SMALL & MID CAPS

Kruk

Financial Services | Poland

Neutral PLN 204 (+8%)

Company update

- **We lift our 12M TP to PLN 204 from PLN 158 previously and maintain our Neutral rating**
- **We increase our 2016E and 2017E net profit estimates by 19% and 17%, respectively.**

Vestor DOM MAKLERSKI equity research

08 march 2016

Earnings beat and foreign expansion to drive re-rating

Over the last three years Kruk proved to be an effective debt collection company with a superior business model and dynamic earnings growth (36% CAGR). We believe that entering new foreign markets will secure long-term growth prospects of Kruk and will position the company to become one of the leading debt collection companies in Europe over the next couple of years. On the back of strong 2015 numbers, including record high cash recoveries, we increase our net profit estimates by 19% in 2016E and by 17% in 2017E. We lift our 12M TP to PLN 204 from PLN 158 previously, but due to share price performance we maintain our Neutral rating.

4Q15 earnings 22% above consensus, cash EBITDA up 10% YoY. In 4Q15 Kruk's net profit came in at PLN 44m (+71% YoY, -16% QoQ) and was 22% above consensus and 9% above our estimates. The earnings beat was driven by higher than expected revenues (9% above consensus) supported by positive revaluation of portfolios. Cash repayments increased to PLN 220m (+20% YoY, +7% QoQ) and cash EBITDA grew +10% YoY. We expect the 4Q15 numbers to lead to upgrades in 2016E consensus estimates (PLN 219m, +7% YoY).

Earnings estimates up by 19% in 2016E and by 17% in 2017E. On the back of higher than expected cash recoveries in 1-4Q15 and positive revaluations of portfolios we lift our 2016E and 2017E revenues estimates by 7% and 8%, respectively. This, coupled with increased costs and lowered net financial expense estimates prompted us to lift our net profit forecasts by 19% in 2016E (to PLN 234m) and 17% in 2017E (to PLN 267m). Our estimates are 7% and 11% above consensus, respectively.

Supportive domestic macro environment. In 2015 Kruk increased its domestic portfolio investments by 24% YoY to PLN 710m (including Presco assets). We believe the implementation of the banking tax in Poland will boost sales of bad debt by banks and the new 500+ social program will positively affect repayments.

Succesful European expansion should drive re-rating. Kruk operates in Poland, Romania, Czech Republic and Slovakia. Recently, the company made its first investments in Germany and Italy and in the coming quarters plans to further increase the scale of foreign operations. We believe that positive newsflow on foreign portfolio acquistions and repayments should drive retating of the stock.

Valuation 14.2x P/E, with 8% discount to Intrum Justitia. At our estimates Kruk is trading at 14.2x 2016 P/E, broadly in line with 3Y average and with 8% discount to Intrum Justitia. The stock offers 13.2% EPS CAGR between 2015 and 2018 comparing to 7.3% CAGR of Intrum.

Figure 1. Kruk - Financials, 2013-2018E

PLNm unless otherwise stated

	2013	2014	2015	2016E	2017E	2018E
Revenues	406	488	611	706	837	985
EBIT	153	208	251	298	357	417
Net profit	98	152	204	234	267	296
YoY change (%)	20%	55%	35%	15%	14%	11%
ROE (%)	27%	30%	30%	26%	24%	22%
P/E (x)	33.9	21.8	16.2	14.2	12.4	11.2
P/BV (x)	8.0	5.7	4.2	3.4	2.8	2.3

Source: Company data, Vestor DM estimates

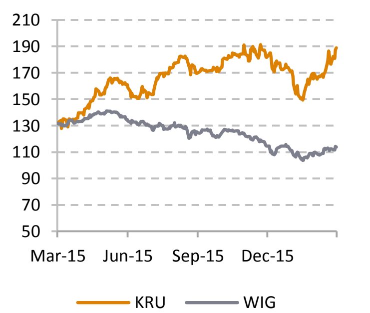
Company data	
Rating	Neutral
Target Price (PLN)	204
Market Price (PLN)	189
Upside/Downside	8%
Previous rating	Neutral
Previous Target Price PLN	158
Min (52W)	126.3
Max (52W)	193.1
Market Cap. (PLNm)	3,310
Avg. 3M Turnover (PLNm)	6.0

Shareholders	%
Piotr Krupa	11.8
N-N PTE	11.5
Aviva OFE	8.3
Generali OFE	6.6
Others	61.8

Company description

Kruk is the leader of debt purchase market in Poland and Romania. The company is focused on unsecured retail receivables from banks, insurance companies, telecom operators and other media. Kruk operates also in debt collection services segment with over 20% market share in Poland and Romania.

Kruk vs. WIG: 12M relative price performance



Source: Bloomberg, Vestor DM

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Over last twelve months, Vestor issued one neutral recommendation concerning Kruk dated 21st April 2015 with target price 158PLN.

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Buy/Accumulate/Neutral/Reduce/Sell – means that, according to the authors of this document, the stock price may perform materially better/better/neutrally/worse/materially worse than the cost of equity of the respective stock.

The recommendation system of Vestor is based on determination of target prices and their relations to current prices of financial instruments; in addition, when recommendations are addressed to a wide range of recipients, two methods of valuation are required.

In preparing this document Vestor applied at least two of the following valuation methods:

1) discounted cash flows (DCF),

2) comparative,

3) target multiple,

4) scenario analysis,

5) dividend discount model (DDM),

6) NAV,

7) Sum of the parts.

8) Discounted residual income model

9) ROE-P/BV model

The discounted cash flows (DCF) valuation method is based on discounting expected future cash flows. The main advantage of the DCF valuation is the fact that this method takes into account all cash streams the issuer is expected to reach and the cost of money over time. From the other hand, DCF valuation method requires a number of assumptions and is very sensitive to changes in parameters used in the in the model. Small changes in inputs can result in large changes in the value of a company.

The comparative valuation method is based on the rule of "one price". The advantages of this method are small number of parameters that need to be estimated, the fact that there is a relatively large number of indicators for companies being compared, the method is well-known among investors and the valuation is based on current market conditions. From the other hand a valuation derived from the comparative valuation method is considerably sensitive to the valuation of the companies classified as peers and can lead to simplification of the picture of the company.

The target multiple valuation approach is based on the assumption that the value of the company should be equal to pre-specified values of selected price multiples. The advantage of this method is its applicability to each company. From the other hand the target multiple approach is a highly subjective method.

The scenario analysis approach is based on the probability weighted valuation for three sets of assumptions: Bear case (20% probability), base case (60% probability) and bull case (20% probability). The base case is based on the assumptions and estimates which we have included in our financial forecasts and DCF valuation. In the bear/bull case scenarios we have analyzed the valuation sensitivity towards negative/positive changes in various assumptions including market size, market shares, profitability, growth, capex, valuation multiples etc. The advantage of this method is presentation of various scenarios and valuation sensitivity. As an disadvantage we find its complication and sensitivity towards probability weights assumption.

The dividend discount model (DDM) valuation uses predicted dividends that are expected to be paid out by the company and discounts them back to present value. The advantages of the DDM valuation method are its applicability to companies with long-term dividend payout history and the fact that it takes into account real cash streams that are expected to receive by equity-owners. From the other side the DDM valuation method requires a number of assumptions regarding dividend payouts.

The net asset value approach considers the underlying value of the company's individual assets net of its liabilities. Some of the advantages of the NAV approach are its applicability to asset holding companies and the fact that data required to perform the valuation are usually easily available. From the other hand the valuation derived from net asset value approach does not take into account future changes in sales or income and can understate the value of intangible assets.

The sum of the parts approach values a company by determining what its divisions would be worth if it was broken up and spun off or acquired by another company. The advantage of this method is a possibility to apply different valuation methods to different divisions. As an disadvantage we find scarcity of comparable basis for the respective business lines.

The discounted residual income model valuation is based on discounted excess equity flows the company is able to deliver. The main advantage of this method is that it is based on return on equity adjusted by cost of equity. The important disadvantage is that it is based on the income statement so does not include actual cash flows, but may fluctuate depending on accounting method.

The ROE-P/BV model valuation is based on the regression line with valuation-to-book value (P/BV) depending on the return on equity the company is able to deliver. The main advantage of the method is that it includes the correlation of valuation with profitability. The main disadvantage is that it does not fully take into account earnings dynamics.

Terminology used in the recommendation:

P/E – price-earnings ratio

PEG - P/E to growth ratio

EPS - earnings per share

P/BV – price-book value

BV – book value

EV/EBITDA – enterprise value to EBITDA

EV – enterprise value (market capitalization plus net debt)

EBITDA – earnings before interest, taxes, depreciation, and amortization

EBIT – earnings before interest and tax

NOPAT – net operational profit after taxation

FCF - free cash flows

ROE – return on equity

WACC - weighted average cost of capital

CAGR – cumulative average annual growth

CPI – consumer price index

COE – cost of equity

L-F-L – like for like

Recommendation definitions:

Buy - indicates a stock's total return to exceed more than 1.5x respective cost of equity over the next twelve months.

Accumulate - indicates a stock's total return to exceed more than respective cost of equity over the next twelve months.

Neutral - indicates a stock's total return to be in range of 0% to respective cost of equity over the next twelve months.

Reduce - indicates a stock's total return to be in range of minus respective cost of equity to 0% over the next twelve months.

Sell - indicates a stock's total return to be less than minus respective cost of equity over the next twelve months.