

May 5, 2017

**Dear clients and colleagues,**

Within the small cap universe, the Italian small cap market has been the top performer year to date with a 27% total return. Quality names, such as De L'onghi and Autogrill, have seen strong price performance, while banks and retailers have underperformed.

In part, outperformance was a result of a rerating effect, an easing of political risk after the constitutional referendum and a better macroeconomic picture. Another major driver behind the strong performance was the implementation of a PIR scheme by the Italian government at the beginning of the year.

The aim of the PIR scheme was to channel household and pension plan savings into domestic companies, thereby encouraging the development of small- and medium-sized enterprises. Financial products classified as a PIR will give investors an exemption on capital gains and inheritance taxes provided the five-year holding period is respected. In order to be eligible, PIR products must be composed of at least 70% Italian-listed securities or any European-listed company with a strong presence in Italy. The introduction of the PIR scheme seems to have been successful, and we believe it should continue to support Italian small caps. One company that could benefit from the PIR scheme is Salini Impregilo, a company we recently added to our International portfolios.

Italian-based Salini Impregilo is a global leader in heavy civil engineering construction that is active in more than 50 countries. The company constructs tunnels, dams, hydroelectric plants, roads and motorways, railways, airports, maritime projects, etc. Following the acquisition of Lane Industries in 2015, its exposure to the strong US construction market has increased considerably. The company is now well-balanced geographically with 25% of sales coming from the US, 25% from the Middle East, 23% from Europe and 27% from other markets. For its fiscal year 2016, Salini reported sales of €6.12B, new orders of €7.3B and an order backlog of €29.4B.

#### **Market size**

- The global infrastructure market should reach €21.4 trillion by 2019, growing at 3.1% per annum.
- Salini's core market, after filtering for countries and project sizes, represents € 1.9 trillion. From that long list, Salini prioritized its effort on projects worth € 478B.

#### **Competitive advantages**

- High barrier to entry for large civil infrastructure projects which are often very complex and more risky
- Salini's strong positioning is confirmed by international rankings and rewards:
  - Ranks number 1 in the water segment and number 6 in sewer/waste
  - Number 25 in the Engineering News-Record (ENR) 2016 Top 250 International Contractors
  - ENR ranks Lane number 1 in US motorways

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- Core expertise in dams and tunneling
- Solid track record delivering a stable margin over time
- One of the highest backlog-to-revenue coverage in the industry
- Family-owned business that imposes strict controls on cost and risk
- Strong balance sheet with a BB rating from Fitch and S&P with a stable to positive outlook

**Growth strategy**

- With additional regional offices worldwide, the company can bid on more projects
- Salini will continue to acquire niche businesses in order to gain expertise (e.g. the Lane acquisition) or client access
- Emerging markets offer the greatest long-term growth, and Salini is well-positioned to benefit from this structural trend
- Important infrastructure renovation projects are expected in the coming years (US, Europe)

**Risks**

- As a construction company, project execution remains a key risk (cost overruns, payment delay, cancellation risk, issues with suppliers, availability of staff ...)
- Construction spending can be cyclical and can also be affected by political changes

Have a good weekend.

The Global Alpha Team

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