

KORADO

INDUSTRY: ELECTRICAL EQUIPMENT

IT IS ALL ABOUT THE MARGINS

KORADO'S Q1'18 TOP AND BOTTOM LINES FELL SLIGHTLY SHORT OF OUR EXPECTATIONS YET SHOWED HIGH GROWTH DESPITE SURGING MATERIAL COSTS. THE QUARTER SAW FEWER SALES AT HIGHER PRICES WHICH DROVE REVENUES UP, FURTHER EXPANDING MARGINS. THE LATTER, COUPLED WITH LEAN OPEX MANAGEMENT, GIVES US COMFORT WITH OUR CURRENT VALUATION, WITH A POTENTIAL UPGRADE IF THE TREND IS SUSTAINED.

TOP LINE STEADILY GROWING ON INCREASED PRICES

In Q1'18 Korado's top line showed stable expansion of 9.6% y/y to BGN 10.6m, resulting entirely from surge in prices, as volumes sold dropped by 3.4% y/y to 154k pieces. The revenue increase marks a positive trend as Korado managed to transfer the increase in material costs, due to growing steel prices, to its end customers. The latter is possible as Korado operates predominantly in the mid-to-high segment of the market, allowing it to maneuver much easier in the events of steel price surges, unlike its higher-end competitors, which are pressed to decrease prices in such cases.

MARGINS ARE CONSIDERABLY UP

The first quarter brought further strengthening in Korado's margins despite material costs advancing 7.9% y/y as global cold rolled coil steel prices added c.10% in Q1'18. Continuing good OPEX management led to further improvement in profitability, as the Company delivered 17% y/y increase in EBITDA to BGN 1.9m and 21% y/y boost in net profit to BGN 1.5m. As a result, net income margin expanded to 14.1%, while EBITDA margin hit record 18.6%.

GERMAN EXPANSION TO FURTHER BOOST EUROPEAN SALES

In the beginning of 2018, Korado announced negotiations of a major panel radiators deal with a German client. The latter is an existing customer buying 15% of its tubular bathroom radiators in the past two years. The deal is expected to further boost the Company's expansion in highly competitive EU market, where in Q1'18 it delivered 11% y/y increase in sales to BGN 10m. The highest growth was registered in Hungary with 10x y/y surge to BGN 837k and Romania – up 7.4% y/y to BGN 3.7m. Traditionally largest Czech market added 0.5% y/y to BGN 5.5m in Q1'18.

STABLE RETURNS TWICE A YEAR

With new legislation enabling local companies to distribute net profit twice a year, Korado proposed the introduction of semi-annual dividends starting from 2018. The latter to be voted on the upcoming general shareholders meeting. Proposed dividend for FY2017 came at BGN 0.26, missing on our estimate by 10%. Although the same in absolute value as the 2016 one, the return for investors is 50% higher, considering the stock dilution which followed the 2017 capital increase.

VALUATION/RISKS

VALUATION: Latest results as well as expected growth boosted by the German client, give us the comfort to restate our expectations. We keep our one year target price unchanged at BGN 8.51 per share with a potential for an upgrade if Korado sustains the current financial performance trend over the quarter. Yet, we update our recommendation from HOLD to BUY as currently there is a 10.5% upside potential. **RISKS:** Further rise in steel prices, heavy reliance on the Czech market and considerable competition from peers, to pose risks on Korado's performance.

RESULTS ANALYSIS

BUY
ONE YEAR PRICE TARGET: BGN 8.51
CURRENT PRICE: BGN 7.70

EXCHANGE RATES

EUR/BGN (FIXED): 1.95583
USD/BGN: 1.63149

MARKET DATA

Shares Outstanding:	13.2m
Share Capital:	13.2m
Free-float:	16.3%
Treasury Shares	0%
Market Cap.:	BGN 101m
Avg. Daily Vol.:	BGN 10 116
52 Weeks Range:	BGN 5.47 – 8.94
BSE Ticker	4KX
Bloomberg Ticker	4KX BU

OUTPACING THE MARKET



Source: Bloomberg

In kBGN, excl. ratios	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q42017	Q1 2018
Revenues	7 637	10 118	9 251	9 624	11 908	10 758	10 340	10 449
Growth y/y	112.18%	125.38%	128.29%	171.83%	55.93%	6.33%	11.77%	8.57%
EBITDA	1 115	1 745	606	1 654	1 927	1 537	1 412	1 940
EBIT	862	1 477	331	1 382	1 651	1 255	1 134	1 665
Net profit	833	1 445	-20	1 220	1 758	1 227	1 107	1 474
Equity	16 193	17 638	17 587	18 942	18 281	19 508	20 541	21 741
ROE (TTM)	15.74%	18.08%	17.29%	19.77%	24.45%	22.76%	27.99%	27.83%
ROA (TTM)	11.82%	13.24%	12.25%	13.35%	16.28%	15.31%	19.23%	19.53%
EBITDA margin	14.60%	17.25%	6.55%	17.19%	16.18%	14.29%	13.66%	18.57%
EBIT margin	11.29%	14.60%	3.58%	14.36%	13.86%	11.67%	10.97%	15.93%
Net profit margin	10.91%	14.28%	-0.22%	12.67%	14.76%	11.41%	10.71%	14.11%
EPS	0.09	0.16	0.00	0.14	0.20	0.09	0.08	0.11
Debt/equity	0.01	0.01	0.23	0.22	0.22	0.21	0.19	0.18
P/E	17.70	14.57	15.84	13.63	16.65	22.98	16.98	18.22
P/B	2.82	2.49	2.64	2.50	4.01	4.93	4.39	4.66
EV/EBITDA	12.47	10.90	11.04	9.82	13.04	17.55	14.42	15.23

KORADO'S RESULTS REVIEW

Bulgaria's only steel panel radiator producer Korado delivered good results in Q1'18, showing lean OPEX management, boosting sales despite strong competition from European and global peers.

Revenue breakdown: The first quarter traditionally delivers weaker results due to lower construction season. Still, Korado managed to expand its top line entirely on boosted prices generating 9.6% y/y growth in revenues to BGN 10.6m in Q1'18. The latter resulted from main raw material driving production costs up and the Company succeeding to transfer it to end customers.

Sold volumes, however, dropped by 3.4% y/y, with panel radiators volume sold decreasing 2.2% y/y to 130.5k pieces, and tubular radiators sales erasing 9.9% y/y dropping to 23.4k pieces.

In Q1'18, revenue by geography showed some differences, as sales in EU countries were boosted, yet Bulgarian and Ukrainian markets plummeted by 14% y/y and 46% y/y to BGN 260k and BGN 140k, respectively. From the EU countries, Hungary and Romania showed the highest growths, the former advancing tenfold to BGN 837k, and the latter adding 7.4% y/y to BGN 3.7m.

Room for expansion: In 2018, steel panel radiators market is expected to grow well-versed on the ongoing energy requirements for heating and ventilation provisioned by the EU. Additionally, construction sector promises expansion in the next couple of years triggered by increased incomes, corporate profits, good state of public finances and overall EU economic growth.

According to the European construction market research institute Euroconstruct, the construction sector in the Czech Republic, Korado's biggest market, is estimated to grow by 5.2% y/y in 2018. The construction sector in its fastest growing market for Q1'18, Hungary, is projected to grow by 22.4% y/y in 2018.

Special attention should be paid to Germany, which will be the main focus during the year. Korado has been in negotiations with a German client for the delivery of large volume panel radiators purchase. The client has been purchasing c.15% of Korado's bathroom radiators for the past couple of years and is now on the threshold of a larger deal, although no specific details have been disclosed so far.

Bottom line results: Korado's Q1'18 bottom line followed the upward trend in the top line, delivering a 21%/y/y increase to BGN 1.5m. Accordingly, profitability continued the growth trend from the past five years despite increased OPEX. Thus, the Company once again built on its performance, meeting its target to deliver higher margins.

The latter is possible as Korado operates predominantly in the mid-to-high segment of the market, allowing it to maneuver much easier in the events of steel price surges. This gives it advantage

over its higher-end competitors, which are pressed to lower prices to sell production when steel prices go too high. Furthermore, the Company is able to tap on regional alternative steel suppliers at lower prices.

The Company's expenses throughout Q1'18, were rather stable with the exception of materials and external services costs, the former advancing 8% y/y to BGN 7.4m and the latter doubling to BGN 382k. External services costs grew mainly on commissions and consulting services, as well as taxes. In Q1'18, Korado kept labor costs in check, the latter rising 4% y/y to BGN 1m.

Overall, the first quarter saw a rather stable OPEX, the latter increasing only 7.7% y/y to BGN 8.9m, slower than sales' growth of 9.6% y/y to BGN 10.6m. Accordingly, good cost management allowed for operating profitability and net income to grow faster than top line, thus expanding margins.

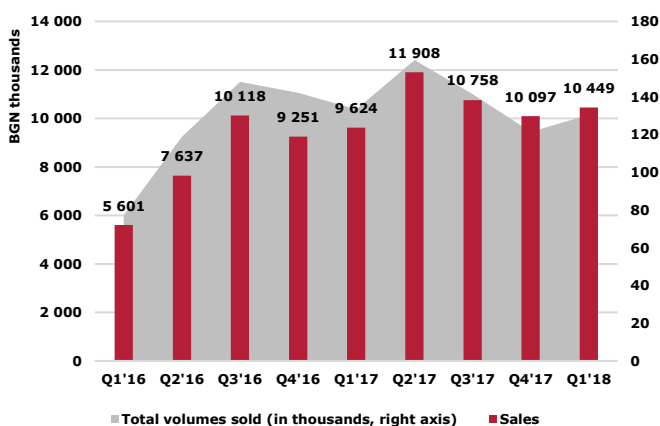
Profitability further improving: Korado's margins in Q1'18 are record high, with net income margin adding 144bps to 14.1% and EBITDA margin hitting the record 18.6%, being 140 bps up y/y. For the same period operating margin added 157 bps to 16% reflecting improved efficiency. All in all, the positive results re-confirm the Company's good CAPEX utilization and lean cost management.

In the meantime, long-term debt was kept in check with debt ratios improving considerably. As a result, total debt to EBITDA and net debt to EBITDA ratios lowered to 2.10 and 0.65, down from their Q1'17 levels of 2.91 and 1.74, respectively.

Furthermore, Korado managed to end Q1'18 with a considerable increase in cash, the latter reaching BGN 2.8m, up 46% y/y. The excess cash puts it in a good position for future investments, as the Company is planning to set up a new painting facility for bathroom radiators in 2018-2019.

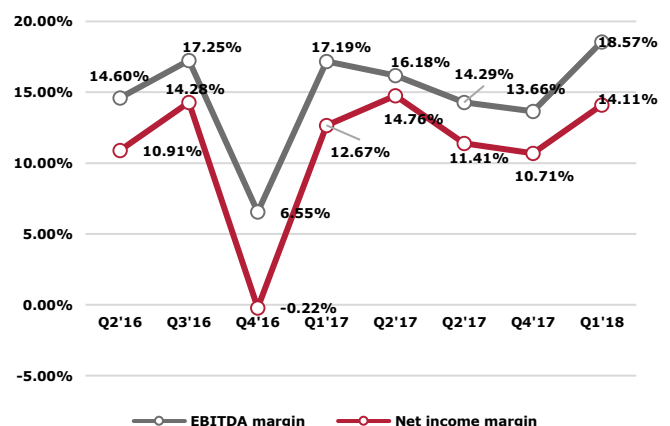
Valuation revision: We keep our expectations for sales in the next three quarters, yet decrease slightly overall 2018 top line on lower than expected Q1'18. We also increase by an inch 2018 bottom line as Q1'18 cost of materials showed milder than expected growth. Estimated dividends for 2018 and 2019 are slightly decreased, as the Company has expressed investment plans for this period. Projected top line expansion following 2018 is kept, with some small corrections in OPEX, which results in a slight change in our bottom line expectations. The latter returns very small changes in the DCF model. Based on the latter and after performing a peer comparison, we arrive at an insignificant change in our valuation. Thus, we keep our price estimate, yet we upgrade our recommendation to BUY as Korado's stock has a 10.5% upside potential at current quotes.

Exhibit 2: Sales in volumes and value



Source: Company data

Exhibit 3: Net income and EBITDA margins by quarters



Source: Company data

INDIVIDUAL FINANCIAL DATA

Income Statement	2015	2016	2017	Q1'17	Q1'18	TTM	2018F	2019F
Sales	27 449	32 607	42 387	9 624	10 449	43 212	49 249	57 129
Other operating income	180	154	243	41	140	342	462	286
Change in Inventories	-78	-183	44	-335	-405	-26	-533	-171
Cost of Materials	19 672	22 715	29 277	6 838	7 379	29 818	34 733	40 333
Cost of External Services	1 182	1 346	1 456	178	382	1 660	1 484	1 714
Cost of Labor	3 135	3 843	4 488	995	1 039	4 532	4 976	5 713
Other operating expenses	725	676	835	335	254	754	1 030	1 200
Total Operating Expenses	24 636	28 397	37 208	8 283	8 924	37 849	41 965	48 788
EBITDA	2 993	4 364	6 530	1 654	1 940	6 816	8 021	8 626
Depreciation and Amortization	797	1 013	1 108	272	275	1 111	1 041	1 143
EBIT	2 196	3 351	5 422	1 382	1 665	5 705	6 980	7 484
Financial revenue	2	1	0	0	0	0	0	1
Financial expense	47	99	111	27	27	111	178	143
Interest Expense	16	70	74	18	18	74	117	114
EBT	2 151	3 253	5 311	1 355	1 638	5 594	6 804	7 342
Income Taxes	219	326	533	136	164	561	680	734
Minority Interest	0	0	0	0	0	0		
Net Income	1 932	2 927	4 778	1 220	1 474	5 033	6 123	6 608

Balance Sheet	2015	2016	2017	Q1'17	Q1'18	TTM	2018F	2019F
Inventories	3 920	4 897	5 414	5 481	6 787	6 787	5 417	6 570
Receivables from related parties	1 351	1 662	4 258	4 253	4 364	4 364	2 462	2 856
Trade Receivables	517	1 489	242	851	1 687	1 687	2 462	1 428
Cash & Cash Equivalents	480	2 301	1 488	1 934	2 822	2 822	2 728	1 456
Current Assets	6 268	10 349	11 402	12 519	15 660	15 660	13 070	12 311
Property, Plant & Equipment	13 516	15 127	15 257	14 938	15 069	15 069	14 676	16 567
Intangibles	12	9	8	8	8	8	9	11
Other receivables	37	45	40	45	40	40	46	54
Non-Current Assets	13 565	15 181	15 305	14 991	15 117	15 117	14 732	16 632
Total Assets	19 833	25 530	26 707	27 510	30 777	30 777	27 802	28 943
Shareholders' Equity								
Share Capital	8 779	8 779	13 169	8 779	13 169	13 169	13 169	13 169
Reserves	5 101	5 294	1 017	5 294	1 017	1 017	1 629	2 290
Retained Earnings	2 391	3 514	5 830	4 869	7 468	7 468	7 055	8 376
Total shareholder's equity	16 271	17 587	20 016	18 942	21 654	21 654	21 853	23 835
Liabilities								
Account Payables	3 022	3 227	2 154	3 618	4 657	4 657	2 462	2 856
Financial lease liabilities	62	92	124	69	94	94	89	63
Liabilities to Related Parties	3	9	2	279	113	113	492	571
Other Current Liabilities	13	433	216	420	64	64	123	114
Current Liabilities	3 100	3 761	2 496	4 386	4 928	4 928	3 167	3 605
Liabilities to Employees on Retirement	154	144	385	144	385	385	148	160
Financial lease liabilities	308	322	94	322	94	94	419	486
Liabilities to related parties	0	3 716	3 716	3 716	3 716	3 716	2 216	857
Non-Current Liabilities	462	4 182	4 195	4 182	4 195	4 195	2 783	1 502
Total Liabilities	3 562	7 943	6 691	8 568	9 123	9 123	5 949	5 107
Shareholders' Equity and Liabilities	19 833	25 530	26 707	27 510	30 777	30 777	27 802	28 943

Source: Company IFRS Financial Statements Audited; Elana Trading Estimates

INDIVIDUAL QUARTERLY FINANCIAL DATA

Income Statement	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Sales	7 637	10 118	9 251	9 624	11 908	10 758	10 340	10 449
Other operating income	45	32	38	41	71	50	-162	140
Change in Inventories	-37	273	-183	-335	-71	-315	765	-405
Cost of Materials	5 271	6 917	6 598	6 838	8 358	7 812	6 269	7 379
Cost of External Services	356	312	437	178	437	455	386	382
Cost of Labor	919	1 025	1 174	995	1 105	1 146	1 242	1 039
Other operating expenses	171	188	201	335	223	173	104	254
Total Operating Expenses	6 567	8 405	8 683	8 283	9 780	9 271	8 766	8 924
EBITDA	1 115	1 745	606	1 654	1 927	1 537	1 412	1 940
Depreciation and Amortization	253	268	275	272	276	282	278	275
EBIT	862	1 477	331	1 382	1 651	1 255	1 134	1 665
Financial revenue	0	0	1	0	0	0	0	0
Financial expense	29	32	26	27	29	28	27	27
Interest Expense	22	23	20	18	19	18	19	18
EBT	833	1 445	306	1 355	1 622	1 227	1 107	1 638
Income Taxes	0	0	326	136	-136	0	0	164
Minority Interest	0	0	0	0	0	0	0	0
Net Income	833	1 445	-20	1 220	1 758	1 227	1 107	1 474

Balance Sheet	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018
Assets								
Inventories	3 445	4 759	4 897	5 481	6 601	6 278	5 414	6 787
Receivables from related parties	3 887	4 580	1 662	4 253	3 350	2 789	4 258	4 364
Trade Receivables	2 347	1 350	1 489	851	3 987	2 163	449	1 687
Cash & Cash Equivalents	789	477	2 301	1 934	1 451	1 256	1 488	2 822
Current Assets	10 468	11 166	10 349	12 519	15 389	12 486	11 609	15 660
Property, Plant & Equipment	14 987	14 990	15 127	14 938	14 972	15 142	15 257	15 069
Intangibles	12	11	9	8	10	9	8	8
Other receivables	37	37	45	45	45	45	45	40
Non-Current Assets	15 036	15 038	15 181	14 991	15 027	15 196	15 310	15 117
Total Assets	25 504	26 204	25 530	27 510	30 416	27 682	26 919	30 777
Shareholders' Equity								
Share Capital	8 779	8 779	8 779	8 779	8 779	13 169	13 169	13 169
Reserves	5 294	5 294	5 294	5 294	5 407	1 017	1 017	1 017
Retained Earnings	2 120	3 565	3 514	4 869	4 095	5 322	6 355	7 468
Total shareholder's equity	16 193	17 638	17 587	18 942	18 281	19 508	20 541	21 654
Liabilities								
Account Payables	4 062	3 267	3 227	3 618	4 423	2 586	2 022	4 657
Financial lease liabilities	41	24	92	69	53	27	124	94
Liabilities to Related Parties	4 701	4 707	9	279	1 156	833	2	113
Other Current Liabilities	27	24	433	420	2 289	514	35	64
Current Liabilities	8 831	8 022	3 761	4 386	7 921	3 960	2 183	4 928
Liabilities to Employees on Retirement	308	308	144	144	176	176	385	385
Financial lease liabilities	172	236	322	322	322	322	94	94
Liabilities to related parties	0	0	3 716	3 716	3 716	3 716	3 716	3 716
Non-Current Liabilities	480	544	4 182	4 182	4 214	4 214	4 195	4 195
Total Liabilities	9 311	544	7 943	8 568	12 135	8 174	6 378	9 123
Shareholders' Equity and Liabilities	25 504	26 204	25 530	27 510	30 416	27 682	26 919	30 777

Source: Company IFRS Financial Statements

KEY FINANCIAL AND PERFORMANCE INDICATORS

	2014	2015	2016	2017	2018F	2019F
Valuation						
Price/Earnings (P/E)	13.62	16.36	15.84	19.84	16.56	15.34
Price/Book (P/B)	1.97	1.94	2.64	5.13	5.07	4.64
Price/Sales (P/S)	0.86	1.15	1.42	2.47	2.06	1.77
EV (in '000 BGN)	21 663	31 511	48 625	107 832	102 009	102 033
EV/EBITDA	10.87	10.53	11.14	16.51	12.72	11.83
Profitability						
Return on common equity	16.30%	15.22%	17.29%	27.86%	29.25%	28.93%
Return on assets	10.09%	10.73%	12.90%	20.25%	22.47%	23.29%
Return on invested capital	12.32%	13.57%	16.87%	23.07%	31.07%	30.58%
EBITDA margin	9.53%	10.90%	13.38%	15.32%	16.29%	15.10%
Operating margin	7.54%	8.00%	10.28%	12.72%	14.17%	13.10%
Net income margin	6.32%	7.04%	8.98%	12.46%	12.43%	11.57%
Dividend						
Dividend yield	4.14%	5.00%	4.92%	3.81%	3.93%	4.24%
Dividend per share	0.12	0.18	0.26	0.26	0.30	0.33
Liquidity						
Current ratio	0.92	2.02	2.75	5.32	4.13	3.42
Quick ratio	0.50	0.76	1.45	2.84	2.42	1.59
Credit						
LT debt/equity	0.03	0.02	0.23	0.19	0.12	0.06
Total debt/equity	0.51	0.02	0.26	0.19	0.15	0.09
Total debt/total assets	0.29	0.02	0.18	0.15	0.12	0.07
EBIT/interest expense	20.75	137.25	47.87	73.27	59.61	65.50

Source: Company IFRS Financial Statements; Elana Trading estimates

KORADO Overview

COMPANY PROFILE

Korado Bulgaria is a leading steel panel radiator producer 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. 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 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.

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.

The Group has also strong market positions in Romania, Ukraine, Russia and the Balkans and has recently started balancing out its influence with orders from mature markets in Western Europe.

FUNDAMENTAL STORY

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

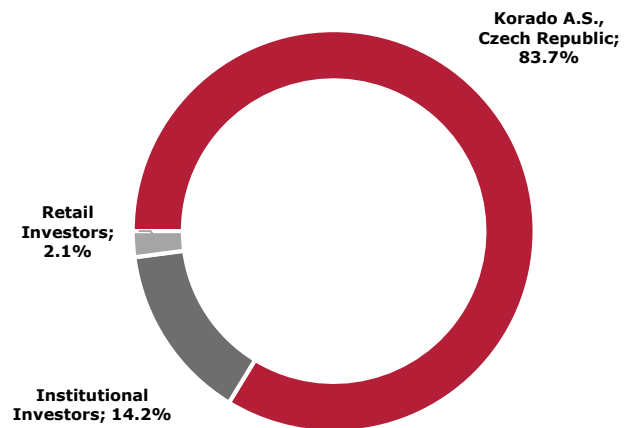
Korado has a diversified portfolio of products, adding tubular bathroom radiators to its portfolio in April 2016.

The Company is focused on selling its production in both Central and Eastern European markets, as well as entering the Western European markets. It has successfully strengthened and even expanded its market positions in almost all its markets. Among its main long-term goals is to increase in its market share in Bulgaria.

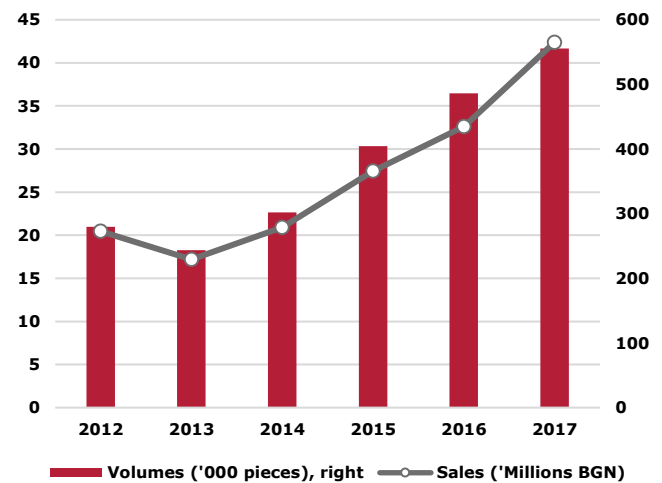
STRENGTHS & OPPORTUNITIES

- Good corporate governance
- Low indebtedness levels
- Successful expansion on EU markets
- EU energy efficiency policy in place

SHAREHOLDERS' STRUCTURE



SALES GROWTH



Source: Company data

WEAKNESSES & THREATS

- Heavy dependence on the Czech market
- Strong rivalry from steel panel radiators producers and substitutes, e.g. aluminum radiators
- Volatile steel prices
- Slowdown in construction sector

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Recommendations: Analyst(s) recommendations are based on the specific factors for the company, sector, country and global developments, as compared to market indices. Recommendations and opinions reflect ELANA Trading's expectations over the 12-month period following publication from the perspective of long-only investment clients. ELANA Trading reserves the right to express different or contrary recommendations and opinions for different timescales or for other types of investment client. Except as otherwise noted, expected performance over next 12 months vary for different recommendations for Bulgarian stocks as follows:

BUY	Target price is more than 10% above current quotes
HOLD	Target price in +/-10% range of the current quotes
SELL	Target price is more than 10% below the current quotes

Frequency of Recommendations: No schedule of recommendations is available. The frequency of recommendations depends on specific factors to individual companies and the opinion of the analyst(s) for the necessity of minor or major changes.

Q4 2017 Recommendation Review			Market Maker Services
Recommendation	#	Share	
BUY	6	38%	SKK BU; Korado
HOLD	10	62%	
SELL	0	0%	

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