GNAM Investment Competition

IE Business School, Madrid, Spain
Construcciones y Auxiliar de Ferrocarriles SA

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Global Network for Advanced Management

Investment Proposal

- We recommend a BUY on CAF as we estimate a target price of EUR 294 with an upside of 16% on current price of EUR 253.

- This is substantiated through our DCF and supported by our relative valuation comparing CAF vs. industry average, which results in a target price EUR 300 and an upside of 18%.

- This is achieved assuming a revenue growth of 0.5% and stable COGS contributing to 88% of sales.

- CAPEX are expected to decrease but increase gradually as the company gains more traction.

Key Company Data	Actual			Expected		
(€ mn)						
P&L						
YoY growth (%)	2012	2013	2014	2015	2016	2017
Revenues	0%	-11%	-6%	-2%	-4%	1%
EBITDA	-14%	35%	0%	-36%	-4%	1%
EBIT	-26%	28%	-44%	-11%	-4%	1%
Net Profit	-23%	-9%	-32%	-53%	-9%	1%
Margins on Sales						
EBITDA	13%	11%	17%	18%	12%	12%
EBIT	11%	8%	11%	7%	6%	6%
Net Income	8%	6%	6%	4%	2%	2%

Performance (%)	1M	3M	12M
Absolute	-4.6	-15.7	-24.2
Relative to IBEX 35	-8.2	-15	-26.7

Rationale

- CAF is a global player in the railway market that is expected to grow at a steady rate of 2.7% per annum for the next 5 years.
- The company has operations in 6 out of the 7 continents.
- Its operations span the entire value chain of the rail industry, including the design of transport systems, manufacturing of trains, repairs and maintenance services, and complete turnkey solutions.

Country	Project	Likelihood
Mexico	Several opportunities; Concession III and new extension Suburbano, other lines.	Medium Probability 2015E.
Sweden	Several Orders.	High Probability 2015E.
Bulgaria	Small mid-size opportunity around EUR 100 Million.	Medium Probability 2015E.
Belgium	Belgium Brussels Metro.	Medium Probability 2015E.
Spain	Large Rolling Stock Package and mid-size opportunities.	Low Probability 2016E.
Brazil	Several mid-sized opportunities.	Low Probability 2016E.
UK	Several opportunities in Glasgow (c EUR 100-150 Million).	High Probability 2015E.
Germany	Mid-size opportunities.	High Probability 2015E.
US	Several mid-size opportunities/extensions, mainly in trams.	Medium Probability 2015E.

Model Assumptions

Assumptions	2015	2016	2017	2018	2019	2020	2021
% Growth	-2%	-4%	0.5%	0.5%	0.5%	0.5%	0.5%
% COGS	88%	88%	88%	88%	88%	90%	90%
% SGA	0.09%	0.09%	0.09%	0.09%	0.09%	0.09%	0.09%
% Depreciation	6%	6%	6%	6%	6%	6%	6%
% Income Taxes	23%	23%	23%	23%	23%	23%	23%
% PP&E	19%	19%	19%	19%	19%	19%	19%
Days Receivable	565	565	565	565	565	565	565
Days Inventory	53	45	45	45	45	60	60
Days Payable	117	117	117	117	117	117	117
Interest Expense	50	50	50	50	50	50	50
PP&E	266	256	257	258	260	261	262

- **CAPM:** The risk free rate we have used is 1.6%, the the 10-year Spanish Government bond yield obtained from Bloomberg.

- **Leveraged Beta:** The beta used, is the company's 52-week beta obtained from the Factset Fundamentals database.

- **CAPEX:** We have assumed no further capital expenditure since CAF has already invested EUR 10.08 million in 2014 to upgrade its production, and engineering and IT facilities. It currently has adequate capacity to meet any growth in future demand for its products.

- **Sales:** Given that the rail industry is expected to grow at 2.7% per annum over the next 6 years as per a report from the European Rail Association, we assume a sales growth rate of 0.5%.

- **Capital Structure:** Cost of debt was obtained from Factset Fundamentals as the company has a detailed debt structure where it raises debt in many different countries, and further hedges its foreign currency exposure through currency forwards and options. The interest corresponding to the year 2014 was used to calculate the pretax cost of debt.

Company Valuation

	(€ mn)	2015	2016	2017	2018	2019	2020	2021
	DCF Valuation	-96	4	-84	-85	-85	-183	-87
=	NOPAT	68	65	66	66	66	45	45
+	Depreciation	81	77	78	78	79	79	79
+/-	Changes in the Working Capital	-10	92	-8	-8	-8	-106	-8
+	Changes in CAPEX	-86	-88	-77	-77	-77	-78	-78
=	**Unlevered Free Cash Flows**	52	147	59	59	60	-59	38
	Terminal Value of Cash Flows							677
	Discount Factor	0.95	0.90	0.85	0.80	0.76	0.72	0.68
	Present Value of Cash Flows	50	131	50	48	45	-43	487

DCF Analysis

•We made a DCF analysis with a resulting target price of EUR 294 and an upside of 16% on current price of EUR 254.

•The target was achieved using a WACC of 4.47% based a company beta of 1.00 and current market conditions.

•This indicates that the company is undervalued since it is trading below industry average.

Dividend Policy

	Company	Industry
Dividend Yield	2.07	2.08
Dividend Yield (5 year average)	2.50	1.83
Dividend 5 Year Growth Rate	-9.20	20.27
Payout Ratio (Trailing 12 months)	0.00	25.45

- CAF last dividend was EUR 5.25, ex-dividend date July 7, 2015. A decrease in CAF's earning per share in 2014 resulted in a decline in dividends paid. A summary of CAF's dividend compared to the industry is show in the table above:

- In 2014, CAF had an annual dividend payout of EUR -39 Million. We believe the firm's dividend policy has proven to be strong and this stable track record will translate into future benefits for shareholders in the firm. Our projections for 2015-2018 indicate that the firm will continue their dividend pay-outs for investors in the future and this will range from EUR -18 Million to EUR -35 Million.

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Recommendation

	WACC					
294.15 (€ mn)	4.00%	4.50%	5.00%	5.50%	6.00%	6.50%
0.00%	401.02	360.38	327.87	301.26	279.08	260.31

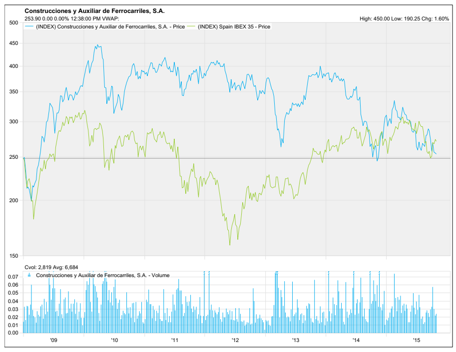
- We recommend a BUY on CAF as we estimate a target price of EUR 294 with an upside of 16% on current price of EUR 253.
- In the sensitivity analysis above the relationship between terminal growth and WACC can be observed. It is clear that as WACC decreases the firm generates more value.
- We think CAF is undervalued and therefore recommend a **BUY** on the stock. Furthermore, the stock issues dividends and thus, we recommend a BUY position for CAF.

Construcciones y Auxiliares de Ferrocarriles, S.A. (CAF-ES)

CAF Pushing through Tough Times

BUY

We recommend a BUY on CAF as we estimate a target price of EUR 294 with an upside of 16% on current price of EUR 253. This is substantiated through our DCF and supported by our relative valuation comparing CAF vs. industry average, which results in a target price EUR 300 and an upside of 18%. This is achieved assuming a revenue growth of 0.5% and stable COGS contributing to 88% of sales. CAPEX are expected to decrease but increase gradually as the company gains more traction.



Cost efficiency has become the biggest trend in the industry for the transportation of people and goods. This creates an increase in demand for new tracks and improvement of existing rail systems. Demand for locomotives and passengers looking for cheaper transportation are the main growth drivers of the business for the next years. Industry barriers are expected to remain at ease as the ability to raise capital and government support continue to be favorable. The number of operators is also expected to increase and create more competition.

The company's pipeline demonstrates a positive outlook for 2015E ensuring revenues during the short term. CAF's technologies and products offer customers everything necessary for rail systems. Their turnkey offerings ensure the operation and viability of the project and, in our view, creates an advantage for CAF against competitors.

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Key Company Data (€ mn) P&L	Actual			Expected		
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Investment Thesis

We estimate a target price of EUR 294 with an upside of 16% on current price of EUR 253 through our DCF valuation. This valuation is substantiated through our relative valuation comparing CAF vs. industry average which results in a target price EUR 300 and an upside of 18%. Key growth drivers for the company are the build up of their order book (specifically in Eastern Europe), global demand for cost effective transportation and a better control on raw materials. The industry poses a favorable atmosphere as new trends drive up demand for rail systems. The freight industry is expected to demand more rail systems this becomes a more cost effective way of transport. Also, the industry is expecting a rise in passengers as they demand cheaper transportation. This should become the leading industry driver as long as governments are willing to continue investments and expand their rail systems.

Company Overview

Construcciones y Auxiliar de Ferrocarriles SA engages in the provision of rail system products and solutions. It offers rolling stock and rail components; transport systems; and management, maintenance, and after-sales services. The company was founded in 1917 and is headquartered in Guipúzcoa, Spain.
Its range of products include:

- **Rolling Stock:** This business segment specializes in the designing of trains. These train designs range from high speed, regional, commuter, metros, LRVs & trams, light metros, and locomotives. The focus for the design of these trains is centered on in-house technologies developed through their focus on R&D. Design, safety and comfort are the main driving forces behind the development of these technologies. Also, their many lines of trains are designed to be efficient and eco-friendly. Depending on the type of the train their product selection can also focus on a variety of specifications ranging from high-capacity to accessibility depending on the need of the customer.

- **Rolling Gear:** Rolling gear has more than 80 years of experience in the design, manufacture and sale of wheel sets, wheels, axles gear units and couplers for the rail market. All of these parts are not only designed for rolling stock made by CAF, but also for other rail systems designers and manufacturers making the company the global leading supplier of high speed platforms.

- **Traction and Communication Systems:** This segment is focused on power and automation solutions through the development of railway systems geared towards intelligent mobility. Within the product offering they have electric traction systems for railway industry which provides direct and alternating current. They also provide energy storage systems and railway information and communication systems.

- **Signaling:** CAF has developed its own technology through important efforts in R&D. With this they are now able to engineer and manage complete projects from testing, commissioning and maintenance. The signaling products and solutions offered by CAF include high-speed lines; main lines; metro and mass transit; tramway, light train and suburban; and freight lines. These provide communication lines to the trains, electronic interlocking solutions and control centers.

- **Services:** The company provides all rail services needed for operations thereby reducing life cycle costs to their customers. They remain by the customers' side providing maintenance and after-sale service for all types of trains, these services are also provided for non-CAF rolling stock.

- **Transport systems:** This business segment specializes in delivering turnkey solutions to the customers. These go beyond supplying rolling stock as they also include viability studies, civil works, electrification and signaling.

Industry

By providing cost-efficient transportation of people, goods, energy products and commodities, rail is expected to grow and play a central role the freight industry. Companies should benefit from low commodities prices, growing demand for new tracks, maintenance expenditures of actual infrastructure and investments to improve railroads to work under severe weather conditions.

Demand for locomotives and passengers looking for cheaper transportation are the main growth drivers of the business for the next years. As long as companies are able to raise capital and governments keep supporting the industry, there should be no barriers to its development. The increasing demand for multimodal transportation and the new technologies available represent challenges that actual players have to surpass. It is expected that companies start using the available data to provide more cost efficient and dynamic freight. This competitive scenario might increase the number of operators and make existing competition fiercer.

Investment Rationale

- CAF is a global player in the railway market that is expected to grow at a steady rate of 2.7% per annum for the next 5 years.
- The company has operations in 6 out of the 7 continents.
- Its operations span the entire value chain of the rail industry, including the design of transport systems, manufacturing of trains, repairs and maintenance services, and complete turnkey solutions.

Deal Pipeline

Country	Project	Likelihood
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Risks

- International projects involve execution risk such as country risk and political risk.
- Lower public spending and may impact demand for the company's products and services.
- Increasing competition (mainly from lower-cost Asian players) could put pressure on margins.
- The company has credit risk when working internationally, and uses export credit insurance policies to hedge this risk.
- Exposure to currency volatility due to operations in different countries, which is mitigated through currency forwards.
- Exposure to fuel volatility

Valuation

We made a DCF analysis with a resulting target price of EUR 294 and an upside of 16% on current price of EUR 254. The target was achieved using a WACC of 4.47% based a company beta of 1.00 and current market conditions.

	(€ mn)	2015	2016	2017	2018	2019	2020	2021
DCF Valuation		-96	4	-84	-85	-85	-183	-87
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	Present Value of Cash Flows	50	131	50	48	45	-43	487

We performed a relative valuation by comparing CAF´s P/E ratio of 14.01x to industry average of 34.90x. This indicates that the company is undervalued since it is trading below industry average. We used a target multiple of 34.90x (same as industry) which resulted in a target price of EUR 300 representing an 18% upside on current price. This valuation further confirms our DCF target price of EUR 294.

Key Growth Drivers

- Building up a bigger order book, specifically in the eastern European region
- Global demand for cost effective transportation
- Control of raw material costs given that COGS make up 88% of sales

Model Assumptions

- Given that the rail industry is expected to grow at 2.7% per annum over the next 6 years as per a report from the European Rail Association, we assume a sales growth rate of 0.5%.
- Cost of debt was obtained from Factset Fundamentals as the company has a detailed debt structure where it raises debt in many different countries, and further hedges its foreign currency exposure through currency forwards and options. The interest corresponding to the year 2014 was used to calculate the pretax cost of debt.
- The risk free rate we have used is 1.6%, the the 10-year Spanish Government bond yield obtained from Bloomberg.
- The beta used, is the company's 52-week beta obtained from the Factset Fundamentals database.
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Assumptions							
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Dividend Policy

CAF last dividend was EUR 5.25, ex-dividend date July 7, 2015. A decrease in CAF's earning per share in 2014 resulted in a decline in dividends paid. A summary of CAF's dividend compared to the industry is show in the table below:

	Company	Industry
Dividend Yield	**2.07**	**2.08**
Dividend Yield (5 year average)	**2.50**	**1.83**
Dividend 5 Year Growth Rate	**-9.20**	**20.27**
Payout Ratio (Trailing 12 months)	**0.00**	**25.45**

In 2014, CAF had an annual dividend payout of EUR -39 Million. We believe the firm's dividend policy has proven to be strong and this stable track record will translate into future benefits for shareholders in the firm. Our projections for 2015-2018 indicate that the firm will continue their dividend pay-outs for investors in the future and this will range from EUR -18 Million to EUR -35 Million.

One-Way Sensitivity Analysis

	WACC					
294.15 (€ mn)	**4.00%**	**4.50%**	**5.00%**	**5.50%**	**6.00%**	**6.50%**
0.00%	**401.02**	**360.38**	**327.87**	**301.26**	**279.08**	**260.31**

In the sensitivity analysis the relationship between terminal growth and WACC can be observed. It is clear that as WACC decreases the firm generates more value. We think CAF is undervalued and therefore recommend a **BUY** on the stock.

Our top four stock picks with a **BUY** recommendation are as follows:

1. Industria de Disena Textil SA (Inditex) – [ITX]

Inditex is a manufacturer and retail distributor of clothing, footwear and fashion accessories, listed on the Spanish stock exchange. The company has over 6,600 stores around the world, making it one to the world's biggest fashion group. The firm is part of the IBEX 35 and the EuroSTOXX indices and currently has a market capitalization of EUR 104.44 Billion.

A look at the company's earnings shows strong growth figures and a robust balance sheet and income statement. In the six months ending July 31, 2015, the company's revenue and net income increased by 17% and 26% respectively. Although Inditex has a strong global presence, it continues to see impressive growth in the local economy of Spain and the rest of Europe. Our Discounted Cash Flow valuation indicates that the company has a 14.43% upside potential from its closing price of EUR 34 as at October 30, 2015 and has a strong probability of reaching this target price in 6months.

Return of Equity for Inditex for the last financial year is 29.39% marginally above the industry average of 28.52%. Dupont's analysis showed that principally the difference in Inditex ROE came from its higher Net income margin 14.13% compared to the industry average of 14.07%. The asset turnover ratio is the same as the industry average 1.27. The company has outperformed the index historically and we believe this trend will continue in the future, at least in the short to medium term. Given these considerations we recommend a **BUY** for Inditex stock.

2.Abertis Infraestructuras SA – [ABE]

Abertis is a Spanish conglomerate, a market leader in motorway tolls that manages significant telecommunication infrastructure. It has high exposure in the Spanish and French market with 38% and 32% of their revenue, respectively. The company is part of the IBEX 35 with market capitalization is EUR 14.25 Billion.

The results released on October 28, 2015 show a 226% growth in net income, which was mostly driven by discontinued operations. The company has significant holdings in Latin America, with a high investment (EUR 535 Million as at FY2014) in Brazil for the improvement and modernization of their infrastructure and is a key partner with the government. In Chile, the company has invested EUR 275 Million with an expected completion of the main highway for 2017. In both cases, Abertis holds concessionary rights securing cash flows. We believe that growth in 2016 would come from the companies increased investment of about EUR 484 Million in telecommunication networks in Spain and investment in Italy and the United states.

Our DCF assumes a WACC of 5.0% given that debt is highly weighted in the capital structure, reducing the cost of capital. Our target price is EUR 18.13, a 20% upside from its closing price of EUR 15.11 on October 30, 2015. Based on our valuations we recommend a **BUY** for the stock. The target price is the midpoint between the DCF valuation and the relative valuation. The relative valuation is calculated by comparing Abertis EV/EBITDA ratio of 5.10x vs. industry average of 5.51x.

3. Amadeus IT Holding [AMS]

Amadeus is a global information technology provider for the travel and tourism industry. It offers cutting edge software systems that manage reservation bookings, departure controls and inventory management for major airlines, railways, travel agencies and hotels among other sectors in the value chain. Its headquarters are in Spain and the firm is part of the IBEX 35 with market capitalization of EUR 17.01 Billion.

We believe that the company is strongly positioned to take advantage of growth in air travel and other related industries, and will drive growth through their various business units. There Q2 2015 earnings result showed positive growth with a 14.2% increase in revenue, 10.8% increase in EBITDA and 10.3% increase in adjusted profit.

We estimate Amadeus will deliver 2014-20E CAGR of 8% for revenues and 7% for adjusted net profit and that it will exceed €5bn in revenues by 2019E (vs €3.4bn in 2014), €2bn in EBITDA (vs €1.31bn) and €1bn in adjusted net profit by 2020E.

Amadeus also has a relatively strong cash position, which they can use to buy back shares and pursue more inorganic growth via strategic acquisitions.

Our DCF valuation assumes a WACC of 5.2% and a terminal growth rate of 2.30%. Our target price for the firm is EUR 46.83. This is the midpoint between our DCF and relative valuation, a 20.82% appreciation from its EUR 38.76 closing price as on October 30, 2015. We believe that the stock is underpriced and therefore we recommend a **BUY** for Amadeus IT Holding.

4. Ferrovial SA [FER]

Ferrovial is the world's leading private investor in transportation infrastructures (toll roads, construction and airports) with operations in more than 15 countries and activities in construction, management maintenance and services. The firm is part of the IBEX 35 with market capitalization of EUR 16.94 Billion. The firm owns a 43% stake of the Ontario highway 407 (407 ETR) and a 25% stake in Heathrow Airport Holdings.

The company's Q3 2014 earning release showed strong growth figures with Revenue and EBITDA growing by 11.5% and 16.2% respectively. Growth prospects continue to be strong with a rise in toll tariffs this year, with opening of sections 1 and 2 of the North Tarrant Express highway in Texas, and benefits from increased traffic on the 407 ETR (a highway that runs along the eastern coast of Canada). The firm also has a backlog of projects at a record high EUR 31.3 Billion which is actively looking to reduce. Currency conversion gains from the depreciation of the Euro against the US dollar, Canadian dollar and British pound is expected to boost the company's earnings.

Based on our DCF analysis of the company's financial statements, we estimate a WACC of 4%, and a terminal growth rate of 1%. As the company has reduced its borrowing costs and extended its debt maturity profile, our target price is EUR 28.93, a 26% appreciation from its October 30, 2015 close price of EUR 22.90. Given these circumstances and track record, we have a **BUY** recommendation for Ferrovial stock.