flow** for the first quarter was a **negative PLN 146m**.
- One of the main drivers behind the first-quarter surge in **debt** was an increase in the balance-sheet item "Construction contracts and advances received toward contracts being performed," soaring by PLN 55m year over year. We suspect the increase in the value of construction contracts alone, at PLN 89m at 31 December 2017, was even greater.
- The other key debt driver was a PLN 34m higher surplus of payables over receivables, coupled with a PLN 25m increase in inventory.
- Total investment in net **working capital** as at 31 March was equivalent to 14% of yearly revenue, an increase from 5% last March.

Updated 2018-2020 financial forecast for Trakcja

(PLN m)	2014	2015	2016	2017	2018E	2019E	2020E
Revenue	1,601.7	1,329.2	1,381.2	1,374.3	1,473.2	1,571.8	1,630.7
Gross profit	202.1	166.1	148.2	93.3	72.0	76.2	88.5
margin	12.6%	12.5%	10.7%	6.8%	4.9%	4.8%	5.4%
EBIT	85.8	76.7	73.8	38.1	12.9	15.2	25.8
Pre-tax income	68.8	72.7	67.3	33.1	8.2	9.0	19.1
Net income	49.5	50.2	54.7	31.4	6.5	7.2	15.3
Net debt	101.8	-140.3	-26.1	4.0	76.5	86.5	78.6
EV	289.4	47.3	161.5	191.6	264.1	274.1	266.2
EBITDA	109.5	99.0	97.2	67.1	42.7	45.7	56.8
DPS	0.00	0.00	0.34	0.50	0.00	0.00	0.20
Dividend Yield	0.0%	0.0%	9.3%	13.7%	0.0%	0.0%	5.5%
P/E	3.8	3.7	3.4	6.0	28.7	26.1	12.3
EV/EBITDA	2.6	0.5	1.7	2.9	6.2	6.0	4.7
P/B	0.3	0.3	0.2	0.2	0.2	0.2	0.2
P/B (adj.)*	0.7	0.6	0.5	0.5	0.5	0.5	0.5

TRK share price (PLN)	3.65
Shares outstanding (millions)	51.4
Market capitalization (PLN m)	187.6

Source: Trakcja, E - estimates by Dom Maklerski mBanku, *After adjustment for goodwill and intangible assets mBank Dom Maklerski

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

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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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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NAV - valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/ profits of a company.

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