
Trace Group Hold IPO

General Information

The IPO of Trace Group Hold is the first initial public offering of road building company in Bulgaria. The sector is attracting enormous interest from market participants due to the huge investments in road infrastructure in the next several years. Trace Group Hold is one of the largest Bulgarian contractors in building highways, bridges and other engineering operations, including military projects. The company proved to be capable of winning and implementing orders for large road projects that are usually won by foreign companies.

Trace Group Hold will offer 200 000 shares at the fixed price of BGN 110.50 per share. The size of the IPO is BGN 22.1 million, which makes it among the mid-sized public offerings for the Bulgarian capital market. The total market capitalization of the company at the IPO price is BGN 243 million. The small size of the IPO along with the investors' interest will result into huge oversubscription despite the valuation of the company and the competitive business environment.

This research note will provide short description of Trace Group Hold current projects, the IPO procedure and timeframe as well as the company's current financial data and the management's projections. The valuation of Trace Group Hold at the IPO price is based on multiples.

Business Description

Trace Group Hold is holding company and has eleven subsidiaries and two associated companies. It is specialized in the building and maintenance of highways and road infrastructure. The list of operations includes also civil and military engineering operations in:

- office buildings;
- recreation buildings;
- retail buildings;
- water and gas plumbs;
- airfields;
- reconstruction and recovery of road infrastructure and landslides.

The companies in the holding structure are producing also various building and inert materials. Trace Group Hold operates 6 quarries, ten asphalt and one bitumen installations. Those facilities provide materials for the building of roads. The holding operates more than 150 specialized machines.

Trace Group Hold is certified by NATO and the Bulgarian government for implementing special military orders.

Market Position

Trace Group Hold is situated mainly in the South-East part of Bulgaria. Companies of the Group were engaged with the building and maintenance of roads in the South part of the country but Trace Group Hold will participate in the tenders for construction of other large highways in the Western Bulgaria. Currently, around 100 companies operate in the sector but smaller entities don't participate in the national infrastructure projects.

The holding is planning to increase its revenues in mid-term perspective due to the large investment program in road infrastructure in Bulgaria. Two thirds of roads need reconstruction to measure up the European standards.

More than EUR 8 billion will be invested in the transportation infrastructure of Bulgaria in the next several years. The financing will be mainly by the EU funds.

IPO Procedure and Timeframe

Trace Group Hold will offer 200 000 shares at the price of BGN 110.50 each, or BGN 22.1 million. The price is fixed and in case of oversubscription all shares will be allocated proportionally to the orders. The IPO date is Friday October 26, 2007, whereas the payment period is extended to November 2.

In case of complete subscription, the total number of shares will be 2 200 000. Additional up to 40 000 shares would be allocated to different investors by the discretion of the majority shareholder from its stake of the capital at the execution price.

Oversubscription

The lack of road show in Bulgaria and the absence of any official documents in language other than Bulgarian are limiting the participation. However, this unclear picture for company's valuation and projections is unlikely to cool down the market. We expect huge oversubscription that will exceed substantially the previous IPOs this year. One of the reasons is the relatively low size of the offering compared to the demand of BGN 500 million to 1 billion that was posted in the IPOs of Corporate Commercial Bank and First Investment Bank in May 2007, which could be repeated.

Financial Situation and Projections

Trace Group Hold is planning 30% increase of revenues for 2008 and substantial improvement of profit margins after the completion of Trakia Highway and the refocusing of operations to maintenance of roads. The decrease of margins was due to the absence of adequate inflationary compensations for the rising costs in the Trakia Highway project.

The company's expectations are based on the increase of financing from EU infrastructure funds and the start of several large construction projects. The capital raised by the IPO will be used for acquiring machines (BGN 14 million or 64%) and developing the material base (BGN 3.5 million or 16%). This should ensure the ability to increase revenues and to implement large construction orders. Trace Group Hold set target of 12.5% net profit margin for the next four years.

	2005	2006	2007	2008	2009	2010	2011
Revenues	113 035	117 883	124 956	162 443	203 053	247 725	302 225
Growth		4,29%	6,00%	30,00%	25,00%	22,00%	22,00%
Net Profit	8 150	5 242	8 122	20 305	25 382	30 966	37 778
Growth		-35,68%	54,94%	150,00%	25,00%	22,00%	22,00%
Net Profit Margin	7,21%	4,45%	6,50%	12,50%	12,50%	12,50%	12,50%

Data provided by Trace Group Hold

The capital raised by the IPO should increase the fixed assets in 2007, according to the company's estimations. The working capital would also improve significantly due to the rising cash and receivables. The company already showed positive working capital in the balance sheet for the second quarter of 2007. Along with the increase of fixed assets, this will create the ability to participate in large infrastructure orders.

Profits could vary significantly comparing to projections due to the character of the road construction business.

	2006	2007	2008
Revenues	117 883	124 956	162 443
Costs	103 642	108 229	130 511
Financial Expenses	1 062	1 110	1 350
Taxes	943	902	2 256
Net Profit	5 242	8 122	20 305
Minority Interest	314	487	1 218
Total Assets	85 159	104 006	135 646
Fixed assets	22 383	38 582	40 014
Current assets	61 921	64 692	94 798
Total liabilities + equity	85 159	104 006	135 646
Equity	18 823	50 029	69 116
Liabilities	66 336	53 977	66 530

Estimations by Trace Group Hold

Valuation

The data for the first half of the year showed lower revenues but better net profit due to the decrease of construction in progress by BGN 17.4 million for the period. Payments are often delayed by the National Road Infrastructure Fund which results in the revenues' volatility. Calculated through the IPO price before the capital increase, the quarterly data improves the trailing P/E ratio to 30 but P/S deteriorates as revenues are lower comparing to 2006. At the price of BGN 110.50 the company is valued 9 times the equity.

The table shows the valuation through multiples based on the expected profits (net of minority interest), revenues and equity for 2007, 2008 and the average of both years to represent the next 12 months. The expectations for 2008 profit make the company very attractive, whereas the profit for 2007 puts the company at the average P/E for the Bulgarian stock market.

The two infrastructure companies on the Bulgarian stock exchange are traded mostly on the expectations for future increase of profits and revenues. The comparison shows that Trace Group Hold has better multiples than its peer Holding Roads (HDPAT) and the bridge-building company Moststroy (MOSTS). This supports our expectations for solid oversubscription and price gains during the first trading session.

	2Q2006	2Q2007
Revenues	49 809	23 657
Costs	47 083	17 743
Profit Before Taxes	2 844	5 919
Minority Interest	17	261
Total Assets	73 111	78 433
Fixed assets	18 845	20 857
Current assets	53 057	56 263
Total liabilities + equity	73 111	78 433
Equity	19 481	25 494
Liabilities	53 630	52 939

Data by Trace Group Hold

Price	110,50		
Number of Shares	2 200 000		
Market Capitalization	243 100 000		
	2007	2008	2007-08
Net Profit	7 635 000	19 087 000	13 361 000
forward P/E	31,84	12,74	18,19
Equity	50 029 000	69 116 000	59 572 500
forward P/B	4,86	3,52	4,08
Sales	124 956 000	162 443 000	143 699 500
forward P/S	1,95	1,50	1,69

Calculations by ELANA Trading

	HDPAT	MOSTS
Market Capitalization	692 081 280	310 969 030
Net Profit (ttm)	10 777 000	540 000
P/E	64,22	575,87
Revenues (ttm)	99 643 000	33 712 000
P/S	6,95	9,22
Equity	35 033 000	6 972 000
P/B	19,76	44,60

Calculations by ELANA Trading

Price Targets

The stock performance in one year horizon will depend on two factors – on one hand are the market expectations and the large orders for road constructions. On the other hand is the ability of the company to fulfill the targets for revenues and the good profit margins. We think that expectations will play the leading role during the first several quarters and that the stock can easily become solidly overbought as Holding Roads and Moststroy are. This will limit also the impact of lower revenues or profits in case of negative earning surprises. Moreover, expectations will drive the price higher and could create buying opportunities when the trading begins despite the higher liquidity and the possible exit of short-term speculators.

Financial Data

Consol. Statement of Income (in thousand BGN)	2005	2006	1Q2007	2Q2007
Sales	113 035	117 883	9 233	23 657
Pretax income	8 954	6 142	573	5 919
Taxes	1 116	900	0	0
After-tax income	6 739	5 242	573	5 919
Minority interest	1 099	314	35	261
Net income	8 954	4 928	538	5 658
Earnings per share in BGN	4,48	2,46	0,27	2,83
Consol. Balance Sheet (in thousand BGN)	2005	2006	1Q2007	2Q2007
Total Assets	63 776	101 549	71 329	78 433
Fixed assets	23 885	36 023	26 020	20 857
Tangible fixed assets	22 278	35 698	25 698	20 531
Financial investments	n/a	n/a	155	
Goodwill			359	
Current assets	39 891	54 069	44 795	56 236
Inventory	8 589	10 238	12 064	18 573
Receivables	26 091	42 524	32 037	34 902
Financial assets and cash	3 818	1 577	694	2 788
Total liabilities + equity	63 776	101 549	71 329	78 433
Equity	14 200	37 642	22 809	25 494
Registered capital	50	3 403	150	2 000
Capital funds	7 411	19 686	8 155	7 074
Earnings	6 739	14 553	14 504	16 420
Liabilities		63 907	48 520	52 939
Long-term payables	2 435	6 461	1 506	306
Long-term bank loans	0	6 063	1 210	3 308
Short-term bank debt	5 362	31 084	6 609	6 769
Short-term payables	38 388	26 186	40 405	42 556
Other liabilities	0	907	0	0
Working capital	(3 859)	(3 201)	(2 219)	6 911
Consol. Cash Flow Statement (in thousand BGN)	2005	2006	1Q2007	2Q2007
Net income	8 954	4 928	573	5 658
Depreciation	2 615	5 141	740	1 172
Changes in Working capital		658	982	9 130
Other operating cash flow items		(3 353)	(12 225)	(22 530)
Net cash from operating activities		7 374	(9 930)	(6 570)
Capital expenditures				
Other investing cash flow items	0	(1 658)	(373)	(707)
Net cash from investing activities		(1 658)	(373)	(707)
Issuance/ Retirement of Stock, Net	0	100	0	855
Issuance/ Retirement of Debt, Net		1 300	1 849	1 099
Dividends paid	0	0	0	0
Other financing cash flow items	0	(1 483)	(303)	(258)
Net cash from financing activities		(83)	1 546	1 696
Other				
Net change in cash	0	5 633	(8 757)	(5 581)
Beginning-of-period cash		(1 905)	3 728	8 369
End-of-period cash	(1 905)	3 728	(5 029)	2 788
Cash per share	-0,95	1,86	-2,51	1,39
Financial and Performance Indicators	2005	2006	1Q2007	2Q2007
Liquidity				
Current ratio	0,91	0,94	0,95	1,14
Quick ratio	0,72	0,77	0,70	0,76
Debt Management				
Debt to total assets	0,0%	62,9%	68,0%	67,5%
LT Debt/Equity	17,1%	33,3%	11,9%	14,2%
Total Debt/Equity	0,0%	169,8%	212,7%	207,7%
Asset Management				
Inventory turnover	13,16	11,51	0,77	1,27
Days sales outstanding	83	130	1249	531
Fixed asset turnover	4,73	3,27	0,35	1,13
Total asset turnover	1,77	1,16	0,13	0,30
Profitability				
Profit margin on sales	7,9%	4,2%	5,8%	23,9%
EBITDA Margin	94,1%	16,4%	-21,2%	-32,7%
Basic earning power	162,6%	14,0%	-3,8%	-11,4%
Return on assets	14,0%	4,9%	0,8%	7,2%
Return on equity	63,1%	13,1%	2,4%	22,2%
Return on investments	53,8%	9,8%	2,1%	19,4%

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