Chagala Group* (CGLO.L)

Interim results prior to closing of $2.15 Offer

Corporate

1H18 results

Share price (as at 21/9/18)	US$2.00
Offer price	US$2.15
Market cap	US$42.5m

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

Chagala's interims announced on 18 September 2018 have followed hard on the heels of its delayed 2017 full year accounts published in July. Revenue, profit and asset value have all decreased, partly as a consequence of adverse currency movement. Increasing competition in Atyrau, the main area of operation of Chagala, is also apparent. However, the Offer of $2.15 per share from Realty Invest Holding LLP ("Realty Invest") remains the focus of attention with the final day for acceptances being 28 September 2018 (shareholders with 63.6% have already accepted, 27.8% have irrevocably not accepted, leaving 8.6% to respond). No further dividends have been declared since the last one for USc2.5 per share in August.

- **Results adversely affected by forex losses:** The Kazakhstan Tenge has decreased in value from 318 to the US Dollar at the end of June 2017, to 332 at the end of December and 342 at the end of June 2018. It is worth noting that the Tenge has further deteriorated since then and currently stands at 367, a decrease of some 13% in the past 15 months. This has resulted from concern about the political situation between the US and Russia (which borders Kazhkstan) as well as the general strengthening of the US Dollar.

- **Revenue in-line with expectations:** Revenue was lower than the corresponding period of the previous year by 12.7%, much in-line with our expectations over the full year, though the further weakening of the Tenge may put additional pressure on the US Dollar reported figures.

- **Costs under control:** Operating costs fell by some 30% due to a mix of currency effect and cost reduction. Despite an Operating Profit of $1.45m being reported, foreign exchange losses of nearly $300,000 and continuing BVI litigation costs, arising from the TIPP Investments PCC court case, of $539,000 contributed to eroding that figure to $189,000 at the PBT level.

- **Forecasts unchanged:** Our forecasts for 2018 remain as they are, though currency movements may well have a further impact.

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%

1H18 Results

Forex a significant effect

- Chagala reported a 12.7% decline in revenue in US$ terms for the interim period to $8.34m.

Revenue six months ended (US$000's)	**30 June 2018**		**30 June 2017**
Room and rent	6,620	-10.6%	7,409
Food and beverages	835	-29.9%	1,191
Other operating revenue	888	-6.9%	954
Total	**8,343**	**-12.7%**	**9,554**

  In relation to the decline in food and beverage income, we noted with the announcement of the full year results that Chagala intended to start outsourcing F&B this year for a fixed return, which should assist margin, though would see a decline in income from this source.

- Operating profit fell to $1.45m from $2.09m in the comparable period of 2017.

- At the pre-tax level an adverse forex movement (from a positive $350,000 to a negative $298,000) had a significant impact whilst an increase in litigation expenses also contributed to paring back the figures.

- Financing costs were down by $94,000, as borrowings declined by over $1m. Costs should fall further as in August Chagala re-financed some of its loans (from Bank CenterCredit JSC to Al-Hilal Islamic Bank JSC) which will reduce rates on those loans from 8% to 6 month LIBOR +4% (but no less than 6.85%).

- Pre-tax profit fell to $189,000 from $1.62m. After a reported tax charge of $201,000 the period ended with a small post-tax loss of $12,000, becoming a loss of $126,000 after minorities.

- EBITDA was $2.85m against $3.53m in the first half of 2017, maintaining a good level of cash flow from the business. There was no further dividend announcement made with the interim results. The last declaration, of USc 2.5 was made on 22 August 2018.

- Reported EPS was USc (0.6) as against USc 5.7 for the first half of 2017. Our adjusted EPS, taking into account litigation costs and the forex loss, amounted to USc 3.4.

- On the balance sheet PP&E fell from $71.3m to $67.7m due predominantly to forex movement, depreciation and a transfer into investment property, as a consequence of the reclassification of a restaurant rented to third parties in Atyrau.

- NAV emerged at $64.3m against $66.1m. EPRA NAV (adding back deferred tax and excluding minorities) is estimated at $70.3m, or US$3.31 per share.

- Net debt was $7.67m, down from $8.52m at the half way point of 2017. Net LTV is 9.9%.

Outlook

The Company does emphasise the consequential effect that sanctions on Russia can have upon the Kazakhstan economy, as well as the impact of a strengthening US Dollar against the Tenge. The economy of Kazakhstan should however continue to benefit from improving oil prices and an increasing level of oil production. This has attracted investment into accommodation, particularly hotel and apartment availability in Atyrau, Chagala's main centre of activity, which makes the accommodation market more competitive.

Despite an expected declining level of custom from North Caspian Operating Company, which remained Chalaga's largest client at the interim stage (41% of debtors), Chagala will help offset this partly by more business won from Karachaganak Petroleum Operating B.V. (KPO) and offering more flexible accommodation to visitors.

The main concentration at present however is on completion of the Offer from Realty Invest, the final day for acceptance being 28 September 2018. Irrevocable acceptances have already been obtained, amounting to 63.6% of the shares in issue (excluding those in Treasury), with irrevocable undertakings not to accept the Offer from 27.8% of shareholders. We await to see what happens thereafter.

Interim results (US$'000)

	1H17	**1H18**	**Change**
Room and rent	7,409	6,620	-10.6%
Food and beverages	1,191	835	-29.9%
Other revenue	954	888	-6.9%
Total revenue	**9,554**	**8,343**	-12.7%
Utilities, cleaning and maintenance	(1,729)	(1,801)	4.2%
F&B	(365)	(247)	-32.3%
Salaries and employee benefits	(2,573)	(2,219)	-13.8%
Gross profit	**4,887**	**4,076**	-16.6%
General and administrative expenses	(1,353)	(1,227)	-9.3%
Depreciation and amortization	(1,449)	(1,399)	-3.5%
Operating profit	**2,085**	**1,450**	-30.5%
EBITDA	**3,534**	**2,849**	-19.4%
Foreign exchange (loss)/profit, net	350	(298)	
(Gain)/Loss on disposal of PP&E	(11)	–	
Finance costs	(477)	(383)	-19.7%
Other income	12	–	
Other expenses	(340)	(580)	70.6%
Profit before tax	**1,619**	**189**	-88.3%
Tax charge	(313)	(201)	-35.8%
Profit after tax	**1,306**	**(12)**	
Minority interest	108	114	5.6%
Attributable profit	1,198	(126)	
Average number of shares outstanding (000s)	20,870	20,870	
EPS (US$)	0.057	(0.006)	
Adjusted EPS (US$)	0.058	0.034	-41.3%
Gross margin	51.2%	48.9%	-4.5%
Operating margin	21.8%	17.4%	-20.4%
EBITDA margin	37.0%	34.1%	-7.7%

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%

Definitions & Disclaimers

This document, which for regulatory purposes is a marketing communication, is issued by Argento Capital Markets Limited.

Recommendation definitions	
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

Disclaimer

This report is issued by Argento Capital Markets Limited ("Argento") in the UK, which is an Appointed Representative (FCA number 583102) of Citation Capital Management Limited which is authorised and regulated by the Financial Conduct Authority (FCA number 198036) in connection with its UK distribution. This report was prepared by the research department. This document meets the FCA requirements in respect of Marketing Material.

This material should not be construed as an offer or recommendation to buy or sell or solicitation of any offer to buy any security or other financial instrument, nor shall it, or the fact of its distribution, form the basis of, or be relied upon in connection with, any contract relating to such action or any other matter. The material in this report is based on information that we consider reliable and accurate on the date of this report but we do not warrant or represent (expressly or by implication) that it is accurate, complete, not misleading or as to its fitness for the purpose intended and it should not be relied upon as such. Any opinion expressed (including estimates and forecasts) is given as of the date of this report and may be subject to change without notice.

In relation to MiFID II. Research on its client companies produced and distributed by Argento is normally commissioned and paid for by the client companies themselves. The research is distributed free of charge and is available through our web site. It therefore meets the definition of a non-monetary benefit. Argento has no securities trading activities and does not make markets.

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

Argento accepts no liability whatsoever for any direct, indirect or consequential loss or damage of any kind arising out of the use of or reliance upon all or any of this material howsoever arising. Investors should make their own investment decisions based upon their own financial objectives and financial resources and it should be noted that investment involves risk, including the risk of capital loss.

This research note is confidential and is supplied to you for information purposes only. It may not (directly or indirectly) be reproduced, further distributed to any person or published, in whole or in part, for any purpose whatsoever. Neither this document, nor any copy of it, may be taken or transmitted into the United States, Canada, Australia, Ireland, South Africa or Japan or into any jurisdiction where it would be unlawful to do so. Any failure to comply with this restriction may constitute a violation of relevant local securities laws.