

Monday, September 17, 2018 | update

Kruk: buy (reiterated)

KRU PW; KRU.WA | Finanse, Polska

Kruk: Reloaded

We maintain a buy call for Kruk, with the 9-month price target raised slightly to PLN 292.77 per share after an upward revision to expected future revenues from purchased debt portfolios, accompanied lowered by expectations for collection profits and raised forecasts as regards financing costs. KRU is trading at very attractive ratios at the moment, with additional upside stemming from improving operations in Italy, record purchases coming up in Poland, low financing risk, imminent hikes in the 2019-2020 FY analysts' consensus by a projected 11%-12%, and contained regulatory risk. The price of a Kruk share has dropped markedly below the average recorded in the last six months (PLN 218) which would serve as a benchmark for a potential tender offer by a prospective strategic investor.

Italy now over the hump

Kruk wrote off the last of the losses it expects to take on impaired Italian portfolios in Q2 2018, and meanwhile the Italian business turned profit of PLN 14m in the period, a dramatic improvement from the PLN 42.2m loss booked in Q4 2017. Kruk does not expect to have to recognize any further charges on the Italian portfolios in future periods; on the contrary, it sees potential for upward adjustments on some of the accounts. In fact, Kruk's firm belief in Italy as a future driver of success has been confirmed by a recent purchase of another local portfolio, whose par value at EUR 300m this time was determined using the Company's own custom benchmarks.

Spending comes back home

Kruk pared down purchases in Poland from 53% of total spend in 2015 to 28% in 2017 as a way of escaping increasing prices, lifted by intensifying competition in the domestic market. With market conditions since improved, we predict Poland's share in purchases will bounce back to 52% in 2018, and stay close to 40% in subsequent years. The future supply of debt in Poland is set to grow as changing regulation forces banks to sell NPLs early.

Low debt

Kruk expects to spend between PLN 1.2bn and PLN 1.5bn on new portfolios in 2018, a revision from the PLN 1bn spending guidance offered earlier this year stemming from plans to increase acquisitions in Italy and Spain. Such hefty spend is possible thanks to the Company's robust financial standing, reflected in a low net debt/equity ratio of 1.1x. Kruk wants to boost investment in the future so that the ratio rises to ca. 2.3x.

Undervalued compared to peers

Kruk is currently trading at a small discount to comparable companies on 2018E and 2019E P/E, a shift from the 9% historical premium enjoyed in the past. What is more, the Company's 12m FWD P/E ratio today is 21% lower than the historical average. In our view KRU should recoup the premium over the peer group given its expected 2017-2020 net earnings CAGR of 19% vs. 17% peers, coupled with increasing dividend yields (5%-6% in 2019-20E), and improving business in new markets.

(PLN m)	2016	2017	2018E	2019E	2020E
Revenue	783.4	1,055.5	1,240.8	1,429.5	1,645.0
Gross profit	476.6	589.4	719.1	818.2	944.8
EBIT	349.0	420.8	527.9	605.7	701.4
Net profit	248.7	295.2	353.5	418.3	457.4
ROE (%)	24.6	21.9	22.1	22.4	21.6
EPS (PLN)	14.1	15.7	18.7	22.2	24.2
BVPS (PLN)	66.0	77.4	91.9	105.6	118.8
P/E (x)	13.3	11.9	10.0	8.5	7.7
P/B (x)	2.8	2.4	2.0	1.8	1.6
DYield	1.0	1.1	2.1	4.5	5.9

Current Price	PLN 187.80
Target Price	PLN 292.77
MCap	PLN 3,544m
Free Float	PLN 3,544m
ADTV (3M)	PLN 26.87m

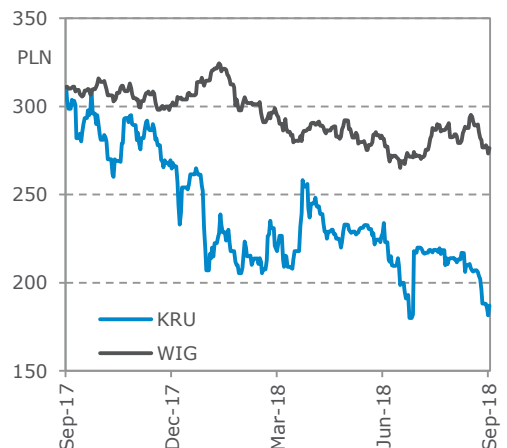
Ownership

NN OFE	10.60%
Piotr Krupa	10.40%
Aviva OFE	6.99%
Others	72.01%

Business Profile

Kruk is the leader of the Polish and Romanian markets for debt management, focusing mainly on retail bank debt. In 2015, the Company also launched operations in Germany and Italy. In the core markets of Poland, Italy, and Romania, Kruk's operations are organized into two complementary businesses debt collection and debt purchases for own account.

KRU vs. WIG



Company	9MTP		Rating	
	new	old	new	old
Kruk	292.77	300.94	buy	buy

Company	Current Price	Target Price	Upside
Kruk	183.80	292.77	+59.3%

Forecast Update	2018E	2019E	2020E
Gross profit, own portfolios	+5.9%	+3.0%	+3.3%
Gross profit, collection serv.	-23.5%	-13.3%	-7.2%
Gross profit, other	-18.1%	-11.8%	-7.2%
General expenses	+2.4%	+1.8%	+2.3%
Net profit	+0.1%	+1.9%	-1.6%

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List of abbreviations and ratios contained in the report:

EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for Kruk S.A. in the 12 months prior to this publication:

Rating	buy	buy	reduce
Rating date	2018-02-02	2017-10-02	2017-09-01
Target price (PLN)	300.94	340.17	308.06
Price on rating day	222.20	293.45	340.95

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