

Zagreb Stock Exchange

Hold

Upgraded from Sell

Price: HRK 13.5
Price target: HRK 15.1
(from HRK 14.3)

Successful ETF market rollout

The stock is down almost 13% since we initiated with a Sell in October last year. In view of this correction and a slight increase in our revenue forecasts, we have decided to upgrade Zagreb Stock Exchange (ZSE) to HOLD, from Sell, and we have increased our price target (PT) by 5.6% to HRK 15.1/share. We have increased our forecasts mostly on the back of the successful implementation and rollout of the ETF market, which seems quite popular among both retail and institutional investors. At this stage, however, when the company is not paying out a dividend, the liquidity of the shares remains low and the shares are trading at a discount of c.17-27% vs. ZSE's peers on our 2021E-22E EV/EBITDAs, our HOLD recommendation is reasonable, we believe. As we have argued previously, an acquisition could trigger a change in our view.

Investment thesis remains unchanged. While nothing has really changed in our investment thesis since we initiated on ZSE, we take the opportunity of the share price declining below our PT recently, and upgrade ZSE to HOLD, with potential upside of c.12%.

Successful start of the ETF market has led us to increase our PT. We are turning more positive on the commission income growth, as we see the ETF market being rolled out successfully. While we remain conservative in our forecasts of the additional volumes generated by the ETFs, due mostly to their very short history on ZSE, we believe the upside could become significant eventually. The upside is dual in character, in our view, as the exchange will earn commissions for each trade in the two new ETFs and, at the same time, the ETFs will generate additional volumes in their underlying assets. While we have increased our commission income expectations vs. our previous forecasts, we have cut our forecast for the quotation maintenance-related fees slightly, which could see a minor drop, despite the increase in prices, due to a lower number of companies traded on the lower tier markets. This offsets the increase in the commission income partially.

M&A announcement could be a trigger, in our view. Given the excess liquidity on ZSE's balance sheet and its current inability to pay dividends, coupled with zero leverage, we believe the only path, going forward, is through M&A. Acquisition-based growth would help to scale up the business and increase returns. In our view, this move would make sense, even from a portfolio management perspective, as the excess liquidity could be invested into businesses with higher returns than they earn currently in equity and bond investment funds.

High bottom-line growth expected. Our 2019-25E EPS CAGR lands at 24% currently. Due to the company's small scale, and its relatively low margins and operational leverage, even a small increase in the top line (2% annually until 2025E) creates large upside for the net income growth, in our view.

ZSE trades currently at 13.2x and 10.9x our 2021E and 2022E EV/EBITDAs, respectively. We believe that a certain discount vs. its peers is justified, due especially to the lower scale of the company, the low liquidity of the shares and because ZSE is not paying out dividends. Thus, we believe that, at these levels, our HOLD recommendation is fair. On our PT, the 2022E EV/EBITDA discount would drop to 15%, from the current 27%, which we would still see as reasonable.

Expected events

FY20 results	26 April
1Q results	26 April
2Q results	26 July
3Q results	25 October

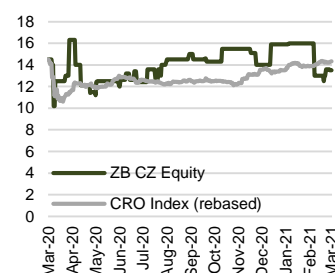
Key data

Market cap	USD 10m
Free float	100%
3M ADTV	USD 320
Shares outstanding	4.6m
Major shareholder	-
Bloomberg code	ZB CZ Equity
CRO Index	1,845.4

Price performance

52-w range	HRK 10.2-16.3
52-w performance	-7%
Relative performance	-6%

ZSE 12M share price performance



Year	Sales (HRK m)	EBIT (HRK m)	Net Profit (HRK m)	EPS (HRK)	P/E (x)	EV/EBITDA (x)	ROE (%)
2019	25.0	-0.4	0.9	0.2	78.7	44.5	2.3%
2020	26.3	2.2	2.2	0.5	29.1	11.9	5.2%
2021E	26.1	2.0	1.9	0.4	33.1	13.2	4.3%
2022E	26.9	2.5	2.3	0.5	27.4	10.9	5.0%
2023E	27.8	3.4	3.1	0.7	20.3	8.3	6.3%

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Closing Prices as of 04 March 2021

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Valuation

Summary

To derive our fair value and PT for ZSE's shares, we use a DCF valuation model. With the company's size and liquidity, it is difficult to find easily comparable peers with which to perform a peer valuation. For this reason, we use the peer group only to cross check our PT-implied multiples. The current share price offers upside of 11.9% to our PT; thus, we upgrade our recommendation from Sell to HOLD.

Valuation summary

ZB CZ Equity	
Discounted cash flow (100% weight)	15.1
Current price	13.5
Potential upside	11.9%
Recommendation	HOLD

Source: WOOD Research

Discounted cash flow model

In our discounted cash flow (DCF) model, we assume both the risk free rate and equity risk premium at 5.0%, combined with a beta of 0.8x. This results in a cost of equity of 9%. Zagreb Stock Exchange is financed solely by equity, so we assume the WACC at 9% as well. We also assume the long-term growth rate for the free cash flows at 3%.

WACC calculation

WACC	
Risk free rate	5.0%
Market risk premium	5.0%
Market return	10.0%
Beta	0.80
Cost of equity	9.0%
Cost of debt pre-tax	6.0%
Marg. tax rate	16.0%
Cost of debt after tax	5.0%
Weight k(e)	100.0%
Weight k(d)	0.0%
WACC %	9.0%

Source: WOOD Research

Discounted cash flow model

	2020	2021E	2022E	2023E	2024E	2025E
Adj. EBIT	2.2	2.0	2.5	3.4	3.5	3.8
Tax rate	-8%	-18%	-18%	-18%	-18%	-18%
NOPAT	2.0	1.6	2.0	2.8	2.9	3.1
Depreciation & amortisation	2.0	1.6	1.6	1.6	1.6	1.6
Changes in working capital	-1.0	-1.3	-0.1	-0.2	-0.2	-0.1
CAPEX	-0.9	-0.9	-0.9	-0.8	-0.8	-0.8
Free cash flow	4.0	3.6	2.8	3.8	3.9	3.9
<i>growth yoy</i>	<i>n.a.</i>	<i>-10%</i>	<i>-21%</i>	<i>35%</i>	<i>3%</i>	<i>1%</i>
Time adjustment for the valuation date		0.8	1.8	2.8	3.8	4.8
Discount factor		0.9	0.9	0.8	0.7	0.7
Discounted free cash flow		3.3	2.4	3.0	2.8	2.6
Sum	14.1					
Long term growth rate	3%					
Residual value at horizon	67.8					
PV of residual value	41.0					
Net debt	-9.1					
EV	64.2					
Number of shares (m)	4.6					
Fair value of ZSE's share	13.9					
Price target	15.1					
Upside	11.9%					

Source: WOOD Research

Zagreb Stock Exchange trades currently at 13.2x and 10.9x on our 2021E and 2022E EBITDA estimates, respectively. A discount to the peer group, in our view, is justified and, thus, we believe that, at these levels, our HOLD recommendation is reasonable. On our numbers, the company's current P/E multiples for 2021-22E are 33.1x and 27.4x, respectively. Furthermore, the company is not paying out dividends currently and we do not expect this to change within our forecast period.

Peer valuation table

Company	Last px Icl	Market cap (USD)	P/E		EV/EBITDA		Div yield	
			2021E	2022E	2021E	2022E	2021E	2022E
Hong Kong Exchanges	483.0	78,514	40.6	35.5	23.3	19.0	2.2%	2.5%
CME Group Inc	207.0	74,327	31.1	28.8	23.7	21.6	3.1%	3.3%
Intercontinental Exchange	111.1	62,422	22.6	21.0	17.5	16.3	1.2%	1.3%
London Stock Exchange	9488.0	64,294	41.2	39.2	21.4	20.0	0.9%	1.0%
Deutsche Boerse	132.6	30,112	21.0	18.9	13.6	12.1	2.4%	2.6%
BM&Fbovespa	55.5	20,152	23.9	22.2	15.9	14.8	4.3%	4.4%
Nasdaq	138.0	22,742	21.6	19.9	16.4	15.1	1.5%	1.6%
ASX	67.2	10,264	27.2	26.9	15.8	15.5	3.3%	3.4%
Singapore Exchange	10.0	7,987	23.1	22.5	15.8	14.9	3.3%	3.4%
TMX Group	123.2	5,471	19.7	17.7	13.4	12.4	2.3%	2.5%
Moscow Stock Exchange*	170.1	5,200	16.3	14.8	8.4	7.5	-5.5%	-6.1%
Bursa Malaysia	9.1	1,804	22.3	25.1	15.8	17.5	4.0%	3.6%
Warsaw Stock Exchange*	44.8	493	15.2	14.1	11.1	10.7	5.6%	5.8%
NZX	2.0	390	30.7	26.8	15.3	14.0	3.2%	3.6%
Hellenic Exchanges*	3.8	277	49.6	37.4	15.5	12.8	2.5%	2.7%
Bucharest Stock Exchange*	24.4	48	18.9	28.0	18.7	43.6	4.8%	4.1%
Zagreb Stock Exchange	13.5	10	33.1	27.4	13.2	10.9	0.0%	0.0%
Zagreb Stock Exchange PT	15.1	11	37.1	30.7	15.3	12.7	0.0%	0.0%
Median			23.1	22.5	15.8	14.9	2.5%	2.7%
Current (discount)/premium			43%	22%	-17%	-27%	-2.5ppts	-2.7ppts
(Discount)/premium on PT			60%	36%	-3%	-15%	-2.5ppts	-2.7ppts

Source: WOOD Research, Bloomberg; *WOOD's estimates

Updated forecasts

New estimates vs. previous forecasts

	2021E			2022E			2023E		
	New	Old	Change	New	Old	Change	New	Old	Change
Sales revenue	16.7	16.6	1%	17.1	16.8	2%	17.7	17.3	2%
Other operating income	9.4	9.6	-1%	9.8	9.8	0%	10.2	10.2	0%
Total operating revenues	26.1	26.1	0%	26.9	26.6	1%	27.8	27.5	1%
Personnel expenses	-11.6	-11.1	5%	-11.8	-11.1	7%	-11.7	-10.9	8%
D&A	-1.6	-1.7	-8%	-1.6	-1.7	-6%	-1.6	-1.7	-3%
Other operating expenses	-11.0	-11.5	-4%	-11.0	-11.7	-6%	-11.1	-11.8	-6%
Total operating costs	-24.1	-24.2	0%	-24.4	-24.5	0%	-24.4	-24.3	0%
EBITDA	3.5	3.6	-2%	4.1	3.8	7%	5.0	4.8	4%
Operating (loss)/profit	2.0	1.9	3%	2.5	2.1	17%	3.4	3.2	8%
Net finance income	0.2	0.3	-25%	0.2	0.3	-31%	0.2	0.3	-26%
Share of loss of equity - accounted investees	0.1	0.2	-50%	0.1	0.2	-50%	0.1	0.2	-50%
Profit before tax	2.3	2.4	-5%	2.8	2.6	6%	3.8	3.7	2%
Income tax	-0.4	-0.4	-5%	-0.5	-0.5	6%	-0.7	-0.7	2%
Profit for the period	1.9	2.0	-5%	2.3	2.1	6%	3.1	3.0	2%
Total assets	54.3	52.7	3%	56.8	55.0	3%	60.2	58.2	3%
Total equity and reserves	44.8	44.9	0%	47.1	47.0	0%	50.2	50.1	0%

Source: WOOD Research

Risks

Market risk

The exchange's revenues are extremely sensitive to trading volumes. A delay in IPOs, an economic downturn and longer-term price declines can all have a negative impact on Zagreb Stock Exchange's trading volumes, revenues and, consequently, the profit it reports.

Low scale of operations

The company's scale is very low. With costs remaining relatively flat over our forecast period, a slight movement in revenues, to both the upside as well as the downside, can have quite large consequences for the margins and the bottom line and cash flows.

Ownership limit

The company has a 10% ownership limit in place. For a stake higher than 10% to be acquired, regulatory approval is needed. This may create some corporate governance issues, as complete control of the exchange would be difficult to achieve.

Low liquidity of the group's shares

The trading volumes for Zagreb Stock Exchange's shares are too low (below USD 1,000/day), which increases the risk of investments.

Interest rate and capital markets risk

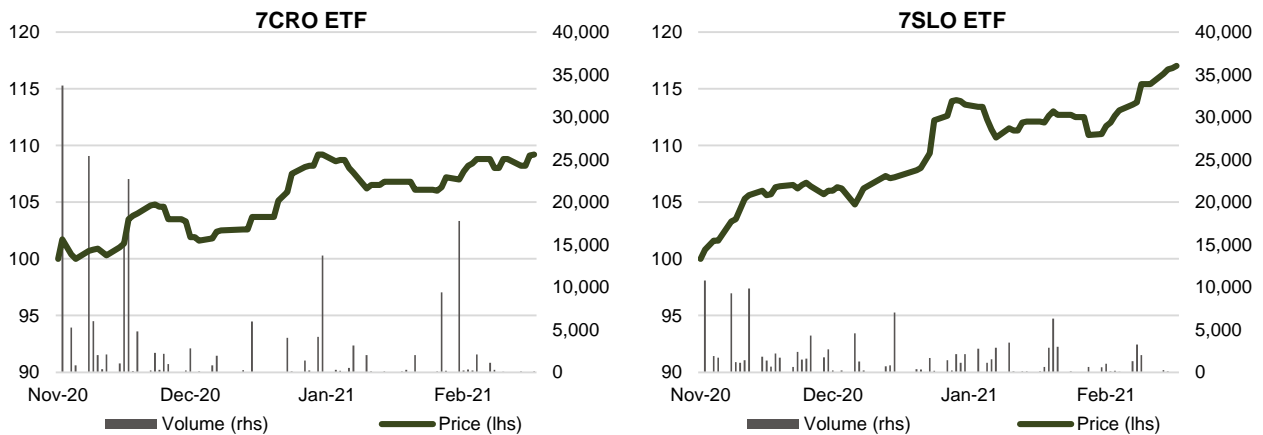
The excess liquidity on the company's balance sheet is invested currently into open-ended money market and bond investment funds, and carries these investments at fair value. While the company does diversify its portfolio by investment in different funds and via different asset management companies, there is a risk that such investment could lose in terms of value, and influence not only the asset size of the balance sheet, but also the financial result.

7CRO and 7SLO ETFs

The two new ETFs, 7CRO and 7SLO, follow the performance of the CROBEX10tr and the SBITOP indices, respectively. They were listed on the ZSE's regular market on 13 November and generated a turnover of HRK 22m in the period between the listing and the end of 2020, suggesting that investor interest is high. In relative terms, the two ETFs generated 5% of the total stock turnover in 4Q20, despite trading only since mid-November.

The CROBEX10tr Index, followed by the 7CRO ETF, tracks the 10 most liquid shares of the Zagreb Stock Exchange, while the SBITOP Index tracks the 11 most liquid names listed on the Ljubljana Stock Exchange. The two ETFs have been listed only in Zagreb so far but, according to our understanding, the intention is to bring the same two ETFs to Ljubljana this year.

New ETFs introduced recently on the Zagreb Stock Exchange



Source: WOOD Research, Bloomberg

While still relatively small in size (the combined market is c.HRK 34.75m (EUR 4.6m)), we believe the upside could be quite significant in the future, especially given the popularity of ETFs across the globe. The upside is dual, however, in our view, as: i) ZSE will earn commissions for the trades in ETFs; and ii) the two ETFs should generate additional volumes in the underlying assets, producing further commission income.

Furthermore, the ETFs could, in our view, increase the interest in investing in the two countries in general, which could, consequently, drive up volumes. However, we remain careful in forecasting larger increases in turnover going forward, and will do so only once we have sufficient data and a long enough history of ETF trading on the exchange.

Financials

Income statement

(HRK m)	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Sales revenue	15.4	15.1	18.6	16.7	17.1	17.7	18.2	18.2
Other operating income	8.5	9.9	7.7	9.4	9.8	10.2	10.5	10.7
Total operating revenues	23.9	25.0	26.3	26.1	26.9	27.8	28.7	28.8
Personnel expenses	-10.9	-11.2	-11.7	-11.6	-11.8	-11.7	-12.0	-11.9
D&A	-1.1	-1.9	-2.0	-1.6	-1.6	-1.6	-1.6	-1.6
Other operating expenses	-11.5	-12.4	-10.5	-11.0	-11.0	-11.1	-11.6	-11.6
Total operating costs	-23.5	-25.4	-24.1	-24.1	-24.4	-24.4	-25.1	-25.1
EBITDA	1.5	1.5	4.1	3.5	4.1	5.0	5.1	5.3
Operating (loss)/profit	0.4	-0.4	2.2	2.0	2.5	3.4	3.5	3.8
Net finance income	0.1	1.4	0.2	0.2	0.2	0.2	0.2	0.2
Share of loss of equity - accounted investees	-0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Profit before tax	0.3	1.0	2.3	2.3	2.8	3.8	3.9	4.1
Income tax	-0.1	-0.1	-0.2	-0.4	-0.5	-0.7	-0.7	-0.7
Profit for the period	0.2	0.9	2.2	1.9	2.3	3.1	3.2	3.4

Source: WOOD Research, Zagreb Stock Exchange

Balance sheet

(HRK m)	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Property and equipment	12.3	8.6	9.3	8.6	8.0	7.2	6.4	5.6
Intangible assets and goodwill	2.5	3.0	2.8	2.8	2.8	2.8	2.8	2.8
Other non-current assets	2.5	3.5	3.6	3.6	3.6	3.6	3.6	3.6
Total non-current assets	17.3	15.0	15.6	15.0	14.4	13.5	12.7	12.0
Trade receivables and other assets	4.0	4.4	3.0	2.9	3.0	3.1	3.2	3.2
Financial assets at fair value through profit or loss	17.7	19.6	17.8	18.8	19.8	21.3	23.8	26.3
Short-term deposits	4.1	1.5	4.0	4.0	4.0	4.0	4.0	4.0
Cash and cash equivalents	2.4	7.6	9.3	12.2	14.2	16.8	18.5	20.2
Other current assets	0.5	0.6	1.4	1.4	1.4	1.4	1.5	1.5
Total assets	46.0	48.7	51.1	54.3	56.8	60.2	63.7	67.2
Issued share capital	46.4	46.4	46.4	46.4	46.4	46.4	46.4	46.4
Accumulated loss	-21.4	-20.4	-20.4	-18.5	-16.2	-13.1	-9.9	-6.6
Other equity	14.6	14.5	16.9	16.9	16.9	16.9	16.9	16.9
Total equity and reserves	39.5	40.5	42.9	44.8	47.1	50.2	53.3	56.7
Total non-current liabilities	0.3	0.9	0.6	0.6	0.6	0.6	0.6	0.6
Trade and other payables	1.9	2.6	2.4	2.5	2.5	2.5	2.6	2.6
Contractual liabilities and provisions	4.2	4.0	5.2	6.4	6.6	6.9	7.2	7.3
Other non-current liabilities	0.1	0.8	0.0	0.0	0.0	0.0	0.0	0.0
Total equity and liabilities	46.0	48.7	51.1	54.3	56.8	60.2	63.7	67.2

Source: WOOD Research, Zagreb Stock Exchange

Cash flow statement

(HRK m)	2018	2019	2020E	2021E	2022E	2023E	2024E	2025E
Profit for the year	0.2	0.9	2.3	1.9	2.3	3.1	3.2	3.4
D&A of fixed assets	1.1	1.9	2.0	1.6	1.6	1.6	1.6	1.6
Interest income	-0.1	-0.2	0.0	-0.5	-0.6	-0.6	-0.6	-0.6
Corporate income tax expense	0.1	0.1	0.0	0.4	0.5	0.7	0.7	0.7
Other	-0.3	-1.2	1.4	0.3	0.3	0.4	0.4	0.4
Net cash from operations before changes in WC	1.1	1.5	5.7	3.6	4.2	5.1	5.2	5.4
Changes in working capital:								
Change in trade, other receivables	-0.6	-0.2	0.0	0.0	-0.1	-0.1	-0.1	0.0
Change in trade, other payables	-1.0	0.1	0.0	0.1	0.0	0.0	0.1	0.0
Change in prepaid expenses	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Corporate income tax paid	0.0	0.0	0.0	-0.4	-0.5	-0.7	-0.7	-0.7
Other	0.6	0.3	-0.1	1.2	0.2	0.3	0.2	0.1
Net cash from operations	0.1	1.5	5.5	4.6	3.8	4.6	4.7	4.8
Purchase of financial instruments	-1.1	-2.6	0.0	-1.0	-1.0	-1.5	-2.5	-2.5
Interest received	0.1	0.2	0.1	0.5	0.6	0.6	0.6	0.6
Other	1.6	6.8	-1.5	-1.3	-1.3	-1.2	-1.2	-1.2
Net cash from investing activities	0.6	4.5	-1.4	-1.7	-1.7	-2.1	-3.1	-3.1
Net cash inflows from financing activities	-0.1	-0.8	-2.4	0.0	0.0	0.0	0.0	0.0
Total cash flows	0.6	5.2	1.7	2.9	2.1	2.6	1.7	1.7
Cash at the beginning of the period	1.8	2.4	7.6	9.3	12.2	14.2	16.8	18.5
Cash at the end of the period	2.4	7.6	9.3	12.2	14.2	16.8	18.5	20.2
Free cash flow	0.0	1.1	4.0	3.6	2.8	3.8	3.9	3.9

Source: WOOD Research, Zagreb Stock Exchange

KPIs

	2018	2019	2020	2021E	2022E	2023E	2024E	2025E
Margins & profitability (%)								
EBITDA margin	6.2%	5.8%	15.7%	13.5%	15.1%	18.1%	17.8%	18.5%
EBIT margin	1.5%	-1.7%	8.2%	7.5%	9.2%	12.3%	12.3%	13.1%
Net margin	0.8%	3.8%	8.2%	7.2%	8.5%	11.1%	11.0%	11.7%
Dividend payout	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROE	0.5%	2.3%	5.2%	4.3%	5.0%	6.3%	6.1%	6.1%
Per share data (x) & multiples								
Shares outstanding (m)	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Year-end share price (HRK)	16.0	15.9	13.5	13.5	13.5	13.5	13.5	13.5
Average price per share (HRK)	13.4	16.0	13.5	13.5	13.5	13.5	13.5	13.5
EPS (HRK)	0.0	0.2	0.5	0.4	0.5	0.7	0.7	0.7
BVPS (HRK)	8.5	8.7	9.3	9.7	10.2	10.8	11.5	12.2
DPS (HRK)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share (HRK)	0.0	0.2	0.9	0.8	0.6	0.8	0.8	0.9
P/E (x)	327.9	78.7	29.1	33.1	27.4	20.3	19.8	18.6
P/BV (x)	1.6	1.8	1.5	1.4	1.3	1.2	1.2	1.1
EV/EBITDA (x)	37.4	44.5	11.9	13.2	10.9	8.3	7.8	7.2
P/FCF (x)	n.m.	67.0	15.7	17.5	22.3	16.5	16.0	15.8
Div. yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: WOOD Research, Zagreb Stock Exchange

Important disclosures

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08/03/2021	HOLD	08/03/2021	HRK 15.1

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