

Zagreb Stock Exchange

Buy

Upgraded from Hold

Price: HRK 11.0
Price target: HRK 14.0
(from HRK 14.1)

A valuation call

In this report, we have upgraded Zagreb Stock Exchange (ZSE) to BUY, from Hold, due mostly to the decline in the share price since our previous report, published in December 2021. Our price target (PT) remains almost unchanged, at HRK 14.0/share, vs. HRK 14.1/share previously; and, since our previous update, nothing has changed in our investment thesis. We believe an acquisition in the region or an increase in the ownership stake in the Macedonian Stock Exchange (MSE) would be supportive and could, in our view, increase the upside. Furthermore, we expect management to continue to steer the company effectively, without major increases in the cost base. Such operational leverage is likely to result in increased margins, which we forecast to grow to c.14.2% by 2026E from 11.1% in 2021, on the EBITDA level. On the negative side, we highlight no dividend payments currently and our expectations of no change in this space in the foreseeable future. As the share price has dropped, however, we believe our BUY rating is justified. On our numbers, ZSE trades at EV/EBITDAs of 7.0-9.5x for 2022-23E, discounts of 28-51% vs. its peers.

As the share price has dropped since our previous update, we recommend to BUY the share of ZSE now. The current share price offers upside of 27.0% to our 12-month PT of HRK 14.0/share. Furthermore, on our numbers, the company trades at a discount vs. its peers on EV/EBITDA, which is justified, we admit, but we note that our PT does not erase it completely. On P/Es, the stock trades at a premium, and it does not pay dividends currently. We note that, given the low net margins, the P/Es may not be relevant when comparing ZSE to its peers. Despite that, we see value in the stock, especially as we expect its profitability to grow in the future.

We pencil in solid cost control, which leads to higher margins and cash flow. Management has been quite successful in steering the company's cost base over the couple of years, managing to reduce the opex to HRK 24-25m in 2020-21, from c.HRK 28m in 2016-17. While we do not model similar declines in the future, we believe the solid cost control is likely to continue and remain more or less flat, at a 2021-26E CAGR of 1%. This, together with the marginally increasing revenues (2021-26E CAGR of 2%), should support the margins and, consequently, the cash flows. Another angle to this story, which could increase the scale, margins and value, is M&A.

M&A remains a major part of the story. ZSE has been increasing its stake slowly, which now stands at 7.06%, in MSE. Such an ownership stake in this small, but highly profitable, company, is unlikely to move the needle, in our view. We consider these moves as in the right direction, nevertheless, and see them as supportive for the investment thesis. Any future announcement in this field would be positive for the story as well, and likely generate upside for our PT, as we do not pencil any acquisitions into our model.

Diversification of the top line is key, in our view. We continue to appreciate the company's top-line diversification. The income from commissions accounts for some 28% of the total, while quotation maintenance, the annual fee paid by issuers on the lower-tier markets, accounts for c.29% of the total. About 23% of the total revenue comes from data vending and the supply of information. The top line is diversified geographically as well, with the company owning a 100% stake in the Ljubljana Stock Exchange (LJSE), and the aforementioned stake in MSE (7.06%).

Expected events

2Q22 results	29 July
3Q22 results	24 October

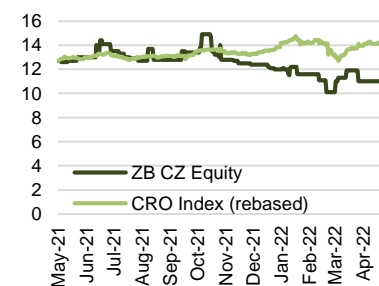
Key data

Market cap	USD 7m
Free float	100%
3M ADTV	USD 154
Shares outstanding	4.6m
Major shareholder	-
Bloomberg code	ZB CZ Equity
CRO Index	2,122.2

Price performance

52-w range	HRK 10.1-14.9
52-w performance	-13%
Relative performance	-25%

ZSE 12M share price performance



Year	Sales (HRK m)	EBITDA (HRK m)	EBITDA margin (%)	Net Profit (HRK m)	EPS (HRK)	EV/EBITDA (x)	P/E (x)
2020	26.3	4.1	15.7%	2.2	0.5	9.1	23.7
2021	25.8	2.9	11.1%	0.4	0.1	11.6	>100
2022E	28.0	4.5	16.2%	1.2	0.3	7.0	42.4
2023E	27.2	3.3	12.0%	0.3	0.1	9.5	>100
2024E	28.3	4.3	15.3%	1.4	0.3	6.8	37.1

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Contents

Company snapshot – BUY, PT HRK 14.0/share	3
Valuation.....	4
Risks	6
Financials	7
Important disclosures	9

Closing Prices as of 03 May 2022

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Company snapshot – BUY, PT HRK 14.0/share

Zagreb Stock Exchange		SHARE PRICE PERFORMANCE		COMPANY DESCRIPTION							
BUY											
Bloomberg ticker	ZB CZ			<p>Zagreb Stock Exchange is the central place for securities trading in Croatia. Today, the exchange is comprised of two markets, the Regulated Market and the Multilateral Trading Facility, and there are more than 130 companies listed. Together with the exchanges in North Macedonia and Bulgaria, the ZSE has created the SEE LINK, a company, the objective of which is a creation of regional infrastructure for securities trading. The ZSE is also a 100% shareholder of Ljubljana Stock Exchange of Slovenia and 7.06% in the Macedonian Stock Exchange.</p>							
Closing price (HRK)	11.0										
Price target (HRK)	14.0										
Upside to PT	27.0%										
Shares outstanding (m)	4.64										
MCAP (HRK m)	51										
Free float	100%										
3M ADTV (USD)	154										
52 Week Range (HRK)	10.1-14.9										
RATIOS & MARGINS											
VALUATION RATIOS	2020	2021	2022E	2023E	2024E	Margins	2020	2021	2022E	2023E	2024E
P/E (x)	23.7	>100	42.4	>100	37.1	EBITDA margin	15.7%	11.1%	16.2%	12.0%	15.3%
P/BV (x)	1.2	1.2	1.1	1.1	1.1	EBITDA margin - LJSE	17.6%	n.a.	n.a.	n.a.	n.a.
EV/EBITDA (x)	9.1	11.6	7.0	9.5	6.8	EBITDA margin - MSE	35.0%	n.a.	n.a.	n.a.	n.a.
P/FCF (x)	12.9	36.4	16.3	22.4	16.2	EBIT margin	8.2%	3.2%	7.4%	3.3%	7.9%
Div. yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	EBIT margin - LJSE	9.5%	n.a.	n.a.	n.a.	n.a.
PER SHARE FIGURES	2020	2021	2022E	2023E	2024E	EBIT margin - MSE	29.3%	n.a.	n.a.	n.a.	n.a.
EPS (HRK)	0.46	0.08	0.26	0.07	0.30	Net margin	8.2%	1.4%	4.3%	1.1%	4.9%
BVPS (HRK)	9.26	9.33	9.58	9.65	9.95	Dividend payout	0.0%	0.0%	0.0%	0.0%	0.0%
DPS (HRK)	0.00	0.00	0.00	0.00	0.00	ROE	5.2%	0.8%	2.7%	0.7%	3.0%
COMPANY FINANCIALS											
INCOME STATEMENT (HRK m)	2020	2021	2022E	2023E	2024E	BALANCE SHEET (HRK m)	2020	2021	2022E	2023E	2024E
Sales revenue	18.3	17.1	18.2	17.6	18.2	Property and equipment	8.7	8.5	7.2	5.7	4.4
Other operating income	8.0	8.7	9.8	9.5	10.1	Intangible assets and goodwill	2.8	2.8	2.8	2.8	2.8
Total operating revenues	26.3	25.8	28.0	27.2	28.3	Other non-current assets	4.1	5.7	5.7	5.7	5.7
Personnel expenses	-12.5	-12.8	-13.3	-13.7	-13.7	Total non-current assets	15.6	17.0	15.7	14.2	12.9
D&A	-2.0	-2.0	-2.5	-2.4	-2.1	Trade receivables and other assets	3.7	3.9	4.2	4.1	4.2
Other operating expenses	-9.7	-10.2	-10.2	-10.2	-10.3	Financial assets at fair value through P&L	17.8	14.5	15.7	16.8	18.0
Total operating costs	-24.1	-25.0	-26.0	-26.3	-26.1	Short-term deposits	4.0	6.0	6.0	6.0	6.0
EBITDA	4.1	2.9	4.5	3.3	4.3	Cash and cash equivalents	9.3	11.6	13.1	13.8	15.4
Operating (loss)/profit	2.2	0.8	2.1	0.9	2.2	Other current assets	0.7	0.6	0.6	0.6	0.6
Net finance income	0.2	-0.4	-0.6	-0.5	-0.5	Total assets	51.1	53.6	55.4	55.6	57.2
Share of loss of equity - investees	0.0	0.0	0.0	0.0	0.0	Issued share capital	46.4	46.4	46.4	46.4	46.4
Profit before tax	2.3	0.5	1.5	0.4	1.8	Accumulated loss	-18.2	-17.8	-16.6	-16.3	-15.0
Income tax	-0.2	-0.1	-0.3	-0.1	-0.4	Other equity	14.8	14.7	14.7	14.7	14.7
Profit for the period	2.2	0.4	1.2	0.3	1.4	Total equity and reserves	42.9	43.2	44.4	44.7	46.1
Dividends	0.0	0.0	0.0	0.0	0.0	Total non-current liabilities	0.6	2.7	2.7	2.7	2.7
Dividend payout	0.0	0.0	0.0	0.0	0.0	Trade and other payables	2.7	2.6	2.6	2.6	2.6
Free cash flow	3.9	1.4	3.1	2.3	3.2	Contractual liabilities and provisions	4.6	4.3	4.8	4.7	5.0
						Other non-current liabilities	0.3	0.8	0.8	0.8	0.8
						Total equity and liabilities	51.1	53.6	55.4	55.6	57.2
OTHER DATA											
	2020	2021	2022E	2023E	2024E						
Average commissions	0.14%	0.14%	0.14%	0.14%	0.14%						
Total turnover - ZSE	3,129	2,540	2,903	2,694	2,763						
Total market turnover - ZSE	1.15%	0.93%	1.06%	0.98%	1.01%						
Total turnover - LJSE	3,006	2,849	3,211	2,890	3,183						
Total market turnover - LJSE	1.00%	0.86%	0.97%	0.88%	0.96%						
Liquidity ratio (Current assets / Liabilities)	4.3	3.5	3.6	3.8	4.0						
Cash and deposits as a % of total assets	26.1%	32.9%	34.6%	35.7%	37.5%						
Cash and deposits as a % of mkt cap	26.2%	34.6%	37.6%	38.9%	42.1%						

Valuation

To calculate the fair value and our 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. Furthermore, the company does not pay a dividend currently, so a dividend discount model cannot be performed either. The current share price levels offer upside of 27.0% to our PT, so we have upgraded our recommendation to BUY ZSE's shares.

Valuation summary

ZB CZ Equity	
Discounted cash flow (100% weight)	14.0
Current price	11.0
Potential upside	27.0%
Recommendation	BUY

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 0.75x. This results in a cost of equity of 8.8%. Zagreb Stock Exchange is financed solely by equity, so we assume the WACC at 8.8% as well.

WACC calculation

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

	2021	2022E	2023E	2024E	2025E	2026E
Adj. EBIT	0.8	2.1	0.9	2.2	2.5	2.4
Tax rate	-22%	-22%	-22%	-22%	-22%	-22%
NOPAT	0.6	1.6	0.7	1.7	1.9	1.9
Depreciation & amortisation	2.0	2.5	2.4	2.1	1.9	1.7
Changes in working capital	0.1	-0.2	0.0	-0.1	0.0	0.0
CAPEX	-1.2	-1.2	-0.8	-0.8	-0.8	-0.8
Free cash flow	1.4	3.1	2.3	3.2	3.0	2.7
growth yoy	-64%	123%	-27%	38%	-4%	-9%
Time adjustment for the valuation date		0.7	1.7	2.7	3.7	4.7
Discount factor		0.9	0.9	0.8	0.7	0.7
Discounted free cash flow		2.9	2.0	2.5	2.2	1.8
Sum	11.5					
Long term growth rate	3%					
Residual value at horizon	46.9					
PV of residual value	28.8					
Net debt (2021E)	-19.2					
EV	59.4					
Number of shares (m)	4.6					
Fair value	12.8					
Price target	14.0					
Upside	27.0%					

Source: WOOD Research

Sensitivity of our PT to the WACC and long-term growth rate estimate in our DCF model

		Long term growth rate				
		2.0%	2.5%	3.0%	3.5%	4.0%
WACC	7.0%	13.7	14.2	14.8	15.6	16.4
	8.0%	13.3	13.8	14.4	15.1	15.9
	9.0%	12.9	13.4	14.0	14.6	15.4
	10.0%	12.6	13.0	13.6	14.2	14.9
	11.0%	12.3	12.7	13.2	13.8	14.5

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. We note that we do not assume any IPOs in our model currently. However, we assume that the average velocity of shares traded on the exchange increases gradually over our forecast period.

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 and the downside, can have quite large consequences for the margins, 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 it 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.

Financials

Income statement

(HRK m)	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
Sales revenue	15.1	18.3	17.1	18.2	17.6	18.2	18.4	18.4
Other operating income	9.9	8.0	8.7	9.8	9.5	10.1	10.2	10.2
Total operating revenues	25.0	26.3	25.8	28.0	27.2	28.3	28.6	28.6
Personnel expenses	-11.2	-12.5	-12.8	-13.3	-13.7	-13.7	-14.0	-14.2
D&A	-1.9	-2.0	-2.0	-2.5	-2.4	-2.1	-1.9	-1.7
Other operating expenses	-12.4	-9.7	-10.2	-10.2	-10.2	-10.3	-10.3	-10.4
Total operating costs	-25.4	-24.1	-25.0	-26.0	-26.3	-26.1	-26.1	-26.3
EBITDA	1.5	4.1	2.9	4.5	3.3	4.3	4.3	4.1
Operating (loss)/profit	-0.4	2.2	0.8	2.1	0.9	2.2	2.5	2.4
Net finance income	1.4	0.2	-0.4	-0.6	-0.5	-0.5	-0.5	-0.5
Share of loss of equity - accounted investees	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	1.0	2.3	0.5	1.5	0.4	1.8	2.0	1.9
Income tax	-0.1	-0.2	-0.1	-0.3	-0.1	-0.4	-0.4	-0.4
Profit for the period	0.9	2.2	0.4	1.2	0.3	1.4	1.6	1.5

Source: WOOD Research, Zagreb Stock Exchange

Balance sheet

(HRK m)	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
Property and equipment	8.6	8.7	8.5	7.2	5.7	4.4	3.3	2.4
Intangible assets and goodwill	3.0	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Other non-current assets	3.5	4.1	5.7	5.7	5.7	5.7	5.7	5.7
Total non-current assets	15.0	15.6	17.0	15.7	14.2	12.9	11.8	10.9
Trade receivables and other assets	4.4	3.7	3.9	4.2	4.1	4.2	4.3	4.3
Financial assets at fair value through profit or loss	19.6	17.8	14.5	15.7	16.8	18.0	19.2	20.4
Short-term deposits	1.5	4.0	6.0	6.0	6.0	6.0	6.0	6.0
Cash and cash equivalents	7.6	9.3	11.6	13.1	13.8	15.4	16.9	18.1
Other current assets	0.6	0.7	0.6	0.6	0.6	0.6	0.6	0.6
Total assets	48.7	51.1	53.6	55.4	55.6	57.2	58.8	60.3
Issued share capital	46.4	46.4	46.4	46.4	46.4	46.4	46.4	46.4
Accumulated loss	-20.4	-18.2	-17.8	-16.6	-16.3	-15.0	-13.4	-11.9
Other equity	14.5	14.8	14.7	14.7	14.7	14.7	14.7	14.7
Total equity and reserves	40.5	42.9	43.2	44.4	44.7	46.1	47.7	49.1
Total non-current liabilities	0.9	0.6	2.7	2.7	2.7	2.7	2.7	2.7
Trade and other payables	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6
Contractual liabilities and provisions	4.0	4.6	4.3	4.8	4.7	5.0	5.1	5.1
Other non-current liabilities	0.8	0.3	0.8	0.8	0.8	0.8	0.8	0.8
Total equity and liabilities	48.7	51.1	53.6	55.4	55.6	57.2	58.8	60.3

Source: WOOD Research, Zagreb Stock Exchange

Cash flow statement

(HRK m)	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
Profit for the year	0.9	2.3	0.5	1.2	0.3	1.4	1.6	1.5
D&A of fixed assets	1.9	2.0	2.0	2.5	2.4	2.1	1.9	1.7
Interest income	-0.2	-0.1	0.0	0.0	-0.1	-0.1	-0.1	-0.1
Corporate income tax expense	0.1	0.0	0.0	0.3	0.1	0.4	0.4	0.4
Other	-1.2	0.0	0.1	0.6	0.6	0.7	0.7	0.7
Net cash from operations before changes in WC	1.5	4.3	2.6	4.6	3.4	4.4	4.4	4.1
Changes in working capital:								
Change in trade, other receivables	-0.2	0.6	0.5	-0.3	0.1	-0.2	0.0	0.0
Change in trade, other payables	0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
Change in prepaid expenses	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Corporate income tax paid	0.0	0.0	0.0	-0.3	-0.1	-0.4	-0.4	-0.4
Other	0.3	0.7	-0.3	0.5	-0.1	0.3	0.1	0.0
Net cash from operations	1.5	5.6	2.7	4.5	3.3	4.1	4.0	3.7
Purchase of financial instruments	-2.6	-0.5	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
Interest received	0.2	0.1	0.0	0.0	0.1	0.1	0.1	0.1
Other	6.8	-2.6	1.6	-1.8	-1.4	-1.5	-1.5	-1.5
Net cash from investing activities	4.5	-3.0	0.5	-2.9	-2.6	-2.5	-2.5	-2.5
Net cash inflows from financing activities	-0.8	-0.8	-0.9	0.0	0.0	0.0	0.0	0.0
Total cash flows	5.2	1.7	2.3	1.5	0.7	1.6	1.5	1.2
Cash at the beginning of the period	2.4	7.6	9.3	11.6	13.1	13.8	15.4	16.9
Cash at the end of the period	7.6	9.3	11.6	13.1	13.8	15.4	16.9	18.1
Free cash flow	1.1	3.9	1.4	3.1	2.3	3.2	3.0	2.7

Source: WOOD Research, Zagreb Stock Exchange

KPIs

	2019	2020	2021	2022E	2023E	2024E	2025E	2026E
Margins & profitability (%)								
EBITDA margin	5.8%	15.7%	11.1%	16.2%	12.0%	15.3%	15.2%	14.2%
EBIT margin	-1.7%	8.2%	3.2%	7.4%	3.3%	7.9%	8.7%	8.3%
Net margin	3.8%	8.2%	1.4%	4.3%	1.1%	4.9%	5.4%	5.2%
Dividend payout	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROE	2.3%	5.2%	0.8%	2.7%	0.7%	3.0%	3.3%	3.1%
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)	15.9	11.0	11.0	11.0	11.0	11.0	11.0	11.0
Average price per share (HRK)	16.0	11.0	11.0	11.0	11.0	11.0	11.0	11.0
EPS (HRK)	0.2	0.5	0.1	0.3	0.1	0.3	0.3	0.3
BVPS (HRK)	8.7	9.3	9.3	9.6	9.7	9.9	10.3	10.6
DPS (HRK)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF per share (HRK)	0.2	0.9	0.3	0.7	0.5	0.7	0.7	0.6
P/E (x)	78.7	23.7	>100	42.4	>100	37.1	32.8	34.3
P/BV (x)	1.8	1.2	1.2	1.1	1.1	1.1	1.1	1.0
EV/EBITDA (x)	44.5	9.1	11.6	7.0	9.5	6.8	6.5	6.6
P/FCF (x)	67.0	12.9	36.4	16.3	22.4	16.2	16.9	18.7
Div. yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Source: WOOD Research, Zagreb Stock Exchange

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Benefit Systems	1, 2, 3
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Bucharest Stock Exchange	5
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CEZ	5
Dino	5
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Electrica	5
Erste Group Bank	5
Eurobank	4
Eurocash	5
Fondul Proprietatea	4, 5
Globe Trade Centre	1, 2, 3
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Kofola CS	5
Komercni	4, 5
Kruk	5
Lotos	5
MedLife	4
MONETA Money Bank	5
NLB Group	5
Nuclearelectrica	5
O2 Czech Republic	4, 5
OMV Petrom	5
Orange PL	5
Piraeus Financial Holdings	1, 2, 3
Pekao	4, 5
PGE	5
PGNiG	5
Philip Morris CR	5
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PKO BP	4, 5

PZU	4, 5
Romgaz	5
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