

Stella Jones (SJ.TO)



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Stock Rating	Hold
My 12 – 18 month Price Target	\$40.00
SJ.TO	\$44.90
52-Week Range	\$42.90 - \$55.22
Shares Outstanding	68.94M
Beta	0.46
Average Volume (3M)	136,600
Market Cap	\$3,110M
Dividend/Div Yield	\$0.48/1.08%
P/E Ratio (TTM)	2.37

Investment Thesis

Stella Jones Inc is a leading supplier of wood ties for railroads in North America. SJ.TO is the principle supplier of durable pressurized wood tie product for CP, CN, CSX and BSNF. There have been signs that demand for wood ties - which are used to maintain the railroad systems across North America – may be in decline due to concrete substitutes. Generally, however, we know that pressurized wood is most appropriate in the northern cold regions of the North

American market, while concrete and other substitutes are increasingly lower cost. Of late, the senior management has not delivered a cogent strategy for revenue growth. The stock has been flagging for the past few years without a discernable growth strategy and analysts are concerned. Stella Jones needs a new acquisition in concrete ties to regain market confidence but it does not look forthcoming. The current market price is too high to justify. Therefore, my recommendation is **HOLD**.

Risks to Share Appreciation

- Threat of substitutes in home markets;
- Concrete ties are widespread as Class 1 routes are shifting to concrete ties;
- Growth in core segments is muted. That muted effect is due to (1) Free trade concerns over **NAFTA** lumber perhaps not the only **uncertainty**, (2) Lumber raw material prices rose by **25%** in 2017 & subject to **high volatility**, (3) Utility transmission poles not growing but telecoms not replacing their poles as rapidly, (4) Difficulty charging a higher price for railroad ties as new **competitors offer lower cost alternative**, (5) **Seasonality of client demand** affects operational efficiency in replacement of railroad ties.

	2016	2017	2018	2019E	2020E
Revenue	1,838	2,228	2,667	3,638	4,142
Revenue growth	18%	21%	20%	36%	14%
EBITDA margin	14%	15%	16%	16%	17%
EBITDA	265	334	427	582	704
Net income margin	10%	10%	11%	12%	14%
Net income	181	212	293	437	580
Shares outstanding	69	69	69	69	69
EPS	\$2.22	\$3.05	\$4.23	\$6.30	\$8.36
EPS Growth	9%	38%	39%	49%	33%

Important Disclaimers

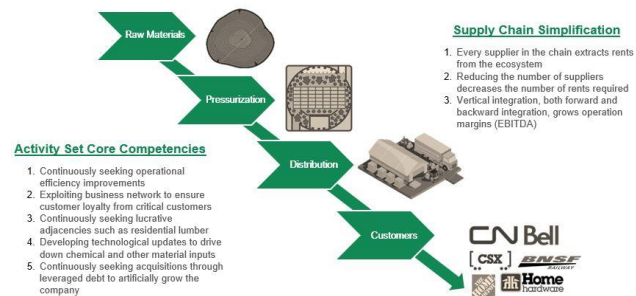
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Acquisition Targets

LBFoster (49% Rail, 21% Energy, 30% Construction) has concrete ties which matches Stella Jones' existing railroad customer demand for new/replacement ties. SJ.TO should investigate an acquisition of LBFoster.



Raw materials, pressurization, distribution and customers processes.



Stella Jones Railway client-base:



Revenues for Stella Jones are projected to be 23% CAGR which is lower than the 27% CAGR historically.



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Why It Works

- The industry trend is to eat or be eaten;
- Organic growth is secondary to growth by acquisition;
- These acquisitions have been consistently accretive to earnings, Stella Jones needs new acquisitions to go after.

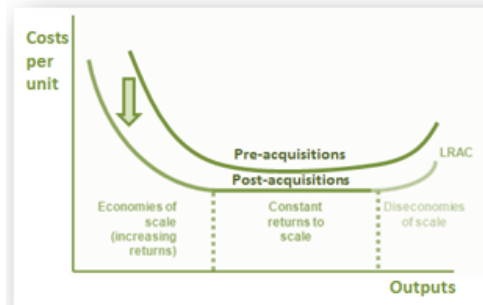
Acquisition History

1992	Stella Jones established in Montreal, Canada	
1993	Acquired wood preserving division of the Domtar Group	
1994	Stella Jones listed on the TSX and MSE at \$5/share	
2005	Acquired Webster Wood Preserving established 1 st manufacturing facility	[US\$16M]
2006	Acquired Bell Pole in order to gain stronger position in Canadian pole market	[CAD\$57M]
2007	Acquired J.H. Baxter which increased access to the US utility pole market	[US\$22M]
2008	Acquired Burke-Parsons-Bowlby gaining a strategic position in railway ties in New Jersey	[US\$81M]
2010	Acquired Tangent Rail US railway tie market and adding adjacencies to railway operators	[US\$165M]
2011	Acquired Thompson Industries enhancing position in railway ties	[US\$41M]
2012	Acquired McFarland Cascade Holdings; largest acquisition	[US\$250M]
2015	Acquired McCormick Piling and Lumber provider of untreated wood poles	[US\$21M]



Superior Distribution

- Every acquisition is actioned on close proximity to prospective new customer bases
- Once consolidation is achieved, distribution cost saving are gained as contracts are close to new customer bases
- Presently there are 13 Canadian and 26 US Facilities in network



Economies of Scale

- Every acquisition facilitates economies of scale within the first 5 years of merger
- Once consolidation is achieved, operational efficiencies are able to drive down costs such as SG&A
- End result is larger EBITDA year on year