Results Note
2 August 2018

Chagala Group* (CGLO.L)

Waiting for the Offer

Corporate

FY17 results

Closing price	US$2.0
Potential offer price	US$2.15
Market cap	US$42.5m
Share price as at	(close) (1/8/18)

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

Results for Year End 31st December 2017

Chagala invests in companies that provide residential accommodation, business space and other services predominantly to the numerous staff working for the oil and gas majors in western Kazakhstan. The properties owned by the Group subsidiaries and investments are based in six locations – Atyrau, Aktau, Aksai, Uralsk, Bautino and Almaty – with more than 900 accommodation units (apartments and hotel rooms), 32,000 square metres of office and real estate, including restaurants, bars, leisure facilities, transport and warehousing and more than 55 hectares of development land.

- The major focus for investors' attention remains the anticipated offer of $2.15 per share from a special purpose vehicle ("SPV") to be procured by TIPP Investments PCC ("TIPP") pursuant to the Heads of Terms of a settlement in the case of TIPP vs Chagala and others. It is anticipated that an offer should be made in August or September.

- The shares returned from suspension on 17 July 2018 following publication of the Annual Report. Chagala's auditor was changed from KPMG to Deloitte which created a delay in the audit arrangements.

- Whilst North Caspian Operating Company N.V. ("NCOC"), has been cutting costs which has had an effect on its occupancy of Chagala facilities, Chagala has well-handled the reduced level of business from what was its major customer. However, more of the impact from those cutbacks will be in evidence during 2018 despite the Group gaining business from other oil companies.

- Given the strengthening of the Kazakhstan economy, we remain optimistic of Chagala's future.

Dec Year End	FY15	FY16	FY17	FY18E	FY19E
Total revenues (US$)	23.5	20.3	19.1	16.7	17.4
EBITDA	8.0	7.7	6.4	5.7	6.4
PBT	2.6	1.6	1.3	1.0	2.7
Reported EPS (USc)	8.8	3.0	2.6	2.1	5.5
Adj EPS (USc)	4.9	3.3	4.7	4.0	5.5
DPS (USc)	5.9	-	4.9	4.9	4.9
Free cash flow (US$m)	(1.54)	2.25	2.67	2.49	3.05
Net (debt)/cash (US$m)	(12.6)	(10.3)	(8.5)	(7.0)	(5.0)
Net LTV (%)	15%	12%	11%	9%	6%
NAVPS (US$)	3.56	3.57	3.48	3.46	3.50
P/NAV (x)	0.35	0.35	0.57	0.58	0.57
Dividend Yield	3.0%	-	2.4%	2.4%	2.4%

Source: Company Data, Argento Capital Markets

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Management has commented about a serious reduction of the workforce within NCOC. NCOC is a consortium including ENI, Total, Exxon and Shell which has been Chagala's largest client. Following the start of commercial production at the Kashagan oil field at the end of 2016, NCOC embarked on a drive to reduce costs, which obviously includes the number of people employed, particularly foreign workers, who would normally utilise certain of Chagala's facilities.

NCOC's contribution to the Group's revenues fell from $10.1m in 2016 to $8m in 2017, with an expectation that this will fall further in 2018 as NCOC's occupation of Chagala's Bautino facilities ends and its bookings in other of Chagala's hotels and apartments falls, though NCOC remains an important occupier of the Chagala Center offices in Atyrau. That the Group has managed the decline in contribution to revenues from NCOC from 65% in 2014 to 42% last year demonstrates resilience in the Group's property income.

Atyrau comprises the largest centre of the Group's properties which includes apartments, town houses, offices and warehouses. NCOC had been a large provider of business here. During 2017, the Group has experienced more short stays at its apartments and it is one of its intentions to extend operations to cover a greater number of short stay visitors. The Atyrau hotel has not been as affected by the decline in NCOC activity.

NCOC had occupied most of Chagala's townhouses in Atyrau, but after leaving them the Group has sought other occupiers and has been particularly successful with Tengizchevroil LLP ("TCO"), a partnership between Chevron, ExxonMobil, KazMunayGas (government owned) and LukArco. It was announced in December that the Group had concluded a lease agreement with TCO for its townhouse residential complex Saraishyk for 1 year. This increased the number of townhouses leased by TCO such that most of the 33 townhouses should now be occupied by TCO.

Karachaganak Petroleum Operating B.V. ("KPO"), owned by a consortium of ENI, Shell, Chevron, Lukoil and KazMunayGas, is Chagala's second largest client. It occupies a 4,000 sqm office in Uralsk (in which Chagala has a 70% shareholding through Kurmangazy Development LLP) which KPO uses as its administrative headquarters. Kurmangazy Development LLP saw an increase in revenues to $1.352m in 2017, from $875,000 in the previous year and made a profit of $491,000 (up from $337,000). KPO also occupies a large proportion of the apartments the Group's investments have in Uralsk.

The Chagala Residential Camp in Aksai, which is 50.1% owned by the Group through Chagala Aksai LLP, services the Karachaganak oil field operated by KPO. In 2017, it produced revenues of $803,000 ($661,000 in 2016) and made a profit before tax of $543,000 ($148,000).

Litigation

The saga of the TIPP dispute with the Company, its directors and other parties in the BVI courts over an attempt by TIPP (along with others together deemed to be a concert party by the Company) to gain board control cost the Group $608,000 during 2017, though this was down from $1.3m in 2016.

The parties involved in the litigation have now come to a settlement agreement which should lead to an offer as mentioned above.

Kazakhstan Background

Kazakhstan's economy is dependent upon the commodities sector - oil and gas and mining. A recovery in the oil price during 2017 combined with an increasing level of production of oil and gas has assisted the Kazakh economy significantly, with GDP increasing in 2017 by 4.0% (1.0% in 2016). Projections for GDP growth in 2018 remain good, in the 2.5-4.0% range.

2017 1Q Occupancy and Half Yearly Revenue Breakdown

The group published some occupancy rates at the end of the first quarter of 2017 and a breakdown of revenues:

Property	*1Q Occupancy %*
Atyrau Hotel	48.0%
Atyrau Apartments	63.0%
Atyrau Offices	79.0%
Aktau	50.0%
Bautino	90.0%
Uralsk Hotel	66.0%
Uralsk Apartments	54.0%
Aksai Camp	67.0%
Aksai Apartments	72.0%

Breakdown $000's	*1Q*	*2Q*	*1H*	*2H*	*FY*
Room Revenue	1,121				
Apartment Revenue	872				
Office Rent	1,629				
Room and Rent	**3,622**	**3,787**	**7,409**	**7,060**	**14,469**
Food & Beverage	638	553	1,191	1,140	2,331
Other Revenue	727	227	954	1,353	2,307
TOTAL	**4,987**	**4,567**	**9,554**	**9,553**	**19,107**

Revenue

Exchange rates had relatively little effect on the Group's results last year as the Tenge's value at the end of 2017 was 332 to the US$ in comparison to 333 at the end of 2016, though the weighted average value was an improved 326 during 2017 against 342 during 2016.

Revenue for the year amounted to $19.1m which fell by 5.9% from the prior year.

Room and rental income was down by 7.4% to $14.5m whilst food and beverage income fell back by 10.6% to $2.3m. The Group intends to start outsourcing food and beverage this year for a fixed return, which should assist margin. Other revenue (which includes revenue from sports facilities, maintenance, utilities reimbursement, service charges etc) increased by 10.9% to $2.3m.

Costs

Whilst the costs of maintaining the facilities, cleaning and utilities went up by 16.9% the costs of F&B continued to fall (partly due to lower sales but also due to better pricing from suppliers), by 16.9%. Salary costs also came down, by 7.4%. Overall costs are being kept under control with the numbers employed expected to fall next year.

Profit

Gross Profit was lower by 11.9%, leading to an Operating Profit down by 18.5%.

After property adjustments, other income and expenses and associates contribution, PBT came in at $1.3m, down 17.5% on the prior year, whilst EBITDA at $6.4m (adding back the exceptional litigation costs) compares to $7.7m in 2016.

The tax charge was $0.4m, nearly half of 2016's figure.

Reported EPS was USc2.6 as against USc3.0 in the prior year. Adjusted EPS emerged at USc4.7 against USc5.4 in 2016 including adjusting for litigation costs.

Cash Flow

Cash generated from operations amounted to some $4.1m, down from $6.7m the previous year. After the purchase of some property ($1.9m), the repayment of loans (the Group is repaying its long term borrowings of $7.5m at a rate of $2.5m per annum) and paying dividends, the Group saw its cash balances lower by about $0.5m at $1.8m.

Balance Sheet

Following the year end valuation, reported PP&E fell 5.0% to $71.3m. The value of Investment Properties went up to $4.6m after the purchase of an asset. Total PP&E amounted to $76.2m, down 4.1%. Total Assets came to $87.7m.

After some re-payments, Long Term Borrowings were $7.5m, Short Term Borrowings were $2.8m giving Total Debt of $10.3m and Net Debt of $8.5m. Deferred Tax being carried was $7.8m.

NAV (adding back the Deferred Tax) equates to $73.9m (down 2.5%) or $3.48 per share.

LTV was 11%.

Acquisitions

The Group bought a company in November 2017 for $903,000 which owns a 1 hectare plot of land in Bautino with planning permission, where it is expected townhouses will be developed.

Associates

Arrowhead B.V.
The Group has a 30% interest in Arrowhead B.V. ("ABV"), which is involved in the development of commercial and residential properties in Kazakhstan. ABV is a joint venture with ADM Capital. ABV has two 100% owned subsidiaries, Flecha LLP with its main activity in Atyrau and Crossbow LLP with its main activity in Almaty. Flecha LLP is the owner of Saraishyk Residential Complex and supermarket building in Atyrau. The complex is located near Chagala properties and comprises 4 blocks of two and three-bedroom apartments covering an area of circa 14,000 square meters. Crossbow LLP also has an office building in Almaty. The six-floor building contains 5,156 square meters of useable 'A' class office space and is being leased to external clients.

The Group has a carried interest in ABV of $3.4m.

Itasia Engineering LLP
The Group has a 49% interest in Itasia Engineering LLP (“Itasia”), which is involved in the construction of properties and provision of capital repair services for the Group. It appears di minimus.

Prospects for 2018

The Group will undoubtedly continue to feel the decline in business from NCOC during 2018 as it impacts for a full year. NCOC was Chagala’s major client, however it has reduced its activity in the Group’s apartments, its townhouses and at the Bautino Hotel. Compensating for this, to an extent, is an increased level of business from TCO and KPO, some cost cutting in certain areas and a higher level of marketing for shorter stay business. Nevertheless, we see revenues falling by nearly $2.5m in 2018 before improvement feeds through from the better economic conditions within the country.

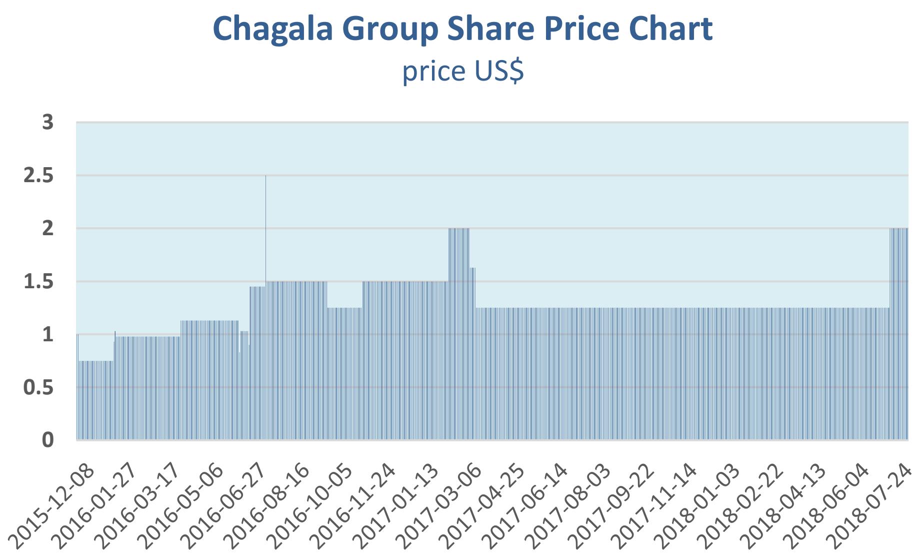
There is still an expectation of litigation costs to be borne, even if the settlement and the bid goes through - we have estimated a further $1m. The lower revenues will impact upon profit, even with good cost control, such that we forecast our Adjusted PBT (excluding the litigation costs) at $2m against $2.35m for 2017. We expect EPRA NAVPS to fall slightly to $3.46.

SPV Offer

The anticipated offer by the SPV at $2.15 is significantly more than the $1.55 offered in June by Asian Investment Management Services Limited (“AIMS”). Directors recommended that shareholders did not accept the AIMS offer albeit there is no firm offer yet made by the SPV. The AIMS Offer was open for 21 calendar days from 20 June 2018 and was to be completed 14 days thereafter, which should have been 25 July 2018. No update has been provided by AIMS.

The SPV Offer will equate to a substantial discount of 38% to December 2017’s NAV of $3.48. Whilst some discount may be reasonable given the emerging market location and the changing occupancy situation with NCOC which was Chagala’s largest customer, the outlook for Kazakhstan’s economy is looking good and the strength of its oil industry should underpin the Group’s relationship with the oil companies in the country. The Group is actively extending its accommodation to more shorter-term guests partly to compensate for the decline in NCOC’s usage and it is intending to improve margins by outsourcing more of its F&B provision and by a planned reduction in employee numbers. Whilst we would anticipate some small decline in the Group’s NAV, it is not likely to be significant.

As there is no formal offer on the table at present, the Directors have given no guidance to shareholders as to whether the anticipated SPV Offer is to be recommended, or not. Shareholders will no doubt weigh up their ability to liquidate their holdings with continuing to hold a very illiquid share which has had a share price standing at a substantial discount to asset value for some time.


Chagala Group Share Price Chart
price US$
3
2.5
2
1.5
1
0.5
0
2015-12-08
2016-01-27
2016-03-17
2016-05-06
2016-06-27
2016-08-16
2016-10-05
2016-11-24
2017-01-13
2017-03-06
2017-04-25
2017-06-14
2017-08-03
2017-09-22
2017-11-14
2018-01-03
2018-02-22
2018-04-13
2018-06-04
2018-07-24

Dec Year End	FY15	FY16	FY17	FY18E	FY19E
P&L (US$m)					
Total revenues	23.5	20.3	19.1	16.7	17.4
Gross profit	11.2	10.6	9.3	8.3	8.9
EBITDA	8.0	7.7	6.4	5.7	6.4
Depreciation	(4.2)	(3.3)	(2.8)	(2.9)	(3.1)
Operating profit	3.8	4.4	3.6	2.8	3.3
Revaluations/Impairments	2.8	(0.1)	(0.3)	-	-
Associates/Disposals	(0.9)	(0.0)	(0.1)	-	-
Net financial expense	(2.1)	(1.5)	(1.0)	(0.8)	(0.5)
Other/Foreign exchange loss	(0.9)	(1.1)	(0.9)	(1.0)	-
PBT	**2.6**	**1.6**	**1.3**	**1.0**	**2.7**
Adjusted PBT	**1.5**	**2.9**	**2.4**	**2.0**	**2.7**
Average shares outstanding (m)	20.7	20.8	20.9	20.9	20.9
Reported EPS (USc)	**8.8**	**3.0**	**2.6**	**2.1**	**5.5**
Adj EPS (USc)	**4.9**	**5.4**	**4.7**	**4.0**	**5.5**
Balance sheet (US$m)					
PP&E/Investment property	77.1	78.9	75.8	74.4	72.9
Other LT assets	6.0	4.7	4.5	4.5	4.5
Current assets	9.7	8.5	7.3	5.2	4.7
Long term borrowings	6.1	10	7.5	5.0	3.4
Other long term liabilities	8.6	8.1	7.8	7.8	7.8
Short term borrowings	8.3	2.5	2.8	2.5	1.7
Other current liabilities	2.0	3.3	3.5	3.0	2.7
Net assets	**68.0**	**68.2**	**66.1**	**65.8**	**66.6**
Closing net debt	**12.6**	**10.3**	**8.5**	**7.0**	**5.0**
EPRA NAVPS (US$)	**3.56**	**3.57**	**3.48**	**3.46**	**3.50**
Cash flow (US$m)					
Operating cash flow	5.7	8.0	5.3	5.1	6.2
Interest & tax	(1.7)	(1.3)	(1.1)	(1.1)	(1.4)
Capex/Acquisitions	(5.5)	(4.5)	(1.5)	(1.5)	(1.6)
Dividends	(1.2)	-	(0.8)	(1.0)	(1.0)
Equity	0.1	-	(0.0)		
Net proceeds from borrowings	2.2	(2.0)	(2.2)	(2.8)	(2.5)
Change in cash	**(0.5)**	**0.3**	**(0.4)**	**(1.3)**	**(0.4)**
Closing cash	**1.8**	**2.2**	**1.8**	**0.5**	**0.0**
Growth rates (%)					
Revenues	(16.5)%	(13.7)%	(5.9)%	(12.4)%	3.7%
EBITDA	(14.3)%	(23.9)%	(17.2)%	(10.6)%	12.8%
Adj EPS	(12.7)%	(32.1)%	0%	(13.5)%	35.1%
NAVPS	(25.6)%	(0.3)%	(2.5)%	(0.4)%	1.1%
Operating ratios					
Gross margin	47.7%	52.0%	48.8%	49.3%	51.4%
EBITDA margin	34.2%	31.8%	32.3%	28.0%	37.0%
OP margin (adj)	16.3%	15.3%	18.6%	16.6%	18.9%
Leverage					
Net debt/equity	19%	15%	13%	11%	7%
Pre-revaluation interest cover (x)	1.8	2.0	2.5	2.4	6.2
Net LTV (%)	15%	12%	11%	9%	6%

VALUATION IN 2016 PROSPECTUS

Type	Description	Fair market value as of 31 July 2016 (US$) (1)
Developed properties		
Atyrau		
Chagala Waterfront Hotel	Hotel (75 rooms and office space 1,000 sq m) 4,163 sq m	2,868,101
Chagala Waterfront Apartment	Apartment (42 units) 1,632 sq m	1,382,236
Chagala Waterfront Apartment	Apartment (43 units) 1,904 sq m	1,223,835
Chagala Centre Office	Office 10,283 sq m Class A	18,794,932
Chagala Annex 1 Office	Office 1,936 sq m Class A	1,190,697
Chagala Annex 2 Office	Office 1,061 sq m Class B	635,006
Chagala Annex 3 Office	Office 1,009 sq m Class B	452,141
Chagala Plaza Apartments	Apartment (41 units) 1,802 sq m	1,081,091
Chagala Plaza Apartments	Apartment (41 units) 1,802 sq m	1,011,900
Chagala Plaza Apartments & technical building	Apartment / technical building (64 units) 4,822 sq m	4,423,612
O'Neill's Pub & office	Restaurant / office 653 sq m	1,348,272
Garage/Storage facility	Storage facility 3,636 sq m	432,881
Petrovski Restaurant	Restaurant 363 sq m	355,163
Hugo's Restaurant (2)	Restaurant 940 sq m	782,661
Townhouses and technical building	Townhouses / technical building (33 houses) 6,375 sq m	7,140,522
Ural Residence and technical building	Residence / technical building (108 units) 8,986 sq m Class A	7,088,668
Sport and leisure complex	Sports complex Swimming pool 274 sq m and Social club 471 sq m	1,740,565
Central Store	Warehouse building 500 sq m completed July 2015	288,128
Bautino		
Chagala Hotel Bautino	Hotel (147 rooms) 5,439 sq m	7,674,946
Bautino Guest House	Hotel (6 rooms) 446 sq m	148,866
Bautino RCP Camp	Land 4.8 hectares	196,411
Aktau		
Chagala Apart Hotel	Hotel 80 units (28 rooms & 52 apartments) 4,446 sq m	2,053,867

Almaty		
Chagala Head Office	Office 552 sq m Class B	1,161,183
Uralsk		
Chagala Serviced Apartments	Apartment (38 units) 2,410 sq m	2,498,477
Chagala Hotel Uralsk	Hotel (47 rooms) 2,290 sq m	850,647
Office (70% owned)	Office 5,610 sq m Class B+	4,963,668
Aksai		
Chagala Residential Camp, Aksai (50.1% owned)	Camp (125 units) 3,920 sq m	1,672,082
Properties held for future development		
Aksai, Aktau, Atyrau, Bautino	Land plots 58.7 hectares	2,764,746
Total Group Properties		**76,225,304**

Additions since 31 July 2016

Aktau	
Office	Office 800 sq m
Bautino	
Land	Land plot 1 hectare

Other Activities
The Group has investments in Arrowhead B.V. (30%) and Itasia Engineering LLP (49%).

(1) The fair market value as assessed by Veritas Brown in the Veritas Brown Property Valuation Report dated 31 July 2016. Ex rate used at that date was KZT 352.25 = US$1.00).

(2) Hugo’s Restaurant was closed at the end of August 2014 but has since been redeveloped and leased externally.

Valuation of Property as at 31 December 2017

Land	$8.591m
Buildings	$60.190m
Investment properties	$4.573m
Total Valuation	**$73.354m**
Furniture and equipment	$2.486m
Capital WIP	$0.361m

**Although the latest valuation in Chagala's accounts is quite close to that of the July 2016 Veritas Brown report, there has no doubt been some significant changes in individual buildings' valuations between the two dates.*

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The Client has seen and made factual amendments to this research note prior to publication.

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