ARGENTO Capital Markets

1st July 2016

Chagala Group Ltd* (CGLO.L)

Corporate

FY15 Results

Concert party overshadows good results

Chagala reported a 17% increase in 2015 adjusted profits, despite a 16% fall in turnover and a severe devaluation in the local currency. Adjusted PBT increased 17% on lower depreciation and interest costs. We have revised our forecasts to reflect the weaker currency and lower cost environment. The stock still trades on a wide discount to NAV and yields 4.4%. Before the AGM Chagala announced it had removed voting rights from shareholders appearing to act as a concert party in connection with the 15% of Chagala shares acquired at an 80% premium.

- **Good results despite devaluation:** Room and rent revenue fell 15%, due mainly to the effect of Tenge devaluation. Cost control, with salaries down 14% and admin costs 11% lower and the currency effect meant that EBITDA was just 12% lower. Reported profits were boosted by a US$2.4m impairment reversal.
- **Earnings forecasts revised up:** With a higher oil price and an improvement in the local currency since year-end the operating outlook has actually improved. Occupancy is still high and new sites have been delivered in Atyrau and Uralsk. We now forecast EBITDA to be 2% higher. Following debt repayment, we expect adjusted PBT and EPS to increase 80% and for NAV to start to recover this year.
- **Concert party announcement:** On 10th June Chagala's board served direction notices on shareholders representing c.40% of the total stock, which it determined was acting as a concert party in acquiring shares. This prevented them voting at the AGM and postpones them receiving distributions. The restrictions will remain unless the group makes an offer for all remaining shares, which seems unlikely.
- **Valuation discount remains:** Although NAVPS fell 24%, due to the currency weakness, the stock is trading on a 65% discount to our 2016 NAV forecast. It now yields over 4% and is valued at 4.8x EBITDA. Recurring free cash flow of c.US$5m is forecast in 2017, which should support the intention to raise the dividend payout.

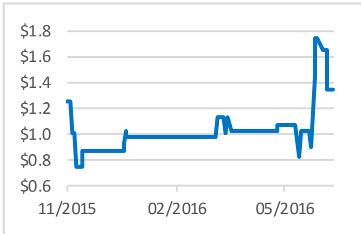
Dec Year End	FY13	FY14	FY15	FY16E	FY17E
Total revenues (US$m)	33.6	28.2	23.5	20.7	20.9
EBITDA (US$m)	11.1	9.2	8.0	8.2	8.4
PBT (US$m)	1.1	2.0	2.6	2.6	3.0
Reported EPS (USc)	2.63	6.84	8.76	8.80	9.92
Adj EPS (USc)	3.21	4.33	4.89	8.80	9.92
DPS (USc)	1.88	5.88	5.88	5.88	5.88
Free cash flow (US$m)	8.54	3.32	(1.54)	3.44	4.98
Net (debt)/cash (US$m)	(24.8)	(17.7)	(12.6)	(10.4)	(6.6)
Net LTV (%)	19%	15%	15%	12%	8%
NAVPS (US$)	5.46	4.78	3.65	3.83	3.91
EV/EBITDA (x)	4.8	5.1	5.1	4.8	4.2
P/NAV (x)	0.25	0.28	0.37	0.35	0.35
Dividend Yield (%)	1.4	4.4	4.4	4.4	4.4

Source: Company Data, Argento Capital

*Argento Capital Markets acts as financial adviser to the company and is an Appointed Representative of Citation Capital Management Ltd, which is authorised and regulated by Financial Conduct Authority.

Closing price	US$1.35
Shares in issue	20.7m
Market cap	£21m
Enterprise value	£29m
Share price as at	(close) (29/06/16)

Residential and commercial property provider to the oil & gas majors operating in Kazakhstan



Source: LSE

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Concert Party Direction Notice

Direction notice issued to concert party with c.40% of shares

On the 31st May TIPP Investments PCC acquired a 14.5% stake from two funds managed by Sturgeon Capital, at a price of US$1.85, which was completed off market. This was a significant (80%) premium to the closing price of US$1.025 before news of the trading emerged.

On 6th June, Chagala received a letter from two shareholders, Eagle Resource Holdings and Typhoon Developments, requisitioning a general meeting of the company. Chagala also received correspondence and had other communications with representatives of East Capital and Nautilus Fiduciary (Asia) Limited and certain other shareholders. These shareholders, together with TIPP, represented c.40% of the total shares outstanding.

Under the company's Articles Chagala's board is effectively required to act in the place of the Takeover Panel. In that capacity the board determined that under the company's Articles, TIPP Investments had become obliged to make an offer to all shareholders in cash, at the same price it paid or higher. It has not done so and has shown no intention of doing so. In accordance with the Articles, the failure by TIPP to make an offer authorised the board to disenfranchise TIPP and the other shareholders, which the board concluded were acting in concert with it.

On June 10th Chagala issued a direction notice to those shareholders. It informed them that, based on the information available to the company, including communication with certain investors, it had concluded that those shareholders were acting as a concert party in connection with the acquisition of shares by TIPP. The direction notice suspended their voting rights and postponed their right to dividends and other distributions. Chagala's AGM was held on 13th June and the existing board members were re-elected. On 14th June the board announced that it had issued the direction notice to these shareholders.

What is the likely outcome?

As TIPP Investments has not made an offer to shareholders or expressed an intention to do so, it cannot be ruled out that a legal dispute between the company and the shareholders could emerge and continue for some time. In our view it is unlikely that an offer will be made by the alleged concert party, at least in the foreseeable future.

Shareholder structure

Portola Group Ltd	29.9%
Eagle Resource Holdings	14.6%
TIPP Investments PCC	14.5%
East Capital	5.9%
Nautilus Fiduciary (Asia) Ltd	4.9%
AIMS Asset Mgmt	5.2%
Halfmoon Bay Capital	4.6%
Other shareholders	18.1%
Treasury stock	2.4%

Source: Company Data

FY15 Results

Good results despite the currency impact

- Chagala reported a 17% increase in adjusted profits for 2015, despite a 16% fall in turnover and a severe devaluation of the local currency.
- Room and rent revenue fell 15% due mainly to the currency effect, although dollar contracts in some hotels and apartments offset part of the weakness in offices and townhouses. F&B was also weaker, due to tenant saving costs.
- Cost control (salaries down 14% and admin costs 11% lower) and the effect of Tenge devaluation meant that operating profit fell 13% and EBITDA was just 12% lower at US$8m.
- Reported profits were boosted by a US$2.4m impairment reversal on apartments in Uralsk, Aktau and Atyrau. There was also a revaluation gain on new developments and other land plots.
- In total, there was a US$17m balance sheet gain on the operating assets, due to improved assumptions in local currency, which was offset by the devaluation.
- These gains were partly offset by a foreign exchange loss of nearly US$1m at the group level, driven by 40% of debt being denominated in dollars and another US$0.6m exchange loss at the associate level.

Chagala FY15 Results (US$m)

	2014	2015	Change
Room and rent	20.66	17.53	-15.1%
Food & Beverage	5.23	3.46	-33.8%
Other	2.28	2.54	11.1%
Total Revenue	**28.17**	**23.53**	**-16.5%**
Utilities, cleaning & maintenance	(5.02)	(4.00)	-20.3%
F&B	(1.58)	(1.15)	-27.4%
Salaries & employee benefits	(8.34)	(7.15)	-14.3%
Gross profit	**13.22**	**11.23**	**-15.1%**
Administrative expenses	(3.67)	(3.28)	-10.5%
Other income and expenses	(0.40)	0.09	N/A
EBITDA	**9.16**	**8.04**	**-12.2%**
Net result on disposal of investment properties	1.73	(0.06)	N/A
Impairment of work in progress/Recovery of PP&E	-	(0.31)	N/A
Revaluation of investment properties	(0.88)	3.07	N/A
Depreciation	(5.25)	(4.21)	-19.9%
Associates	(0.26)	(0.85)	223.2%
Foreign exchange loss	(0.13)	(0.94)	601.5%
EBIT	**4.37**	**4.74**	**8.5%**
Interest income	0.03	0.05	103.8%
Interest expenses	(2.42)	(2.18)	-10.1%
Profit before tax	**1.97**	**2.61**	**32.7%**
Adjusted PBT	**1.25**	**1.46**	**16.9%**
Tax charge	(0.60)	(0.73)	21.6%
Profit after tax	**1.37**	**1.88**	**37.6%**
Minority interest	(0.04)	0.07	N/A
Attributable profit	**1.41**	**1.81**	**28.6%**
Average number of shares outstanding (m)	20.60	20.70	0.5%
EPS (US$)	**0.068**	**0.088**	**27.9%**
Adjusted EPS (US$)	**0.044**	**0.047**	**7.5%**

Source: Company Data, Argento Capital

- Reported EPS were 28% higher at US$0.09 and EPS adjusted for one-offs and revaluations improved 8% to US$0.05.
- The devaluation had more of an impact on the balance sheet, where PP&E was 27% lower, which was largely driven by currency depreciation.
- Net debt fell 29% to US$12.6m, partly owing to local currency weakness, but also due to some debt repayment. Nevertheless, the NAVPS still fell 26% to US$3.56.

Earnings forecasts revised higher

- With a higher oil price and an improvement in the local currency since year-end the operating outlook has actually improved. We are now expecting slightly higher revenues than previously, although they are still expected to fall 12%.
- However, we have revised our EBITDA forecasts to reflect the weaker average currency estimate, which may not all be offset in lower costs. We now forecast EBITDA to be up 2% YoY, although that is 4% lower than our previous forecast.
- Nevertheless, we do still expect to see further margin improvements, as the cost base, which is largely local currency, continues to fall in dollar terms. Our EBITDA margin forecast is still over 39%, up from 34% last year.
- We are not forecasting any revaluation gains in the income statement, but with lower interest expenses, following debt repayment, especially the relatively more expensive bonds, which should be refinanced this year, we expect pre-tax profits to be flat, which is 33% above our previous forecast.
- As a result, we are expecting a significant increase in adjusted EPS this year, which has increased 32% from the previous forecast, due to lower interest costs, following lower debt than expected at year end.
- In the current uncertain environment management has not declared a dividend, so we have left the dividend forecast unchanged from 2014, which assumes a payout of US$1.2m, or 67% of adjusted EPS.
- The board's intention is to pay out at least 50% of adjusted EPS, so the rise in dividends should at least track earnings growth, as debt is paid down and free cash flow increases.

Forecast changes

(US$m)	2016E Previous	2016E Current	Change
Total revenues	20.4	20.7	1%
EBITDA	8.5	8.2	-4%
PBT	2.0	2.6	33%
EPS (USc)	6.6	8.8	32%
Adj EPS (USc)	6.6	8.8	32%
NAVPS (USc)	3.9	3.8	-1%

Source: Company Data, Argento Capital

Financial summary

Dec Year End	FY13	FY14	FY15	FY16E	FY17E
P&L (US$m)					
Total revenues	33.6	28.2	23.5	20.7	20.9
Gross profit	15.7	13.2	11.2	10.9	11.0
EBITDA	**11.1**	**9.2**	**8.0**	**8.2**	**8.4**
Depreciation	(6.4)	(5.3)	(4.2)	(4.3)	(4.4)
Operating profit	**4.7**	**3.9**	**3.8**	**3.9**	**3.9**
Revaluations/Impairments	(0.1)	(0.9)	2.8	-	-
Associates/Disposals	(0.1)	1.5	(0.9)	-	-
Net financial expense	(3.3)	(2.4)	(2.1)	(1.2)	(1.0)
Foreign exchange loss	(0.1)	(0.1)	(0.9)	-	-
PBT	**1.1**	**2.0**	**2.6**	**2.6**	**3.0**
Adjusted PBT	**1.4**	**1.2**	**1.5**	**2.6**	**3.0**
Average shares outstanding (m)	21.3	20.6	20.7	20.7	20.7
Reported EPS (USc)	**2.6**	**6.8**	**8.8**	**8.8**	**9.9**
Adj EPS (USc)	**3.2**	**4.3**	**4.9**	**8.8**	**9.9**
Balance sheet (US$m)					
PP&E/Investment property	128.8	106.3	77.1	82.0	79.4
Other LT assets	3.4	8.5	6.0	3.8	3.8
Current assets	14.5	10.8	9.7	7.5	8.8
Long term borrowings	22.1	16.1	6.1	9.1	6.3
Other long term liabilities	7.7	7.0	8.6	8.1	7.9
Short term borrowings	4.6	4.2	8.3	2.7	2.7
Other current liabilities	4.0	3.7	2.0	1.8	1.7
Net assets	**108.3**	**94.6**	**68.0**	**71.6**	**73.2**
Closing net debt	**24.8**	**17.7**	**12.6**	**10.3**	**6.6**
Cashflow (US$m)					
Operating cash flow	14.2	9.3	5.7	7.4	7.8
Interest & tax	(3.7)	(2.4)	(1.7)	(2.0)	(1.8)
Capex / Acquisitions	(1.9)	(3.6)	(5.5)	(2.0)	(1.0)
Dividends	-	(0.4)	(1.2)	(1.2)	(1.2)
Equity	(0.6)	-	0.1	-	-
Net proceeds from borrowings	(6.8)	(2.5)	2.2	(2.6)	(2.7)
Change in cash	**1.1**	**0.4**	**(0.5)**	**(0.4)**	**1.1**
Closing cash	**1.9**	**2.5**	**1.8**	**1.4**	**2.5**
Growth rates (%)					
Revenues	5.0	(16.1)	(16.5)	(11.9)	1.0
EBITDA	3.5	(13.2)	(14.3)	(19.4)	1.0
Adj EPS	N/A	35.2	12.7	80.0	12.8
NAVPS	(1.4)	(12.4)	(23.7)	4.8	2.1
Operating ratios					
Gross margin	46.9%	47.0%	47.7%	52.7%	52.7%
EBITDA margin	33.1%	32.5%	34.2%	39.5%	40.0%
OP margin	14.1%	13.9%	16.3%	18.7%	18.9%
Adj EPS/DPS	170%	74%	83%	150%	169%
Leverage					
Net debt/equity	23%	19%	19%	14%	9%
Pre-revaluation interest cover (x)	1.3	1.6	1.8	3.0	3.9
Net LTV (%)	19%	15%	15%	12%	8%

Source: Company data, Argento Capital Markets

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BUY	Share price appreciation of 15% or more in absolute terms over 12 months
HOLD	Share price appreciation or depreciation of less than 10% in absolute terms over 12 months
SELL	Share price depreciation of 15% or more in absolute terms over 12 months
SPEC BUY	Share price appreciation of 15% or more in absolute terms over 12 months, but with an unusual level of risk relative to return

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