

# Pro Kapital Grupp AS

October 19, 2016



## Basic report update

### Analysts

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### Evaluation result

# BUY

(previous: BUY)

### Fair value

# €2.50

(previous: € 3.50)

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

## First 6M with lower top-line and a doubling net loss – we expect better second half

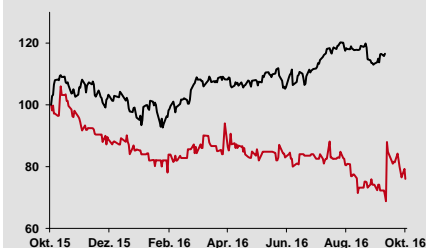
On August 24, Pro Kapital Grupp AS, a leading Estonian developer of commercial and residential real estate in the three Baltic countries of Estonia, Latvia and Lithuania released its unaudited report for the first six months of 2016. The numbers were below our expectations as all key figures were below the comparably high 2015 level flattered by an extremely high level of revenues from sales which had tripled from €2.3 mln in 2014 to €6.0 mln in 2015. The H1/2016 sales number was at €4.4 mln, which might be seen as a more “normalized” level. The EBIT was also much lower, at €-1.3 mln (1H 2015 €-0.4 mln). The net loss after minorities almost doubled from €-1.7 mln to €-3.1 mln in 1H 2016.

In 1H 2016 the company continued on developing the new T1 shopping and entertainment center in the Estonian capital Tallinn which is the firm’s largest single project in company history with a gross lease area of about 55k sqm. The company has already entered into negotiations with some well-known international and national consumer brands from the retail industry. Furthermore, Pro Kapital continued its Latvia based Kliversala residential project (NSA 56k sqm) as well as the two other prominent residential development projects in Saltiniu Namai in Vilnius (NSA 21k sqm) and the mixed residential / commercial development Tondi Quarter in Tallinn (NSA 86k sqm). Pro Kapital also continued its work to improve its financing situation and attain an attractive mix of bank debt, corporate bonds and private equity. In this context the firm completed two tranches of a corporate bond with a total €16 mln volume. The arrangement of further short-term financing facilities will remain a top priority for the management in order to drive the steep growth path of development business. With regards to balance sheet the cash and cash equivalents doubled from €6.4 mln at year-end 2015 to €12.6 mln as of end-June 2016. In the same period the current bank debt quadrupled from €0.9 mln to €3.7 mln and the long-term bank debt came down from €6.9 mln to €3.7 mln. With a lower level of bank debt Pro Kapital worked more with the non-convertible bonds which doubled from €15.6 mln at year-end 2015 to €31.5 mln as of June 30.

A significant switch occurred in shareholder structure where Nordea Bank now holds a stake of almost 51% as of end-June (year-end 2015: 36%) which results in a lower free float but strongly underlines the trust of Nordea in the future success of Pro Kapital.

**Based on 1H results and discussion with management we expect sales and bottom line to improve in the second half of the year. Nevertheless, we have to clearly cut our 2016 net result forecast from €-1.3 mln to €-5.3 mln and also take a more cautious view on 2017 and 2018 figures. With our updated P&L and DCF we reduce our target price to €2.50. In light of the current share price we reiterate our Buy rating.**

Sector	Real Estate Development		
WKN	579797		
ISIN	EE3100006040		
Bloomberg/Reuters	17E GF		
Accounting standard	IFRS		
Financial year	Dec 31		
Financial reporting Q3 2016	November, 23		
Market segment	Open Market		
Transparency standard	Quotation Board		
<b>Financial ratios</b>	<b>2016e</b>	<b>2017e</b>	<b>2018e</b>
EV/Sales	7.3	5.1	3.9
EV/EBITDA	neg.	14.6	10.5
EV/EBIT	neg.	15.6	10.9
P/E adj.	neg.	25.8	14.0
Price/Bookvalue	1.3	1.2	1.1
Price/FCF	677.2	8.2	6.6
ROE (in %)	-6.5	5.0	8.6
Dividend yield (in %)	0.0	0.0	0.0
<b>Number of shares outs.</b> (in '000)	54,204		
<b>MarketCap / EV</b> (in € m)	103.0 / 143.3		
<b>Free float</b> (in %)	25.5%		
<b>Ø daily trading vol.</b> (3M, in €)	9,632		
<b>12M high / low</b> (in €; close)	2.65 / 1.72		
<b>Price October 18, 2016</b> (in €; close)	1.90		
<b>Performance</b>	<b>1M</b>	<b>6M</b>	<b>12M</b>
absolute (in %)	2.5	-11.9	-24.6
relative (in %)	6.1	-13.0	-29.3
<b>Benchmark index</b>	STOXX Europe 600 Real Estate Superindex		



Pro Kapital Grupp AS (red/grey), Performance 1y vs. STOXX Europe 600 Real Estate Supersector Total Return (black)

Source: Bloomberg

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### A 17% drop in 1H total revenues, mainly from much lower trading activities (-28%), EBIT still negative

2015 was successful in terms of a high 77% jump in group's revenues to more than €18 mln, mainly coined by the Estonian and Lithuanian markets which both delivered strong trading growth and account for more than 70% of total revenues. The most important contribution comes from sales activities which quadrupled in 2015 to more than €10 mln.

**The 2015 numbers were driven by a very high jump in sales.**

#### Revenue by business lines, in thousands of euros

	2015	2014	Change
Real Estate	10 055	2 720	269,7%
Rent	205	205	0,0%
Hotels	6 489	5 880	10,4%
Other	1 573	1 530	2,8%

Source: Company data

The first half of 2016 was lagging behind the high level of 2015. The total revenues fell by 17% from €9.9 mln to €8.2 mln which was mainly driven by real estate sales which sharply declined by 28% from more than €6 mln to only €4.4 mln.

**The first half of 2016 delivered a sharp drop of 17% in revenues which was caused by much lower trading activities (-28%).**

in thousands of euros	2016 6M	2015 6M	2016 Q2	2015 Q2
Revenue from sales of real estate	4 364	6 046	3 316	4 623
Rental revenue	90	105	42	52
Hotel operating revenue	2 929	2 900	1 722	1 692
Revenue from maintenance services	799	785	331	352
Other services	21	58	15	40
<b>Total</b>	<b>8 203</b>	<b>9 894</b>	<b>5 426</b>	<b>6 759</b>

Source: Company data

**The bottom line loss almost doubled to €3.1 mln, above the 2015 level and clearly above our 2016 forecast.**

The lower top line translated again into a negative EBIT result (before financial expenses) of €-1.3 mln, even worse than the tiny €-0.4 mln in last year. With higher net financing expenses (€1.8 mln, after €1.1 mln in 1H 2015) to finance the growth and many current developments, the company delivered a net loss after minorities of €-3.1 mln, after €-1.7 mln in the year before. This is more than the full 2015 level (€-1.9 mln) and more than our latest 2016 forecast of €-1.3 mln.

**The second half of the year will unveil a big hike in sales revenues but the net loss might still widen.**

After our recent discussion with management we are convinced that real estate sales will surge in the second half of the year and will help to drive the full 2016 numbers. In fact, we expect sales revenues to double from last year's 2H level of €4 mln to more than €8 mln in the second half of 2016 as some transactions are already underway and near to be closed. Nevertheless, we expect the net loss to widen to about €-5 mln in the full year which means about €-2 mln in the second half of the year, just slightly better than in the first six months.

**Cutting the 2016e – 2018e forecast we also come up with a lower DCF value of €2.50 which is our new target.**

We cut our 2016 profit forecast from €-1.3 mln to €-5.3 mln. We also take a more cautious standpoint regarding 2017 numbers as we bring down our total revenues forecast by about 20% from €35.1 mln to €28.2 mln and our net profit forecast from €5.2 mln to approx. €4.0 mln. With an adjusted DCF we reduce our target price from previously €3.50 to €2.50.

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## Valuation

### DCF Analysis

	2015a	Phase 1				Phase 2				Terminal Value
		2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	
in € '000	Basis	1	2	3	4	5	6	7	8	
Growth		7.5%	43.2%	30.0%	-32.9%	5.4%	5.0%	5.0%	5.0%	2.0%
Revenues	18,322	19,700	28,220	36,700	24,620	25,958	27,256	27,257	28,620	29,192
EBIT	1,424	-783	9,209	13,201	11,165	11,494	11,777	11,486	11,754	11,677
- Tax	0	-39	460	660	558	575	589	574	588	584
+ Depreciation and amortization	693	662	617	510	510	510	488	488	488	250
+ Change in long-term provisions	0	0	0	0	0	0	0	0	0	0
- Change in net working capital	-4,384	0	0	0	0	0	0	0	0	0
- Other non-cash items	3,003	0	0	0	0	0	0	0	0	0
- Capex	1,368	7,545	255	255	255	250	250	250	250	250
<b>= Free Cash Flow</b>	<b>2,130</b>	<b>-7,626</b>	<b>9,111</b>	<b>12,797</b>	<b>10,862</b>	<b>11,180</b>	<b>11,427</b>	<b>11,150</b>	<b>11,405</b>	<b>11,093</b>
Terminal Value										221,565
Discount factor	n.a.	0.95	0.87	0.80	0.74	0.68	0.62	0.57	0.53	0.53
<b>NPV of Free Cash Flows</b>	<b>n.a.</b>	<b>-7,232</b>	<b>7,923</b>	<b>10,226</b>	<b>7,995</b>	<b>7,567</b>	<b>7,119</b>	<b>6,403</b>	<b>6,043</b>	
<b>NPV of Terminal Value</b>										<b>117,403</b>
<b>Valuation</b>		<b>Proportion of EV</b>								
Result of Future Cash Flows	46,043	28%								
+ Result of Terminal Value	117,403	72%								
<b>= Value of the Entity</b>	<b>163,446</b>									
+ Cash + Equiv. (as of Dec 31, 2015)	6,392									
- Debt (as of Dec 31, 2015)	35,058									
<b>= Value of Equity</b>	<b>134,780</b>									
Current No. of Shares (in '000)	54,204									
<b>Fair Value per Share (Euro)</b>	<b>2.49</b>									

Source: BankM Research

### Key Model assumptions

	Source	2016e	2017e	2018e	2019e	2020e	2021e	2022e	2023e	TV
Riskfree Return*	Bloomberg	-0.71%	-0.67%	-0.67%	-0.61%	-0.50%	-0.45%	-0.37%	-0.25%	0.44%
Expected Market Return (mean of S&P 500 / MSCI World, 10y; on € basis)	Bloomberg	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%	7.50%
Market Risk Premium		8.21%	8.17%	8.17%	8.11%	8.00%	7.95%	7.87%	7.75%	7.06%
Sector Beta, re-levered with target capital structure	Damodaran	1.42	1.42	1.42	1.42	1.42	1.42	1.42	1.42	1.00
Country Risk Premium Baltics – Mean of the three Baltics –	Damodaran	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
<b>Cost of Equity</b>		<b>12.42%</b>	<b>12.41%</b>	<b>12.41%</b>	<b>12.38%</b>	<b>12.33%</b>	<b>12.31%</b>	<b>12.28%</b>	<b>12.23%</b>	<b>8.97%</b>
Target Weight		40%	40%	40%	40%	40%	40%	40%	40%	40%
<b>Cost of Debt</b>		<b>7.50%</b>	<b>7.30%</b>	<b>7.10%</b>	<b>6.90%</b>	<b>6.70%</b>	<b>6.50%</b>	<b>6.30%</b>	<b>6.10%</b>	<b>6.00%</b>
Target Weight		60%	60%	60%	60%	60%	60%	60%	60%	60%
Tax Shield		5%	5%	5%	5%	5%	5%	5%	5%	5%
<b>WACC</b>		<b>9.24%</b>	<b>9.12%</b>	<b>9.01%</b>	<b>8.88%</b>	<b>8.75%</b>	<b>8.63%</b>	<b>8.50%</b>	<b>8.37%</b>	<b>7.01%</b>

\* Spot Rates of German Government Bonds with maturities 1 to 8 years. Terminal value: 20 years

Source: BankM Research

### Sensitivity Analysis of NPV Terminal Value

		Discount rate of Terminal Value						
		6.00%	6.50%	7.00%	7.01%	8.00%	8.50%	9.00%
Growth in Terminal Value	0.00%	2.09	1.96	1.84	1.84	1.65	1.57	1.50
	1.00%	2.47	2.27	2.11	2.11	1.85	1.75	1.66
	<b>2.00%</b>	<b>3.03</b>	<b>2.73</b>	<b>2.49</b>	<b>2.49</b>	<b>2.13</b>	<b>1.99</b>	<b>1.87</b>
	3.00%	3.97	3.45	3.06	3.05	2.51	2.31	2.15
	4.00%	5.85	4.74	4.01	4.00	3.08	2.78	2.53

		EBIT Margin in Terminal Value						
		37.0%	38.0%	39.0%	40.0%	41.0%	42.0%	43.0%
Growth in Terminal Value	0.00%	1.72	1.76	1.80	1.84	1.88	1.91	1.95
	1.00%	1.97	2.02	2.06	2.11	2.15	2.20	2.24
	<b>2.00%</b>	<b>2.32</b>	<b>2.38</b>	<b>2.43</b>	<b>2.49</b>	<b>2.54</b>	<b>2.59</b>	<b>2.65</b>
	3.00%	2.85	2.92	2.99	3.05	3.12	3.19	3.26
	4.00%	3.72	3.81	3.91	4.00	4.09	4.18	4.27

Source: BankM Research

## Tables

### Profit & Loss Account

Fiscal Year 31.12 (IFRS)	2014a	2015a	2016e	2017e	2018e	2019e	4y - CAGR 2015 - 2019
in € '000							
<b>Total Sales</b>	<b>10,335</b>	<b>18,322</b>	<b>19,700</b>	<b>28,220</b>	<b>36,700</b>	<b>24,620</b>	
<i>Growth rate in %</i>	-15.9	77.3	7.5	43.2	30.0	-32.9	6.1
Cost of sales	7,756	13,874	15,145	13,410	17,120	6,755	
<b>Gross Profit</b>	<b>2,579</b>	<b>4,448</b>	<b>4,555</b>	<b>14,810</b>	<b>19,580</b>	<b>17,865</b>	
<i>Growth rate in %</i>	-16.5	72.5	2.4	225.1	32.2	-8.8	32.1
Selling and marketing expenses	530	466	556	795	1,404	1,485	
General and administration expenses	5,160	5,250	4,782	4,806	4,974	5,215	
Other income	29,050	3,353	0	0	0	0	
Other expenses	80	661	0	0	0	0	
<b>EBIT</b>	<b>25,859</b>	<b>1,424</b>	<b>-783</b>	<b>9,209</b>	<b>13,201</b>	<b>11,165</b>	
<i>Growth rate in %</i>	n.a.	-94.5	-155.0	-1,276.1	43.4	-15.4	51.0
<b>Financing Result (+inc./-exp)</b>	<b>-2,716</b>	<b>-2,593</b>	<b>-4,264</b>	<b>-4,725</b>	<b>-4,588</b>	<b>-4,595</b>	
<i>Finance income</i>	45	13	36	35	42	45	
<i>Financing expenses</i>	2,761	2,606	4,300	4,760	4,630	4,640	
<b>EBT</b>	<b>23,143</b>	<b>-1,169</b>	<b>-5,047</b>	<b>4,484</b>	<b>8,613</b>	<b>6,570</b>	
<i>Growth rate in %</i>	n.a.	n.a.	n.a.	n.a.	92.1	-23.7	n.a.
Taxes on Income (Exp.+/Inc.-)	1,908	841	240	485	1,240	810	
<b>Net profit</b>	<b>21,235</b>	<b>-2,010</b>	<b>-5,287</b>	<b>3,999</b>	<b>7,373</b>	<b>5,760</b>	
<i>Growth rate in %</i>	n.a.	n.a.	n.a.	n.a.	84.4	-21.9	n.a.
<i>For information purposes</i>							
<i>Depreciation and amortization</i>	749	693	662	617	510	510	
<i>in % of total sales</i>	7.2	3.8	3.4	2.2	1.4	2.1	
<b>EBITDA</b>	<b>26,608</b>	<b>2,117</b>	<b>-121</b>	<b>9,826</b>	<b>13,712</b>	<b>11,675</b>	
No. of shares (Ø '000 outstanding)	54,107	54,204	54,204	54,204	54,204	54,204	
Net profit / share (EPS)	0.39	-0.04	-0.10	0.07	0.14	0.11	
Adj. net profit / share (adj. EPS)	0.39	-0.04	-0.10	0.07	0.14	0.11	

Source: Company (a), BankM Research (e)

### Margins

in %	2014a	2015a	2016e	2017e	2018e	2019e
Gross Profit Margin	25.0	24.3	23.1	52.5	53.4	72.6
EBITDA Margin	257.5	11.6	-0.6	34.8	37.4	47.4
EBIT Margin	250.2	7.8	-4.0	32.6	36.0	45.3
EBT Margin	223.9	-6.4	-25.6	15.9	23.5	26.7
Net Profit Margin	205.5	-11.0	-26.8	14.2	20.1	23.4

Source: Company (a), BankM Research (e)

### Balance Sheet Key Data

Fiscal Year 31.12 (IFRS)	2014a	2015a	2016e	2017e	2018e	2019e
in € '000						
Equity	85.788	83.432	78.145	82.144	89.518	95.278
Total Liabilities	39.243	46.891	61.156	85.820	89.050	107.800
thereof Current Liabilities	22.839	15.150	17.124	28.321	28.496	32.340
thereof Non-Current Liabilities	16.404	31.741	44.032	57.499	60.554	75.460
Investment Property	88.110	92.457	93.440	102.330	105.347	111.366
Balance Sheet Total	125.031	130.323	139.301	167.964	178.568	203.078
Equity ratio	68.6%	64.0%	56.1%	48.9%	50.1%	46.9%

Source: Company (a), BankM Research (e)

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Analysts	Date	Evaluation Result	Fair Value
Denis Kuhn, CCrA, Dr. Roger Becker, CEFA	November 24, 2014	Buy	€3.70
Stefan Scharff, CREA, Dr. Roger Becker, CEFA	April 23, 2015	Buy	€3.70
Stefan Scharff, CREA, Dr. Roger Becker, CEFA	October 22, 2015	Buy	€3.40
Stefan Scharff, CREA, Dr. Roger Becker, CEFA	June 10, 2016	Buy	€3.50

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

**October 19, 2016**

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

**Closing prices of October 18, 2016**

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