



Stock Price of Kaolin



- The fourth quarter of 2011 was not either better or worse than the usual seasonally weak period of the year for the producer of building materials Kaolin (6K1). The loss were higher as compared to 4Q 2010, although the decline of revenues were negligible. The spin-off of the subsidiary SolarPro Holding in 3Q 2010 is distorting the quarterly data but both unconsolidated and consolidated reports of Kaolin showed expansion of revenues in 2011. The period of growth was the first quarter of last year. Since then Kaolin is maintaining stable revenues.

- The company announced 4.88% increase of unconsolidated sales, whereas consolidated revenues added 6.48%. Products for the glass and ceramic industry are rising, while the demand for building materials and limestone declined substantially.

- The net profit for 2011 jumped 14%. All major groups of expenses posted increase as percentage of revenues at the end of 2011. The improved profitability during the second and the third quarter contributed to the large growth of net profit.

- Costs of external services, mainly transportation, soared above 50% of revenues and pushed down the profitability. Kaolin is planning to transfer the inflation pressure on its product prices but we don't expect any sudden improvement of margins. Moreover, the first quarter is the weakest period of the year that in the beginning of 2012 was even harsh due to bad weather.

- The spin-off of SolarPro Holding in 3Q 2010 resulted to huge decrease of receivables of Kaolin. The working capital declined more than two times to BGN 25 million and remained hardly changed since then. Current ratio also fell to 1.40 but it is still indicating the good liquidity of Kaolin.

- The company is one of the most indebted among blue chips in Bulgaria, although its debt-to-equity ratio hovered above 0.90 during the last year. Short-term and long-term debts are evenly distributed. Interest expenses represented 3% of revenues in 2011.

- Kaolin increased substantially its investments last year. The company's net purchases of machines and equipment jumped to BGN 18.8 million and part of the investments were grants from EU funds.

- The stock was under constant selling pressure during the second half of 2011 and erased all gains from the previous period of appreciation. The main reason was the overall market weakness as its financial results did not deteriorate. The deceleration of growth rates of Kaolin reminded the market for the susceptible situation in the market of building materials, which is essential for the company.

Multiples Valuation

*Table 1
Multiples
comparison*

	2009	2010	2011
Last Price	2.88	2.45	2.08
Number of Shares	50 000 000	50 000 000	47 339 996
Market Capitalization	143 750 000	122 500 000	98 514 532
Net Profit	5 013 000	7 545 000	8 532 000
P/E	28.68	16.24	11.55
Equity	106 798 000	79 650 000	84 798 000
P/B	1.35	1.54	1.16
Sales	126 423 000	141 344 000	164 784 000
P/S	1.14	0.87	0.60
EV	233 282 000	192 256 000	170 738 532
EBITDA	24 575 000	27 542 000	26 779 000
EV/EBITDA	9.49	6.98	6.38
RoE	4.69%	9.47%	10.06%
RoA	1.88%	3.88%	4.08%

Source: Kaolin
Calculations: ELANA Trading

Kaolin is traded at the lowest multiples for the last three years. At the same time the company is not facing major risks for its revenues and profits but we expect some decrease on trailing base when consolidated data for 1Q 2012 are published. The price of fuels had large effect on the profitability and Kaolin has the potential to improve further its P/E ratio if it manages to increase its product prices.

Peers' comparison

We compared Kaolin to companies that produce similar materials and we also added large number of stocks from the basic materials industry. The list of peers includes many companies from emerging markets that don't have positive financial results. We used the median of multiples and gave equal weight of the ratios.

*Table 2
Peers'
Comparison*

Multiples	P/E	P/B	P/S	EV/EBITDA
Median	9.88	1.77	1.96	6.95
Market Capitalization	84 316 236	150 375 770	323 483 516	113 888 363
Price	1.78	3.18	6.83	2.41
Weight	25%	25%	25%	25%
Current Price		2.08		
Fair Price		3.55		
Premium (Discount) to Current Price		70.55%		

Source: Bloomberg
Calculations: ELANA Trading

Kaolin is undervalued when compared to three of four multiples. The company's profit is the indicator that is above the median of peers but the price difference is not substantial. The fair price of Kaolin is BGN 3.55 and is above our previous calculation from mid-2011 due to the substantially higher P/S ratio in our last list of sector companies. However, median P/E and EV/EBITDA declined since then and are suggesting that the current price is influenced mainly by the profitability of the company. Investors are eager to see improvement of profits before to add more stocks to their portfolios. We consider Kaolin under-

valued but not at the large discount of the fair value as seen by comparing to sector peers.

Discounted Cash Flows

The DCF is better valuation method as it includes the future growth opportunities. Our DCF is based on accelerating growth of revenues in the next four years and moderate decline since 2015 to long-term growth rate of 3.5%. The economic slowdown in Europe had small effect on revenues during the second half of 2011.

Table 3, DCF

Kaolin											Terminal
BGN'000	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Year
EBIT	15 572	17 129	19 185	22 063	24 710	27 181	29 356	31 117	32 673	33 980	35 169
EBIT(1-T)	14 015	15 416	17 266	19 856	22 239	24 463	26 420	28 005	29 405	30 582	31 652
Add: D&A	14 707	16 178	18 119	20 837	23 337	25 671	27 725	29 388	30 858	32 092	33 215
Less: Investments	14 707	16 178	18 119	20 837	23 337	25 671	27 725	29 388	30 858	32 092	33 215
Less: Change NWC	2 026	2 595	3 426	4 796	4 413	4 118	3 624	2 936	2 593	2 178	2 052
FCF	11 988	12 821	13 840	15 060	17 827	20 345	22 796	25 070	26 812	28 403	29 600
PV FCF	10 899	10 596	10 399	10 286	11 069	11 484	11 698	11 695	11 371	10 951	
Sum of PV FCF	110 447										
PV of Continuing Value	175 573										
Total PV Free Cash Flows	286 020										
					Growth Rate						
					SA	2.0%	3.0%	3.5%	4.0%	5.0%	
Less: Outstanding Debt	77 313				8.0%	5.85	6.81	7.46	8.26	10.67	
Plus: Financial Assets	3 045				9.0%	4.66	5.29	5.69	6.17	7.49	
PV of Equity	211 752				10.0%	3.78	4.21	4.47	4.78	5.59	
Number of Shares	47 340				11.0%	3.10	3.40	3.59	3.80	4.32	
Price Per share	4.47				12.0%	2.56	2.78	2.91	3.06	3.42	
					WACC						

Calculations: ELANA Trading

The deceleration of growth rate in 2011 was influenced also by the spin-off of SolarPro Holding. However, given the fragile nature of the recovery in construction industry in Bulgaria we prefer to be more conservative in our expectation, thus decreasing the forecasted growth to 5% this year. EBITDA margin is higher due to the current investments and the expected decrease of costs pressure from fuel prices. Depreciation will rise and will limit the improvement of EBIT margin, which we set to 9% from the last year's 8.97%. The calculated intrinsic value per share is BGN 4.47 or 115% above the current market price. The difference between both methods for valuation is significant and could be explained with the low multiples of peers along with the growth potential of Kaolin. The main risk is further decrease of EBITDA margin due to rising fuel costs or decline of revenues.

Recommendation And Price Target

Recommendation: Our price target is the lower of both valuation methods or it is BGN 3.55. This is 70% above the current market price, which is huge return if it happens in the near future. More achievable price target is BGN 3.00 as the stock traded at this level 8 months ago. In both cases the market should improve substantially. The current trading liquidity is very low, which could ease the gains during bull market phase as seen in the previous periods of stock gains.

BUY

Target price: BGN 3.55

Upside: 70%

Financial data

Statement of Income (in '000 BGN)	2007	2008	2009	2010	2011
Sales	117 729	143 036	135 610	154 072	164 784
Production expenses	78 238	101 150	95 459	109 777	118 326
Personnel expenses	14 671	18 548	16 438	17 190	18 262
Net income from financial activities	4 124	1 244	712	356	(1 593)
Other revenues and expenses	2 004	150	150	81	176
EBITDA	30 948	24 732	24 575	27 542	26 779
Depreciation	8 375	10 419	14 526	14 377	12 006
EBIT	22 573	14 313	10 049	13 165	14 773
Interest expense	1 559	2 482	3 337	4 245	4 144
Pretax income	21 014	11 831	6 712	8 920	10 629
Taxes	2 362	1 491	1 430	1 203	1 756
After-tax income	18 652	10 340	5 282	7 717	8 873
Minority interest	540	649	269	172	341
Net income	18 112	9 691	5 013	7 545	8 532
Earnings per share in BGN	0.72	0.39	0.20	0.32	0.18
Balance Sheet (in '000 BGN)	2007	2008	2009	2010	2011
Total Assets	154 125	224 307	266 846	194 280	209 160
Equity subscriptions receivable	0	0	0	0	0
Fixed assets	64 764	126 353	146 539	106 167	116 653
Tangible fixed assets	55 962	110 041	127 758	89 967	101 423
Financial investments	69	12	12	10	9
Current assets	89 361	97 954	120 307	88 113	92 507
Inventory	19 185	27 308	34 149	31 335	32 681
Receivables	32 212	48 341	58 228	45 301	48 955
Financial assets	0	6	7	3 055	2 737
Cash and cash equivalents	33 394	19 790	25 494	5 652	5 089
Total liabilities + equity	154 125	224 307	266 846	194 280	209 160
Equity	115 231	113 765	106 798	79 650	84 798
Registered capital	25 000	25 000	25 000	23 670	47 340
Capital funds	63 548	78 878	75 753	49 679	31 691
Earnings	26 683	9 887	6 045	6 301	5 767
Liabilities	38 894	110 542	160 048	114 630	124 362
Long-term payables	3 981	5 401	5 483	4 486	5 754
Long-term bank loans	39	52 516	74 274	38 988	40 931
Short-term bank debt	10 294	20 203	40 752	36 420	36 382
Short-term payables	21 630	26 314	24 350	25 715	30 815
Other liabilities	294	279	275	958	1 383
Working capital	57 437	51 437	55 205	25 978	25 310
Cash Flow Statement (in '000 BGN)	2007	2008	2009	2010	2011
Net income	18 112	9 691	5 013	7 545	8 532
Depreciation	8 375	10 419	14 526	14 377	12 006
Changes in Working capital	61 619	(6 000)	3 768	(29 227)	(668)
Other operating cash flow items	(78 116)	(2 489)	(9 889)	14 006	10 088
Net cash from operating activities	9 990	11 621	13 418	6 701	29 958
Capital expenditures	(24 365)	(58 952)	(33 358)	(8 822)	(18 823)
Other investing cash flow items	(2 299)	(12 710)	(847)	(10 022)	(1 333)
Net cash from investing activities	(26 664)	(71 662)	(34 205)	(18 844)	(20 156)
Issuance/ Retirement of Stock, Net	62 438	2 892	3 653	4 642	18
Issuance/ Retirement of Debt, Net	(15 427)	52 559	29 185	(3 692)	(4 562)
Dividends paid	(5)	(7 396)	(3 705)	(3 877)	(3 814)
Other financing cash flow items	270	(1 618)	(2 642)	(4 772)	(2 007)
Net cash from financing activities	47 276	46 437	26 491	(7 699)	(10 365)
Net change in cash	30 602	(13 604)	5 704	(19 842)	(563)
Beginning-of-period cash	2 792	33 394	19 790	25 494	5 652
End-of-period cash	33 394	19 790	25 494	5 652	5 089
Cash per share	1.34	0.79	1.02	0.24	0.11

Financial and Performance Indicators	2007	2008	2009	2010	2011
Valuation Ratios					
Price/Earnings (P/E)	23.16	8.90	28.68	15.37	11.40
Book Value (BV)	4.61	4.55	4.27	3.37	1.79
Price/Book (P/B)	3.64	0.76	1.35	1.46	1.15
Sales Per Share	4.71	5.72	5.42	6.51	3.48
Price/Sales (P/S)	3.56	0.60	1.06	0.75	0.59
Price/Cash per share	15.84	4.29	7.36	5.29	4.74
EV (in BGN)	396 439	139 179	233 282	185 739	169 508
EV/Sales	3.37	0.97	1.72	1.21	1.03
EV/EBITDA	12.81	5.63	9.49	6.74	6.33
EV/EBIT	17.56	9.72	23.21	14.11	11.47
Liquidity					
Current ratio	2.80	2.11	1.85	1.42	1.38
Quick ratio	2.20	1.52	1.32	0.91	0.89
Debt Management					
Debt to total assets	0.07	0.32	0.43	0.39	0.37
Interest coverage	14.48	5.77	3.01	3.10	3.56
LT Debt/Equity	0.00	0.46	0.70	0.49	0.48
Total Debt/Equity	0.09	0.64	1.08	0.95	0.91
Asset Management					
Inventory turnover	6.14	5.24	3.97	4.92	5.04
Days sales outstanding	99	122	155	106	107
Fixed asset turnover	1.82	1.13	0.93	1.45	1.41
Total asset turnover	0.76	0.64	0.51	0.79	0.79
Profitability					
Profit margin on sales	15.4%	6.8%	3.7%	4.9%	5.2%
EBITDA margin	26.3%	17.3%	18.1%	17.9%	16.3%
Basic earning power	14.6%	6.4%	3.8%	6.8%	7.1%
Return on assets	11.8%	4.3%	1.9%	3.9%	4.1%
Return on equity	15.7%	8.5%	4.7%	9.5%	10.1%
Return on investments	15.2%	5.6%	2.7%	6.1%	6.5%
Dividend Information					
Dividend Yield	1.70%	4.35%	2.61%	3.06%	-
Dividend per share	0.29	0.15	0.15	0.15	-
Number of shares:					
	25 000 000	25 000 000	25 000 000	23 669 998	47 339 996
Price in BGN - period end:					
	16.78	3.45	5.75	4.90	2.06
Market cap in BGN - period end:					
	419 500 000	86 250 000	143 750 000	115 982 990	97 283 692

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