

KORADO (4KX BU)

INDUSTRIALS/ ELECTRICAL EQUIPMENT

TOO GOOD TO BE TRUE, AND TRUE

WITH 10% CAGR OF REVENUES OVER THE LAST FIVE YEARS, THE LEADING STEEL PANEL RADIATOR PRODUCER IN BULGARIA – KORADO, REAPS PROFITS FROM THE SURGE IN CAPACITY. NEW PRODUCTS ADD TO THE 7X RISE IN PROFITABILITY DESPITE THE RISE IN STEEL PRICES. PRODUCT DIVERSIFICATION AND RECOVERING CONSTRUCTION MARKET TO SUSTAIN STRONG LONG TERM PERFORMANCE.

WELL-MANAGED COMPANY IN A RECOVERING MARKET

The only steel panel radiator producer in Bulgaria, part of the Czech Korado Group, with strong position in Central and Eastern Europe and well-recognized brand. The Company delivered 10% CAGR of the top line and a 7x rise in its bottom line over the last 5 years with remaining free capacity to take on the recovering construction industry in Europe as new EU energy efficiency regulations kick in and macroeconomic conditions improved considerably.

REAPING PROFITS FROM WELL-EXECUTED CAPACITY EXPANSION CAPEX

After major capacity expansion investments in late 2014 and beginning of 2016, Korado is currently reaping considerable profits from booming capacity utilization as lower manufacturing costs in Bulgaria remain a competitive advantage vs. Western European production. Volumes sold rose 50%+ over the last 5 years with new bathroom radiator product delivering margin growth.

STRONG COST CONTROL AND LOW LEVERAGE SUPPORT SURGE IN MARGINS

Despite commodity prices fluctuations, Korado sustains strong cost control and low debt levels which led to surge in margins – EBITDA and net profit margins more than tripling over the last 5 years. Cost control and low leverage also a competitive advantage to large, higher production cost and more leveraged Western European competitors.

STEADY FREE CASH FLOW GENERATION AND LUCRATIVE INVESTOR RETURNS

With major CAPEX accomplished, Korado generates steady free cash flows and lucrative returns to investors. ROE tripled over the last 5 years to 17% in 2016 and rising. In 2015, Korado initiated dividend distribution with a lucrative 4.7% average dividend yield over the last 3 years despite tripling in market value. Upcoming dividends to yield 5% on average over the next 5 years.

SURGE IN MARKET VALUE WITH FURTHER UPSIDE AVAILABLE POST STOCK DIVIDEND

The Company's market value advanced in line with the surge in fundamentals. - 3x in 3 years. The August 2017 50% stock dividend led to an artificial doubling of the market capitalization while multiples expanded 40% for the period. The stock dividend considerably improved the stock liquidity while Korado's plans to double the free float to further strengthen the stocks market performance.

VALUATION/RISKS

VALUATION: We initiate our coverage for Korado with a BGN 8.51 per share fair value and a BUY recommendation based on a weighted DCF and peer multiples valuation.

RISKS: Considerable competition, volatile commodity prices and uneven macroeconomic development among key risks to developing Korado's potential

in kBGN, excl. ratios	2014	2015	2016	2017F	2018F
Sales	20 912	27 449	32 607	42 926	50 182
EBITDA	1 993	2 993	4 364	6 300	7 878
Net profit	1 321	1 932	2 927	4 635	6 083
Equity	9 124	16 271	17 587	19 095	20 312
ROE	16.30%	15.22%	17.29%	25.27%	30.87%
ROA	10.09%	10.73%	12.90%	17.64%	22.12%
EBITDA margin	9.53%	10.90%	13.38%	14.68%	15.70%
Net profit margin	6.32%	7.04%	8.98%	10.80%	12.12%
EPS	0.21	0.22	0.33	0.35	0.46
Debt/equity	0.51	0.02	0.26	0.26	0.19
P/E	13.62	16.36	15.84	19.89	15.15
P/B	1.97	1.94	2.64	4.83	4.54
EV/EBITDA	10.87	10.53	11.14	15.00	11.72
Payout ratio	80%	82%	78%	80%	80%
Dividend yield	4.14%	5.00%	4.92%	4.02%	5.28%

BUY
ONE YEAR PRICE TARGET: BGN 8.51
CURRENT PRICE: BGN 7.00

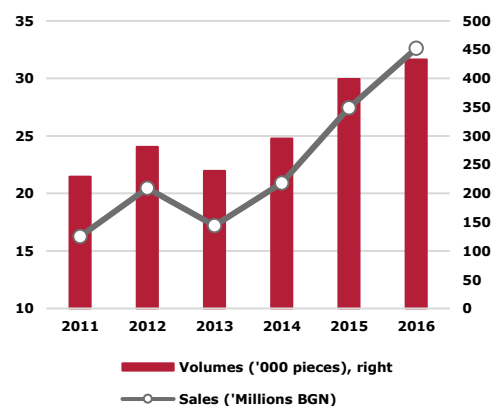
EXCHANGE RATES

EUR/BGN(FIXED): 1.95583
USD/BGN: 1.67825

MARKET DATA

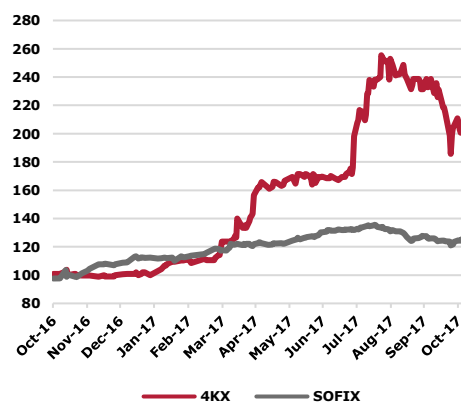
Shares Outstanding:	13.2m
Share Capital:	BGN 13.2m
Free-float:	16.3%
Treasury Shares	0%
Market Cap.:	BGN 92m
Avg. Daily Vol.:	BGN 8 000
52 Weeks Range:	BGN 3.36-8.94

10% CAGR OF SALES OVER THE LAST 5 YEARS



Source: Company data

PRICE PERFORMANCE



Source: Bloomberg

EXECUTIVE SUMMARY

WE INITIATE COVERAGE OF KORADO WITH A BUY RECOMMENDATION AND A ONE YEAR PRICE TARGET OF BGN 8.51 PER SHARE OFFERING 22% UPSIDE OVER THE NEXT 12 MONTHS.

THE COMPANY

Korado Bulgaria (Korado, the Company) is the only steel panel radiator producer in Bulgaria and among the key heating equipment manufacturers in the country. The Company is part of the biggest Czech steel panel and tubular radiator producer - Korado Group (the Group), thus among the key players on the European heating equipment market. According to Korado estimates, it among the top 10 radiator producers in Europe.

Operations breakdown: Korado Bulgaria serves as a low cost production base for the Czech Korado Group due to low labor and energy costs. Thus, the Company is competitive to both high-end Western European producers as well as low-end Turkish producers.

Korado has almost doubled its operations over the last five years increasing its contribution to the Group's volumes to about 1/3 of the total group production. In 2016, the Company produced 433k panel radiators, 10% CAGR in volumes over the last five years, vs. 814k pieces produced by the Czech parent company, 3.6% negative CAGR in volumes for the same period.

Korado's main product is steel panel radiators which currently represent 80% of the Company's operations. In April 2016, it introduced tubular bathroom radiators producing a total of 50 897 in FY2016. The latter volumes have already doubled by the end of the 9M 2017 on increased capacity utilization. Currently, the new product line represents 20% of the Company's overall production. Tubular and designer products are expected to be key long term sustainable growth drivers due to free capacity and considerable margin contribution.

Revenue breakdown: Korado delivered 10% CAGR of revenues over the last five years on capacity expansion and utilization. At the end of 2014, the Company installed a second steel panel welding line while in 2016 it installed a tubular bathroom soldering furnace. Capacity utilization was key growth driver for the Company's organic growth over the last five years followed by recovering construction markets and market share expansion. These are expected to be mid to long term drivers as well.

Approximately 70% of Korado's production is currently distributed through the parent company. Respectively, the majority of sales are realized via the parent company with the Group using transfer pricing methodology and policy approved by auditors (previously Ernst & Young, currently PricewaterhouseCoopers). The Czech market is the biggest for the Company and the Group with Romania, Bulgaria, Ukraine, Slovakia and Russia other key markets. Over the past few years, the Company also initiated geographic diversification of sales by trying to balance out viable but volatile markets like Ukraine and Russia with more stable once like France, Germany and UK. Overall, sales to the European Union represent 84% of total sales with Bulgaria 3% and the remaining going to the rest of the world.

Corporate governance: Korado is listed on the Bulgarian Stock Exchange, trading on the top Premium segment of the market. It is part of the BGBX40 market index tracking the 40 top traded stocks on the market.

The Company is also actively working on improving its stock liquidity. In August 2017 it distributed a 50% stock dividend (free shares). It is also planning to double the free float available on the market from the current 16% to approximately 33%. The latter is expected to give a further boost to Korado's stock liquidity and market performance. Accordingly, it is among the best corporate governance companies on the market with an 80% dividend payout and considering 6-months dividend payouts.

THE COUNTRY AND THE MARKET

Bulgaria is under a currency board and the Bulgarian Lev is pegged to the Euro at fixed rate of 1.95583.

Joining the Eurozone is a midterm strategic goal for the country. Yet, it has been experiencing political instability with three caretaker governments in four years. The current political situation looks contained as Bulgaria is to take over the presidency of the Council of Europe starting Jan 1st, 2018. Thus, no political surprises expected in the short term.

Despite the political instability, consensus 2017-2018 GDP growth estimates are in the 3.5%-4% range due to rising consumer spending, low unemployment, and ongoing export expansion and investment recovery.

The construction industry has been in recovery ever since 2015 on improving macroeconomic situation, rising disposable income and low interest rate environment. In Bulgaria alone, construction permits for both residential and commercial property are registering double digit growth y/y.

In all the EU, the construction sector is on the rise with accelerating y/y rise over the last three years. We expect the latter trend to continue of improving macroeconomic conditions while residential renovations in CEE countries to sustain sustainable heating equipment industry growth as well. EU energy efficiency push to further support buildings' renovations and retrofits.

THE VALUATION

We use a discounted cash flows model and peer comparison to arrive at a fair value for Korado. All calculations are based on the individual results of the Company.

We value the stock of Korado at BGN 8.51 per share or 22% above current market quotes.

SOME RISKS

Uneven macroeconomic development in volatile markets like Russia and Ukraine

Dependence on the Czech market for a bulk of the Company's, respectively, the Group's sales

Considerable competition in the steel panel segment of the heating equipment industry as well as from substitutes e.g. aluminum products

Volatile commodity prices

COMPANY OVERVIEW

Korado Bulgaria is a leading steel panel radiator producers in Bulgaria. The Company is part of the Czech Korado Group, being a low cost manufacturing base, situated in the town of Strazhica in Northcentral Bulgaria.

The Company's core operations are steel panel radiators with 1.2 million pieces per annum capacity under 4 shifts operations with single type of radiators. It has 2 welding lines for steel panel radiators with 433k pieces produced in FY2016. The Company's main products in the segment are positioned both on the premium and low price end of the market with two corresponding brands – Kingrad and Radik, respectively.

In April 2016, Korado Bulgaria added tubular bathroom radiator production capacity, manufacturing 51k pieces for the first year of the line's operation. Bathroom radiator capacity under a 4 shifts operational scheme is estimated by the Company at 170k pieces per annum. By the end of Sept. 2017, Korado Bulgaria has already produced 100k+ tubular radiators.

Approx. 70% of the Company's production is distributed via the parent company in the Czech Republic. On the one hand, this is due to better bargaining power by the parent company. On the other, due to the lack of radiator paint shop that can service Korado Bulgaria's total radiator capacity. The Company's current paint shop can service 650k steel panel radiators only. Accordingly, Korado uses the Group's paint shops in the Czech republic to finish its tubular products. The Company is working on expanding its radiator paint shop capacity. In August 2017, it acquired adjacent 30 000 sqm premises where to work on a solution for painting all steel panel and bathroom radiators.

Overall, the Korado Group, part of which is Korado Bulgaria, is a leading steel panel radiators producer in Europe with Czech and adjacent countries key markets. The Group has also strong market positions in Romania, Ukraine, Russia and the Balkans and has recently started balancing out their influence with orders from mature markets in Western Europe where manufacturers have been struggling with high indebtedness in a downturn environment.

Leading steel panel radiator producer in Bulgaria

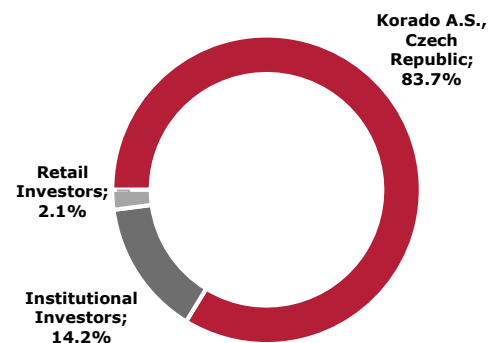
SHAREHOLDERS' STRUCTURE

Korado Bulgaria's registered share capital is BGN 13.2m distributed among 13 168 614 outstanding ordinary shares with a nominal value of BGN 1 per share.

The Company's majority shareholder is Korado A.S., Czech Republic, which currently holds 83.7% of the outstanding shares. The rest is free float traded on the Bulgarian Stock Exchange and distributed among local institutional and retail investors.

Indirect controlling stake in Korado Bulgaria hold the Czech Republic via the Ministry of Finance and the European Bank for Reconstruction and Development. The latter two hold 34.22% and 29.14%, respectively, of Korado A.S. The rest is distributed among individual investors. Korado A.S. is not traded publicly.

Number of shares outstanding: 13 168 614



Source: Company data

POTENTIAL CATALYSTS

Recovering construction industry: The considerable macroeconomic improvement all over Europe and especially in Central and Eastern Europe together with continuing low interest rate environment and rising disposable income are remain growth drivers in the recovery of the construction sector on the continent. This implies considerably upturn both in the new buildings segment and the old building renovation segment, including with replacement of old heating appliances with new ones.

EU climate change targets; energy efficiency boost and smartness revolution: The EU strive to reduce carbon footprint and encourage energy savings pushes for considerable energy efficiency improvement, including via energy smartness regulation. This gives a considerable boost to renovation and retro-fit construction work with traditional steel panel appliances a competitive solution even vs cheap Turkish and Chinese products.

Strong fundamental position: Korado's strong balance sheet and low cost manufacturing cost base to remain a considerable advantage as growing demand adds pressure on already financially stretched radiator manufacturers in Western Europe.

Free float increase: Korado's plans to double its free float traded on market which should also give a boost to the Company's stock liquidity.

SECTOR OVERVIEW

EUROPEAN HEATING MARKET

According to a 2016 study by Ecofys, ordered by the Association of the European Heating Industry (EHI), 30% of the EU overall CO2 emissions are due to residential heating inefficiency as 65% of the installed stock of heaters in Europe is old and inefficient while a majority of the buildings stock is built prior to 1970.

Energy efficiency and climate change initiatives in the EU to drive major change in the industry

Accordingly, the EU new climate change targets, buildings energy performance regulation and ongoing considerable energy efficiency initiative, would boost the replacement rate of the inefficient heating systems. Ecofys estimates that the current replacement rate of about 4% per year will rise by at least 25% by 2020 and maintain that level until 2030.

The abovementioned trends are expected to give a considerable up push to the European heating industry as well as to the overall heat emitters segment as steel panel radiators have proved efficient even with lower-temperature heated water.

In addition, the recovery of the construction sector seen over the last couple years all over Europe is also expected to positively affect the heating industry and radiator producers, in particular.

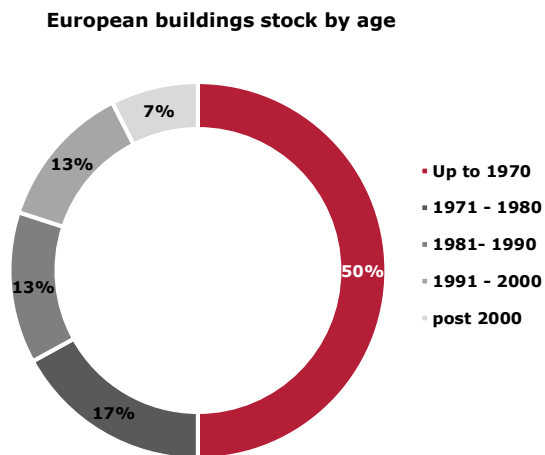
Construction sector in recovery

Currently, the steel panel radiator market in Europe is divided among premium Western European producers and lower cost Eastern European and Turkish manufacturers. The overall branded and non-branded production capacity is estimated at approx. 60 million units/annum while the market absorption potential has shrunk by approx. 25% since the financial crisis from as high as 36 million units prior the crisis to c.27 million units in 2014.

This has led to Western European branded high-cost manufacturers to close or transfer capacity to lower cost destinations in Eastern Europe. For example, one of the leading radiator producers – Dutch Rettig ICC, closed out some of its Western European plants and transferred capacity to its Polish operations. Accordingly, Rettig’s subsidiaries in Poland (Purmo) and Hungary (Vogel & Noot) are among the lower cost base producers in Eastern Europe competing with Korado Group. Nevertheless, the above mentioned producers are among the leading European manufacturers of steel panel heating radiators taking up from 1st to 5th place on different European markets. For example, in Russia, one of the largest markets in Europe for steel panel radiators, the latter three manufacturers together with Kermi (Germany) account for 1/3 of the market, another 33% is held by local producers while Turkish radiators take up approx. 17% of the market.

Turkish manufacturers dominate the non-branded low cost – low price segment of the European market. However, new energy regulations are expected to favor better quality products were Korado Bulgaria and the Korado Group have competitive advantage.

Exhibit 1: Europe’s inefficient and older building stock to drive renovation as part of EU’s energy efficiency stimuli ...



Source: The European Commission

Exhibit 2:... while recovery in the construction sector to add speed to the heating industry



Source: Eurostat

KORADO’S MARKET PRESENCE

Korado Bulgaria is the only steel panel radiator producer in Bulgaria, part of the leading European heating appliances manufacturer Korado Group, Czech Republic.

Sole steel panel radiators producer in Bulgaria

The Company distributes c.70% of its products via the parent company in the Czech Republic while direct sales in Bulgaria and other markets are accomplished via specialized dealers. When dealing with the parent company, Korado Bulgaria and Korado AS use transfer pricing policies in line with accepted good business practice. The transfer pricing methodology and

policy are monitor by the Company’s auditors – previously Ernts & Young, currently PricewaterhouseCoopers.

About 80%+ of the Company’s production is sold in Europe with key markets being the Czech Republic, Ukraine and Romania. Sales on the local market – Bulgaria, represent less than 5% of overall sales and are relatively stable over the last five years with no major fluctuations.

Korado has solid market positions in the Czech Republic due to the presence of the parent company there. It is also among the leading players in Ukraine and has been present in Romania for more than 20 years. Russia is another key market for the Group, where it is among the top 5 radiator players.

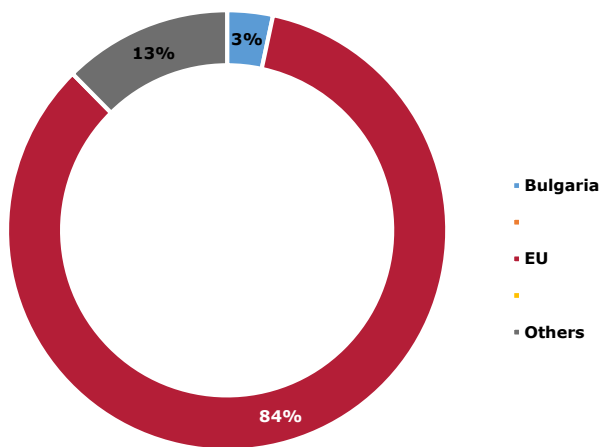
Nevertheless, the Group and the Company have been working to balance out its dependence on the above mention key markets in Eastern Europe with more stable and mature markets like Germany, France and the UK. In 2016, Korado Bulgaria added new direct sales to France and Hungary, thus expanding its client portfolio while in 2017 it also had sales to Chile.

The Company competes with other major European players as well as low cost Turkish competitors on all markets where it operates. The overall steel panel technology is in severe competition with aluminum radiators, where China has been the global low cost manufacturer. Turkish steel panel producers, however, compete mostly on cost and price of the radiators while Korado focuses on margins thus will sacrifice volumes for the realization of better priced higher end products.

Key positions in the Czech Republic, Ukraine and Romania

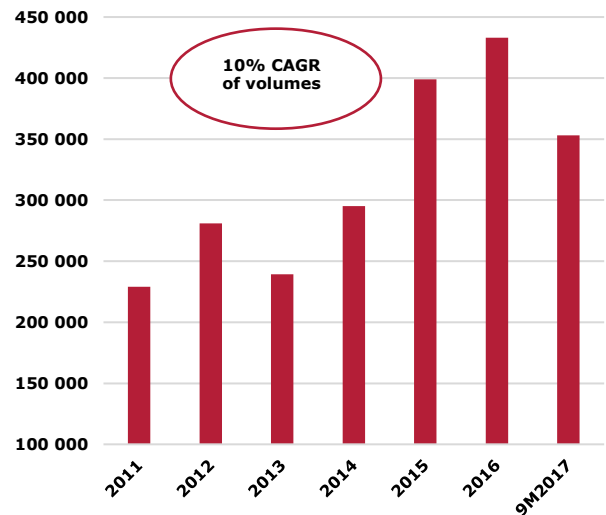
Severe competition from low cost producers in Turkey and China

Exhibit 3: Sales to Europe dominate and have 2x over the last five years



Source: The Company

Exhibit 4:... with the 50%+ rise in volumes for the same five year period



Source: The Company

FINANCIAL ANALYSIS AND VALUATION

Korado is a solid steel panel radiator producer in Eastern Europe with strong fundamentals to take up the expected upturn in the construction sector amid severe competition. The Company has doubled steel panel capacity at the end of 2014 and introduced a new production line for tubular bathroom radiators in 2016, thus making it fit to meet the expected rise in heating appliances demand due to the buildings’ energy efficiency push in the EU.

The Company is not a leverage fan and has lowered its pre-financial crisis leverage to low and healthy D/E ratio. Its interest bearing debt obligations come from loans extended by the parent company at favorable terms due to bargaining power of the larger Group.

Currently, Korado is focused on margins. It managed to sustain a relatively stable materials cost structure over the last five years despite the surge in steel prices over the last 12+ months. Thus, with capacity utilization and surge in volumes, 10% CAGR over the last 5 years, Korado tripled profitability and increased ROE to mid-teens range in the last three years.

In the 2014-2016 period, the Company has finalized all CAPEX intensive investment plans (mostly capacity expansion). Accordingly, no major CAPEX is expected over the next couple of years with the exception of setting up a new bathroom radiators paint shop to lower logistics costs as these products are currently shipped to the Czech Republic for painting. Still, current investments are focused on less CAPEX intensive energy efficiency projects. Thus, the Company generates considerable excess free cash flows which it is willing to share with investors. It initiated dividend distribution paying out approx. 80% of profits over the last three years.

The latter fundamental strength led to the Company’s market value tripling over the last three years. Accordingly, we base our valuation on the discounted cash flow model and a

peer multiples comparison to arrive at a fair value for Korado. The Company is fairly valued based on peers' EV/EBITDA and P/E multiples comparison. However, the discounted cash flow model reveals considerable undervaluation compared to current market quotes. When weighting both models Korado's fair value remains undervalued vs. current market quotes.

(in BGN)	2014A	2015A	2016A	2017F
Last Price	2.9	3.6	5.28	7.00
Number of Shares, year end	6 202 290	8 779 076	8 779 076	13 168 614
Market Capitalization	17 986 641	31 604 674	46 353 521	92 180 298
Net Profit	1 321 000	1 932 000	2 927 000	4 635 489
P/E	13.62	16.36	15.84	19.89
Equity	9 124 000	16 271 000	17 587 000	19 095 098
P/B	1.97	1.94	2.64	4.83
Sales	20 912 000	27 449 000	32 607 000	42 926 084
P/S	0.86	1.15	1.42	2.15
EV	21 662 641	31 510 674	48 624 521	94 475 268
EBITDA	1 993 000	2 993 000	4 364 000	6 300 151
EV/EBITDA	10.87	10.53	11.14	15.00
ROE	16.30%	15.22%	17.29%	25.27%
ROA	10.09%	10.73%	12.90%	17.64%

FINANCIAL PERFORMANCE ANALYSIS

Korado delivered impressive growth both on the top and bottom line over the last five years. Key growth driver was capacity expansion and utilization. The Company has outpaced the market and the general economy with 10% organic CAGR of revenues on 10% CAGR of volumes. Profitability rose sevenfold over the last five years.

*10% organic CAGR of revenues
for the last five years*

New steel panel radiators capacity was quickly utilized and the Company has almost doubled volumes sold from 280k pieces at the end of FY2012 to 433k pieces at the end of FY2016. The start of 2017 was also very active in terms of demand as steel prices were on the rise and dealers began earlier stocking with radiators. Accordingly, steel panel volumes sold in H1'17 surged almost 20% y/y while tubular volumes rose 6x on lower base. This translated into 63% surge in sales revenues to BGN 21.5m for the period.

In 3Q17 alone, early stocking and higher steel prices dampened some of the demand which translated to a slowdown in volumes and sales growth of 11% y/y and 38% y/y, respectively. The top line in 3Q17 vs. 3Q16, alone, rose only 6% y/y in line with volumes while pre-tax net income declined 15% y/y to BGN 1.2m.

Nevertheless, despite the 3Q17 slowdown in growth, cumulatively and on an annual basis Korado booked record high results. EBITDA rose 4x while net profit rose sevenfold over the last five years with a 49% CAGR. For 9M17, EBITDA came at BGN 5.1m, up 36% y/y, and pre-tax net profit came at BGN 4.2m, up 42.6% y/y. EBITDA margin, however, fell from an average of 16.6% in H1'17 to 15.9% for the 9M17 while pre-tax net profit margin slid from 13.8% in H1'17 to 13% for the 9M17. Nevertheless, margins are well above historical average and are on record high levels as well.

Korado's management, both on the parent company level and on the level of the Bulgarian subsidiary, is especially focused on margins and cost control. Accordingly, all sales directed to Bulgaria have to deliver cost efficiency both on the manufacturing and logistics side. Over the last five years this has led to maintaining material costs at a level of c.70% of sales. This is achieved despite a surge in steel prices over the last 12 months with 20%. External service costs have also been kept in check at a 4% average share of sales. In 2017, they even came below 4% of sales, 3.7% of sales in H1'17.

*49% CAGR of net profit
for the last five years*

Cost of labor rose over historical average to approximately 11.5% of sales on considerable wage indexation in Bulgaria over the last few years. In 2017 alone, average wage levels in Bulgaria are up 10% y/y. Korado Bulgaria has also index personnel remuneration.

We expect growth to remain in the double digit spectrum with a 13.8% CAGR for the 2018-2020 period on stronger construction sector performance and EU energy efficiency urge. Afterwards, we expect the pace to gradually decline to a 2% long term growth rate post 2022 as competition intensifies.

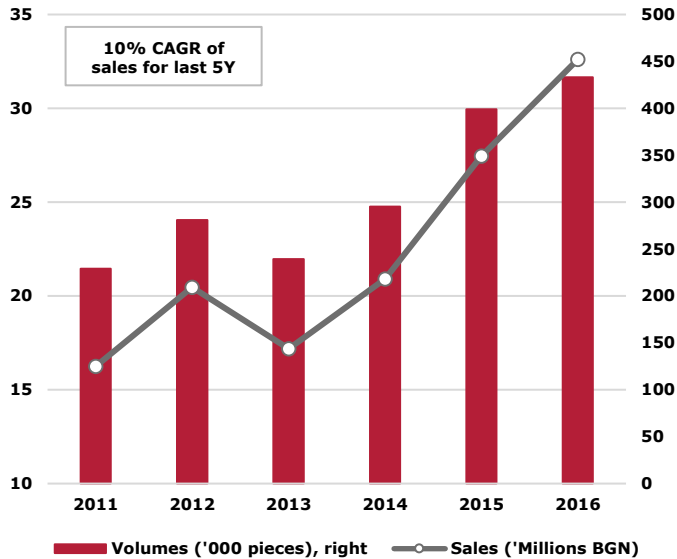
Accordingly, we also expect profitability to remain in the 11-12% net profit margin range over the 2018 – 2022 period on continuous cost control and margin focus. Our EBITDA margin estimate is to remain close to 14%-14.5% over the next five years.

No major CAPEX is expected for the period. It peaked in 2014 and 2016, totaling c. BGN 5 m, when the Company invested in a new steel panel welding line and a new tubular bathroom radiators soldering furnace, respectively. Until current capacity is fully utilized no new major capital expenditures are expected with the exception of setting up a bathroom radiators paint shop. Korado planned to acquire a new painting line for c. BGN 1.7m with the last capital raise in 2014, however, the new shares offered then were not fully subscribed. Currently, the

Company is exploring technical solutions to paint bathroom radiators from several potential suppliers with no decision on the latter yet.

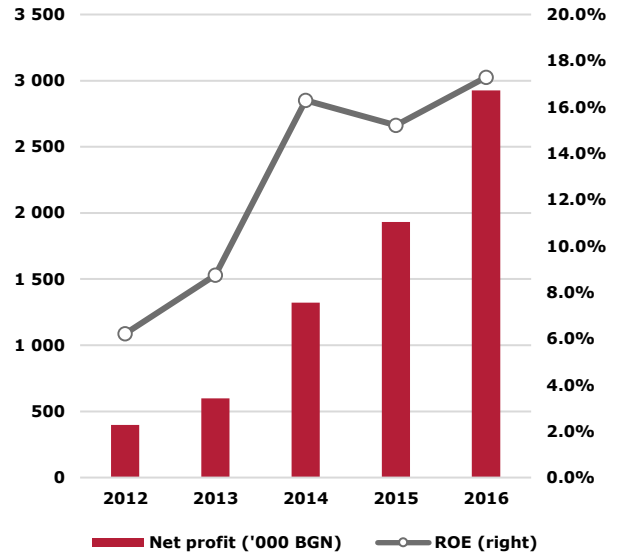
Finally, debt levels should be kept in check and remain relatively unchanged due to Korado's management reluctance to leverage the Company. The latter is due to the industry's historical bad experience with overleverage especially at the time and post the 2008 financial crisis. Korado's management prefers to use minimal level of debt to keep the balance sheet in check and to allow it to take up market share quickly where competitors are having problems due to higher leverage levels.

Exhibit 5: Strong top line historic performance



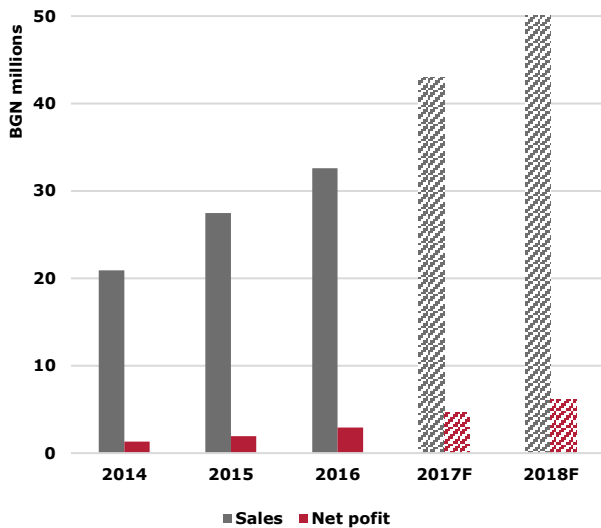
Source: Company data

Exhibit 6: Profitability surging 7x in 5 years



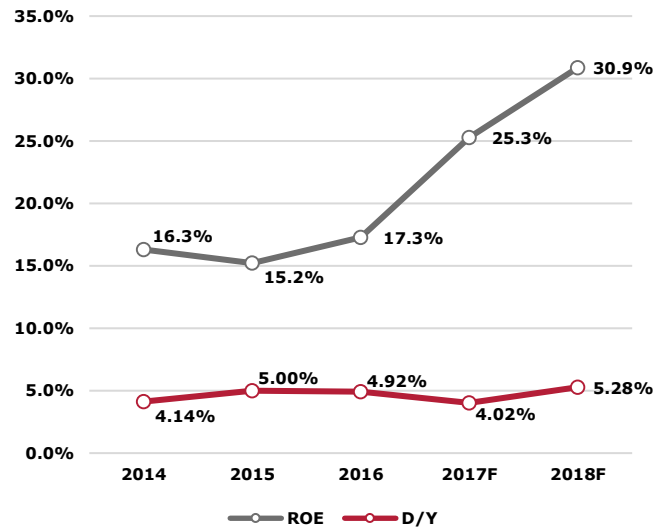
Source: Company data

Exhibit 7: Top and bottom line expansion to continue



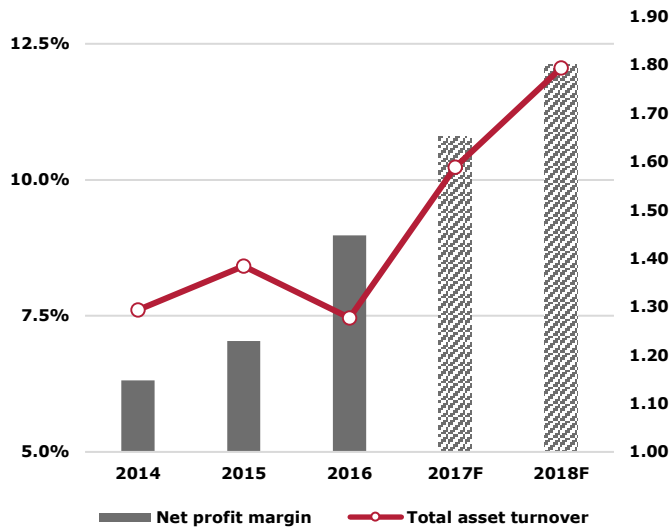
Source: Company data; Elana Trading estimates

Exhibit 8: ... with investor returns to remain lucrative



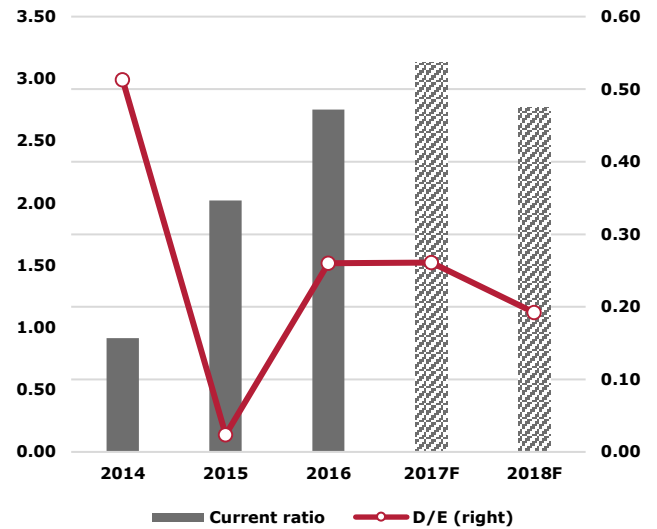
Source: Company data; Elana Trading estimates

Exhibit 9: ROE to be supported by rising profit margin and asset turnover



Source: Company data; Elana Trading estimates

Exhibit 10: ... while debt and liquidity remaining at healthy levels



Source: Company data; Elana Trading estimates

VALUATION OF KORADO

To value Korado's fair value we take into account the Company's ability to generate healthy cash flows out of normal operations as well as compare it to regional and global peers. Accordingly, we conduct a discounted cash flow analysis and a peer comparison evaluation. The final fair value is a weighted average of the outcomes from the above to models.

We base our DCF analysis on a 10% CAGR of the top line for the 2017-2021 period and a 2% sustainable long term growth rate from 2022 onwards. The initial higher growth period is based on the expected construction sector and energy efficiency upturn that should add fuel to the already considerable growth pace of the Company over the last five year. We expect the growth rate to decline gradually over the next five years as competition intensifies.

We also incorporate a relatively stable profitability margins over the course of the forecasted period due to the Company's attention on margins and its historical ability to sustain material costs with appropriate deal transfers from the parent company. Accordingly, we incorporate a relatively stable EBITDA and net profit margin over the next five years of 15% and 12%, respectively. Afterwards we expect profitability margins to level off only slightly lower at 13% EBITDA margin and 11% net profit margin.

We do not expect significant changes in the Company's capital structure during the analyzed period with debt levels projected to steadily decline. Also, CAPEX should be relatively negligent and to the extend of replacing amortizing asset. Depreciation expense would, accordingly, be declining over the forecasted period as we do not expect any major new assets to be added by the Company.

In our DCF analysis we incorporate a fixed 6.8% weighted average cost of capital. It is based on our average estimate for the expected WACC for the next six years. For the forecasted period we expect the current low interest rates both on corporate and sovereign debt to start gradually rising. We keep a constant equity risk premium for the Bulgarian capital market, as stipulated by the latest NYU Stern Professor Damodaran's estimate and as we believe that the absolute amount is adequate for the Bulgarian capital market for the forecasted period.

Finally, when projecting Korado's relative volatility to the market returns, we take into account the average relative volatility of peer companies, adjusted for leverage differences. The DCF analysis yields a BGN 10.86 per share fair value for Korado's shares. This entails significant undervaluation for the Company.

To arrive at a final fair value for the Company we also incorporate a peer comparison analysis based on the median P/E and EV/EBIDA multiple for the industry. The peer multiple comparison yields BGN 6.01 per share fair value for Korado's stock. This entails an overvaluation compared to current market quotes.

When equally weighting the outcomes of the two valuation models - DCF and peer comparison, we arrive at a BGN 8.51 per share intrinsic value to Korado's stock. This allows for a 22% upside to current quotes.

Cash flows generation to be strong in the 2018-2022 period

DISCOUNTED CASH FLOWS

BGN'000	2017F	2018F	2019F	2020F	2021F	2022F TERMINAL YEAR
EBIT	5 260	6 942	7 849	9 243	9 660	8 805
EBIT(1-T)	4 734	6 248	7 064	8 319	8 694	7 925
Add: D&A	1 040	936	866	711	548	489
LESS: INVESTMENTS	644	502	577	646	685	699
LESS: CHANGE NWC	1 454	-939	-365	2 148	1 300	850
FCF	3 676	7 621	7 717	6 235	7 258	6 866
PV FCF	3 737	8 274	8 948	7 721	9 599	
SUM OF PV FCF	38 279					
PV OF CONTINUING VALUE	108 145					
TOTAL PV FREE CASH FLOWS	146 424					
LESS: OUTSTANDING DEBT	4 872					
PLUS: FINANCIAL ASSETS	1 451					
PV OF EQUITY	143 003					
FAIR VALUE PER SHARE (BGN)	10.86					

WEIGHTED AVERAGE COST OF CAPITAL

	2017	2018	2019	2020	2021	2022 Terminal Year
Risk free rate (Yield on 10-year Bulgarian Bonds)	1.50%	2.00%	2.50%	3.00%	3.00%	3.50%
Equity risk premium (NYU Stern Estimate)	8.40%	8.40%	8.40%	8.40%	8.40%	8.40%
Beta (Adjusted industry average)	0.53	0.53	0.53	0.53	0.53	0.53
Cost of equity	5.95%	6.45%	6.95%	7.45%	7.45%	7.95%
Cost of debt	2.00%	2.50%	3.50%	3.50%	3.50%	4.00%
Effective tax rate	10%	10%	10%	10%	10%	10%
After-tax cost of debt	1.80%	2.25%	3.15%	3.15%	3.15%	3.60%
Weight of equity	96%	95%	95%	95%	95%	95%
WACC	5.79%	6.24%	6.76%	7.24%	7.24%	7.73%
Weighted average WACC	6.83%					

PEER COMPARISON

Company	Ticker	Country	Mkt Cap (BGN m)	P/E	ROE (%)	EV/EBITDA T12M
KORADO BULGARIA AD	4KX BU	BULGARIA	34	22.94	17.29	10.15
NEDERMAN HOLDING AB	NMAN SS	SWEDEN	290	15.46	19.62	10.15
KYUNG DONG NAVIEN CO LTD	009450 KS	SOUTH KOREA	323	16.72	10.90	11.15
ZEHNDER GROUP AG-RG	ZEHN SW	SWITZERLAND	360	23.90	-2.38	9.15
SINKO INDUSTRIES LTD	6458 JP	JAPAN	361	12.59	11.24	7.18
SUNONWEALTH ELECTRIC MACHINE	2421 TT	TAIWAN	420	20.77	18.93	8.16
WALTER MEIER AG - REG	WMN SW	SWITZERLAND	424	29.46	9.06	29.10
VLUTION GROUP PLC	FAN LN	BRITAIN	462	29.57	9.49	10.70
SYSTEMAIR AB	SYSR SS	SWEDEN	727	25.77	N/A	12.88
ARBONIA AG	ARBN SW	SWITZERLAND	982	52.96	3.4	15.54
Min			34	12.59	-2.38	7.18
Mean			343	25.01	10.84	12.42
Median			361	23.42	10.90	10.42
Max			727	52.96	19.62	29.10

Source: Bloomberg

Peer Multiples	P/E ttm	EV/EBITDA ttm
Median peer multiple	23.42	10.42
Korado's fair value based on peer multiple ('000 BGN)	98 009	59 673
Fair value per share based on peer multiple (BGN)	7.44	4.22
Weight of multiple fair value	60%	40%
Final peer multiple fair value per share (BGN)	6.15	

	DCF	Peer Comparison
Fair Value per Model (BGN)	10.86	6.15
Weight of Model	50%	50%
FINAL FAIR VALUE PER SHARE (BGN)	8.51	

RECOMMENDATION AND PRICE TARGET

We initiate coverage of Korado with a BUY recommendation due to the Company’s solid fundamental growth track record and management commitment to increase the Company’s free float and improve the stock’s liquidity.

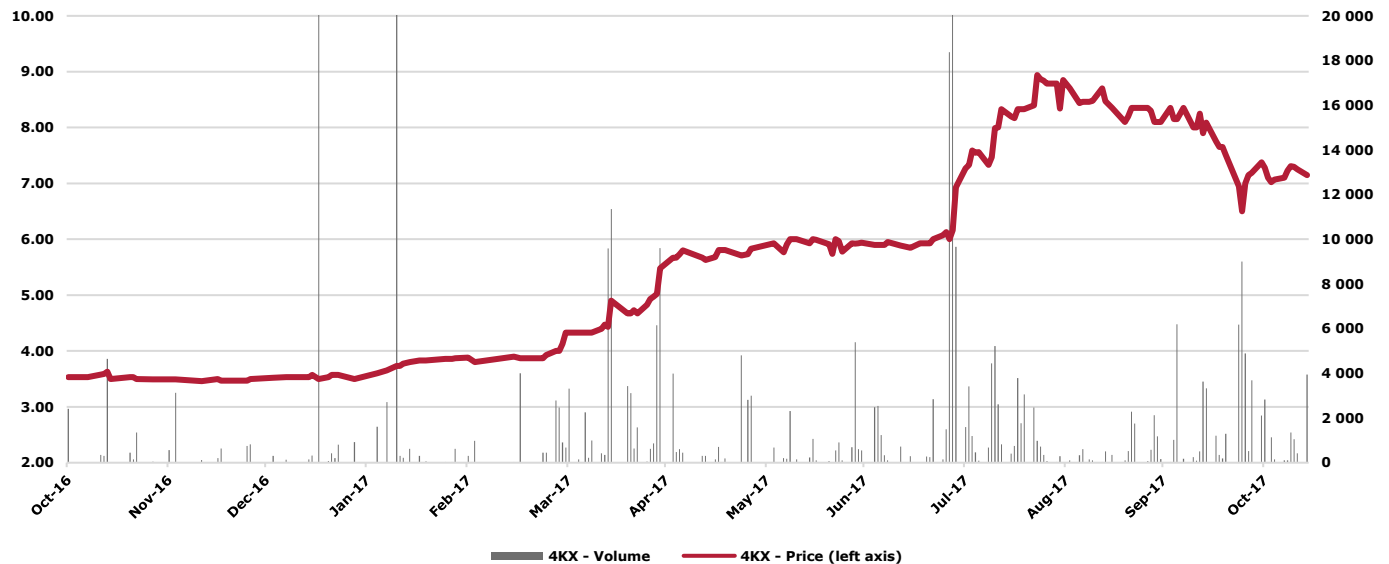
Recommendation: BUY
Target Price: BGN 8.51
Upside: 22%

Our valuation model makes us comfortable with a BGN 8.51 per share 12-month price target. It provides a lucrative 22% upside to current market quotes sweetened with the potential of steady dividend flows and increased liquidity. Accordingly, we expect demand from both institutional and individual investors.

In terms of significant investors involved in our stock market, we share the following observations:

- Bulgarian institutional investors, mostly, pension funds, consider the stock attractive and would increase exposure upon available liquidity. They acquired most of the free float during Korado’s 2014 capital raise and prefer buying and holding long term.
- Domestic individual investors were increasing their exposure to the stock prior to the stock dividend in August 2017. After taking some profits over the last few months, the Company’s performance will be a new accumulation catalyst for them.
- Foreign investors have not been active on the stock. Yet, investors interested in good corporate governance and steady cash flows would find the stock attractive.

STOCK PRICE DYNAMICS OVER THE LAST 12 MONTHS



Source: Bloomberg

ANNUAL FINANCIAL DATA (AUDITED)

INCOME STATEMENT ('000 BGN)	2014	2015	2016	9M 2016	9M 2017	TTM	2017F	2018F
SALES	20 912	27 449	32 607	23 356	32 290	41 541	42 926	50 182
OTHER OPERATING INCOME	209	180	154	116	162	200	219	254
CHANGE IN INVENTORIES	14	-78	-183	-456	-721	-448	-277	-434
COST OF MATERIALS	14 893	19 672	22 715	16 117	23 008	29 606	30 386	35 497
COST OF EXTERNAL SERVICES	1 005	1 182	1 346	909	1 070	1 507	1 417	1 336
COST OF LABOR	2 494	3 135	3 843	2 669	3 246	4 420	4 377	4 996
OTHER OPERATING EXPENSES	722	725	676	475	731	932	942	1 163
TOTAL OPERATING EXPENSES	19 128	24 636	28 397	19 714	27 334	36 017	37 337	43 494
EBITDA	1 993	2 993	4 364	3 758	5 118	5 724	6 300	7 878
DEPRECIATION AND AMORTIZATION	416	797	1 013	738	830	1 105	1 040	936
EBIT	1 577	2 196	3 351	3 020	4 288	4 619	5 260	6 942
FINANCIAL REVENUE	0	2	1	0	0	1	0	0
FINANCIAL EXPENSE	113	47	99	73	84	110	110	183
INTEREST EXPENSE	76	16	70	50	55	75	83	121
EBT	1 464	2 151	3 253	2 947	4 204	4 510	5 151	6 759
INCOME TAXES	143	219	326	0	0	326	515	676
MINORITY INTEREST	0	0	0	0	0	0		
NET INCOME	1 321	1 932	2 927	2 947	4 204	4 184	4 635	6 083
BALANCE SHEET ('000 BGN)	2014	2015	2016	9M 2016	9M 2017	TTM	2017F	2018F
CURRENT ASSETS								
INVENTORIES	2 762	3 920	4 897	4 759	6 278	6 278	5 151	5 520
RECEIVABLES FROM RELATED PARTIES	2 161	1 351	1 662	4 580	2 789	2 789	1 331	1 104
TRADE RECEIVABLES	234	517	1 489	1 350	2 163	2 163	3 219	3 011
CASH & CASH EQUIVALENTS	1 003	480	2 301	477	1 256	1 256	2 687	3 751
	6 160	6 268	10 349	11 166	12 486	12 486	12 389	13 387
NON-CURRENT ASSETS								
PROPERTY, PLANT & EQUIPMENT	9 961	13 516	15 127	14 990	15 142	15 142	14 595	14 553
INTANGIBLES	5	12	9	11	9	9	13	15
OTHER RECEIVABLES	38	37	45	37	45	45	21	25
	10 004	13 565	15 181	15 038	15 196	15 196	14 629	14 593
TOTAL ASSETS	16 164	19 833	25 530	26 204	27 682	27 682	27 018	27 980
SHAREHOLDERS' EQUITY								
SHARE CAPITAL	6 481	8 779	8 779	8 779	13 169	13 169	13 169	13 169
RESERVES	947	5 101	5 294	5 294	1 017	1 017	1 368	1 976
RETAINED EARNINGS	1 696	2 391	3 514	3 565	5 322	5 322	4 559	5 167
	9 124	16 271	17 587	17 638	19 508	19 508	19 095	20 312
LIABILITIES								
CURRENT LIABILITIES								
ACCOUNT PAYABLES	2 361	3 022	3 227	3 267	2 586	2 586	2 790	3 613
FINANCIAL LEASE LIABILITIES	4	62	92	24	27	27	86	90
LIABILITIES TO RELATED PARTIES	4 364	3	9	4 707	833	833	1 073	1 004
OTHER CURRENT LIABILITIES	0	13	433	24	514	514	11	125
	6 729	3 100	3 761	8 022	3 960	3 960	3 960	4 833
NON-CURRENT LIABILITIES								
LIABILITIES TO EMPLOYEES ON RETIREMENT	0	154	144	308	176	176	150	151
FINANCIAL LEASES	311	308	322	236	322	322	386	427
LIABILITIES TO RELATED PARTIES	0	0	3 716	0	3 716	3 716	3 426	2 258
	311	462	4 182	544	4 214	4 214	3 963	2 835
TOTAL LIABILITIES	7 040	3 562	7 943	544	8 174	8 174	7 923	7 668
SHRS' EQUITY AND LIABILITIES	16 164	19 833	25 530	26 204	27 682	27 682	27 018	27 980
WORKING CAPITAL	-1 572	2 688	4 287	2 667	7 270	176	5 741	4 802
NUMBER OF SHARES:	6 202 290	8 779 076	8 779 076	8 779 076	13 168 614	13 168 614	13 168 614	13 168 614
PRICE IN BGN - PERIOD END:	2.9	3.6	5.28	5.00	7.3	7.00	7.00	7.00
MARKET CAP IN BGN - PERIOD END:	17 986 641	31 604 674	46 353 521	43 895 380	96 130 882	92 180 298	92 180 298	92 180 298

FINANCIAL AND PERFORMANCE INDICATORS

	2014	2015	2016	2017F	2018F
VALUATION					
PRICE/EARNINGS (P/E)	13.62	16.36	15.84	19.89	15.15
PRICE/BOOK (P/B)	1.97	1.94	2.64	4.83	4.83
PRICE/SALES (P/S)	0.86	1.15	1.42	2.15	1.84
EV (IN '000 BGN)	21 663	31 511	48 625	94 475	92 333
EV/EBITDA	10.87	10.53	11.14	15.00	11.72
PROFITABILITY					
RETURN ON COMMON EQUITY	16.30%	15.22%	17.29%	25.27%	30.87%
RETURN ON ASSETS	10.09%	10.73%	12.90%	17.64%	22.12%
RETURN ON INVESTED CAPITAL	12.32%	13.57%	16.87%	24.59%	33.92%
EBITDA MARGIN	9.53%	10.90%	13.38%	14.68%	15.70%
OPERATING MARGIN	7.54%	8.00%	10.28%	12.25%	13.83%
NET INCOME MARGIN	6.32%	7.04%	8.98%	10.80%	12.12%
DIVIDENDS					
DIVIDEND YIELD	4.14%	5.00%	4.92%	4.02%	5.28%
DIVIDEND PER SHARE	0.12	0.18	0.26	0.28	0.37
LIQUIDITY					
CURRENT RATIO	0.92	2.02	2.75	3.13	2.77
QUICK RATIO	0.50	0.76	1.45	1.83	1.63
CREDIT					
LT DEBT/EQUITY	0.03	0.02	0.23	0.20	0.13
TOTAL DEBT/EQUITY	0.51	0.02	0.26	0.26	0.19
TOTAL DEBT/TOTAL ASSETS	0.29	0.02	0.18	0.18	0.14
EBIT/INTEREST EXPENSE	20.75	137.25	47.87	63.35	57.31

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SELL	Target price is more than 10% below the current quotes

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Q3 2017 Recommendation Review			Market Maker Services
Recommendation	#	Share	
BUY	8	40%	SKK BU; 4KX BU
HOLD	9	45%	
SELL	0	0%	
Under review	3	15%	

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For more information, please contact:

Research Analyst	Phone:	E-mail:	Internet:
Tsvetoslav Tsachev	+359 2 810 00 23	tsachev@elana.net	www.elana.net
Research Team	+359 2 81 000 24	research@elana.net	www.elana.net