KRUK

Poland, Specialty Finance

Reuters: KRU.WA Bloomberg: KRU PW

9 April 2013

Aiming higher

Buy maintained, TP upped to PLN 72.3

Last week's exit of Enterprise Investors from Kruk, removed the long overdue stock overhang. Not only this should improve the liquidity in the stock but also allow the share price to start fully reflecting company's strong fundamentals. We up our target price (TP) to PLN 72.3 (PLN 58.6) owing to lowered RFR and higher comps. Yet, we trim 2013-14E earnings to reflect our more conservative assumptions on recoveries from the 2011 vintage, costs of entry into new markets and higher tax rate from 2014 on, among others. On our sub-consensus estimates, Kruk trades at less that 12x 2013E earnings, which put it at a discount to both international peers and Polish banks. Given the 17% upside potential we re-iterate our Buy rating.

Focus back on fundamentals. Last week, Enterprise Investors, a private equity fund which pre-IPO (April 2011) owned 81% of Kruk, sold its remaining 24.8% stake in the company. This removed the long overdue stock overhang and should allow investors to refocus on Kruk's strong fundamentals. The supply of banking NPLs should stabilise in both Poland and Romania while prices should moderate. Assuming a slight improvement of Kruk's market share in Poland (25% vs. 19% in 2012, consumer NPLs), intact at 38% in Romania and a positive contribution from stronger foothold in the Czech R./Slovakia, Kruk's outlays should increase to c. PLN 400m in 2013 from PLN 309m in 2012 and grow at c. 10% yoy thereafter. While IRRs on new portfolios are unlikely to be anywhere near to these prior to 2011 (36% vs. 55%, we assume), still cash generation should remain strong and cash EBITDA should be twice as high as the headline one, while operating c-f from purchased portfolios should expand further. As a result gearing ratios should start to moderate (net debt/equity of 1.1x at YE15 vs. 1.7x at YE12, net debt/cash EBITDA of 1.1x vs. 1.9x respectively) allowing dividend pay-out from 2015 on unless Kruk enters a new large market(s) meanwhile.

Trimming 2013-14 earnings. On the reported earnings front, things may not be that overwhelmingly positive though. The somewhat flattened recovery yield of the 2011 vintage (41% of the NPL stock at YE12) will likely dent 2013 top line while the relatively low 2012 NPL purchases (55% of 2011 outlays) will weigh on 2014 revenues. We also factor in entry costs into a new market(s) (Spain and/or Turkey) as hinted by the management during the 4Q12 results presentation and slightly higher costs related to the likely lower use of electronic court (e-Sad) and increasing number of agents in Poland. Finally, we cautiously plug in a higher 10% effective tax rate from 2014, assuming a taxation of dividends from Luxembourg subsidiaries. Lowered cost of funding (Kruk's bonds and loans are floaters) should be a positive breather, in contrast. All in all, we trim our 2013E EPS by 1% and cut 2014E by 13%. Following the alterations, we now expect a more moderate 2013-15E EBITDA and EPS CAGR compared to past growth rates, yet at 11% and 12%, we still consider these as attractive.

We up our price target (TP) to PLN 72.3 from PLN 58.6 despite negative revisions to estimates. This is because of the positive impact of comparable multiples component in our valuation model (Kruk's peers' enjoyed multiple expansion), lower RFRs in the DCF and finally a replacement of the mid-cycle method with residual income one. The latter, better captures Kruk's superior ROE, in our view.

We re-iterate our Buy rating given the 17% upside implied by our TP. Valuation (2013E P/E of 11.5x and EV/EBITDA of 10.8x) remains attractive given the forecast EPS and EBITDA growth of 11% and 12% (2013-15E CAGR). In relative terms, Kruk continues to trade at EV/EBITDA premium to international peers but remains at a discount in P/E terms. We also note that Kruk remains cheaper than Intrum Justitia, the only genuinely comparable foreign peer, at practically all metrics despite boasting higher ROE and offering EPS growth.

KRUK: Financial summary

In PLN millions, unless otherwise stated

	2011	2012	2013E	2014E	2015E
Revenues	274.0	343.0	397.6	460.7	532.9
EBITDA	101.4	144.0	153.4	172.2	196.7
EBIT	96.0	136.7	144.3	160.9	183.0
Net profit	66.2	81.0	91.3	97.6	113.4
EPS	4.01	4.79	5.40	5.77	6.71
P/E (x)	15.5	13.0	11.5	10.7	9.2
EV/EBITDA (x)	14.7	11.2	10.8	9.7	8.6

Source: Company data, DM BZ WBK estimates

Recommendation	BUY
Portfolio weighting	—

Price (PLN, 8 April 2012)	62.0
Target price (PLN, 12M)	72.3
Market cap. (PLN m)	1,053
Free float (%)	81.8
Number of shares (m)	16.9
Average daily turnover 3M (shares)	11.1k
EURPLN	4.14
USDPLN	3.18

The chart measures performance against the WIG index. On 8/04/2013, the WIG index closed at 44,591

Rec.	Date	Price on issue date	Price 12 month target	Performance absolute	Performance relative (p.p)
Buy	01/25/2013	49.75	58.6	24.6%	31.0%
Buy	10/12/2012	45.0	58.6	10.6%	2.3%
Buy	07/10/2012	46.03	58.6	-2.2%	-11.2%

Shareholders	% of votes
Piotr Krupa	15.7
Generali OFE	9.1
Aviva OFE	5.2
Management and employees	2.5

Company description

KRUK is a credit management services group operating in outsourced debt collection and debt purchases. It is a market leader in Poland and Romania and has recently entered into the Czech and Slovak markets. It employs over 1.4k staff and as at YE12 serviced over PLN 14bn worth of receivables.

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Throughout the report we use share prices as of April 8, 2013.

Valuation

We have raised our target price (TP) for Kruk to PLN 72.3 from PLN 58.6 and given the nearly 17% upside implied re-iterate our Buy rating on the stock. The increase in the TP stemmed largely from the higher fair value implied by the comparable multiples component (higher multiples of Kruk's peer) and a replacement of the mid-cycle method with residual income model. We continue to ascribe equal weights to all three methodologies.

Fig. 1. KRUK: changes to fair values (PLN/share)

Methodology	New	Old	Change
Comparable multiples	67.5	50.0	35%
Residual income	79.1	-	n/a
DCF	53.6	65.0	-18%
Blended fair value	66.7	53.8	24%
12-month price target	**72.3**	**58.6**	**23%**

Source: DM BZ WBK Research

Fig. 2. KRUK: fair values and price targets (PLN/share)

Methodology	Fair value	Weight
Comparable multiples	67.5	33%
Residual income	79.1	33%
DCF	53.6	33%
Blended fair value	66.7	
12-month target price	**72.3**	
Upside potential	**17%**	

Source: DM BZ WBK Research

Comparable multiples method

The comparable multiples method yielded higher fair value as all Kruk's peers have performed well recently taking the average sector's multiples up. This good share price performance helped to more than offset the negative impact on the P/E component from the cuts to our 2013-14E estimates for Kruk.

Fig. 3. Kruk: comparable multiples

		EV/EBITDA		P/E		P/BV		ROE	
	Mcap (EUR m)	2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Intrum Justitia AB	1,177	10.5	9.6	15.2	13.4	3.1	2.8	20.4	21.0
Portfolio Recovery Associates Inc	1,587	-	-	13.7	12.1	2.4	2.2	17.3	18.5
Encore Capital Group Inc	508	7.1	6.3	8.1	7.0	1.5	1.2	18.2	17.4
Credit Corp Group Ltd	330	9.4	8.4	13.9	12.7	3.0	3.3	21.8	26.1
Asset Acceptance Capital Corp	158	6.9	6.2	17.4	13.7	-	-	-	-
Median		**7.1**	**6.3**	**13.9**	**12.7**	**2.4**	**2.2**	**18.2**	**18.5**
Mcap weighted average		**9.3**	**8.4**	**13.6**	**11.9**	**2.5**	**2.4**	**18.9**	**19.9**
Kruk (at current price)*	**254**	**10.5**	**9.3**	**11.5**	**10.8**	**2.6**	**2.1**	**25.1**	**21.3**
premium/discount		13%	11%	-15%	-10%	2%	-13%	33%	7%
Implied Kruk's EV (PLNm)		**874**	**893**	**1,238**	**1,164**	**1,382**	**1,294**		
Weights		17%	17%	17%	17%	17%	17%		
Implied blended EV (PLN m)		**1,141**							
Implied EV per share (PLN)		**67.5**							

*Source: Bloomberg, DM BZ WBK Research, * Bloomberg convention used, hence multiples may differ from these of DM BZ WBK; P/B calculated from regression analysis of P/B vs. ROE*

Fig. 2. Kruk/Intrum Justitia – rel. performance vs. home indices
In %

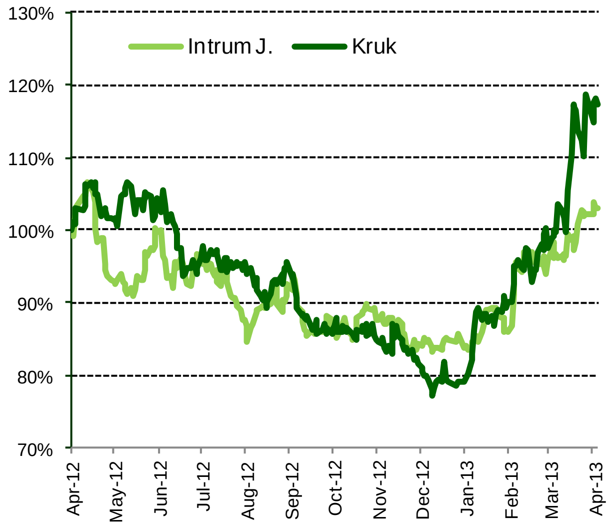
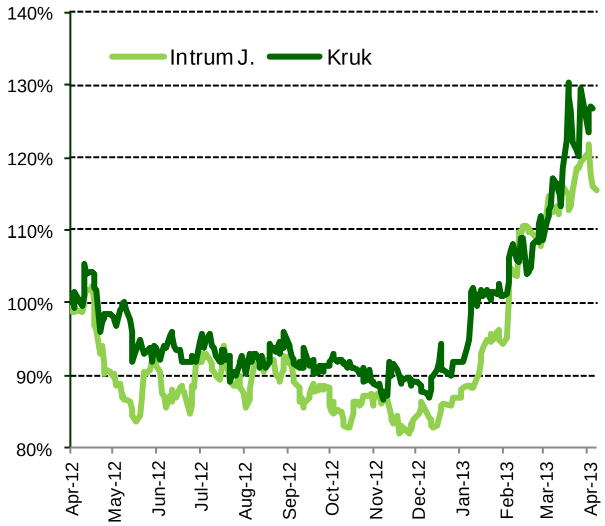


Fig. 3. Kruk/Intrum Justitia – performance since Sept'11
In % (PLN rebased)



Source: Bloomberg, DM BZ WBK Research

DCF method

The fair price implied by the DCF component is 18% lower compared to our previous report chiefly on altered assumptions on the change in the shape of recovery curve of 2011 and thereafter. This was partly offset by lower COE/WACC as RFRs dropped both in Poland and Romania.

Fig. 4. Kruk: DCF model

(PLN m)	2012	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E	2021E	2022E	TV
Revenues	343	398	461	533	621	750	852	945	1,024	1,082	1,114	1,147
yoy	*25%*	*16%*	*16%*	*16%*	*17%*	*21%*	*14%*	*11%*	*8%*	*6%*	*3%*	
EBIT	136.7	144.3	160.9	183.0	213.3	250.1	275.6	296.3	310.6	317.4	326.9	336.7
yoy	*42%*	*6%*	*11%*	*14%*	*17%*	*17%*	*10%*	*8%*	*5%*	*2%*	*3%*	
EBIT margin	40%	36%	35%	34%	34%	33%	32%	31%	30%	29%	29%	29%
Taxes on EBIT	-6.3	-6.6	-16.1	-18.3	-24.5	-32.5	-35.8	-38.5	-40.4	-41.3	-42.5	-43.8
NOPAT	130.4	137.7	144.8	164.7	188.7	217.6	239.8	257.8	270.3	276.1	284.4	292.9
Depreciation	7.3	9.1	11.3	13.7	16.4	19.4	23.0	26.9	31.3	31.3	31.3	32.3
Portfolio amortisation	147.3	229.4	308.5	371.0	387.0	402.9	411.8	432.3	461.2	493.5	523.1	538.8
Portfolio purchases	-309.0	-399.5	-440.0	-498.4	-519.7	-541.1	-553.1	-580.7	-619.5	-662.8	-702.6	-723.7
Capex	-9.7	-11.3	-13.1	-15.1	-17.6	-18.8	-21.3	-23.6	-26.3	-26.3	-26.3	-27.1
WC change	-28.0	14.9	8.4	8.6	1.2	15.0	6.3	5.5	6.9	6.9	6.9	6.9
FCF	**-61.7**	**-19.6**	**19.9**	**44.6**	**56.0**	**95.0**	**106.4**	**118.2**	**123.9**	**118.7**	**116.8**	**120.1**
Period		1	2	3	4	5	6	7	8	9	10	
Discount factor		0.92	0.85	0.78	0.72	0.67	0.62	0.57	0.52	0.48	0.45	
Discounted FCF		-18.1	16.9	34.9	40.5	63.4	65.5	67.1	64.8	57.3	52.0	
Sum of FCF	**444**											
Terminal value (TV)	2,211	-170.1	-131.5	-127.3	-132.8	-138.3	-141.3	-148.3	-158.3	-169.3	-179.5	
g (%)	3%											
PV of TV	**984**											
Total EV	1,428											
Net debt/cash (last reported)	554											
Minorities	0											
Equity value (Jan 1, 2013)	**875**											
Month	5											
Equity value (current)	**905**											
# of shares	16.9											
Value per share (PLN)	**53.6**											
12-month price target	**58.1**											

Source: DM BZ WBK Research

Fig. 5. Kruk: DCF model – sensitivity analysis of EV

		WACC				
		6.4%	7.4%	8.4%	9.4%	10.4%
g%	1.0%	968	700	504	356	240
	2.0%	1,301	921	661	471	327
	3.0%	1,827	1,243	**875**	622	438
	4.0%	2,786	1,751	1,185	828	584
	5.0%	5,084	2,677	1,676	1,127	782

		RFR				
		3.0%	3.5%	4.0%	4.5%	5.0%
Beta	0.8	1,098	1,050	1,005	962	922
	0.9	1,023	979	937	898	860
	1.0	954	913	**875**	838	803
	1.1	890	852	816	782	750
	1.2	830	795	762	730	700

Source: DM BZ WBK research

Fig. 6. Kruk: DCF model – sensitivity analysis of TV

		WACC				
		6.4%	7.4%	8.4%	9.4%	10.4%
g%	1.0%	1,032	793	626	503	411
	2.0%	1,357	1,008	776	613	493
	3.0%	1,876	1,323	**984**	758	599
	4.0%	2,828	1,825	1,288	959	739
	5.0%	5,118	2,744	1,773	1,252	933

Terminal value sensitivity

		RFR change				
		3.0%	3.5%	4.0%	4.5%	5.0%
Beta	0.8	1,189	1,145	1,103	1,064	1,027
	0.9	1,119	1,079	1,041	1,005	971
	1.0	1,056	1,019	**984**	951	919
	1.1	998	964	931	901	871
	1.2	944	913	883	854	827

Source: DM BZ WBK research

Residual income method

Finally, we introduce a new methodology – the residual income method. It is conceptually close to the discounted cash flow method (DCF) for non-financial stocks, the difference being that it is based on expected residual income (returns over COE) rather than expected future cash flows. The fair value is the sum of the last reported BVPS and the present value of residual income in three stages – a three-year initial stage (based on our explicit forecasts), a seven-year convergence period, for which we use our summary forecasts, and the perpetuity period (we use a perpetuity formula here).

Fig. 7. Kruk: Residual income model

	2013E	2014E	2015E		
Net profit	91	98	113		
Equity (YE)	409	506	590		
ROE	25%	21%	21%		
COE	10%	10%	10%		
Excess return	16%	12%	11%		
Residual income	56	54	61		
PV of residual income (2013-15E)	143				
	Growth (CAGR)	**ROE (avg.)**	**Pay-out (avg.)**	**Total value**	**PV**
Transition period (2016-2022E)	9%	19%	60%	553	291
Perpetuity	3%	18%	83%	1,332	534
Total intrinsic value	968				
# of shares (m)	16.9				
Value per share	57.2				
Last reported BVPS	18.8				
Fair value (Jan'13)	76.0				
Month	5				
Fair value (current)	**79.1**				
12-month target price	**85.7**				
Upside potential	38%				

Source: DM BZ WBK Research

Fig. 8. Kruk: Residual income model – sensitivity analysis

		ROE				
		21%	23%	25%	27%	29%
COE	6%	99.8	100.2	100.6	101.0	101.4
	8%	88.0	88.4	88.8	89.3	89.7
	10%	78.2	78.6	79.1	79.5	79.9
	12%	70.0	70.4	70.8	71.2	71.6
	14%	63.1	63.5	63.9	64.3	64.7

Source: DM BZ WBK Research

Key issues

Supply of NPLs stabilising, prices moderate

Following the strong growth supply of banking consumer NPLs in 2011 (nominal), 2012 brought a stabilisation in both Poland and Romania. Falling purchase prices have however reduced the value of outlays at both markets. In the mid-term, we expect the growth in supply to remain in 8-12% range in Poland and no growth whatsoever in Romania. The stock of consumer NPL is substantial in both countries and we expect that banks will continue to regularly dispose of their bad debts. Earnings pressure on the banking sector this year, should be among decisive factors, behind the expected supply growth in Poland.

Fig. 9. Poland – consumer NPL ratio and stock

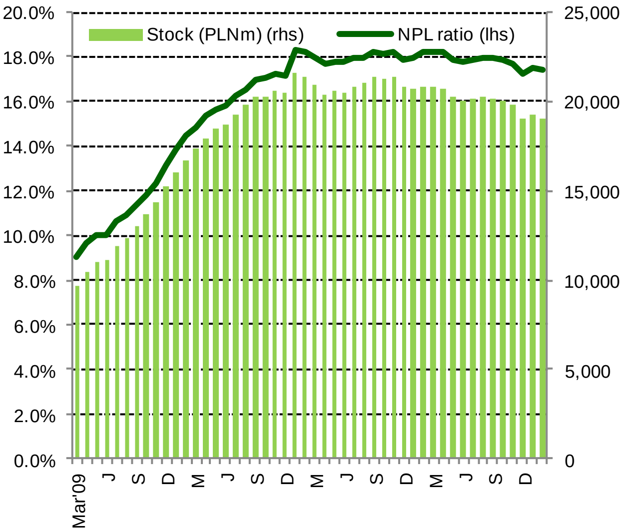
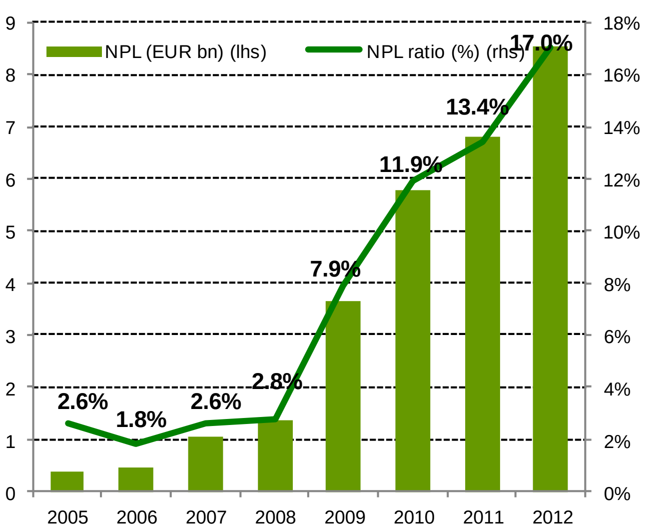


Fig. 10. Romania – total NPL ratio and stock



Source: Bloomberg, DM BZ WBK Research

Purchase prices should however trend down in both markets (13% of nominal value in Poland in 2013 and 12% in 2014 from nearly 14% in 2011 and 6.0% from 6.1% in Romania) reflecting lower competitive pressure and the much increased leverage of most of Kruk's local competitors. The combination of moderating prices and stable to slightly growing nominal supply should ultimately translate into 0-19% growth in total outlays of NPLs in Poland in 2013-15. 2016 should bring particularly strong growth in supply owing to accelerated consumer loan generation in late 2013 and 2014 overall. We assume Kruk's market share to increase to 25% in each forecast year, hence despite the relatively slow growth in supply, its outlays on portfolios should accelerate substantially (PLN260m in 2013 and PLN 269m after PLN 201m spent in 2012). In Romania, the respective growth ratios should remain broadly close to zero, while Kruk's market share should stay broadly unchanged at 38%. This should keep the outlays at relatively unchanged level of PLN 57m. Similarly, in the Czech Republic/Slovakia, we expect a flat market, but the assumed increase in Kruk's market share should allow outlays to nearly double in 2013 compared to 2011/12 levels. Finally, we expect an increased supply of corporate NPLs. Last year, portfolios of a nominal value of PLN 2bn were sold In Poland for the price of c. 5.5% on company's estimates. On top of large/mid cap NPLs typically disposed of by banks, a supply of microcompanies/SME's bad debts should also be expected. We therefore assume an increasing share of corporate NPLs which we model in at c. 10-11% of Kruk's outlays on NPLs vs. 7-8% in the last two years.

Fig. 11. NPLs purchased – main assumptions

(PLNm)	2009	2010	2011	2012	2013E	2014E	2015E
Poland							
Consumer NPLs (PLN m)	15,284	20,437	20,792	19,082	19,000	18,500	18,000
Consumer NPL ratio	13%	17%	18%	17%	18%	17%	16%
Consumer NPLs sold (PLN m)	2,650	3,463	6,900	7,400	7,992	8,951	9,846
% of NPLs	17%	19%	33%	37%	42%	48%	54%
Price paid (% nominal)	11.0%	12.3%	16.9%	14.0%	13.0%	12.0%	13.0%
Kruk's market share	8.3%	19.9%	31.3%	19.4%	25.0%	25.0%	25.0%
Portfolios purchased (PLN m)	24	85	365	201	260	269	320
Corporate NPLs (PLN m)	22,264	23,646	23,724	27,651	33,900	34,171	34,982
Corporate NPL ratio	12%	12%	10%	12%	13%	12%	12%
Corporate NPLs sold (PLN m)	2,081	1,072	1,200	2,000	2,600	3,640	4,186
% of NPLs	5%	5%	10%	8%	5%	5%	5%
Price paid (% nominal)	1.3%	3.0%	4.2%	5.5%	5.5%	5.5%	5.5%
Kruk's market share	37.2%	1.1%	20.0%	21.0%	22.0%	23.0%	23.0%
Portfolios purchased in PL (PLN m)	10	0	10	23	31	46	53
Total portfolios purchases in Poland	34	85	375	224	291	315	373
Romania							
Consumer NPLs (RON m)	8,000	10,355	10,498	9,897	9,582	9,286	9,843
Consumer NPL ratio	10.5%	14.2%	14.0%	13.0%	11.0%	10.0%	9.0%
Portfolios sold (PLN m)	1,301	2,079	2,550	2,500	2,500	2,500	2,500
% of NPLs	17%	22%	25%	25%	24%	23%	22%
Price paid (% nominal)	5.5%	8.0%	7.8%	6.1%	6.0%	6.0%	6.0%
Kruk's market share	27.2%	65.8%	78.6%	38.0%	38.0%	38.0%	38.0%
Portfolios purchased in RO (PLN m)	19	109	156	58	57	57	57
Czech R.							
Consumer NPLs (CZKm)	901,865	974,828	1,040,953	1,073,543	1,143,543	1,193,543	1,223,543
Consumer NPL ratio	4.3%	5.5%	5.2%	5.5%	5.6%	5.7%	5.5%
Portfolios sold (PLN m)	-	-	-	1,800	1,800	1,800	1,800
Price paid (% nominal)	-	-	-	19%	19%	19%	19%
Kruk's market share				8%	15%	20%	20%
Portfolios purchased in Czech R./Slovakia (PLNm)					38	27	51
Debt portfolios purchased (PLN m)							
O.B.	156	150	263	719	874	1,044	1,175
Portfolio purchases	54	193	569	309	400	440	498
C.B.	**150**	**263**	**719**	**874**	**1,044**	**1,175**	**1,302**

Source: Kruk, KNF, NBP, RNB, CNB, DM BZ WBK research

Higher tax likely from 2014 on

Polish Ministry of Finance intends to change regulations allowing tax effective schemes based on favourable taxation of dividends from Luxembourg subsidiaries. Respective works have started in 2012 (relevant draft of changes in the tax code was approved by the lower house of the Parliament in autumn in 2012) and although mothballed due to late timing is likely to be resumed this year. Our conversations with the company concluded that despite the likely changes to the Polish tax code from 2014 on, the effective tax rate is unlikely to come close to nominal rates of 19% in Poland (16% in Romania, 21% in the Czech Republic/Slovakia). In our model, we assume a hike to 10% in 2014 and thereafter from less than 5% in 2012 and 2013.

Electronic court (e-Sad)

In late March, the Polish parliament adopted changes to regulations on the electronic court (*e-Sad*) and its electronic, simplified procedure (*PL: postepowanie upominawcze)* (EPU) limiting its scope to cases not overdue more than three years. EPU which had been introduced in 2010, facilitated the mass filing of claims to court, dramatically reducing the time required for the issuance of a warrant of execution (*PL: nakaz*) and enforceability clause (*PL: klauzula wykonalnosci*), and has allowed for the considerable reduction of the cost of legal actions against debtors. In 2010 alone, nearly 56k cases were filed with the e-court, in 2011 the number increased to nearly 700k cases, while in 2012 to c. 2.7m.

Fig. 12. Kruk – time saved owing to EPU

Court proceedings	Time before filing in court	Court order	Enforceability clause
Standard	40 days	46 days	65 days
EPU	14 days	24 days	65 days
Difference	26 days	22 days	0 days

Source: Company data

Although Kruk's business is predominantly based on amicable proceeding (c. 2/3 of cases), still approximately 1/3 of cases are settled through a court proceeding. Hence, given that typically majority NPLs purchased are close to the three-year overdue limits, the scope for using the much faster (and cheaper) electronic court would be limited. In 4Q12 and 1Q13, the company much accelerated the filling to court in order to log as many cases as possible ahead of the expected change in the regulations. Additionally, in order to increase the share of amicable proceeding and secure the early tranches of repayments, Kruk decided to increase the number of its in-field employees.

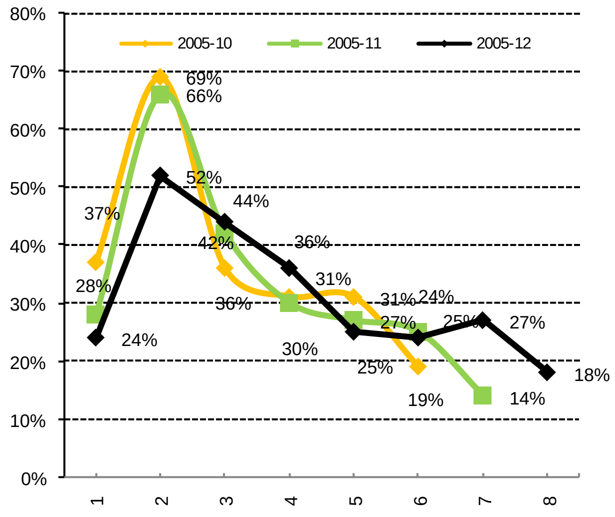
Entry into new markets

Following the successful entry to Czech R./Slovakia in late in 2011 and scrapped plans to enter the Hungarian markets, currently the company considers an expansion into new markets. During the recent results conference, the management hinted at Spain, Turkey and Russia as currently researched markets. The former appears to be the mostly likely country in which Kruk may set its foot in 2013 given the cultural similarities and similar regulatory framework. Initially, the company would like to start from learning the business via setting up (or acquiring) a debt service business, but ultimately it would like to engage into debt purchases. Given the long-term nature of the entry into such large market(s) and geographical distance, we plug in few PLNm start-up costs into our 2013-14 debt purchase division cost assumptions, while not yet reflecting any potential contribution of the undertaking(s).

Flattening yield curves, but improvement in vintages post 2011

The shape of cash recovery yield continues to change with cash recoveries shifting back, falling IRRs but broadly stable or even improving total returns on the purchased portfolios. This is due to increasing share of voluntary arrangements with debtors (and hence longer cash collection periods) and to some extent different characteristics of the recently acquired NPL portfolios as well as higher prices paid. Total returns however remain well above the 200% mark. 2011 vintage appears to be an exception given the high prices bad and relatively poor quality characteristics. Given its relatively high share in the total stock of acquired NPLs (41%) it will augment the overall recovery yield, however. For this reason, we opted to model cash recoveries separately for this vintage (for details please refer to next section).

Fig. 13. Kruk – recovery curves



Year>	1	2	3	4	5	6	7	8	9	Total return
2005-10	37%	69%	36%	31%	31%	19%				223%
2005-11	28%	66%	42%	30%	27%	25%	14%			232%
2005-12	24%	52%	44%	36%	25%	24%	27%	18%		250%

Source: Company data, DM BZ WBK Research

Also the relatively late purchases in both 2011 and 2012 have impacted the recoveries in the first two years of the collection. The cash recovered from the 2011 in the first year stood at 20% and 63% in year, adding to 83% of the nominal value recovered in the first two years. This compares against 37%, 69% and 106% for earlier vintages. The 2012 vintage looks even more challenging in terms of recoveries as in the first two years a mere 83% of initial outlays has been recovered.

Fig. 14. Kruk – vintages of NPL portfolios and recent acquisitions weighted by time of purchase

	Size (PLNm)	Share in total
2003	1	0%
2004	12	1%
2005	34	2%
2006	35	3%
2007	82	6%
2008	104	7%
2009	54	4%
2010	193	14%
2011	564	41%
2012	309	22%
TOTAL	1,387	

	2005-10 vintages	2011 vintage	2012 vintage
Y1	37%	20%	10%
Y2	69%	63%	n/a
Y1 + Y2	106%	83%	

PLNm	2010	2011	2012
Outlays	194	569	309
Weighted outlays	51	212	82
%	26%	37%	27%

Source: Company data, DM BZ WBK Research

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Changes to estimates

Following 4Q12 results, we have revisited our NPL market and earnings assumptions for Kruk and as a result trimmed our revenues and earnings estimates for the company in 2013-14 period.

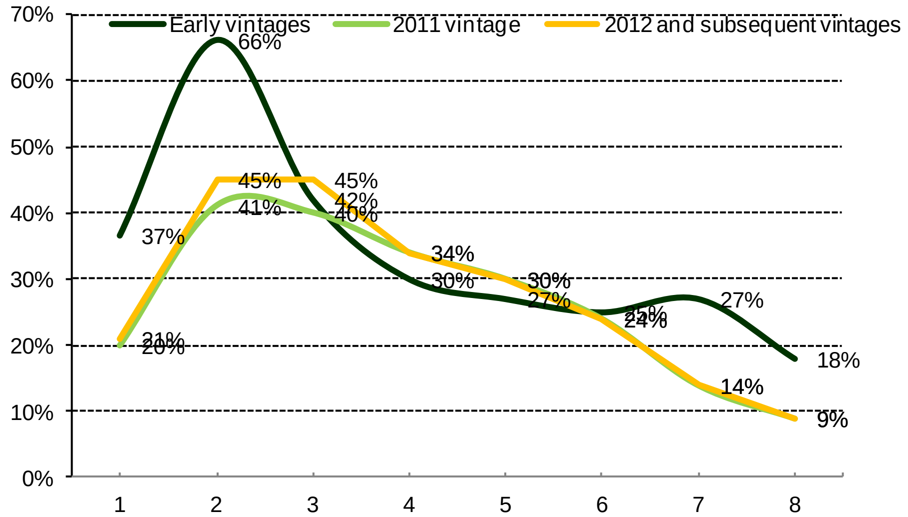
Fig. 15. Kruk: Changes to estimates (PLNm)

	2013E			2014E		
	New	**Old**	**Difference**	**New**	**Old**	**Difference**
Revenues	398	450	-12%	461	493	-6%
Opex	-253	-289	-12%	-300	-315	-5%
EBITDA	153	169	-9%	172	187	-8%
EBIT	144	160	-10%	161	176	-9%
Net financials	-49	-64	-24%	-52	-60	-13%
Net profit	91	92	-1%	98	112	-13%

Source: DM BZ WBK Research

The 2013 estimates borne the brunt of the cuts in revenues owing to the aforementioned relatively late NPL purchases in 2011 and 2012 as well as the somewhat different characteristics of the 2011 vintage. The reduced revenue expectations therefore relate to the purchased debt segment as the flattened recovery yield has negative implications for the P&L recognised revenues.

Fig. 16. Kruk: Changes to estimates (PLNm



Source: DM BZ WBK

In our assumptions we also factored in start- up costs (entry into new markets in 2013-14) as well as relatively higher opex in the debt management segment due to the constraints in the use of the electronic court and the higher number of employees a field. Additionally, due to the correlation of segment's direct cost with the level of cash recoveries (steeply up we expect), the reported gross margin should decline over time to 52% in 2015 from the nearly 60% in 2012. Increasing economies of scale and the expected greater focus on cost should however allow maintenance of the robust margins (gross margin of 51-53% vs. 57% in 2012, EBIT margin of 34%-36% vs. 40%) and thus preserve the positive operating leverage that the company enjoys. On our estimates the expected 5% 2013-15E CAGR in revenues should be accompanied by the nearly 12% average annual growth in profits, 11% in EBITDA and 12% of earnings.

Fig. 17. Kruk – revenues by segment (PLNm)

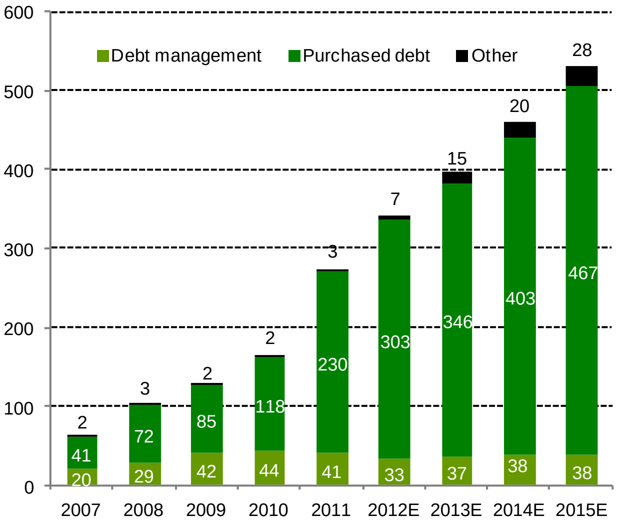
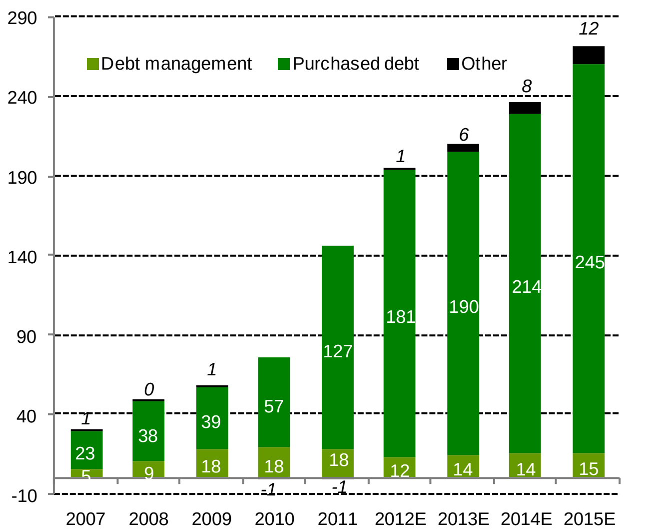


Fig. 18. Kruk – gross profit by segment (PLNm)



Source: Bloomberg, DM BZ WBK Research

Fig. 6. Kruk – debt management segment (PLNm)

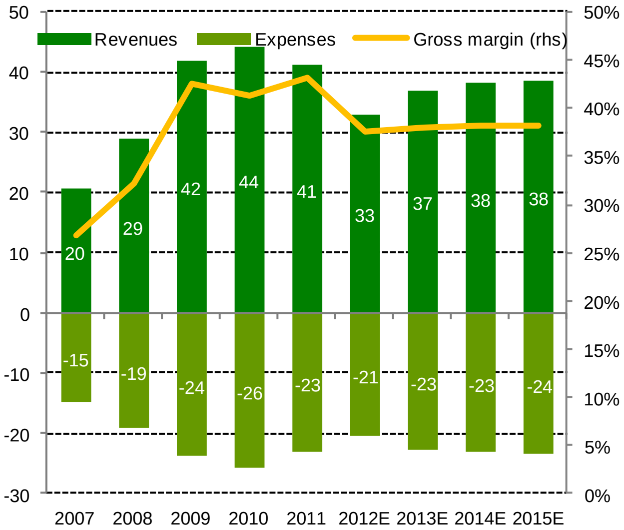
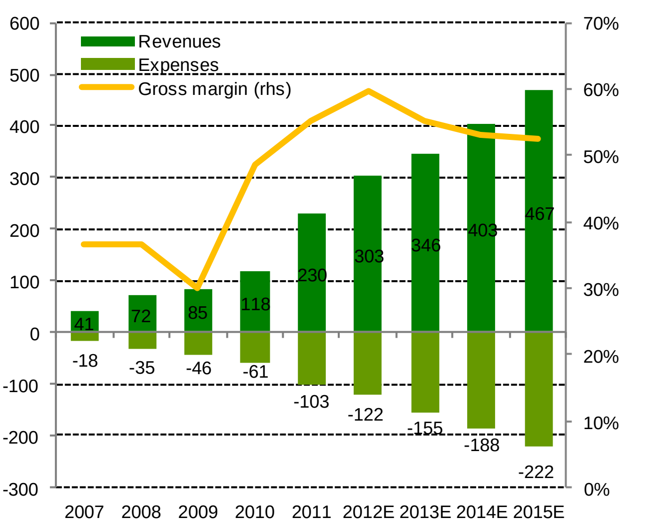


Fig. 6. Kruk – purchased debt segment (PLNm)



Source: Bloomberg, DM BZ WBK Research

Despite the expected flatter curve, cash generation in the early stage of NPLs recovery should be strong owing to high outlays in the past two years. Combined with lower assumptions on NPL purchases going forward this allowed us to trim our estimates on the external funding. On our new estimates, the gearing ratios should continue to trend down with net debt reaching 1.1x at YE15 vs. 1.7x at YE12 and net debt/EBITDA 3.3x vs. 3.8x respectively.

Fig. 6. Kruk – portfolio purchases and gross debt (PLNm)

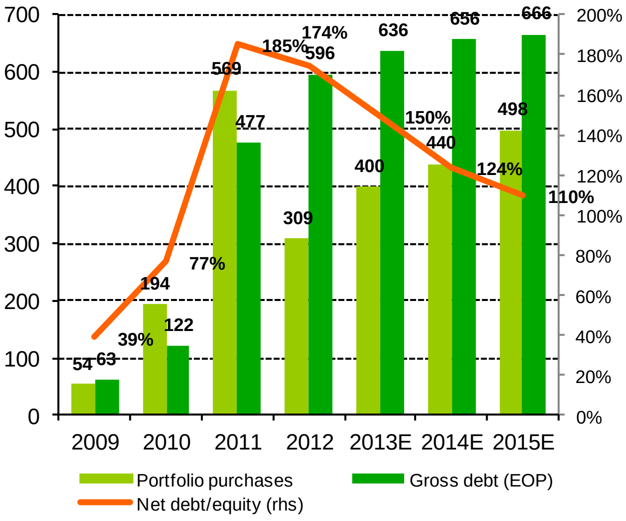
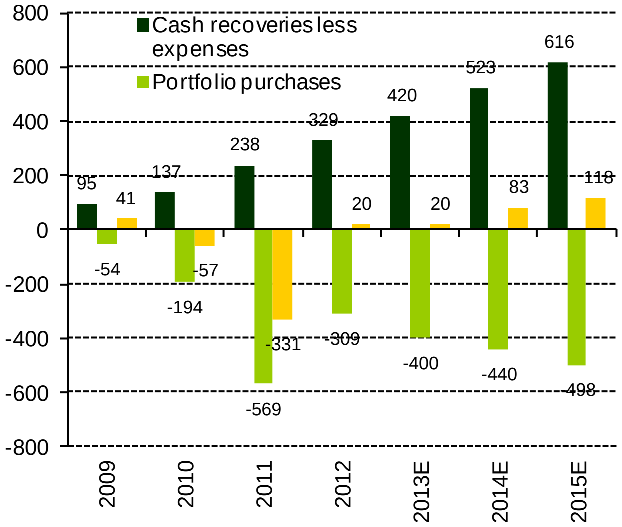


Fig. 6. Kruk – cash flows in purchased debt segment (PLNm)



Source: Kruk, DM BZ WBK Research

As for our expectations for the debt management segment we marginally upped our revenue assumptions, but now expect a generally flat performance of the segment for an extended period of time due to flat volumes of NPLs to be handed for services by banks and B2C companies and expectations on a continued strong competition in the sector which is unlikely to allow for neither major increase of Kruk's market share nor for a major improvement of segment's profitability. Cost control remains tight however allowing superior gross margin of c. 38% throughout the forecast period.

Quarterly results in a rear view

Fig. 17. Kruk – quarterly results in brief

PLNm	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12	*yoy*	4Q12E
NPL portfolios										
Cash collected	66.2	77.6	90.4	106.9	108.1	107.8	116.0	118.3		125.0
Portfolios acquired	-67.1	-248.0	-110.5	-143.3	-12.3	-83.9	-92.8	-119.0		-120.0
Portfolios owned (EOP)	307.0	533.9	607.9	718.7	692.8	739.9	785.4	873.5		0.0
Revenues	53.2	70.7	66.8	83.4	79.9	79.4	85.8	97.9	*17%*	91.5
o/w debt management	9.7	10.4	10.7	10.2	8.6	7.3	7.6	9.3	*-9%*	7.2
o/w portfolios acquired	42.9	59.5	54.8	73.2	69.8	70.6	76.5	86.2	*18%*	82.4
o/w other	0.6	0.8	1.3	0.0	1.5	1.5	1.7	2.4	*34386%*	1.9
Direct and indirect expenses	-25.3	-27.7	-31.7	-45.6	-37.5	-33.3	-35.4	-42.7	*-6%*	-38.0
o/w debt management	-6.2	-6.2	-5.7	-5.1	-5.5	-5.1	-4.9	-5.0	*-3%*	-4.5
o/w portfolios acquired	-18.4	-20.7	-24.8	-39.2	-30.5	-26.6	-29.2	-35.9	*-9%*	-32.0
Gross profit	27.8	43.0	35.1	37.8	42.5	46.1	50.3	55.2	*46%*	53.5
gross profit margin	*52.3%*	*60.8%*	*52.5%*	*45.3%*	*53.1%*	*58.1%*	*58.7%*	*56.4%*	*24%*	*58.5%*
o/w debt management	3.5	4.2	4.9	5.1	3.1	2.3	2.7	4.3	*-15%*	2.7
gross profit margin	*36%*	*40%*	*46%*	*50%*	*36%*	*31%*	*35%*	*47%*	*-6%*	*38%*
o/w portfolios acquired	24.5	38.8	29.9	34.0	39.3	44.0	47.3	50.3	48%	50.4
gross profit margin	*57.1%*	*65.2%*	*54.7%*	*46.4%*	*56.3%*	*62.3%*	*61.8%*	*58.3%*	*25.7%*	*61.1%*
SG&A	*-8.2*	*-10.7*	*-10.0*	*-12.0*	*-12.7*	*-12.3*	*-12.2*	*-13.0*	*23%*	*-14.0*
EBITDA	**19.3**	**31.9**	**25.1**	**25.1**	**30.1**	**33.5**	**38.0**	**42.5**	*69%*	**39.3**
EBITDA margin	*36%*	*45%*	*38%*	*30%*	*38%*	*42.1%*	*44.2%*	*43.4%*	*18%*	*43.0%*
Cash EBITDA	**42.7**	**50.0**	**60.7**	**58.9**	**68.5**	**70.7**	**77.5**	**74.6**	*27%*	**82.0**
EBIT	**18.1**	**30.6**	**23.6**	**23.7**	**28.6**	**31.9**	**36.3**	**40.0**	68%	**37.5**
EBIT margin	*34%*	*43%*	*35%*	*28%*	*36%*	*40%*	*42%*	*41%*	*43%*	*41%*
Net financials	-3.9	-5.5	-9.6	-8.5	-12.8	-12.4	-13.1	-13.2	*56%*	-11.7
Pre-tax profit	*14.2*	*25.1*	*13.9*	*15.3*	*15.7*	*19.5*	*23.1*	*26.7*	*75%*	*25.8*
Tax	-0.1	0.0	-0.9	-1.1	-1.7	-1.2	-1.3	0.4	*-135%*	-1.5
Tax rate	*-1%*	*0%*	*-6%*	*-7%*	*-11%*	*-6%*	*-6%*	*1%*	*-120%*	*-6%*
Net profit	**14.1**	**25.0**	**13.0**	**14.1**	**14.0**	**18.2**	**21.8**	**27.0**	*92%*	**24.3**
EPS (PLN)	0.9	1.6	0.8	0.8	0.8	1.1	1.3	1.6	*92%*	0.0
Net debt	134.9	277.8	354.4	436.8	405.2	440.7	473.1	549.7		
Net debt/EBITDA* (x)	1.0	1.7	1.9	2.1	1.7	1.7	1.7	1.9		
Net debt/equity (x)	0.9	1.3	1.6	1.8	1.6	1.6	1.6	1.7		
ROE**	40%	56%	24%	24%	23%	28%	31%	36%		

Source: Kruk, DM BZ WBK Research

Fig. 18. Kruk – operating drivers at a glance

PLNm	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
Portfolios owned (EOP)	307.0	533.9	607.9	718.7	692.8	739.9	785.4	873.5
o/w banking NPLs	263.5	479.0	535.2	655.2	627.1	674.2	712.8	810.8
- consumer loans	260.1	476.1	532.6	653.0	625.1	674.2	711.0	809.6
- car loans	2.3	2.1	2.0	1.8	1.7	1.5	1.4	0.9
- mortgage loans	1.0	0.8	0.4	0.3	0.4	0.4	0.4	0.3
o/w telecom NPLs	25.9	52.9	57.7	54.5	49.3	46.1	47.1	43.6
o/w other	17.6	2.0	15.1	9.0	16.4	19.6	25.5	19.1
Debt management								
Nominal value ptflios. processed	726	1,258	1,267	1,051	816	914	800	760
Fee (%)	1.33%	0.83%	0.84%	0.97%	1.06%	0.80%	0.95%	1.23%

Source: Kruk, DM BZ WBK Research

Fig. 19. Kruk – quarterly results by geography

	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	*4Q12*	*yoy*
Poland									
Revenues	32.3	47.1	33.0	57.6	56.8	55.8	60.1	*67.5*	*17%*
Direct and indirect expenses	-20.9	-23.0	-25.5	-37.4	-31.0	-26.3	-27.6	*-30.6*	*-18%*
Gross profit	11.3	24.0	7.6	20.3	25.8	29.5	32.4	*36.9*	*82%*
Gross profit margin	*35%*	*51%*	*23%*	*35%*	*45%*	*53%*	*54%*	*55%*	*56%*
Foreign mkts									
Revenues	20.9	23.6	33.7	25.8	23.1	23.7	25.7	*30.4*	*18%*
Direct and indirect expenses	-4.4	-4.7	-6.2	-8.2	-6.4	-7.0	-7.8	*-12.1*	*47%*
Gross profit	16.5	18.9	27.5	17.5	16.7	16.6	17.9	*18.3*	*4%*
Gross profit margin	*79%*	*80%*	*81%*	*68%*	*72%*	*70%*	*70%*	*60%*	*-12%*

Source: Kruk, DM BZ WBK Research

Financial statements and forecasts

INCOME STATEMENT

(PLN m)	2007	2008	2009	2010	2011	2012	2013E	2014E	2015E
Debt management	20	29	42	44	41	33	37	38	38
Debt purchased	41	72	85	118	230	303	346	403	467
Other	2	3	2	2	3	7	15	20	28
Total revenues	**64**	**104**	**129**	**164**	**274**	**343**	**398**	**461**	**533**
Direct and indirect expenses									
o/w debt management	-15	-19	-24	-26	-23	-21	-23	-23	-24
o/w debt purchased	-18	-35	-46	-61	-103	-122	-155	-188	-222
o/w other	-1	-2	-2	-3	-4	-6	-9	-12	-16
Total direct and indirect expenses	**-34**	**-56**	**-72**	**-90**	**-130**	**-149**	**-188**	**-224**	**-262**
Gross profit from debt management	5	9	18	18	18	12	14	14	15
Gross profit from debt purchased	23	38	39	57	127	181	190	214	245
Gross profit from other	1	0	1	-1	-1	1	6	8	12
Gross profit	**29**	**48**	**57**	**75**	**144**	**194**	**210**	**236**	**271**
SG&A	-15	-19	-21	-28	-41	-50	-57	-64	-75
Depreciation	-3	-3	-3	-4	-5	-7	-9	-11	-14
Total opex	**-52**	**-78**	**-96**	**-122**	**-177**	**-206**	**-253**	**-300**	**-350**
Net other income/expenses	0	-1	-1	0	-1	0	0	0	0
EBITDA	**14**	**27**	**35**	**47**	**101**	**144**	**153**	**172**	**197**
EBIT	**11**	**25**	**32**	**43**	**96**	**137**	**144**	**161**	**183**
Net financial cost/income	-2	-8	-4	-7	-27	-52	-49	-52	-57
Profit before taxes	9	16	27	36	69	85	96	109	126
Income tax	0	0	-4	1	-2	-4	-4	-11	-13
Net profit	**9**	**16**	**23**	**36**	**66**	**81**	**91**	**98**	**113**

Source: Kruk, DM BZ WBK Research

GROWTH RATES

YoY (%)	**2007**	**2008**	**2009**	**2010**	**2011**	**2012E**	**2013E**	**2014E**	**2015E**
Total revenues		63%	24%	28%	67%	25%	16%	16%	16%
Total direct and indirect expenses		65%	27%	25%	46%	14%	26%	20%	17%
Gross profit		62%	20%	31%	92%	35%	8%	13%	15%
SG&A		27%	12%	31%	46%	23%	13%	13%	16%
Total opex		50%	23%	26%	45%	17%	23%	18%	17%
EBITDA		96%	27%	34%	118%	42%	7%	12%	14%
EBIT		122%	28%	34%	125%	42%	6%	11%	14%
Net financial cost/income		263%	-48%	60%	290%	88%	-6%	8%	9%
Net profit		89%	42%	54%	84%	22%	13%	7%	16%

Source: Kruk, DM BZ WBK Research

BALANCE SHEET

(PLN m)	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E
Shareholders equity	49	76	100	132	238	317	409	506	590
Net (debt)/cash	-65	-82	-39	-101	-441	-554	-610	-626	-649
Gross debt	76	107	63	122	477	596	636	656	666
Capital Employed	**114**	**158**	**139**	**233**	**679**	**871**	**1,019**	**1,133**	**1,239**
Non-current assets	**18**	**21**	**15**	**19**	**24**	**27**	**31**	**34**	**37**
Inventories	0	1	1	0	1	1	1	1	1
Receivables	7	8	10	11	13	12	16	17	20
Payables	-4	-19	-27	-49	-67	-39	-57	-67	-78
Short-term investments	93	152	155	264	722	880	1,044	1,175	1,302
Other current assets/(liabilities)	1	-4	-15	-12	-13	-11	-14	-27	-37
Working Capital	**97**	**137**	**124**	**215**	**655**	**844**	**989**	**1,099**	**1,208**
Total assets	**134**	**212**	**208**	**318**	**800**	**971**	**1,126**	**1,267**	**1,389**

Source: Kruk, DM BZ WBK Research

CASH FLOW

(PLN m)	2007	2008	2009	2010	2011	2012	2013E	2014E	2015E
Debt purchased - cash recoveries	61	117	141	198	341	451	575	711	838
Debt purchased - cash cost	-18	-35	-46	-60	-103	-122	-155	-188	-222
Debt management - net cash	5	9	18	18	18	12	14	14	15
Other	-16	-27	-28	-30	-68	-97	-95	-108	-119
Change in Working Capital	-1	8	7	3	15	-28	15	8	9
Net Cash from Operations	**31**	**72**	**92**	**129**	**203**	**216**	**354**	**437**	**521**
Capex and Acquistions	-12	-7	-4	-7	-10	-10	-11	-13	-15
Portfolios purchases - cash cost	-82	-104	-54	-194	-569	-309	-400	-440	-498
Free Cash Flow	**-63**	**-38**	**34**	**-72**	**-376**	**-103**	**-57**	**-16**	**7**
Change in debt	53	29	-45	57	355	119	40	20	10
Share issuance	0	11	0	0	41	0	0	0	0
Dividends paid	0	0	0	0	0	0	0	0	-29

Source: Kruk, DM BZ WBK Research

KEY RATIOS

	2007	2008	2009	2010	2011	2012E	2013E	2014E	2015E
Gross profit margin	46%	46%	44%	45%	52%	57%	53%	51%	51%
o/w debt management	27%	32%	42%	41%	43%	38%	38%	38%	38%
o/w debt purchased	57%	52%	46%	48%	55%	60%	55%	53%	52%
o/w other	32%	16%	27%	-33%	-46%	13%	38%	39%	42%
EBITDA margin	22%	26%	27%	28%	37%	42%	39%	37%	37%
EBIT margin	18%	24%	25%	26%	35%	40%	36%	35%	34%
Net margin	14%	16%	18%	22%	24%	24%	23%	21%	21%
Effective tax rate	1%	-3%	14%	-1%	3%	5%	5%	10%	10%
Dividend payout	0%	0%	0%	0%	0%	0%	0%	30%	40%
ROE	20%	26%	27%	31%	36%	29%	25%	21%	21%
NOPAT/Capital employed (ROCE)	9.7%	16.0%	22.8%	18.5%	14.1%	15.7%	14.2%	14.2%	14.8%
Net debt/Equity	-132%	-107%	-39%	-77%	-185%	-174%	-149%	-124%	-110%
Net debt/EBITDA	-4.7	-3.0	-1.1	-2.2	-4.3	-3.8	-4.0	-3.6	-3.3

VALUATION MULTIPLES

EPS	0.6	1.1	1.5	2.3	4.0	4.8	5.4	5.8	6.7
Fully diluted EPS	0.6	1.1	1.5	2.3	4.0	4.7	5.2	5.5	6.4
BVPS	3.4	4.8	6.3	8.6	14.1	18.8	24.2	29.9	34.9
Fully diluted BVPS	3.4	4.8	6.3	8.6	13.9	18.2	23.1	28.7	33.4
DPS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.7
FCFS	-4.3	-2.6	2.1	-4.7	-22.8	-6.1	-3.4	-0.9	0.4
P/E (x)	103.2	56.5	41.8	26.5	15.4	12.9	11.5	10.7	9.2
FCF yield	-7%	-4%	3%	-8%	-37%	-10%	-5%	-2%	1%
P/Book (x)	18.2	12.8	9.8	7.2	4.4	3.3	2.6	2.1	1.8
EV/EBITDA (x)	79.6	41.3	31.2	24.7	14.7	11.1	10.8	9.7	8.6
EV/Sales (x)	17.5	10.9	8.5	7.0	5.4	4.7	4.2	3.6	3.2
Div. yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	2.8%
Net debt/EBITDA (x)	-4.7	-3.0	-1.1	-2.2	-4.3	-3.8	-4.0	-3.6	-3.3
Net debt/Equity (x)	-1.3	-1.1	-0.4	-0.8	-1.9	-1.7	-1.5	-1.2	-1.1
# shares (EOP)	14.5	15.8	15.8	15.3	16.9	16.9	16.9	16.9	16.9
# shares (EOP, fully diluted)	14.5	15.8	15.8	15.3	17.2	17.4	17.7	17.7	17.7
# shares (avg.)	14.5	15.0	15.8	15.4	16.5	16.9	16.9	16.9	16.9
# shares (avg., fully diluted)	14.5	15.8	15.8	15.3	16.8	17.3	17.5	17.7	17.7

Source: Kruk, DM BZ WBK Research

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2) comparative multiples,
3) residual income,
4) dividend discount model (DDM).

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EBIT – earnings before interest and tax
EBITDA – earnings before interest, taxes, depreciation, and amortization
P/E – price-earnings ratio
EV – enterprise value (market capitalisation plus net debt)
PEG - P/E to growth ratio
EPS - earnings per share

CPI – consumer price index
WACC - weighted average cost of capital
CAGR – cumulative average annual growth
P/CE – price to cash earnings (net profit plus depreciation and amortisation) ratio
NOPAT – net operational profit after taxation
FCF - free cash flows
BV – book value
ROE – return on equity
P/BV – price-book value

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