

**Bridge financing to secure railway tracks capex?
Upgraded to Outperform rating, TP upped to PLN22.7**

We are upgrading rating for Torpol to Outperform (from Neutral). We still see the risk of delays in the EU funds distribution to Poland, but the pre-financing mechanism could open room for backlog improvement in the short-term. Moreover, CPK has recently announced the planned high-scale investments in the high-speed railway tracks in Poland, in which Torpol could participate, we believe. We expect record high 4Q22E earnings (2.2 2022E P/E ratio), and q/q net cash growth, while both suggest a hefty 2023E dividend (15% DY). Any changes in the company's dividend policy or management team following the likely sale of the stake by Silesia to CPK represent the key short- to mid-term risks, we think.

Is pre-financing of the EU Recovery Fund nearing? The Polish PM and the Ministry of Infrastructure have stated that the pre-financing mechanism of the EU Recovery Fund could be launched and that the railway sector participants should expect a good news flow. The bridge funding is considered due to delays in the EU funds distribution. PFR, which is expected to pre-finance investments in the railway sector, had previously informed about the secured PLN12.5bn, while the recent statement suggests almost PLN2-3bn cash flow in the short-term.

Torpol is likely to double y/y backlog. In 2022 Torpol submitted c. 16 offers in tenders worth PLN16bn, while three offers worth PLN1.4bn have been already picked by the investor. We think that the launch of aforementioned bridge financing mechanism could potentially open room for signing the contracts, which – if happens – might double Torpol's backlog from c. PLN0.9bn (as at 4Q22E) to c. PLN2.2bn, and improve visibility of 2023E-24E results, we think. The plans of high-speed railway tracks construction recently announced by CPK represent another possible source of large-size contracts in the long-term, we think.

Strong 4Q22E profits. We project a strong gross margin in 4Q22E thanks to the execution/completion of high-margin contracts signed in 2020-21 and the fact that the contract risks have not materialized. Totally, we estimate c. PLN59mn net profit in 4Q22E, which lifts FY22E net profit to PLN165mn (2.2x 2022E P/E ratio), i.e. way above our previous expectations. We also expect positive operating CF of c. PLN23mn in 4Q22E (a slightly positive message following insignificant OCF in 3Q22) which lift net cash to PLN309mn as at 2022E-end (PLN13.5 per share).

CPK to acquire a 38% stake. TF Silesia entered into an initial agreement with CPK for the sale of 38% stake in Torpol. We cannot exclude that CPK would potentially look for a 100% ownership holding (purchase of 50%+ stake requires announcement of a call tender offer) at the end of the day.

Financial forecasts. We have upped our sales and earnings forecasts for Torpol in order to reflect the likelihood of signing a new contract in the short- to medium-term. We estimate gross margin at 5.8% as of 2023E (21.8% in 2022E) in order to reflect high competition in the sector. We estimate a 50% dividend pay-out ratio, which implies PLN3 DPS in 2023E (flat y/y) and 15% DY.

Upsides: Any 50bps change in gross margin estimate represents c. 12% upside/downside to our Target Price. We expect annual sales to approach PLN1.7bn in terminal, a level which settles below the company's capacity of PLN2bn+. **Risks:** (1) any further delays in the launch of the European Recovery Fund/or bridge financing, 2) tough completion, 3) any additional investment in building equipment to scale-up capacity, 4) any changes in dividend policy or Board following the stake purchase by CPK.

Valuation. We increase Target Price to PLN22.7 from PLN17.2, as a net of changes in financial forecasts.

TORPOL: Financial summary (year to December)

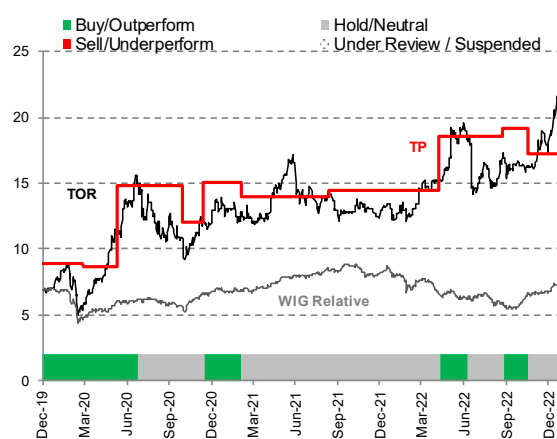
PLNmn	2019	2020	2021	2022E	2023E	2024E
Sales	1,603	1,392	1,121	1,060	1,010	1,400
EBITDA	65	86	127	217	45	68
EBIT	43	63	105	195	23	45
Net profit	29	48	77	165	21	33
P/E (x)	5.2	4.9	4.0	2.2	20.5	13.5
EV/EBITDA (x)	2.3	-0.3	0.0	0.2	4.9	4.5
DY (%)	3.9%	8.9%	11.4%	19.4%	15.5%	2.4%

Source: Company data, Santander Brokerage Poland estimates, 2019-22 multiples calculated on avg. share price

Recommendation	Outperform (↑)
Target Price (Dec'23, PLN)	22.7 (↑)
Price (PLN, 2 February 2023)	19.44
Market cap. (PLNmn)	446
Free float (%)	62
Number of shares (mn)	22.97
Average daily turnover 3M (mn)	0.4

What has changed

- We upgrade rating to Outperform from Neutral
- Target Price increased to PLN22.7 (from PLN17.2 previously) as an effect of upped financial forecasts.



The chart measures performance against the WIG index.

Main shareholders	% of votes
TF Silesia	38.0
NN pension fund	11.2
PKO mutual fund	8.8

Source: www.gpw.pl

Company description

Torpol is a construction company which is focused on construction of railway tracks.

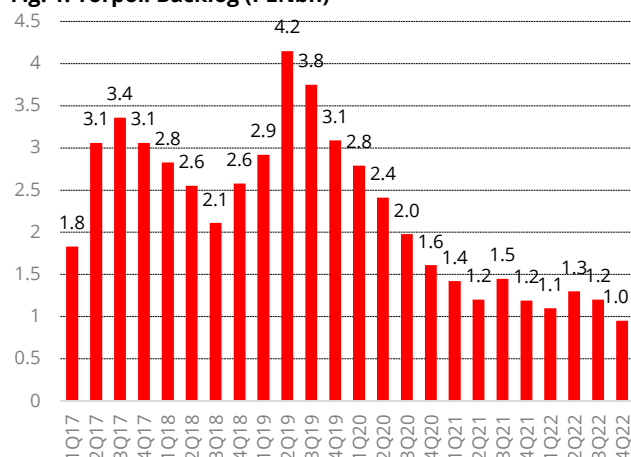
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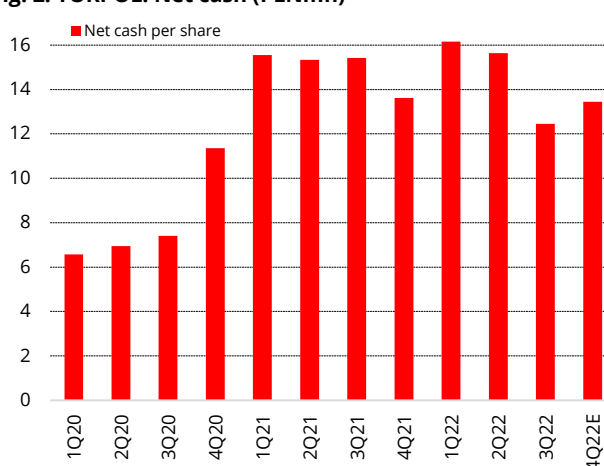
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Fig. 1. Torpol: Backlog (PLNbn)



Source: Company data, 4Q22 – our estimate

Fig. 2. TORPOL: Net cash (PLNmnn)



Source: Company data

Fig. 3. TORPOL: Forecast changes

PLNmnn	2022E			2023E			2024E		
Year to Dec	New	Previous	Change	New	Previous	Change	New	Previous	Change
Sales	1,060	1,050	1%	1,010	900	12%	1,400	1,200	17%
EBITDA	217	172	26%	45	34	31%	68	54	26%
EBIT	195	150	30%	23	12	86%	45	32	44%
Net profit	165	126	31%	22	13	68%	33	22	51%

Source: Company data, Santander Brokerage Poland estimates

Fig. 4. TORPOL: Valuation changes

PLN per share	New	Previous	Change
DCF	22.7	17.2	32%
Comparable valuation (based on 2022E-2024E multiples)	39.8	31.0	28%
Weighted valuation*	22.7	17.2	32%

Source: Company data, Santander Brokerage Poland estimates

* Target Price based 100% on DCF valuation, for illustrative purposes: comparable valuation, based on 2022E-24E P/E for foreign peers (valuation includes record high 2022E earnings of Torpol)

Fig. 5. TORPOL: DCF valuation

PLNmnn	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E
Net sales	1060	1010	1400	1650	1700	1700	1700	1700
EBIT	195	23	45	59	61	60	59	58
Cash taxes on EBIT	37	4	9	11	12	11	11	11
NOPAT	158	18	37	48	49	48	48	47
Depreciation	22	22	22	22	22	22	22	22
Change in operating WC	-105	-31	-109	-45	-9	0	0	0
Capital expenditure	-22	-22	-22	-22	-22	-22	-22	-22
Free cashflow	53	-13	-72	3	40	48	48	47
Sum of FCFs PVs (2024E-2029E)	45							
Residual growth of FCFs	1.5%							
Residual value	496							
Present value of the residual value	229							
Torpol's EV	274							
Net debt (2023E end)	-228							
Dividend (2023E)	69							
Advance payments	-50							
Equity value	521							
Target Price (PLN, Dec 2023)	22.7							

Source: Company data, Santander Brokerage Poland

4Q22E Results Preview

We expect Torpol to deliver strong 4Q22E results. We project gross margin growth to solid 25% in 4Q22E from 20.2% in 3Q22 thanks to execution/completion of high margin contracts signed over 2020-21 and the fact that contract risks have not materialized. Totally, we estimate c. PLN59mn net profit in 4Q22E which lifts FY22E net profit to PLN165mn i.e. way above our previous expectations. We also expect positive operating CF of c. PLN23mn in 4Q22E (slightly positive message following insignificant OCF in 2Q22) which lifts net cash to PLN309mn as at 2022E-end (PLN13.5 per share). On the other hand, we expect the backlog to decrease below PLN1bn as at 2022-end, i.e. way below the company's capacity.

Overall, the margins might come in as a positive surprise in 4Q22E which used to positively surprise also over the past few quarters. On the other hand, the company has not managed to sign any large size contract in 4Q22 (PLN1.3bn best offers submitted but investor has not secured financing as we see it), which resulted in backlog contraction to tiny level of below PLN1bn - the key risk to Torpol's post-2024E results, we think.

Fig. 6. TORPOL: 4Q22E results preview

PLNmn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22E	y/y	q/q
Sales	249	340	398	405	220	271	282	349	208	254	270	328	-6%	22%
Gross profit	17.6	18.9	23.8	39.6	16.5	26.1	29.5	73.4	31.0	62.3	56.1	82.1	12%	46%
EBITDA	15.4	16.0	22.7	32.2	14.3	23.9	25.9	63.3	29.1	56.9	54.5	79.0	25%	45%
EBITDA margin	6.2%	4.7%	5.7%	7.9%	6.5%	8.8%	9.2%	18.1%	14.0%	22.4%	20.2%	25.0%	6.9	4.8
EBIT	9.8	10.2	16.9	26.8	8.6	19.0	20.1	57.5	23.0	51.0	48.5	73.1	27%	51%
EBIT margin	3.9%	3.0%	4.2%	6.6%	3.9%	7.0%	7.1%	16.5%	11.1%	20.1%	18.0%	22.3%	5.8	4.3
Net profit	7.1	6.8	12.4	22.3	6.5	13.7	15.7	41.2	20.3	45.0	40.6	59.2	44%	46%
Net profit margin	2.9%	2.0%	3.1%	5.5%	3.0%	5.1%	5.6%	11.8%	9.7%	17.7%	15.0%	18.0%	6.2	3.0
Gross margin	7.1%	5.6%	6.0%	9.8%	7.5%	9.6%	10.5%	21.0%	14.9%	24.5%	20.8%	25.0%	4.0	4.2

Source: Company data, Santander Brokerage Poland estimates

Fig. 7. TORPOL: Peers multiples

Company	Market Cap (EURm)	P/E (x)			EV/EBITDA (x)		
		2022E	2023E	2024E	2022E	2023E	2024E
Bilfinger	1,295.1	22.6	12.8	9.8	5.9	4.8	4.1
Eiffage	9,600.1	10.7	10.0	9.4	6.4	6.2	6.0
Ferrovial	19,670.1	117.4	61.1	42.0	40.5	30.7	26.4
Skanska	6,790.0	12.4	14.9	13.3	6.6	7.2	6.8
Strabag	3,980.9	9.0	9.2	9.0	2.9	2.9	2.9
Vinci	61,084.1	14.6	13.6	12.6	8.7	8.1	7.7
Sacyr	1,842.8	11.5	10.8	9.9	8.9	8.5	8.0
PEAB	1,693.0	9.3	9.8	9.4	9.0	9.4	9.4
ACS	7,844.8	14.1	13.3	12.2	5.3	5.0	4.7
AF GRUPPEN	1,407.5	16.3	14.4	13.3	8.2	7.2	6.8
Hochtief	4,513.5	8.7	9.0	8.0	4.8	4.9	4.6
Median		12.4	12.8	9.9	6.6	7.2	6.8

Source: Bloomberg

CPK announced purchase of stake from Silesia

TF Silesia – a key shareholder of Torpol has entered recently an initial agreement with CPK for the sale of 38% stake in Torpol. The deal is a subject to all required approvals incl. regulator's. Torpol revealed that in April 13, 2022 it has received the statement of CPK in which it had declared a potential purchase of up to 100% shares in Torpol.

Both CPK and TF Silesia who are the parties of the deal for the purchase/sale of a 38% stake in Torpol are the entities of the Polish Treasury, thus we do not expect any changes in Torpol's strategy or dividend policy to follow the deal completion. Nevertheless, any changes in the management team or dividend policy represent the key short- to mid-run risk factor for Torpol.

CPK is the entity responsible for the construction of Polish Central Airport and all infrastructural investments which are needed to connect the airport with the Polish road/railway tracks network. Moreover, the representatives of Polish Central Airport and railway tracks investors from Czechia, Latvia, Lithuania and Estonia signed a cooperation agreement targeting the construction of fast railway connections linking Tallin-Warsaw-Katowice-Budapest or Tallin-Warsaw-Katowice-Budapest or Tallin-Warsaw-Wroclaw-Prague. Overall 4.5k km railway tracks construction is planned in the Three Seas region. By 2028, when the launch of the central airport in Poland is planned, the fast railway connection between Warsaw and Łódź should be also completed. The total spendings in the Three Seas region are estimated at EUR60bn.

We believe that Torpol would potentially participate in the large scale investments in the fast railway tracks, but note that these are public contracts and public tender procedures are required to pick the contractor, thus we believe the new investor does not change much in Torpol's strategy of bidding for contracts.

Note that we cannot exclude that CPK would potentially look for a 100% stake in Torpol (purchase of 50%+ stake requires announcement of a call tender offer according to Polish regulations) at the end of the day.

We also cannot exclude that Torpol would need investment in building equipment to scale up its capacity before the launch of large scale construction contracts connected with a Central Airport and that CPK opens the room for such capex.

Note that the Polish Treasury is indirectly controlling also another WSE listed construction companies as Polimex-Mostostal (via energy companies) or tracks contractors Trakcja (via PKP).

Financials

Fig. 8. TORPOL: Income statement forecasts

PLNmn	2019	2020	2021	2022E	2023E	2024E
Net sales	1603	1392	1121	1060	1010	1400
COGS	1528	1292	976	829	951	1319
Gross profit	75	100	146	231	59	81
SG&A	33	36	39	36	36	36
Other operating income, net	0	-1	-2	0	0	0
EBITDA	65	86	127	217	45	68
Operating profit	43	63	105	195	23	45
Net financial income (costs)	-6	-5	-4	8	4	-5
Profit before tax	37	58	101	204	27	41
Income tax	-7	-10	-24	-39	-5	-8
Net profit	30	48	77	165	22	33
<i>Gross margin</i>	4.7%	7.2%	13.0%	21.8%	5.8%	5.8%
<i>EBITDA margin</i>	4.1%	6.2%	11.4%	20.5%	4.5%	4.8%
<i>Operating margin</i>	2.7%	4.5%	9.4%	18.4%	2.3%	3.2%
<i>Net profit margin</i>	1.8%	3.5%	6.9%	15.6%	2.2%	2.4%

Source: Company data, Santander Brokerage Poland estimates

Fig. 9. TORPOL: Balance sheet forecasts

PLNmn	2019	2020	2021	2022E	2023E	2024E
Current assets	1077	815	702	747	664	693
Fixed assets	207	227	254	234	234	234
Total assets	1284	1042	956	981	898	927
Current liabilities	936	683	522	468	433	440
bank debt	82	67	37	37	37	37
Long-term liabilities	125	109	127	127	127	127
bank debt	115	78	83	83	83	83
Equity	223	252	294	390	342	364
Total liabilities	1284	1042	956	981	898	927
Net debt	-3	-259	-313	-307	-228	-141

Source: Company data, Santander Brokerage Poland estimates

Fig. 10. TORPOL: Cash flow statement forecasts

PLNmn	2019	2020	2021	2022E	2023E	2024E
CF from operations	185	259	132	77	9	-49
CF from investment	-51	-5	-32	-22	-22	-22
CF from financing	45	-78	-65	-61	-65	-15
dividends	-6	-21	-35	-69	-69	-11
Net change in cash	179	176	35	-6	-79	-87

Source: Company data, Santander Brokerage Poland estimates

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Periodicity: our recommendations/ target prices for each issuer are going to be reviewed at least once a year and whenever market events so warrant.

In the Technical Analysis reports (TA reports), Santander Brokerage Poland does not apply direct investment ratings, and all opinions and elements of analysts' assessment are included in a descriptive form in the study itself.

The period of validity of the TA report is a maximum of 30 days, while the publication of a new TA report for a given financial instrument means that the previously published study is no longer valid.

Due to the short time horizon of the Technical Analysis reports, Santander Brokerage Poland is not going to update them on a regular basis.

In preparing this report Santander Brokerage Poland applied at least one of the following valuation methods: discounted cash flows (DCF), comparative, mid-cycle, dividend discount model (DDM), residual income, warranted equity method (WEV), SOTP valuation, liquidation value.

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 multiple valuation is based on long-term average valuation multiples of a sector or a peer group. The methodology aims to calculate a fair, through the cycle value of the company. 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 usually use Bloomberg or Damodaran databases). 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.

Residual income method is conceptually close to the discounted cash flows method (DCF) for non-financial stocks, the difference being that it is based on expected residual income (returns over COE) rather than expected future cash flows. One advantage of this valuation method is that it captures the excess of profit potentially available to shareholders and the cost of money over time. Main disadvantage of the valuation method is that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.

The warranted equity method (WEV) is based on the formula $P/BV = (\text{two year forward ROE less sustainable growth rate}) / (\text{Cost of equity less sustainable growth rate})$ which allows estimating a fair value (FV) of a given stock in two years' time. Subsequently the FV is discounted back to today. The main advantage of the WEV method is that it is a transparent one and based on relatively short term forecasts, hence substantially reducing the margin of forecasting error. The main disadvantage in our view is that the model is based on the principle that stock price should converge towards its fair value implied by company's ROE and COE.

SOTP valuation - different assets of a company are being valued according to different valuation methods, and the sum of these valuations represents the final valuation of the company. SOTP valuation advantages / disadvantages are identical to advantages and disadvantages of the specific valuation methods used.

Liquidation value method - liquidation value is the estimated amount of money that an asset or company could be quickly sold for, such as if it were to go out of business. Then, the estimated assets value is adjusted for liabilities and liquidation expenses. One advantage of this valuation method is its simplicity. This method does not account for intangible assets as goodwill, which is the main disadvantage.

In the opinion of Santander Brokerage Poland, this report has been prepared with all due diligence and excludes any conflict of interests which could influence its content. In Santander Bank Polska there are implemented internal regulations, which are designed to prevent conflicts of interest concerning recommendations. Physical and logic barriers are established, and the principles of documentation adequate to the type of Santander Bank Polska operations are implemented. Additionally, Santander Bank Polska introduced a number of obligations and restrictions relating to the protection of confidential information flow between organizational units.

The date and time on the first page of this report indicates the date of the production of the recommendation, and the dissemination of the recommendation takes place on the same day before the start of the session.

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