

# Pro Kapital Grupp AS

November 24, 2014

## Basic Report

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### Evaluation Result

# BUY

Initiation of Coverage

### Fair Value per share

# € 3.70



BankM Research on Bloomberg, Thomson/Reuters, Factset, CapitalIQ and www.BankM.de

## Benefitting from the Positive Momentum of the Baltic Real Estate Markets

Pro Kapital Grupp AS was founded in 1994 and is one of the most experienced and well-known real estate developers in the three Baltic countries of Latvia, Estonia and Lithuania. During the past 20 years, the company has successfully developed more than 180,000sqm of residential, retail, hotel and office real estate space in over 20 projects. The group's shares are listed at the Nasdaq OMX Baltic stock exchange in Tallinn (EST) as well as in the Open Market of the Frankfurt Stock exchange.

Besides its real estate development core business, the company is currently operating three hotels in Riga (LAT), Tallinn (EST) and Bad Kreuznach (GER) under its own brand PK Hotels.

A unique advantage of the Pro Kapital group is its huge land-bank of currently ca. 350k sqm of land plots in prime locations of Riga, Tallinn and Vilnius. The founders of Pro Kapital were able to acquire the vast majority of these plots at extremely attractive prices between 1998 and 2002, enabling the company to realize outstanding operating profit margins during the following years.

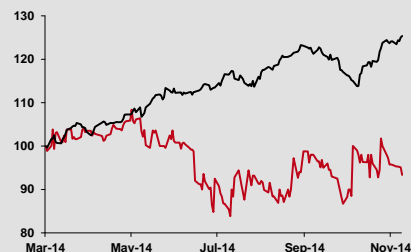
We examined the general economic sentiment and outlook in the Baltics both on and off site and see a very favorable momentum in the local real estate markets. There is a growing, extremely well-educated middle class with substantial personal income growth, looking for modern living and office space in the three capital cities of Riga, Tallinn and Vilnius. At the same time, financing conditions are excellent for companies with a proven track record and a sound balance sheet structure like Pro Kapital. Both financing costs and conditions are very similar to Western European countries, while costs of construction are significantly lower. In combination with the very low acquisition prices of the land plots and attractive sales prices for modern, upscale residential and office space in prime locations of the three capital cities, we expect excellent profit margins from the real estate development business in the Baltics.

The group's track record in planning, building and selling large real estate projects in different asset classes and its extensive network among the Baltics with dedicated local management teams perfect the equity story.

In our view, thanks to its large track-record and very low acquisition prices, Pro Kapital offers a unique opportunity to leverage the positive momentum of these markets in the next years.

**Based on very conservative sales price assumptions of the respective real estate projects, our DCF analysis results in a fair value of € 3.70 per Pro Kapital share. This implies a mid-term upside of more than 50% for investors. We rate the stock as "Buy".**

Sector	Real Estate Development		
WKN	579797		
ISIN	EE3100006040		
Bloomberg/Reuters	17E GF		
Accounting standard	IFRS		
Financial year	Dec 31		
Financial reporting FY 2014	April 14, 2015		
Market segment	Open Market		
Transparency standard	Quotation Board		
<b>Financial ratios</b>	<b>2014e</b>	<b>2015e</b>	<b>2016e</b>
EV/Sales	11.9	11.5	5.3
EV/EBITDA	neg.	n.a.	26.3
EV/EBIT	neg.	n.a.	28.6
P/E adj.	neg.	neg.	65.3
Price/Bookvalue	2.1	2.2	2.1
Price/FCF	neg.	202.3	18.3
ROE (in %)	neg.	neg.	3.3
Dividend yield (in %)	0.0	0.0	0.0
<b>Number of shares outs.</b> (in '000)	54,107		
<b>MarketCap</b> (in € m)	126.3		
<b>Free float</b> (in %)	45.6%		
<b>Ø daily trading vol.</b> (3M, in €)	3,101.33		
<b>12M high / low</b> (in €; close)	2.59 / 2.10		
<b>Price November 21, 2014</b> (in €; close)	2.33		
<b>Performance</b>	<b>1M</b>	<b>6M</b>	<b>12M</b>
absolute (in %)	-4.7	-8.6	n.a.
relative (in %)	-11.4	-23.1	n.a.



AS Pro Kapital Grupp (red/grey), Performance since Listing in Frankfurt (17E GF) vs. DAXsubsec. Real Estate (black).  
Source: Bloomberg

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## Company Description and Analysis

### Executive Summary

Pro Kapital was founded in Tallinn, Estonia in 1994 and is one of the leading real estate development companies in the Baltics today. It focusses on the development, management and sale of modern retail, residential and office real estate projects in the capital cities of Tallinn, Riga and Vilnius. In the course of the last 20 years of operations, the group has successfully completed more than 20 development projects, comprising about 180,000sqm of total saleable space. In addition, the company currently owns and operates three hotels in Tallinn, Riga and Bad Kreuznach, Germany. The company has developed all three hotels and operates them under the proprietary brand "PK Hotels".

At the center of the operating strategy of Pro Kapital is the ongoing development of prime retail and office space, as well as modern, up-scale residential units in the booming capitals of the three Baltic capital cities Tallinn, Riga and Vilnius.

Pro Kapital's strategy is to achieve attractive returns on equity via covering the whole life cycle of real estate development.

Compared to competitors or new players entering the Baltic real estate market, Pro Kapital has a land-bank of unique size, location and diversification, totaling ca. 350k sqm. The vast majority of land plots have been acquired in the late 1990s, after the fall of the Soviet Union, at very attractive prices. Therefore the company is looking at a large pipeline of projects while land plots are already bought, providing additional planning security for management and investors alike. The clear focus is on developments in Estonia and Latvia. Lithuania currently accounts for less than 10% of total project volume in terms of planned space.

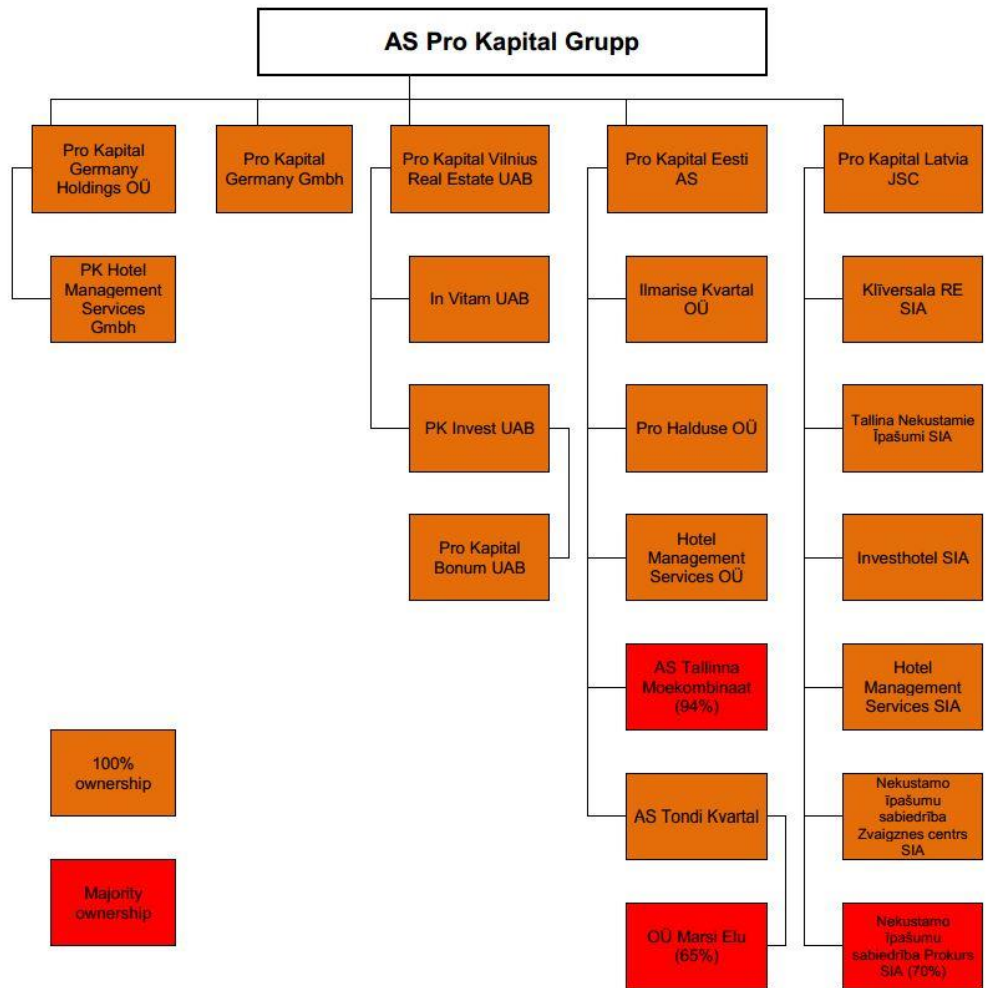
With an equity ratio of more than 60%, the company has a rather conservative balance sheet structure, compared to peers in the real estate development sector. This should also benefit the company in gaining access to project financing, due to its sound credit rating.

**Founded in 1994; one of the leading real estate development companies in the Baltics today**

**Majority of land plots have been acquired in the late 1990s, after the fall of the Soviet Union, at very attractive prices**

## Group Structure

### Group Structure as of 30 September 2014



Source: Company reports

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## Management Board

### Mr. Paolo Vittorio Michelozzi, CEO

Mr. Michelozzi was appointed as CEO of the group in 2001 and has been working with Pro Kapital since 1994. Before that, he has been working in several senior management positions in the European real estate industry for more than 30 years. Mr. Michelozzi was born in 1961 and holds the Italian citizenship.

### Allan Remmelkoor, COO

Allan has been working for Pro Kapital since 1997 and was able to gain extensive experience in the management of shopping centers as he served as the Managing Director of Pro Kapital's Kristiine and Domina shopping malls from 1999 until 2008 when he was appointed COO of Pro Kapital Grupp AS. He has a degree in Business Administration from the Tallinn University of Technology. Mr. Remmelkoor was born in 1971 and is Estonian Citizen.

**All senior staff has been with the company for many years**

### Ervin Nurmela, Head of Legal Department

Ervin Nurmela has been serving as Head of the Legal Department of Pro Kapital since 2007 and holds a degree in law from the University of Tartu. Prior to his employment with Pro Kapital, he worked in a law firm from 2005 until 2007. He was born in 1982 and is Estonian Citizen.

### Olga Rudzika, Managing Director of Pro Kapital Latvia

Mrs. Olga Rudzika currently serves as the Managing Director of Pro Kapital Latvia and is based in Riga. She is with the company since 2001 and was appointed as member of the board and Managing Director in 2005. She holds degrees in English Philology and Public Administration from the University of Latvia. Mrs. Rudzika was born in 1973 and is a citizen of Latvia.

### Neringa Rasimaviciene, Managing Director of Pro Kapital Vilnius

Mrs. Rasimaviciene has been working for the group since 2001 as a project manager and a hotel manager and was appointed as member of the management board and General Manager PK Invest in 2008. She holds a degree in International Trade from International Business School of Vilnius University and graduated from Management School at Johnson & Wales University in the United States of America. Mrs. Rasimaviciene was born in 1973 and holds Lithuanian citizenship.

### Angelika Annus, CFO

Mrs. Annus has been working with the group since 1998 as financial assistant, financial manager and member of the board both in the holding and in subsidiaries. She holds a degree in business administration from the Estonian Business School. Mrs. Annus was born in 1971 and holds Estonian citizenship.

## Company History

- **1994**
  - Pro Kapital is established, making it one of the real estate market leaders in Estonia. The company was founded by Italian entrepreneur Ernesto Preatoni.
- **1996**
  - Pro Kapital actively starts obtaining development projects
  - Ilmarise residential/hotel development project starts.
- **1997**
  - Pro Kapital expands to Latvia.
  - Pro Kapital Business Centre in Tallinn is opened denoting the completion of Pro Kapital's first successful development project.
  - Pro Kapital begins restoration and development of two apartment buildings in Tallinn Old Town, the Dermi shopping centre and a residential building and an apartment building in Riga Old Town.
- **1998**
  - Pro Kapital expands to Lithuania.
  - Listing on Tallinn Stock Exchange.
- **1999**
  - Pro Kapital opens Kristiine Shopping Centre in Tallinn.
  - Pro Kapital renovates a historic Art Nouveau building in Riga into apartments and commercial space, another apartment in Riga Old Town and a historic apartment building in Vilnius.
- **2000**
  - Pro Kapital is the project manager for the renovation of a hotel in Tallinn.
- **2001**
  - Pro Kapital converts an 11,400sqm old office building Tallinn Old Town.
  - Delisting of the company from the Tallinn Stock Exchange.
  - Domina Shopping Centre project in Riga is started.
- **2002**
  - Pro Kapital begins the development of another apartment building in Riga.
- **2003**
  - Domina Shopping Centre is opened in Riga.

# Pro Kapital Grupp AS

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Company Description and Analysis - 7/28 -

- **2006**
  - The last phase of Ilmarise development project in Tallinn is completed.
- **2007**
  - Sale of Domina Shopping Centre in Riga to the German real estate investment fund KanAm Grundinvest for 147 million euros.
- **2011**
  - Sale of Kristiine Shopping Centre to the Finnish shopping centre developer Citycon for € 105m.
- **2012**
  - Listing on Secondary list of Tallinn Stock Exchange
  - Pro Kapital divests its Italian and Russian activities from its Baltic property development operations.
- **2014**
  - Secondary listing of the shares at the Frankfurt Stock Exchange

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## Current Development Projects

**The management aims at creating a modern shopping experience with lots of entertainment opportunities, including a state-of-the-art multiplex cinema**

### Peterburi Road Shopping Center, Tallinn (EST)

The Peterburi Road Mall development is situated in a very attractive location between the Tallinn International Airport and the city center, directly adjacent to Peterburi road, one of the major roads of Tallinn. Pro Kapital is planning to develop about 55,000sqm of total usable space on 53,290sqm land plot. Total building volume is expected at more than 130,000sqm, making the project one of the largest and most important for the company. The management aims at creating a modern shopping experience with lots of entertainment opportunities, including a state-of-the-art multiplex cinema. Most importantly, Pro Kapital has a comprehensive and successful track record of planning, building and operating large shopping malls. In the past, the group has already developed and operated Kristiine Shopping Centre and Domina Mall in Tallinn and Riga and has successfully sold both to international institutional buyers in 2011 and 2007, respectively.

### Computer Simulation of the Peterburi Road Mall



Source: Company website ([www.prokapital.com](http://www.prokapital.com))

**During the past months, the company continued to sign rental agreements for the shopping center premises**

During the reporting period the group finalized the excavation works on the premises. The subsidiary of Pro Kapital, AS Tallinna Moekombinaat, rose over € 1.2m for the financing of the excavation works and for continuing the project documentation in order to finalize the tender for choosing the main constructor for the project. During the past months, the company continued to sign rental agreements for the shopping center premises. We expect total costs of development of about € 90m.

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## Ülemiste 5, Tallinn (EST)

Located in a prime location of Tallinn, Ülemiste is currently Pro Kapital's only pure office project that will comprise about 23,000sqm of modern office space. Thanks to a significant overhang of demand for large, modern office space in Tallinn, Pro Kapital is expecting excellent rental yields and should be able to win over tenants with a good creditworthiness. At the moment, many large multinationals are seeking adequate office spaces in the Baltic capitals to expand their business in the region. Office supply is rather small, particularly when potential tenants are seeking large spaces at international standards.

**Project will comprise about 23,000sqm of modern office space**

**The project has a total land plot size of about 130,000sqm**

## **Tondi Quarter, Tallinn (EST)**

With a total land plot size of about 130,000sqm, Tondi represents Pro Kapital's largest development potential in terms of space. Tondi Quarter is one of the largest residential quarter developments in the Baltics, situated in Tallinn's Kristiine borough, a residential area in the City Centre periphery of Estonia's capital. The unique project foresees impressive red brick buildings smoothly integrated with the modern architecture that will arise over the hill in the center of the new block, providing a series of apartment and office buildings built on land plots historically occupied by barracks. Overall the project is aimed at middle-class individual buyers, who prefer to live in the proximity of the city center and appreciate a spacious green environment. The project is expected to be developed in 5 stages. We visited the site in October 2014 and saw the first new building already in an advanced stage of construction. As of November 2014, 17 presale agreements out of 31 available flats in the first building have been signed and based on this marketing success, Pro Kapital has already launched the presales of the second building, where at the moment presale agreements for 2 flats out of 31 have been signed.

**We visited the site in October 2014 and saw the first new building already in an advanced stage of construction**

## **Computer Simulation of the Tondi Quarter**



Source: Company website ([www.prokapital.com](http://www.prokapital.com))

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## Kalaranna District, Tallinn (EST)

Similar to Tondi, Kalaranna, located in the heart of Tallinn at the waterfront represents more of a quarter-development than a single residential property development, thanks to its sheer size. PK had acquired the 61,000sqm plot in 2001 for € 4m. When looking at the current market value of € 14.5m as of 30 September 2014, one can already see the extreme cost advantage of Pro Kapitals cheaply acquired land bank.

The neighbourhood expands on more than 7 hectares and has been processed for over a decade. The area that should be one of Tallinn's gateways and landmarks is still disarranged. The company aims to create waterfront parks and a public promenade open to the sea with a stairway descending to the sea, i.e. the so-called Sunset Theatre, jetties, flag square, fish market, bike paths and walking trails. In order to achieve an outstanding result in terms of quarter planning, Pro Kapital has initiated a public architecture competition. Following the establishment of the detailed plan, the management will announce the competition in cooperation with the Union of Estonian Architects and Tallinn City Planning Department.

Another important fact regarding Kalaranna is that Pro Kapital has already realized a significant volume residential, office and hotel space in the neighborhood. The hotel is currently successfully operated under the group's own brand PK Hotel.

**PK had acquired the 61,000sqm plot in 2001 for € 4m**

**The company aims to create waterfront parks and a public promenade open to the sea with a stairway descending to the sea, i.e. the so-called Sunset Theatre, jetties, flag square, fish market, bike paths and walking trails**

## Bird's View on the Kalaranna District



Source: Company website ([www.prokapital.com](http://www.prokapital.com))

## Tallinas Quarter, Riga (LAT)

**Pro Kapital was able to acquire the whole plot, which was home to a factory, for only € 1.55m in 1999**

Tallinas Quarter is a large development with mixed use including residential units, office space as well as some smaller retail spaces. The 17,000sqm of land are located in the “quiet center” of Riga, a sought-after quarter both for living and working. This is because of its central location in combination with excellent infrastructure and parking options, which we saw during our site inspection in October 2014. As with all large plots of PK, the company was able to acquire the whole plot, which was home to a factory, for only € 1.55m in 1999.

## Computer Simulation of the Tallinas Residential Complex



Source: Company website ([www.prokapital.com](http://www.prokapital.com))

**As of today the group has already obtained approval for the amortized buildings on the plot to be demolished, but some buildings will be kept and renovated**

The project for the residential area foresees a series of apartment buildings with commercial functions on the ground floor. As of today the group has already obtained approval for the amortized buildings on the plot to be demolished, but some buildings will be kept and renovated. The project is expected to be developed in several stages.

Overall, the project is targeted to middle-class people seeking to upgrade their living condition without sacrificing a location close to the city center.

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## Kliversala District, Riga (LAT)

Kliversala represents a unique residential quarter development in Riga with upscale to luxury living space right at the waterfront opposite the old town of Riga. Thanks to its location, there is hardly any competition regarding luxury residential space directly at the waterfront. Pro Kapital was able to acquire the plot in 2001 and has already refurbished about 100 residential units directly at the waterfront overlooking the River and the old town of Riga, totaling 11,400sqm. During our property tour in the Baltics, we were able to examine both the existing residential units as well as the remaining land plot of almost 52,000sqm, where the group intends to build up to 75,400sqm of upscale to luxury residential living space. Given the latest offers for existing units on the premises, we expect very attractive selling prices of 3,500 up to 5,500 Euros per sqm, which is rather conservative. In fact, residential units in other prime locations of Riga have been sold at prices of up to € 10,000 per sqm lately. All in all, we expect development costs of € 90m to 100m at operating cash profits of 75% to 85%, based on current market prices. Given the recent market price momentum, even higher margins are possible.

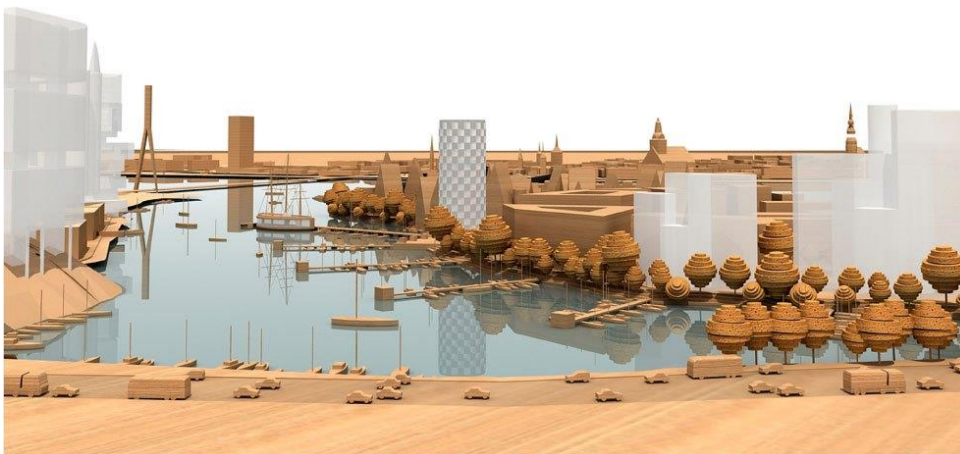
Two specific advantages of the project are its large shoreline directly opposite the old town of Riga with stunning views over the river and the city, which is a unique selling point of the project, as well as the very attractive location in between the city (2 minutes by car) and the airport (15 minutes by car).

The land is located between two main bridges, next to one of the biggest parks in Riga and has a long coastline. It is only a ten minutes' walking distance from the Old Town of Riga. The property is situated on the waterfront and enjoys views of the Old Town on the opposite bank. The project for the residential area foresees a series of exclusive apartment buildings coupled with commercial premises including a hotel. The location is extremely attractive for upscale residential and commercial real estate development. As of November 2014, there is approval for the amortized buildings on the plot to be demolished and the new master plan is already approved by the authorities. The new detailed planning is submitted and currently being processed by the city.

**During our property tour in the Baltics, we were able to examine both the existing residential units as well as the remaining land plot of almost 52,000sqm**

**The property is situated on the waterfront and enjoys views of the Old Town on the opposite bank**

## Computer Simulation of the Kliversala Residential Project



Source: Company website ([www.prokapital.com](http://www.prokapital.com))

**The premises are located at one of the main transport arteries heading through the City, next to the railways within a former industrial area**

## Zvaigznes Quarter, Riga (LAT)

With a plot size of about 17,000sqm, the project represents one of the smaller residential and office space projects of the group in Riga. The company is currently planning a building volume of about 23,000sqm. The premises are located at one of the main transport arteries heading through the City, next to the railways within a former industrial area. Pro Kapital group was able to acquire the whole plot for as little as € 330,000 in 1999, implying a price per sqm of about € 19.45 (book value as of 30 September 2014: € 2.5m).

The project foresees renovation of the existing industrial building into a residential and office building and the construction of 6 new building for residential and retail purposes. The project is expected to be developed in two phases as the initial phase includes the renovation works of the existing building and the second phase a construction of new buildings and underground parking. A building permit for reconstruction works of existing building has already been obtained by the company. We expect a total investment volume of about € 25m for both phases of the project.

## Computer Simulation of the Zvaigznes Quarter Office Buildings



Source: Company website ([www.prokapital.com](http://www.prokapital.com))

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## Saltiniu Namai, Vilnius (LIT)

Currently the only active development project in Lithuania, the company aims at developing about 27,000sqm of residential living space in the heart of Vilnius, next to the Old Town. The business plan for the Saltiniu Namai residential quarter foresees a series apartment buildings built in two stages. The location is attractive for a residential area: it is located right next to the Old Town and enjoys a good access both by cars and public transport. The first stage of Project Saltiniu Namai has been completed: four five floor buildings with attics and 11 private cottages have been built (see pictures below).

**The company aims at developing about 27,000sqm of residential living space in the heart of Vilnius**

## Current Picture of Saltiniu Residential Complex



Source: Company website ([www.prokapital.com](http://www.prokapital.com))

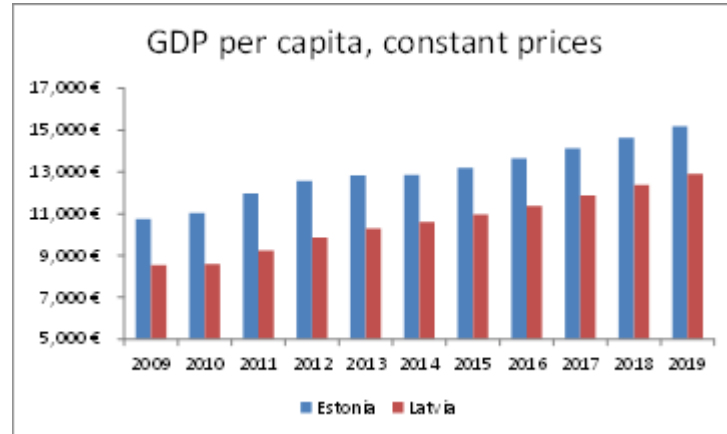
Residents of Saltiniu Namai quarter are already enjoying the private courtyard, finished landscape works and fully equipped children's playground.

We expect total costs of construction of about € 30m to 35m with operating cash margins well above 70%.

As of November 2014, there have been signed 16 presale agreements out of 19 available flats for the Vilnius Saltiniu Namai new stage project. For further development of the project in Vilnius the Company established a new subsidiary, Pro Kapital Bonum UAB, which has concluded the construction contract with UAB Merko Statyba for construction and design works of new residential building on August 1, 2014. Construction works have not started yet.

**As of November 2014, there have been signed 16 presale agreements out of 19 available flats for the Vilnius Saltiniu Namai new stage project**

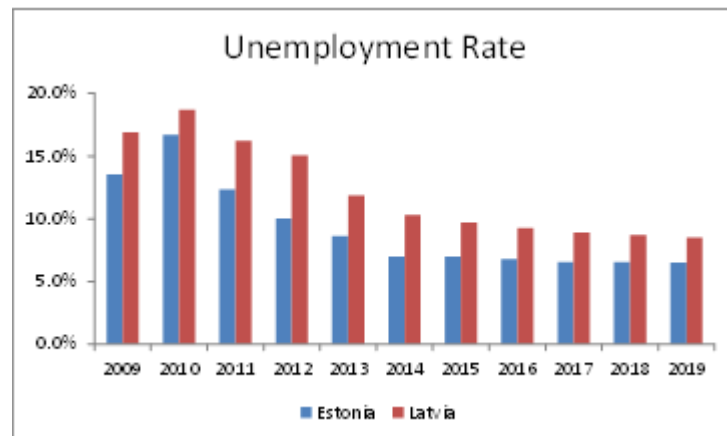
## Economic Data and Outlook



Source: IMF World Economic Outlook October 2014

**Rising GDP per capita will further improve the spending power of middle- and upper-class households who are looking for modern living space**

When looking at the macro outlook for the Baltics, one can see significant positive momentum. The forecasts for GDP per capita, very important for the real estate buying power of private households and hence real estate sales prices for Pro Kapital, are excellent. In the most recent World Economic Outlook, published in October 2014 by the International Monetary Fund (IMF), one can see that GDP per capita is expected to rise by another 20% to 25% within the next years, despite the steep growth seen in the last years since the peak of the crisis in 2009.



Source: IMF World Economic Outlook October 2014

**Unemployment already halved since the peak of the crisis and is expected to stay low**

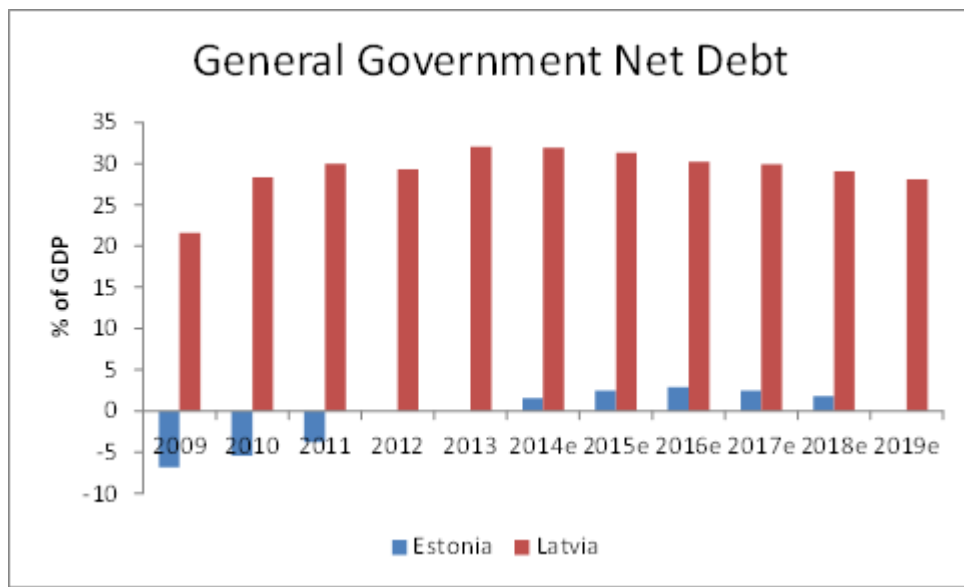
Alike GDP per capita, low unemployment rates serve as an important indicator for mid- to long-term prosperity of a country. When looking at the numbers above, one can see that the Baltics suffered from relatively high unemployment in the aftermath of the worldwide financial crisis 2009 to 2012. As of today, unemployment in Estonia, PK's most important market, has dropped by more than 50% from its crisis levels already and is expected to stay below the 7% mark.

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Unlike most Western European Countries or the United States, the Baltic countries do not have the severe problem of over-indebtedness. As you can see in the chart below, Estonia used to have negative net debt over the past years and is expected to remain in the lower single digit percentage range regarding its government net debt in per cent of GDP. Latvia's Government net debt is expected to have passed its peak in the range of 30% to 35% and is forecasted to go back below the 30% threshold within the next years. These are the latest forecasts of the IMF in its World Economic Outlook from October 2014.

**Extremely low government net debt is a crucial advantage for the Baltic economies in the future**



Source: IMF World Economic Outlook October 2014

We consider this sound financing structure of the public sector as a crucial advantage over countries with large public debt. Once interest rates start to pick up to long-term average levels, many countries will be put in severe pressure to compensate the exploding interest costs, inevitably resulting in tax increases. These tax increases would harm both the growth of the private sector as well as the buying power of private households. Ultimately, this could also harm real estate prices in countries with large government debt.

Having no or little government net debt is therefore a huge long-term advantage and perfects the macro picture of the Baltic countries in our view.

## Real Estate Market Environment

*“Over time the Baltic property market is expected to converge with the Nordic”*

Quote from Newsec Property Outlook Autumn 2014

**Some sectors offer a particularly good outlook, e.g. modern office space and new residential units in Riga, Tallinn and Vilnius**

As the statement from the most recent market outlook of local real estate consulting firm Newsec indicates, the Baltic real estate markets are heading towards closing the gap to the Nordic markets within the coming years. The reasons for this development are not only macro-economic, but also driven by market specific parameters like costs of construction or the gap and structure of office demand and supply. In the past years, we have been seeing a yield compression in all three Baltic Markets, regardless of asset class. However, some sectors offer a particularly good outlook, e.g. modern office space and new residential units in Riga, Tallinn and Vilnius. Compared to the Nordic markets, there is very little volume of modern office space on the market or being developed at the moment.



Source: Newsec Property Outlook Autumn 2014

**New office space is rare in the Baltics**

Independent market research group Newsec expects about 50,000sqm of office space to be erected this year in Riga, and less than 20,000sqm in Tallinn and Vilnius, respectively (see charts below).



Source: Newsec Property Outlook Autumn 2014

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# Pro Kapital Grupp AS

November 24, 2014

Real Estate Market Environment - 19/28 -

Below there is an overview of the current retail and office prime rents in the three capital cities of Estonia, Latvia and Lithuania. Retail prime rents are in the range of 250 to 270 Euro/sqm.



Source: Newsec Property Outlook Autumn 2014

Taking into account the large demand from both local and international clients, the volume of new space will most likely not satisfy the demand from tenants. When looking at the offered space more closely, one can also see that much of the office space being offered is either small spaces or not located in prime locations. Particularly large corporate tenants demand large, modern and flexible office space when opening local offices in one or all of the Baltic capital cities. See an overview of the current prime office rents in the Baltic capitals.

**Prime office space is rare and sought-after by large corporates entering the Baltics**



Source: Newsec Property Outlook Autumn 2014

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## SWOT Analysis

### Strengths

- Comprehensive track record of about 200,000sqm in successfully developed retail, residential and hotel real estate in the Baltics since 1996
- Huge reserves of land plots in prime locations of Riga, Tallinn and Vilnius, acquired at very low prices in the late 1990s
- Experienced management and supervisory board
- Sound balance sheet structure with more than 60% equity ratio
- Diversified in terms of location (all three Baltic capitals) and asset classes (residential, retail, office and hotel properties)
- High flexibility with regards to schedule and type of development, due to large, unused land plots, already paid in full with equity

### Weaknesses

- Relatively low liquidity of the share at the moment, also due to low freefloat volume
- Due to few relatively large real estate development projects at a time, cash flows and net profits will remain volatile for the next years
- In order to build the next stages of the respective projects, Pro Kapital is dependent on banks' willingness to finance these costs of construction
- As we see Pro Kapital also as a macro play on the further recovery of the Baltic economy, the company's outlook is tied strongly to the overall economic development of the region. Geographical diversification aside from the Baltics is extremely low

### Opportunities

- Further growing demand for modern, up-scale residential units and office space in the three Baltic capitals Riga, Tallinn and Vilnius
- Strong growth of GDP per capita and disposable income of private households in the Baltics
- Low interest rate environment further boosts margins and flexibility in development projects
- Lithuania is about to join the Euro Zone as of 1 January 2015, this should further drive the momentum of economic activity and real estate prices
- Sale of a large retail project like Peterburi Road Mall will lead to large cash backflows and significant impact on net profit

### Threats

- The strong upswing in GDP and buying power per capita will also materialize in higher wages and material prices, which could lower margins in the long run
- The financing sentiment of banks in the Baltic countries is closely tied to the development of the Euro-Zone. In case of another worsening of the Euro-Crisis, this could negatively affect banks' financing capabilities
- A drop in the general capital markets sentiment could affect Pro Kapital's access to fresh equity and/or debt at the capital markets, which would slow the speed of developing projects

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## Financial Analysis and Discussion

### Profit & Loss Statement

Fiscal Year 31.12 (IFRS)	2012a	2013a	2014e	2015e	2016e	2017e	2018e	2019e	2020e	4y - CAGR 2015 - 2019
in € '000										
<b>Total Sales</b>	<b>16,078</b>	<b>12,287</b>	<b>13,526</b>	<b>16,582</b>	<b>36,048</b>	<b>39,270</b>	<b>38,220</b>	<b>38,887</b>	<b>39,650</b>	
<i>Growth rate in %</i>	-7.9	-23.6	10.1	22.6	117.4	8.9	-2.7	1.7	2.0	23.7
Cost of sales	12,750	9,199	10,142	10,856	23,530	17,797	18,252	19,542	20,198	
<b>Gross Profit</b>	<b>3,328</b>	<b>3,088</b>	<b>3,385</b>	<b>5,726</b>	<b>12,518</b>	<b>21,473</b>	<b>19,968</b>	<b>19,345</b>	<b>19,452</b>	
<i>Growth rate in %</i>	-80.9	-7.2	9.6	69.2	118.6	71.5	-7.0	-3.1	0.6	35.6
Selling and marketing expenses	531	420	485	500	515	530	545	560	575	
General and administration expenses	6,179	4,606	4,725	4,875	5,025	5,175	5,325	5,475	5,625	
Other income	411	410	425	430	435	440	445	450	455	
Other expenses	1,932	167	650	650	725	850	875	900	925	
<b>EBIT</b>	<b>-4,903</b>	<b>-1,695</b>	<b>-2,051</b>	<b>131</b>	<b>6,688</b>	<b>15,358</b>	<b>13,668</b>	<b>12,860</b>	<b>12,782</b>	
<i>Growth rate in %</i>	-128.1	-65.4	21.0	-106.4	5,014.9	129.6	-11.0	-5.9	-0.6	214.9
Finance Result (+inc./-exp)	-1,417	-967	-1,765	-4,003	-4,654	-5,073	-4,003	-3,709	-1,551	
<i>Finance income</i>	48	447	120	150	150	150	150	150	150	
<i>Finance expense</i>	1,465	1,414	1,885	4,153	4,804	5,223	4,153	3,859	1,701	
<b>EBT</b>	<b>-6,320</b>	<b>-2,662</b>	<b>-3,816</b>	<b>-3,872</b>	<b>2,034</b>	<b>10,285</b>	<b>9,665</b>	<b>9,151</b>	<b>11,231</b>	
<i>Growth rate in %</i>	-136.2	-57.9	43.3	1.5	-152.5	405.6	-6.0	-5.3	22.7	65.1
Taxes on Income (Exp.+/Inc.-)	-141	-84	-191	-194	102	514	483	458	562	
<b>Net profit</b>	<b>-6,179</b>	<b>-2,578</b>	<b>-3,625</b>	<b>-3,679</b>	<b>1,933</b>	<b>9,771</b>	<b>9,181</b>	<b>8,694</b>	<b>10,670</b>	
<i>Growth rate in %</i>	-135.4	-58.3	40.6	1.5	-152.5	405.6	-6.0	-5.3	22.7	65.1
<i>For information purposes</i>										
Depreciation and amortization	600	600	600	600	600	1,350	2,100	2,100	2,100	
<i>in % of total sales</i>	0	0	0	0	0	0	0	0	0	
<b>EBITDA</b>	<b>-4,303</b>	<b>-1,095</b>	<b>-1,451</b>	<b>731</b>	<b>7,288</b>	<b>16,708</b>	<b>15,768</b>	<b>14,960</b>	<b>14,882</b>	
No. of shares (Ø '000 outstanding)	54,107	54,107	54,107	54,107	54,107	54,107	54,107	54,107	54,107	
Net profit / share (EPS)	-0.11	-0.05	-0.07	-0.07	0.04	0.18	0.17	0.16	0.20	
Adj. net profit / share (adj. EPS)	-0.11	-0.05	-0.07	-0.07	0.04	0.18	0.17	0.16	0.20	

Source: Pro Kapital Grupp, BankM Research

### Margins

in %	2012a	2013a	2014e	2015e	2016e	2017e	2018e	2019e	2020e
Gross Profit Margin	20.7	25.1	25.0	34.5	34.7	54.7	52.2	49.7	49.1
EBITDA Margin	-26.8	-8.9	-10.7	4.4	20.2	42.5	41.3	38.5	37.5
EBIT Margin	-30.5	-13.8	-15.2	0.8	18.6	39.1	35.8	33.1	32.2
EBT Margin	-39.3	-21.7	-28.2	-23.4	5.6	26.2	25.3	23.5	28.3
Net Profit Margin	-38.4	-21.0	-26.8	-22.2	5.4	24.9	24.0	22.4	26.9

Source: Pro Kapital Grupp, BankM Research

## Segment Discussion

Pro Kapital has three major pillars of income:

- Income from the sale of real estate assets
- Rental revenues from owned properties
- Hotel revenues

### First Pillar

When looking at the first, and in the long-term most important pillar, the income from the sale of properties, the proceeds will stem predominantly from the sale of residential units in Riga and Tallinn. Depending on the volume of new equity and/or debt injections into the company and thus, the speed of completions, the proceeds in this segment alone may sum up to a range of € 150m and € 250m within the next years. Taking current real estate prices and construction costs into account, we forecast operating gross margins of more than 30% per annum for Pro Kapital in this segment. As a result, the first pillar is the most important to us when evaluating the outlook for the Pro Kapital group, both in terms of volume and profitability. Another important fact regarding this source of income is that the developer has significantly easier access to financing and lower costs of financing due to the fact that buyers of residential units usually pay significant portions of the sales price upfront and during the construction phase, depending on the progress of the development. This lowers the overall financing volume over the total duration of the project and provides for more granular cash flows, reducing counterparty risks at the same time.

**Larger share of residential developments helps to lower the financing needs as buyers pay part of the price upfront**

### Second Pillar:

Future rental income from owned properties will stem predominantly from the group's landmark retail project: the Peterburi Road Shopping Centre in Tallinn. We expect annual rental income of € 12m to 15m in the mid-term. In addition, Pro Kapital will receive rental income from the office projects in Tallinn and Riga until the properties are sold to institutional investors.

### Third Pillar:

The three hotels currently operated under the group's own brand PK Hotels generate annual revenues of about € 5m to 7m. Although we do not regard the hotel segment as a strategic focus of the group, the constant cash flow from the segment helps to smooth the overall revenues structure of the Pro Kapital group.

## Operating Cash Flow – Specifics and Outlook

Typical for real estate development companies, cash flows of Pro Kapital are strongly tied to the stage of completion of the current projects. During the planning, erection and marketing of a new real estate project, the group usually faces strong outflows of cash. At the time of a sale of the entire project, there are usually large cash backflows, also positively impacting the balance sheet ratios, as project debt can be repaid in full. In the years 2007 and 2011 for example, the sales of Domina and Kristiine Mall took place, resulting in annual net profits of € 85m and 50m, respectively.

In our view, a clear advantage with regards to the aim of smoothing cash flows over time is the large portion of residential developments in Pro Kapital's current development pipeline. As residential units are usually sold piece by piece to private owner-users or private investors, the backflows are much more granular than e.g. when selling a large shopping mall all at the same point of time. In addition, private buyers of apartments that are still to be built usually pay in three stages, meaning that there is immediate cash flow at the time of the sale. These effects benefit both the operating cash flow as well as the balance sheet structure.

In the past fiscal years, Pro Kapital's net profit swung around € -7m and € +5m, when no large project completions took place. However, when looking at years with big projects being completed and sold like 2007 or 2011, we saw large positive net profits. So in order to assess the future cash flows of the group, we took a detailed view on the completion schedule of the single project (stages) for the next years and determined positive operating cash flows of about € 150m to € 250m for the next five years. It is hard to determine the exact cash backflow for every single year, as Pro Kapital does not do forward sales, meaning that the group is waiting for the most attractive offer for large objects rather than forcing itself to selling it immediately after completion.

On the other hand, regardless of the split of cash flows to the respective fiscal years, we see a large cash flow potential of € 150m to € 250m from the current projects within the next five years. This would translate into operating cash flow returns of about 35% to 40% p.a..

**Future cash flows will be much more granular than in the past, thanks to large portion of residential projects**

**PK's net results in the past were heavily tied to sales of large shopping malls**

## Valuation

In order to calculate a fair value for the Pro Kapital share, we applied a Discounted Cash Flow Model (DCF analysis), using the estimated future free cash flows and the Weighted Average Cost of Capital (WACC).

## DCF Model

For the analysis of Free Cash Flows we have applied a 3-stage model:

Phase I	2014 – 2017 (short-term planning)
Phase II	2018 – 2021 (mid-term prognosis)
Phase III	Terminal Value

## DCF analysis

	2013a	Phase 1				Phase 2				Terminal Value
		2014e	2015e	2016e	2017e	2018e	2019e	2020e	2021e	
in € '000	Basis	1	2	3	4	5	6	7	8	
Growth	-23.6%	10.1%	22.6%	117.4%	8.9%	-2.7%	1.7%	2.0%	10.0%	3.0%
<b>Revenues</b>	<b>12,287</b>	<b>13,526</b>	<b>16,582</b>	<b>36,048</b>	<b>39,270</b>	<b>38,220</b>	<b>38,887</b>	<b>39,650</b>	<b>43,615</b>	<b>44,924</b>
<b>EBIT</b>	<b>-1,695</b>	<b>-2,051</b>	<b>131</b>	<b>6,688</b>	<b>15,358</b>	<b>13,668</b>	<b>12,860</b>	<b>12,782</b>	<b>14,393</b>	<b>14,825</b>
- Tax	-84	-191	-194	102	514	483	458	562	720	741
+ Depreciation and amortization	600	600	600	600	1,350	2,100	2,100	2,100	2,100	1,000
+ Change in long-term provisions	0	0	0	0	0	0	0	0	0	0
- Change in net working capital	0	0	0	0	0	0	0	0	0	0
- Other non-cash items	0	0	0	0	0	0	0	0	0	0
- Capex	0	300	300	300	675	1,050	1,050	1,050	1,050	1,350
<b>= Free Cash Flow</b>	<b>-1,011</b>	<b>-1,560</b>	<b>624</b>	<b>6,887</b>	<b>15,519</b>	<b>14,234</b>	<b>13,453</b>	<b>13,271</b>	<b>14,723</b>	<b>13,734</b>
Terminal Value										315,714
Discount factor	n.a.	0.93	0.87	0.82	0.76	0.71	0.66	0.62	0.58	0.58
<b>NPV of Free Cash Flows</b>	<b>n.a.</b>	<b>-1,457</b>	<b>545</b>	<b>5,615</b>	<b>11,815</b>	<b>10,119</b>	<b>8,925</b>	<b>8,213</b>	<b>8,496</b>	
<b>NPV of Terminal Value</b>										<b>182,176</b>
<b>Valuation</b>		<b>Proportion of EV</b>								
Result of Future Cash Flows	52,270	22%								
+ Result of Terminal Value	182,176	78%								
<b>= Value of the Entity</b>	<b>234,446</b>									
+ Cash (as of 30 September 2014)	1,894									
- Debt (as of 30 September 2014)	36,045									
<b>= Value of Equity</b>	<b>200,295</b>									
Current No. of Shares (in '000)	54,107									
<b>Price per Share</b>	<b>3.70</b>									

Source: BankM Research

Source: BankM Research

## Key model assumptions

Source	2014e	2015e	2016e	2017e	2018e	2019e	2020e	2021e	TV
Riskfree Return*	0.12%	0.15%	0.18%	0.21%	0.30%	0.40%	0.50%	0.60%	0.80%
Market Risk Premium	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
Sector Beta	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90	0.90
Country Risk Premium Baltics	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%	1.30%
Company Specific Risk Premium	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
<b>Cost of Equity</b>	<b>8.32%</b>	<b>8.35%</b>	<b>8.38%</b>	<b>8.41%</b>	<b>8.50%</b>	<b>8.60%</b>	<b>8.70%</b>	<b>8.80%</b>	<b>9.00%</b>
Target Weight	50%	50%	50%	50%	50%	50%	50%	50%	50%
<b>Cost of Debt</b>	<b>6.00%</b>	<b>6.00%</b>	<b>6.00%</b>	<b>6.00%</b>	<b>6.00%</b>	<b>6.00%</b>	<b>6.00%</b>	<b>6.00%</b>	<b>6.00%</b>
Target Weight	50%	50%	50%	50%	50%	50%	50%	50%	50%
Tax Shield	5%	5%	5%	5%	5%	5%	5%	5%	5%
<b>WACC</b>	<b>7.01%</b>	<b>7.03%</b>	<b>7.04%</b>	<b>7.06%</b>	<b>7.10%</b>	<b>7.15%</b>	<b>7.20%</b>	<b>7.25%</b>	<b>7.35%</b>

Source: BankM Research

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# Pro Kapital Grupp AS

November 24, 2014

Valuation - 25/28 -

## Sensitivity Analysis of NPV Terminal Value

		Discount rate of Terminal Value						
		6.00%	6.50%	7.00%	7.35%	8.00%	8.50%	9.00%
Growth in Terminal Value	2.00%	3.96	3.56	3.23	3.05	2.75	2.57	2.41
	2.50%	4.50	3.98	3.57	3.34	2.98	2.76	2.58
	3.00%	5.22	4.52	4.00	3.70	3.26	3.00	2.78
	3.50%	6.22	5.24	4.54	4.16	3.61	3.28	3.01
	4.00%	7.73	6.25	5.27	4.75	4.03	3.62	3.29

Source: BankM Research

## Valuation Summary

Our DCF analysis returns a value of the equity of € 200.3m, which represents our fair value estimate for the shareholder's equity of Pro Kapital, translating into a fair value per Pro Kapital share of € 3.70.

We applied conservative sales prices regarding the current market sentiment in Estonia, Latvia and Lithuania and regard our revenue forecast as a base case scenario without further rises in real estate prices or additional sales proceeds of Pro Kapital's landmark shopping mall project "Peterburi Road Shopping Mall". As we have witnessed in the fiscal years 2007 and 2011, a successful sale of a large shopping mall that was completely developed and operated by the company itself usually unlocks huge hidden reserves. As the vast majority of the development projects are accounted for using the at-cost method, the company will continue to build up significant hidden reserves that will become visible once a sale is concluded. However, the amount of time in which the described projects will be completed also depend on Pro Kapital's ability to access fresh capital at the markets.

Looking at the company's comprehensive development track record in the Baltics within the past 20 years, we are confident that the group will also be able to achieve outstanding margins in its current development projects.

With regard to current share prices in the range of € 2.40 to 2.50, we therefore see significant upside in the PK shares and rate the stock as "Buy".

**Fair Value of the equity: € 200.3m or € 3.70 per PK share**

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**Responsible for the content of this document: biw Bank für Investments und Wertpapiere AG, Willich, Germany.**

**Authors: Denis Kuhn, CCrA and Dr. Roger Becker, CEFA, Analysts.**

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Issuer of the analysed instruments is AS Pro Kapital Grupp.

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No previous publications. Initiation of coverage.

### II. Additional Information:

#### 1. Sources of information:

Main sources of information for the compilation of this document are publications in national and international media and information services (e.g. Reuters, VWD, Bloomberg, dpa-AFX, ACMR-IBIS World and others), financial newspapers and magazines (e.g. Börsenzeitung, Handelsblatt, Frankfurter Allgemeine Zeitung, Economist and others), specialist media, published statistics, rating agencies as well as publications by peer group companies and the company itself. Furthermore talks with the management of the issuer have been held. This document was made available to the issuer before publication to ensure the accuracy of the information provided. This resulted in no textual changes.

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The following valuation methods are being used: Multiple-based models (Price/Earnings, Price/Cash-flow, Price/Book value, EV/Sales, EV/EBIT, EV/EBITA, EV/EBITDA), peer-group comparisons, historical valuation approaches, discount models (DCF, DDM), break-up value and sum-of-the-parts-approaches, asset-based evaluation methods or a combination of the above. The used valuation models depend on macroeconomic factors, such as interest rates, exchange rates, raw materials and on basic assumptions about the economy. Additionally, market sentiment affects the valuation of companies. The valuation is also based on expectations that might change rapidly and without notice, depending on developments specific to individual industries. Rendered evaluation results and fair values derived from the models might therefore change respectively. The evaluation results in general relate to a 12-month horizon. However, evaluation results are subject to changing market conditions and represent only the situation at a given point of time. The evaluation results and fair value prices may in fact be achieved more quickly or slowly than expected by the analysts. Also, the evaluation results and fair value prices might need to be revised upward or downward.

#### 3. Date of first publication of this document:

**November 24, 2014**

#### 4. Date and time of prices of the instruments quoted in this document:

**Closing prices of November 21, 2014**

#### 5. Updates:

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**5. Updated information according to sec. 5 para. 4 N<sup>o</sup>. 3 FinAnV is available at: [http://www.bankm.de/webdyn/138\\_cs\\_Gesetzliche+Angaben.html](http://www.bankm.de/webdyn/138_cs_Gesetzliche+Angaben.html).**

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