

KRUK: Initiation of coverage

Poland, Specialty Finance

Reuters: KRU.WA Bloomberg: KRU.PW

1 July 2011

Turning bad debts into profits

Kruk S.A. (Kruk) is Poland's and Romania's leader in debt management services for financial institutions, telcos and utility companies, among others, with a YE09 market share of c.27% and 15-27% respectively. Kruk plans to become a meaningful player on the Czech market (just entered) and in Hungary (entry planned for 2012). Strong operating leverage and more than doubling portfolio purchases will, we expect, contribute to a three-fold increase in earnings between 2010 and 2012. Based on a comparable valuation, mid-cycle multiples and DCF, we arrived at a 12-month price target of PLN 56.8 per share. On our estimates, Kruk trades at 9.7x 2011E earnings (7.6x 2012E) and 10.5x 2011E EV/EBITDA (8.0x 2012E), both multiples representing a significant discount to peers. We initiate the coverage of the stock with a BUY.

Kruk is Poland's leader in debt management services for financial institutions, telcos and utility companies, among others, with a YE09 market share of c.27%. The company is also present in Romania and is already the largest player there, with a market share of between 15-27%, depending on the segment, only three years after its entry. Kruk plans to become a meaningful player on the Czech market (just entered) and in Hungary (entry planned for next year).

Kruk's largest business segment is the purchasing, collection and management of the portfolios of defaulted consumer receivables (72% of revenues in 2010), with banks being the segment's largest clients. Fee-based credit management services are its second key line of business. Combining the two activities under the one roof makes Kruk uniquely positioned in the market, gives it a strong competitive edge and, last but not least, brings significant revenue and cost synergies. Kruk also owns ERIF, one of three licensed credit information agencies in Poland. ERIF not only offers solid growth prospects as a stand-alone business, but is also a strong tool for supporting the recovery of bad debts.

Kruk offers exposure to the fast-growing market of banking NPLs and B2C overdue receivables. Owing to the complementary nature of the main business lines, its business is practically counter-cyclical or, at the very least, not directly correlated with the NPL cycle. Fee business typically picks up when overdue receivables rise, while the bad debt purchase business grows the most when delinquency ratios are falling. We expect the supply of bad debts from banks in Poland to increase significantly in 2011 through to 2013, with the nominal value of NPLs sold expected to reach PLN 6.3bn in 2011 and PLN 7.6bn in 2012, on our estimates, following the PLN 4.5bn sold in 2010. In Romania, where we expect more moderate growth, we forecast the market to total RON 2.5bn in 2011/12.

Over the past four years, Kruk has grown its business exponentially – earnings have risen five-fold and the balance sheet over eight-fold. Going forward, growth rates should be remain robust, our estimates show. We expect a 2011-13E EBITDA CAGR of 54%, following the 49% for 2007-10, and an EPS compound growth rate of 43% (57%) for 2011-13E. We expect ROE of between 30% and 36%, and assume that a dividend should be payable from the 2012E profits (a 20% payout, dividend yield of 2.6%).

We set a 12-month price target at PLN 56.8/share, implying 42% upside. We value the stock using a blend of three valuation methodologies – comparable multiples, mid-cycle multiples and a DCF (with a WACC of between 9.2% and 10.0%, and a g of 3%). On our estimates, Kruk trades at 9.7x 2011E earnings (7.6x 2012E) and 10.5x 2011E EV/EBITDA (8.0x 2012E), both multiples implying 11% to 21% discount to peers.

The key company/business-specific risks include the banks' propensity to outsource NPL collection/sell bad debts, portfolio pricing and IRR/recovery assumptions, taxation (the company pays very low taxes), regulatory/law changes and FX risks.

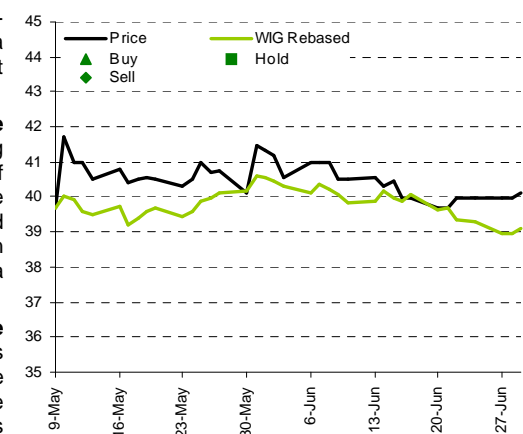
KRUK: Financial summary

PLN in millions, unless otherwise stated

	2009	2010	2011E	2012E	2013E
Revenues	128.6	164.3	278.7	404.3	476.1
EBITDA	34.8	46.6	98.5	137.3	170.6
EBIT	31.7	42.6	93.8	130.9	162.2
Net profit	23.4	36.1	67.8	88.6	114.8
EPS	1.48	2.32	4.11	5.24	6.79
P/E (x)	26.9	17.2	9.7	7.6	5.9
EV/EBITDA (x)	20.5	16.7	10.5	8.0	6.6

Source: Company data, DM BZ WBK estimates

Recommendation	BUY
Portfolio weighting	–
Price (PLN, 28June 2011)	40.0
Target price (PLN, 12M)	56.8
Market cap. (PLN m)	676.0
Free float (%)	56.9
Number of shares (m)	16.9
Average daily turnover 3M (shares)	60k
EURPLN	4.01
USDPLN	2.79



The chart measures performance against the WIG index. On 28/06/2011, the WIG index closed at 47,976.

Shareholders	% of votes
Enterprise Fund IV L.P.	24.8
Piotr Krupa	15.7
Management and employees	2.5

Company description

KRUK is a credit management services group operating in outsourced debt collection and debt purchases. It is a market leader in Poland and Romania and has recently entered into the Czech market. It employs 1,300 people and serviced PLN 4bn receivables in 2010.

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Throughout the report we use share prices as of 28 June 2011.

Investment summary

The leading debt service provider in Poland, with regional ambitions

Kruk S.A. (Kruk) is Poland's largest provider of a wide range of debt management services to financial institutions, telcos and utility companies, among others. At YE09, its share in Poland's overdue receivables market was c.27%, with the next company in line commanding a 12% share. Kruk's largest business segment is the purchasing, collection and management of the portfolios of defaulted consumer receivables (72% of revenues in 2010), with banks being the segment's largest clients. Since 2003, the company has acquired nominal portfolios worth PLN 4.7bn. Credit management (fee-based outsourcing services) is Kruk's second key line of business. It also owns ERIF, one of three licensed credit information agencies in Poland. A leading player in the Polish market, in 2007, the company also entered into Romania, where it currently commands a market share of between 15-27%, depending on the segment. Kruk just entered into the Czech Republic plans an entry into Hungarian market next year.

Complementary businesses make Kruk a counter-cyclical play on banking NPLs

Combining credit management and debt purchase under the one roof makes Kruk uniquely positioned in the market, gives it a strong competitive edge and, last but not least, brings significant revenue and cost synergies. Owing to the complementary nature of the main business lines, its business is practically counter-cyclical or, at the very least, not directly correlated with the NPL cycle – fee business picks up when overdue receivables rise, while the bad debt purchase business grows the most when delinquency ratios are falling.

Good outlook for the market

We expect the supply of bad debts from banks in Poland to increase significantly in 2011 through to 2013 as NPLs seem to have peaked in both countries in 2010 and banks typically sell their bad debt portfolios 18 months (or later) after a default. On our estimates, the face value of banking NPLs sold in Poland should total PLN 6.3bn in 2011 and PLN 7.5bn in 2012, following the PLN 4.5bn sold in 2010. This should translate into PLN 790m and PLN 1bn real value in 2011 and 2012, respectively. In Romania, we expect more moderate growth, with a total market size in 2011 and 2012 equivalent to PLN 2.4bn each, and PLN 210m and PLN 252m, respectively, in value to be paid. Given our assumption that Kruk's market share in bad debt purchases will remain at c.20% in Poland and 40% in Romania, this should translate into total outlays for NPL portfolios of PLN 227m in 2011 and PLN 272m in 2012. We believe Kruk's revenues from credit management services should pick up in 2011 and then remain roughly flat.

Strong track record...

Over the past four years, Kruk has grown its business exponentially, with earnings having risen five-fold and the balance sheet over eight-fold since 2006. Its ROE averaged 26% in the period, with each consecutive year bringing an improvement (31% in 2010). The total value of debt portfolios serviced (outsourcing and own portfolio) stood at PLN 11.2bn at YE10 (up 138% from YE07) and the total number of cases processed at 1.8m.

...and robust prospects

Our estimates suggest a 2011-13E EBITDA CAGR of 54%, following 49% for 2007-10, and an EPS compound growth rate of 43% (57%) for 2011-13E. We expect ROE of between 30% and 36%, and assume that a dividend should be payable from the 2012E profits (a 20% payout, equal to a dividend yield of 2.6%). We believe the subsequent

year should bring a higher payout ratio, with the dividend yield rising to 5.1% in 2014. Our model assumes a continuing improvement in the EBITDA margin (36% in 2013E vs. 28% in 2010), due to our assumption of maintained strong gross margins in Kruk's credit management services (c.40%) and maintained strong margin in its debt purchase business).

We set 12-month target price at PLN 56.8/share

We set a 12-month price target at PLN 56.8/share, which implies 42% upside potential from the current share price level. We value the stock using a blend of three valuation methodologies – comparable multiples (implied current fair value of PLN 55.0/share), mid-cycle multiples (PLN 50.1) and a DCF (PLN 49.8) with a WACC of between 9.2% and 10.0%, and a g of 3%. On our estimates, Kruk trades at 9.7x 2011E earnings (7.6x 2012E) and 10.5x 2011E EV/EBITDA (8.0x 2012E), both multiples implying 11% to 21% discount to peers

Key risks

The key company/business-specific risks include the banks' propensity to outsource NPL collection/sell bad debts, portfolio pricing and IRR/recovery assumptions, taxation (the company pays very low taxes), regulatory/law changes and FX risks.

Valuation

We value Kruk using a blend of three valuation methodologies – comparable multiples, mid-cycle multiples and a DCF. Our valuation models yield a fair equity value (EV) ranging between PLN 842m (PLN49.8/share) and PLN 930m (PLN 55/share), with weighted average of PLN 879m (PLN 52/share). We set our 12-month target price (TP) at PLN 56.8/share.

Fig. 1. KRUK: Fair values and price targets (PLN/share)

Methodology	Fair value	Weight
Comparable multiples	55.0	33%
Mid-cycle multiples	51.2	33%
DCF	49.8	33%
Blended fair value	52.0	
12-month target price	56.8	
Upside potential	42%	

Source: DM BZ WBK Research

On our estimates, Kruk currently trades at 10.0x and 7.6x our 2011E and 2012E earnings respectively (Bloomberg's convention), discounts of 21% and 22%, respectively, to the medians of its peers. On our TP, Kruk trades at 14.2x 2011E earnings and 11.9x 2012E earnings, premiums of 13% and 22% respectively, but we the premiums justified given our expectation for Kruk's superior EPS growth in the next three years. On our estimates, Kruk's EPS should grow by a 29% CAGR over 2012-13E, which compares against its peers' respective median EPS growth of 19%, on consensus forecasts.

Similarly, our estimates for Kruk's EV/EBITDA ratio, of 7.8x for 2011 and 5.6x for 2012, put the company at 11% and 21% discounts, respectively, to its peers' medians. At our TP, Kruk trades at respective multiples of 10.7x and 7.7x, premiums of 22% and 8%. Again, our mid-term expectations for Kruk's above-average EBITDA growth prospects (a 2011-13E CAGR of 32%, against its peers' average of 16%) justify this premium, in our opinion. We also note that Kruk's business is heavily skewed toward bad debt portfolios' purchasing compared to Intrum Justicia, its closest peer geographically, and that this is penalising the former's EV/EBITDA somewhat. We expect Kruk to accelerate its debt purchases strongly in 2011 and 2012, which, through a higher net debt (and, thus, higher EV) and the delayed contribution of recoveries from the portfolios to the EBITDA (the recovery rates and accounting peculiarities of recognising income from debt portfolios purchased), naturally puts it on higher EV/EBITDA multiples than its more credit management-biased peers.

Fig. 2. Kruk vs. its peers (P/E and EPS growth)

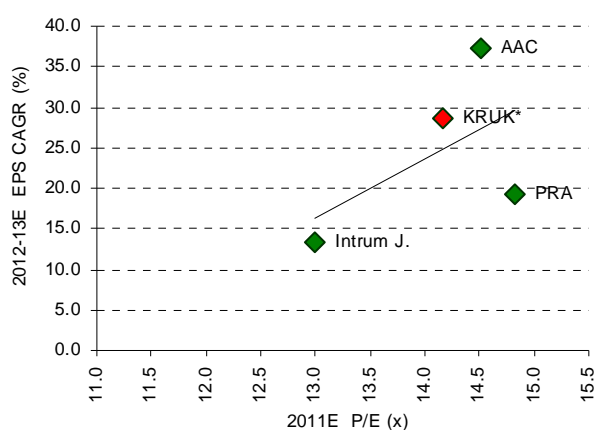
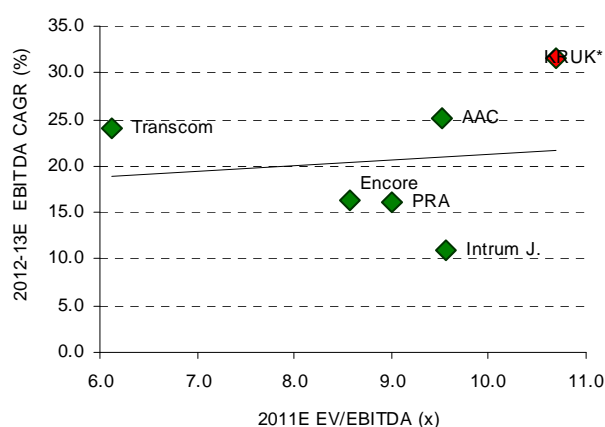


Fig. 3. Kruk vs. its peers (EV/EBITDA and EBITDA growth)



Source: DM BZ WBK Research, Bloomberg estimates, * Kruk's estimates at target price

Our main operating assumptions

The main operating and financial assumptions that we have used in our earnings model for Kruk are as follows:

- We expect a 15% 2011-14E CAGR in the nominal value of the portfolios sold in Poland and a 2% CAGR in Romania. We have assumed a flat to declining market share for Kruk in both markets, which translates into a combined PLN 1.9bn spend on portfolios acquired vs. PLN 434m over 2007-10.
- We have assumed a 4% contraction 2011-14E CAGR in the value of debt management contracts in Poland and a positive 2% CAGR in Romania, with Kruk's market share remaining roughly intact. However, we have assumed marginally improving recovery rates and, hence, higher fees, which would translate into a revenue CAGR of 1% in the red for the forecast period.
- Assuming a slow improvement in cost efficiency (chiefly from economies of scale) in the two main business lines and incremental (but small) contributions from the two new business lines – Novum cash loans and ERIF, the credit agency – we have arrived at a 39% 2011-14E gross profit CAGR, with the gross margin improving from 46% in 2010 to 51% in 2014.
- We have assumed a 28% 2011-14E CAGR in SG&As and 28% in depreciation, which translates into a 44% EBITDA CAGR for the forecast period. We have also assumed that there will be an EBITDA margin improvement, from 28% in 2010 to 37% in 2014.
- We have assumed a flat tax rate of 3% throughout the forecast period.
- We have factored in a flat PLN/RON exchange rate throughout the whole forecast period.
- We have assumed a 222% total return rate on the portfolios already purchased by Kruk, as well as those to be purchased in the future.

Peer group valuation

Our peer group valuation implies an equity value for Kruk ranging from PLN 772m to PLN 1,285m, with a weighted blended average of PLN 930m, or PLN 55.0/share. We have used consensus estimates for its peers' P/E, EV/EBITDA and PEG ratios and, using the respective median ratios, calculated the implied fair value, or equity value, of Kruk. We have assigned an equal 20% weighting to each of the multiples used.

Fig. 4. Kruk: comparable multiples

	Ticker	Mcap (PLN m)	EV	EV/EBITDA		P/E		PEG	CAGR 2012-13E	
				2011E	2012E	2011E	2012E		EPS	EBITDA
Intrum Justitia AB	IJ SS	3,052	3,966	9.6	8.6	13.0	11.4	1.0	13.4	10.9
Aktiv Kapital ASA	AIK NO	750	767	3.6	4.0	3.2	-	-		
Transcom WorldWide SA	TWWSDBB SS	462	760	6.1	4.4	9.3	5.7	0.2	39.8	23.9
Asset Acceptance Capital Corp	AACC US	316	751	9.5	7.0	14.5	8.5	0.4	37.2	25.1
Portfolio Recovery Associates Inc	PRAA US	4,054	4,806	9.0	7.7	14.8	12.4	0.8	19.3	16.1
Encore Capital Group Inc	ECPG US	2,042	3,038	8.6	7.1	12.2	9.7	0.7	18.4	16.3
Median				8.8	7.1	12.6	9.7	0.7	19.3	16.3
Kruk (at current price)*		676	770	7.8	5.6	10.0	7.6			
premium/discount				-11%	-21%	-21%	-22%			
Kruk (at price target)**		960	1,054	10.7	7.7	14.2	11.9	0.5	28.6	31.6
premium/discount				22%	8%	13%	22%	-25%		
Implied Kruk's EV (PLN m)				772	878	853	863	1,285		
Weights				20%	20%	20%	20%	20%		
Implied blended EV (PLN m)				930						
Implied EV per share (PLN)				55.0						

Source: DM BZ WBK Research, * Bloomberg convention used, hence multiples may differ from these of DM BZ WBK, ** at target price of PLN 56.8/share

We have analysed the current consensus valuations for other listed credit management companies. Given the relatively small size and liquidity of Kruk's domestic peers and the lack of consensus estimates, we have only looked at the largest international peers for the sake of comparison.

Our comparable EV/EBITDA method yielded an equity value of between PLN 772m and PLN 878m. We have applied the consensus forecast blended median EV/EBITDA for the peer group for 2011 and 2012 and calculated the median value for the group. We have used the last-reported net debt for both Kruk and its peers, hence our presented EV/EBITDA values for Kruk may differ from those presented elsewhere as, for the sake of calculating Kruk's forward multiples, we have used estimated EOP net debt in the respective years. Also, please note our comment on the 'penalising' nature of EV/EBITDA multiples on companies with a significantly increasing stock of purchased bad debts earlier in this report.

Our comparable P/E method yielded an equity value of between PLN 853m and PLN 863m. We have applied the consensus forecast blended median P/E ratios for the peer group for 2011 and 2012.

Finally, we have used the median PEG ratios calculated from consensus expectations for Kruk's peers and estimated the implied equity value of Kruk at PLN 1,285m. This method yielded the highest value, but we note that Kruk's PEG ratio is among the lowest of all the comparable companies. This is particularly striking if Kruk is compared to Intrum Justitia, its closest peer geographically. We note that Intrum trades at broadly similar 2012E multiples to Kruk's but, at the same time, offers inferior EBITDA and EPS growth prospects in the 2011-13 period.

Mid-cycle multiples

We have calculated the long-term averages for the two-year forward consensus P/E and EV/EBITDA multiples for the members of Kruk's peer group. We have applied the medians of these (11.3x P/E and 7.8x EV/EBITDA) to our 2013 forecasts for Kruk's earnings, EBITDA and net debt and discounted the implied fair value back to today. Finally, we have calculated a blended EV, applying a 50% weight to the mid-cycle P/E and 50% to the mid-cycle EV/EBITDA, arriving at a valuation for Kruk of PLN 865m (PLN 51.2/share).

Fig. 5. KRUK: Mid-cycle multiples

Mid-cycle P/E	11.3 x
x 2013E earnings	1,297
PV (Jan'12)	1,082
Month	6
PV (current)	1,035
Weight	50%
Mid-cycle EV/EBITDA	7.8 x
x 2013E EV/EBITDA	872
PV (Jan'12)	728
Month	6
PV (current)	696
Weight	50%
Equity value (blended) (PLN m)	865
Equity value per share (PLN/share)	51.2
12-month price target	55.9

Source: DM BZ WBK Research. *including net cash proceeds from IPO

DCF method

Our DCF model is based on our detailed five-year forecasts (2011-15E), estimated FCFs in the 2nd stage (2016-18E), when we assumed portfolio purchases resulting in the cash recoveries equalling the amortisation of the acquired portfolios, and, finally, the terminal value (TV) calculated from the FCFs in the last year of the 2nd stage, 2018. Our model yields an EV of PLN 842m, or PLN 49.8/share. We use:

- An RFR of 5.90% for Poland and 7.31% for Romania, and risk premiums of 4.5% and 5.5%, respectively. We have calculated the blended cost of equity (CoE) for each forecast year, with the revenue mix being the main blending factor.
- A beta of 1.0, derived from a blend of the betas of comparable companies, which translates into a cost of equity of between 9.2% and 10.0%, depending on the equity/debt weighting in the funding mix in any given year.
- A terminal growth rate of 3%, a notch below the estimated long-term nominal growth of Poland's and Romania's blended GDP, and in line with our long-term growth forecasts for the retail market in Poland.
- Net debt as last reported (end of 1Q11 level) adjusted for cash proceeds from the IPO.

Fig. 6. Kruk: DCF model

(PLN m)	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Revenues	279	404	476	548	602	633	648	657	666
yoy	70%	45%	18%	15%	10%	5%	2%	1%	1%
EBIT	93.8	130.9	162.2	189.8	197.2	205.2	207.6	203.8	199.1
yoy	120%	40%	24%	17%	4%	4%	1%	-2%	-2%
EBIT margin	34%	32%	34%	35%	33%	32%	32%	31%	30%
Taxes on EBIT	-4.7	-6.5	-8.1	-9.5	-9.9	-10.3	-10.4	-10.2	-10.0
NOPAT	89.1	124.4	154.1	180.3	187.4	195.0	197.2	193.6	189.2
Depreciation	4.7	6.4	8.3	10.7	13.3	16.1	19.1	22.0	25.1
Portfolio amortisation	160.6	269.5	296.4	353.4	434.8	482.3	498.7	522.6	545.4
Portfolio purchases	-533.2	-422.2	-433.8	-473.3	-486.4	-506.7	-500.6	-506.2	-545.4
Capex	-7.8	-11.3	-13.3	-15.4	-16.8	-17.7	-18.1	-18.4	-18.6
WC change	1.7	4.4	8.0	8.1	8.6	8.6	8.6	8.6	8.6
FCF	-284.9	-28.9	19.7	63.8	140.9	177.7	204.8	222.2	204.2
Discount factor	0.92	0.84	0.76	0.70	0.63	0.58	0.48	0.36	0.24
Discounted FCF	-261.0	-24.2	15.0	44.4	89.2	102.2	97.3	79.3	49.7
Sum of FCF	192								
Terminal value (TV)	2,905								
g (%)	3%								
PV of TV	707								
Total EV	899								
Net debt/cash (last reported)*	94								
Minorities	0								
Equity value (Jan 1, 2011)	805								
Month	6								
Equity value (current)	842								
# of shares	16.9								
Value per share (PLN)	49.8								
12-month price target	54.4								

Source: DM BZ WBK Research. *including net cash proceeds from IPO

Fig. 7. Kruk: sensitivity of EV

g%	WACC change						Beta	RFR change				
	-2.0%	-1.0%	0.0%	1.0%	2.0%	-1.0%		-0.5%	0.0%	0.5%	1.0%	
1.0%	1,097	840	648	501	386	0.8	1,127	1,032	947	871	802	
2.0%	1,251	941	717	549	420	0.9	1,034	949	873	803	740	
3.0%	1,467	1,075	805	609	462	1.0	951	874	805	742	684	
4.0%	1,790	1,263	922	686	514	1.1	876	806	743	685	633	
5.0%	2,326	1,544	1,086	788	581	1.2	807	744	686	634	585	

Source: DM BZ WBK Research

Fig. 8. Kruk: sensitivity of EV

Fig. 9. Kruk: sensitivity of terminal value

g%	WACC					Beta	Terminal value sensitivity				
	8.0%	9.0%	10.0%	11.0%	12.0%		-1.0%	-0.5%	0.0%	0.5%	1.0%
1.0%	707	619	550	495	451	0.8	994	909	833	765	705
2.0%	824	707	619	550	495	0.9	911	835	767	706	651
3.0%	988	824	707	619	550	1.0	836	768	707	652	602
4.0%	1,233	988	824	707	619	1.1	769	708	653	603	559
5.0%	1,640	1,233	988	824	707	1.2	709	654	604	559	519

Source: DM BZ WBK Research

Fig. 10. Kruk: sensitivity of terminal value

Fig. 11. Kruk: WACC assumptions

	2011E	2012E	2013E	2014E	2015E
RFR - PL	5.90%	5.90%	5.90%	5.90%	5.90%
RFR - RO	7.31%	7.31%	7.31%	7.31%	7.31%
Risk premium - PL	4.50%	4.50%	4.50%	4.50%	4.50%
Risk premium - RO	5.50%	5.50%	5.50%	5.50%	5.50%
Share of PL	70%	65%	60%	60%	60%
Beta	1.0	1.0	1.0	1.0	1.0
CoE (blend)	11.1%	11.2%	11.4%	11.4%	11.4%
Cost of debt	9.8%	9.8%	9.8%	9.3%	9.3%
After tax cost of debt	8.0%	8.0%	8.0%	8.0%	8.0%
% equity	38%	43%	47%	53%	61%
% debt	62%	57%	53%	47%	39%
WACC	9.2%	9.4%	9.6%	9.8%	10.0%
Terminal WACC (10YR)	10.0%				

Source: DM BZ WBK Research. *including net cash proceeds from IPO

Key investment risks and sensitivities

Apart from the usual business risks (competition, IT system disruption, funding costs, key personnel losses), we find the following to be the key company-specific risk factors for Kruk:

Macroeconomic risks. The level of NPLs in the banking sector and arrears in non-banking receivables are correlated with economic growth and, in the case of consumer liabilities, unemployment rates. For Kruk, the correlations are inverted compared to banks/B2C companies: while the latter tend to suffer from higher delinquency rates during times of slow economic growth/recession, Kruk actually sees a pick-up in its fee business (credit management) during such times, as banks/B2C companies (after trying to cope with increasing delinquency rates among their customers by first stepping up their in-house bad debt collection activities), ultimately decide to outsource the service. Following a few iterations, the unrecovered bad debts are put up for sale. This counter-cyclicality is, however, delayed by at least a few months compared to the economic cycle, with the gap caused, among other things, by the in-house debt recovery activities of the banks/B2C companies. Furthermore, during times of economic slowdown, recovery tends to be more difficult and more costly, therefore the greater volume of business is partly neutralised by the lower profitability of the collection activities. Lastly, the economic cycle has a relatively small (if any) impact on the recovery rates of the bad debt portfolios in Kruk's balance sheet as the company often offers its debtors the option to repay the delinquent amounts in instalments, while, additionally, it continues to introduce new recovery tools that help bolster its recovery rates and increase its recovery yield. These all compensate for the potential economic cycle-induced deterioration of the recovery rates.

NPL formation risk. An environment of high banking NPL formation is generally supportive for Kruk's business. Apart from the GDP/unemployment rate-related drivers, as described above, the NPL formation and the trend in the NPL rate are dependent on a number of variables, including FX movements, interest rate levels and even the pace of loan growth (the dilution effect). In our earnings/valuation model for Kruk, we have assumed a gradual slowdown in NPL formation and a decline in the NPL rate over the forecast period.

Bank's propensity to outsource NPL collection/sell NPLs. Banks' propensity to outsource NPL collections/sell NPLs. Irrespective of the developments on the loan quality front, the banks' propensity to outsource bad debt collection services and/or sell their bad debts differs over time. Tax regulations, the level of capital (including the minimum levels and calculation formulas imposed by the regulators), and the prices offered by potential buyers are just a few of the drivers of the size of the potential business available to Kruk and its peers. In our model, we have assumed a growing propensity of the banks to outsource the collection of defaulted loans and to sell NPLs. The sensitivity of our 2011-14E EBITDA CAGR to changes in the propensity level is quite high (as presented in the tables below), with every 2ppt drop in the ratio translating into an approximate 1.5% lower EBITDA growth rate, all else being equal.

Market share risk. We have based our earnings and valuation model for Kruk on specific assumptions regarding the company's market share in both outsourced bad debt collection and the NPLs sold in Poland and Romania. The sensitivity of our model relative to market share change is relatively low in the case of Romania due to its relatively low share assumed in the total mix (as presented in the table above). For Poland, every 2.5ppt change to our market share assumption translates into an approximate 1.5ppt change in our estimated EBITDA CAGR over 2011-14E.

Portfolio pricing risk. The proper pricing of bad debt portfolios is an important element that affects the returns on the purchased portfolios. Our model shows that, ceteris paribus, with every 2ppt increase in the price paid for bad debt portfolios, the 2011-14E operating cash flow CAGR falls by approximately 2%. We note, however, that this risk factor is partly mitigated by the inversely correlated recovery rates. To put things simply, debt collectors are willing to pay more for bad debt portfolios if the prospects for the recovery rates improve. Hence, higher prices paid typically do not automatically translate into lower recoveries or ROIs on the acquired portfolios.

IRR/recovery rates assumption risk. The company calculates these for each acquired portfolio. Should the actual recovery rates differ, Kruk reevaluates the portfolios through its P&L. Actual cash recoveries also change, with sensitivity similar to that presented above. In our model, we have assumed an IRR of 52% and a six-year recovery and total return averaging 222% on all the portfolios. These are conservative assumptions, in light of the fact that, owing to changes in the regulations governing debtors' data (the so-called ERIF factor), as well as the introduction of voluntary settlement on a mass scale, the company currently recovers substantial amounts from portfolios older than six years (see the data on the 2003-10 portfolios further in the report).

Taxation risk. Kruk's historic and assumed effective tax rates are substantially below the statutory 19% CIT rate in Poland and the 16% rate in Romania. The company benefits from favourable tax regulations in Luxembourg, where its subsidiary, investing in certificates issued by the securitisation funds, is domiciled. Additionally, Poland and Romania have double taxation treaties, which allow the further reduction of tax charges. Any negative change in the regulations could alter our earnings assumptions significantly, given the 5% effective tax rate that we have assumed, going forward.

Regulatory risks. At the moment, Kruk benefits from a number of regulations, including the zero taxation of investment funds, the tax deductibility of bad loans sold by banks to securitisation funds (and, hence, their much increased propensity to sell NPLs), economic data processing/sharing, and many more. Any adverse change could obviously be detrimental to Kruk's business.

Licensing risk. A number of Kruk's businesses – its securitisation fund, detective bureau and credit agency – are licensed activities. A loss of licence, which we regard as a low probability, or, conversely, the removal of the licensing requirement and, thus, the lowering of the barrier to entry for the competition, could be negative for its business.

Law change risk. Kruk has benefited from the recent changes to some regulations, such as alterations to data processing/sharing, and the introduction of an electronic court. Adverse changes would be detrimental to Kruk's business. Any potential changes to consumer bankruptcy law could also harm its business.

FX risk. Kruk owns a business in Romania, just entered into the Czech Republic and intends to enter into Hungary next year. At present, the company does not hedge its open FX (RON-PLN) position due to the lack of attractively-priced instruments, among other reasons. While, historically, PLN and RON have been relatively closely correlated, any major deviation could affect Kruk's results. At present, Kruk is funding its Romanian business through PLN-denominated equity and PLN debt/bonds. The company is attempting to mitigate this risk somewhat by factoring in an additional risk margin when pricing the portfolios offered for sale in Romania. In our model, we have assumed a flat PLN/RON rate throughout the forecast period.

Interest rate/access to external funding risk. Kruk partly funds its business through loans from banks and, recently, through the issuance of unsecured bonds as well. At YE10, its net debt/EBITDA ratio stood at 2.2x, while its net debt/equity ratio was 0.8x.

Kruk's borrowing is pegged to the interest rates (WIBOR 3M and 6M); therefore, any change in interest rates affects its bottom line. While Kruk's cash generation should increase over time due to cumulated cash recoveries from the bad debt portfolios acquired in the past, its indebtedness level should after a hike expected in 2011 and 2012 gradually fall going forward, with our expectation of its net debt/EBITDA ratio at 2.2x for YE14. Additionally, the improvement of Kruk's risk profile (that we expect as the result of the listing of its shares on the market), should allow for a reduction of the margin it pays on its debt, partly mitigating the potentially negative impact of higher market interest rates.

Portfolio revaluations and risks to forecasts. Kruk is constantly controlling the actual recoveries vs. the rates assumed in its internal budgets and values assumed for the recognition of the bad debt portfolios in the balance sheet. Adjustments are made on a quarterly basis. The past couple of years have brought significant positive revaluations in the P&L. In our forecasts, we have assumed no impact from revaluation, but the actual results may deviate significantly from our assumptions.

Company overview

Kruk, at a glance

The Kruk group is Poland's largest provider of debt management services to financial institutions, telcos and utility companies, among others. Having started in 1998 as a collector of overdue B2C receivables, it now offers a wide range of services. Its largest business segment is the purchasing, collection and management of portfolios of defaulted consumer receivables (debt purchasing, 72% of its revenues and 77% of its gross profit in 2010), with banks being its largest clients. Since late 2002, the company has acquired 140 portfolios, worth a total of PLN 4.7bn (nominal), and it commands a market share of c.27%, on 2010 preliminary data. The YE10 value of the portfolios acquired in Kruk's balance sheet stood at PLN 263m. This was a partially amortised value and, in fact, the gross value of the portfolios (or, more precisely, the cash spent on their purchase) amounted to PLN 516m. Kruk's second key source of revenues is the fee-based collection of overdue receivables (27% of its revenues and 29% of its gross profit in 2010).

Apart from its parent company (Kruk S.A.) in Poland, the group also includes Rejestr Dłużników Biuro Informacji Gospodarczej S.A. ERIF (ERIF), one of three licensed credit information agencies in Poland; a detective bureau; a legal firm, Kancelaria Prawna Raven (Raven); and two securitisation funds (Prokura NS FIZ and Prokulus NS FIZ), used chiefly to purchase bad debts from banks. Additionally, the group encompasses a special purpose vehicle in Luxemburg, which invests in the investment certificates of the two securitisation funds and, due to the favourable tax treaties between Poland and Luxemburg, allows tax optimisation.

Kruk is a leading player in the Polish market and, in 2007, the company also entered into Romania, where it already commands a dominant market share in banking debt purchases (66% in 2010) and a meaningful 16% in credit management services, operating there through Kruk International. This year, Kruk is planning to enter into the Czech Republic and/or Hungary and replicate the business models it has developed in Poland and then rolled out in Romania.

Kruk employs over 1,200 people, with the headcount in Poland totalling close to 1,000 and over 200 in Romania. The company operates two call centres in Poland (over 278 employees) and Romania (90).

Kruk's business is regulated by the KNF, the financial market regulator in Poland. Kruk owns licensed closed-end securitisation funds that may purchase overdue debt from banks, while the parent company itself holds a KNF licence, which allows it to offer its outsourcing services to banks.

Over the past four years, Kruk has grown its business exponentially, with earnings having risen five-fold and the balance sheet over eight-fold since 2006. Its ROE averaged 26% over 2007-10, with each consecutive year bringing an improvement (31% in 2010). The total value of debt portfolios serviced (outsourcing and own portfolio) stood at PLN 11.2bn at YE10 (up 138% from YE07) and the total number of cases processed at 1.8m (up 57%).

Fig. 12. Kruk: snapshot of the 2007-10 results

(PLN m)	2007	2008	2009	2010
Revenues	64	104	129	164
yoy		63%	24%	28%
Gross profit	29	48	57	75
yoy		62%	20%	31%
Opex	-52	-78	-96	-122
EBITDA	14	27	35	47
yoy		96%	27%	34%
EBIT	11	25	32	43
Net financial income	-2	-8	-4	-7
Net profit	9	16	23	36
Gross margin	46%	46%	44%	45%
EBITDA margin	22%	26%	27%	28%
EBIT margin	18%	24%	25%	26%
Tax rate	-1%	3%	-14%	1%
Net (debt)/equity	-1.3	-1.1	-0.4	-0.8
Net cash from operations	31	72	92	129
Capex and acquisitions	-12	-7	-4	-7

Source: Company data, BZWBK Research

Kruk's history

Kruk's history goes back to 1998, when Piotr Krupa (the current CEO) and Wojciech Kuznicki (who sold out completely in 2007), two law faculty graduates, founded a company publishing tax and law handbooks. Winning and successfully completing their first debt collection project in 1999 for one of the major mobile telco companies in Poland prompted the founders to refocus and expand into the bad debt collection business.

By 2003, Kruk became a market leader in debt collection services. In 2003, Enterprise Investors assumed a 70% stake in the company, buying shares from both founders and raising capital for a total consideration of USD 12m. In the same year, Kruk bought its first bad debt portfolio, added new services – a licences detective agency and a firm of attorneys (Raven) – and rolled out the first version of *Delfin*, its proprietary IT system.

In 2004, Enterprise Investors, through one of its funds, invested a further USD 10m in the company. The changes to tax and investment fund law in 2005 opened up a new segment of the market – banking debt – on a larger scale and Kruk responded quickly by opening its first securitisation fund and setting up its Luxembourg-based subsidiaries. The fast expansion of the business prompted the opening of Kruk's first remote operating business – a back-up conference call centre in Walbrzych.

In 2006, the first fully-fledged securitisation transaction of overdue banking receivables took place. In 2007, Kruk entered into Romania and acquired ERIF, the credit information agency, from an Austrian owner.

2008 brought a change to Kruk's bad debt recovery strategy or, actually, the company's philosophy/approach to the debtors – the introduction of an amicable settlement procedure – on a mass scale.

2010 brought the long-awaited change in the economic data exchange/sharing law, allowing the redefinition of ERIF's role in the group. Two internet platforms – *e-Kruk* and *Infokonsument.pl* – were set up, supporting the debt recovery process on the one hand and also becoming additional tools for bad debt recovery. In 2H10, Kruk launched its first TV advertising campaign aimed at promoting *e-Kruk*, highlighting the benefits of not

being recorded at ERIF, and also flagging the new benefits of voluntary settlement (PL: postępowanie ugodowe) to actual and potential debtors.

Fig. 13. KRUK: Milestones, at a glance

1998	Kruk founded in Wrocław
1999	First contract in debt service won
2003	Kruk becomes a leader in debt service
2003	Enterprise Investors (EI) becomes a 70% investor First portfolio of bad debt purchased
2004	EI invests further USD 10m
2005	Securitisation fund and Luxembourg subsidiary launched First remote operation – Wałbrzych call centre – set up
2007	Entry into Romania Acquisition of ERIF
2008	Introduction of mass amicable settlement as key bad debt recovery tool
2010	Breakthrough change to the law governing credit information agencies Kruk's first TV advertising campaign

Source: Company data

Kruk's business at a glance

Credit management and debt purchasing – the main business lines

The Kruk group offers a broad range of services, from loss prevention, monitoring, soft collection, detective services, legal services and credit agency to the purchasing and securitisation of overdue receivables. The fee-based collection of overdue receivables (credit management services, hereafter), and overdue debt purchasing (debt purchasing) and its recovery are, however, the company's two main business lines, which generate the vast majority of its revenues and operating profits. The debt purchase business dominates in the revenue mix and, consequently, gross profit, but the margin of the credit management services was higher in the past couple of years. Kruk's business is well-balanced as its two main businesses are complementary, i.e. they both benefit the most at different stages of the NPL cycle. Moreover, the synergies between the two businesses are strong.

Fig. 14. Revenue and gross profit breakdown 2007-10

(PLN m)	2007	2008	2009	2010
<u>Revenues</u>				
Credit management	20	29	42	44
Debt purchase	63	117	140	190
<u>Gross profit</u>				
Credit management	5	9	18	14
Debt purchase	23	38	39	42
<u>Gross profit margin</u>				
Credit management	27%	32%	42%	33%
Debt purchase	37%	32%	28%	22%

Source: Company data

Focus on recovery rates

While bad debt collection is common for the fee business and own portfolios activities, and, in both cases, the focus is on the maximisation of recovery rates, each line of business still requires a slightly different approach. The fee-based collection has a limited timeframe (from a few weeks up to three months per portfolio/batch, typically) and, hence, the ability to process the data quickly and identify the debtors that have the highest potential of a prompt repayment of overdue debt is key. For purchased bad debt portfolios, the recovery may take anything up to 10 years. Here, the ability to assess the recovery potential and, hence, the valuation of the portfolio plays a crucial role, while the recovery process itself requires the use of a much broader set of techniques and information sources.

Main tools

Kruk uses a wide range of techniques and tools to locate debtors and assets, and to recover the overdue debts processed/acquired. Of these, the key ones are:

- *Delfin*, its proprietary IT system, which allows the monitoring, management reporting and processing of its bad debt recovery related data.
- Its highly-automated, modern call centre (278 employees in two locations in Poland, 90 in Romania), integrated with *Delfin*. Its capacity (2.3m calls made and 5.4m text messages sent per annum) is by far the largest in the market.
- 85 field agents using an in-house GPS-supported tracking and assistance system.
- Licence detectives.

- High capacity print house (70k claims/day).
- Internet service (*e-Kruk*), providing debtors with full access to information on their debts, payments schedules, and allowing online settlements.
- Credit information agency (ERIF BIG), which not only stores data on debtors, but also serves as an excellent prevention and recovery tool.
- Law firm, Raven, which, among other activities, is involved in amassing the filing for debt repayment through an electronic court (EPU).

Substantial synergies between its main business lines

The synergies between Kruk's two main business lines are substantial as the debt collection process is shared between the credit management and debt purchasing businesses, allowing the use of the same resources (cost synergies) and credit information. Additionally, Kruk's debt services activities, provided to a large number of B2C companies and banks over the past couple of years, have allowed it to gain substantial knowledge of the market and to build a comprehensive statistical model. This model not only enables the efficient recovery of debt, but also allows Kruk to promptly and accurately value the bad debt portfolios put up for sale.

Its economies of scale, vast expertise and large database make Kruk a unique player in the market as most competitors typically either concentrate on one area of activity (such as credit management or bad debt purchase) or, if they offer more complex services, they are much smaller than Kruk, often lacking economies of scale and/or capacity. Synergies with the other members of the group are also significant, to name ERIF BIG, the credit information agency, as an example. The agency is not only a self-sufficient business due to the exponentially-growing number of records/inputs, but it is also an excellent tool for motivating debtors to pay off their debts.

Kruk's key clients – the banks

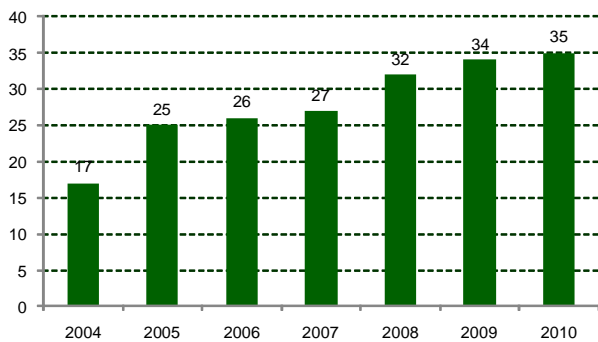
While Kruk co-operates with companies from a number of sectors (banks, hire-purchase companies, insurance and leasing companies, telcos, cable TV operators, DTH providers and FMCG companies), consumer debt is Kruk's main area of interest, and banking receivables account for the lion's share of its business in both the credit management and debt purchase segments. Over the past couple of years, it has built up a strong business relationship with the largest Polish banks and regularly services eight of the top 10 of Poland's largest banks. As at YE10, Kruk was co-operating with 35 financial entities in Poland and the three largest banks in Romania.

Fig.15. KRUK: Debt portfolios purchased

(PLN m)	2007	2008	2009	2010
Bank loans	73	134	137	164
Telecom bills	17	17	13	26
Cash loans (non-banking)	3	1	1	1
Others	0	0	0	2
Bank loans	78%	88%	91%	85%
Telecom bills	18%	11%	8%	13%
Cash loans (non-banking)	3%	1%	0%	0%
Others	0%	0%	0%	1%

Source: Company data

Fig. 16. Kruk – client base – no of co-operating financial entities



Source: Company data

Fig. 17. Kruk – client base – frequency of co-operation

Start year	No of banks from top 10	2007	2008	2009	2010
2003	3	100%	97%	100%	100%
2004	2	96%	92%	96%	100%
2005+	3	75%	83%	94%	82%
Total	8	92%	91%	97%	93%

Source: Company data

Credit management services

The market

The credit management services market is highly fragmented and, hence, the competition is high. Barriers to entry do exist, particularly in the banking part of the business. The external processing of banking receivables needs to meet high data protection and ethical standards, among other things. In fact, the banks monitor the service providers on a regular basis, carefully checking for any instances of a breach of standards, the use of unethical or excessive measures, and the attainment of data protection standards.

Between 2007 and 2010, the size of the credit management market in Poland more than doubled to PLN 11.4bn, while the 2007-10 CAGR equated to 28% (banking debts: 35%, non-banking: 2%). Kruk's market share for this period was in the 21-29% range. Banking overdue receivables account for most of the market (c.80%), with retail debts (80%), unsurprisingly, representing the vast majority (80%).

In Romania, the market is currently approximately half the size of Poland's (PLN 4.5bn in 2010), but its growth rate (a 51% CAGR in 2007-10) outpaces Poland's by a wide margin. Kruk's market share in Romania fell from 22% in 2008 to 15% in 2009 and remained at 15% in 2010, but the company intends to increase it to the 20%+ level, going forward.

Historically, the fees earned on credit management have ranged between 1-2% of the value of the portfolios received for processing.

Fig. 18. Debt management market

PLN bn

	2007	2008	2009	2010
Poland – market	5.4	5.2	8.9	11.4
Kruk's market share (%)	22%	21%	29%	26%
Romania – market	-	1.6	3.2	4.5
Kruk's market share (%)		22%	15%	16%
Kruk's portfolio	1.2	1.4	3.1	3.7
Revenues (PLN m)	18	24	37	39
Fee	1.5%	1.7%	1.2%	1.1%
Revenues from corporate portfolios (PLN m)	2	4	5	5
Total revenues	20	28	42	44

Source: Company data

Kruk's credit management business

Kruk entered into the credit management business back in 1998, by winning a receivables recovery contract from one of the telco companies. It has since developed

significant competence in this area and has emerged as the largest provider of outsourcing services for Poland's B2C companies, particularly the banks.

Fig. 19. Credit management – Kruk in Poland

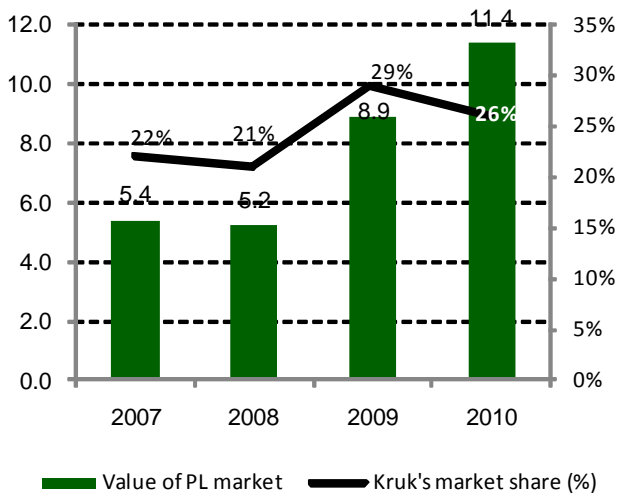
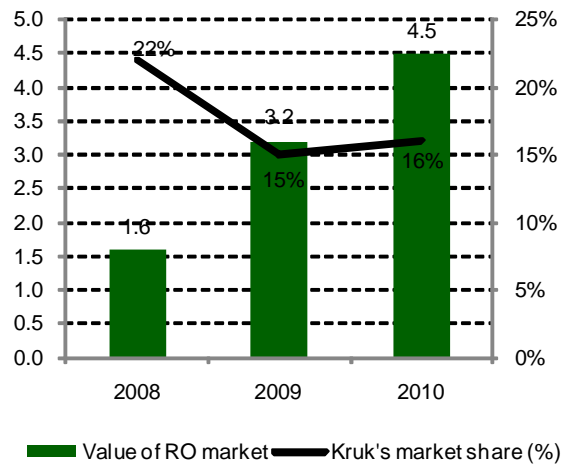


Fig. 20. Credit management – Kruk in Romania



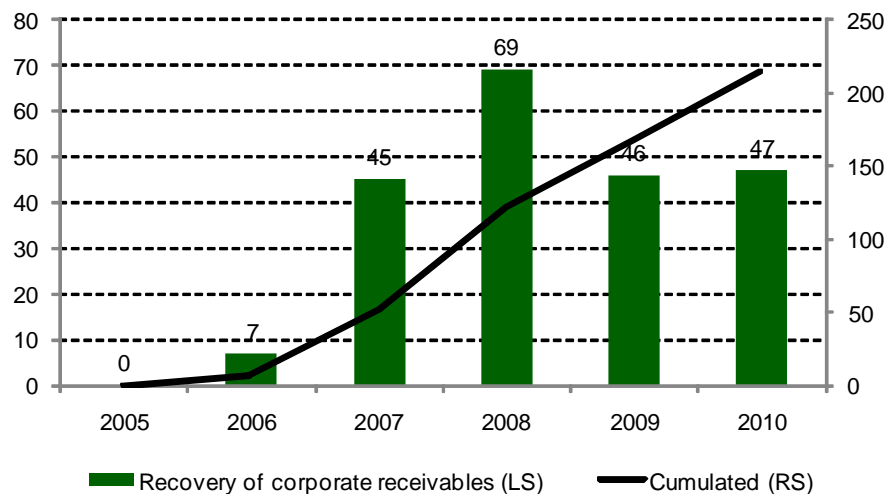
Source: Company data

Source: Company data

In Poland, Kruk has also built up its competence in the recovery of corporate bad debts. The company renders such services typically to foreign owners of such portfolios, which had acquired them between 2006 and 2008. Going forward, Kruk intends to acquire some of these portfolios and to eventually become more active in the purchases of new portfolios coming to the market.

The range of credit management services offered by Kruk is wide (from loss prevention, monitoring and soft collection to detective services and collateral repossession), but consumer debt collection is the one so far most commonly outsourced by the Polish and Romanian companies/banks.

Fig. 21. Poland – the recovery of corporate receivables



Source: Company data

Delfin, an integrated IT system that Kruk developed on its own, is one of the company's competitive advantages over its peers and one of its sources of its high operating and cost efficiency. The system is modular, scalable, flexible and, apart from supporting credit management at various stages, it also allows for data aggregation/analysis for the sake of the valuation of bad debt portfolios (see below).

Additionally, Kruk runs two call centres in Poland (the main one is in Wroclaw and a backup in Walbrzych, 278 employees altogether as at YE10) and one in Romania (90 employees). The comprehensive IT system, combined with the efficient call centres

(2.3m calls made per year, 5.4m text messages sent) make Kruk one of the most efficient providers of credit management services on the market. Web-based services – *e-Kruk* (www.ekruk.pl) and *Infokonsument.pl* – as well Kruk’s other business lines – the detective bureau, the law firm and the credit agency – additionally complement the debt recovery process, allowing Kruk to render complex services on bad debt in different stages of maturity, size, nature and complexity.

Operating model

A portfolio/batch of overdue receivables, typically already processed in-house by a bank/creditor, is offered for outsourcing through a tender process. The price (the fee on the recovered amount) is the key determinant in the tender process. The more mature Polish market is more sophisticated and variable fees based on recovery rates are applied increasingly often. In Romania, flat fee transactions still prevail. The fee level is normally correlated with the quality of the portfolio, its vintage, or the number of processing iterations it has gone through.

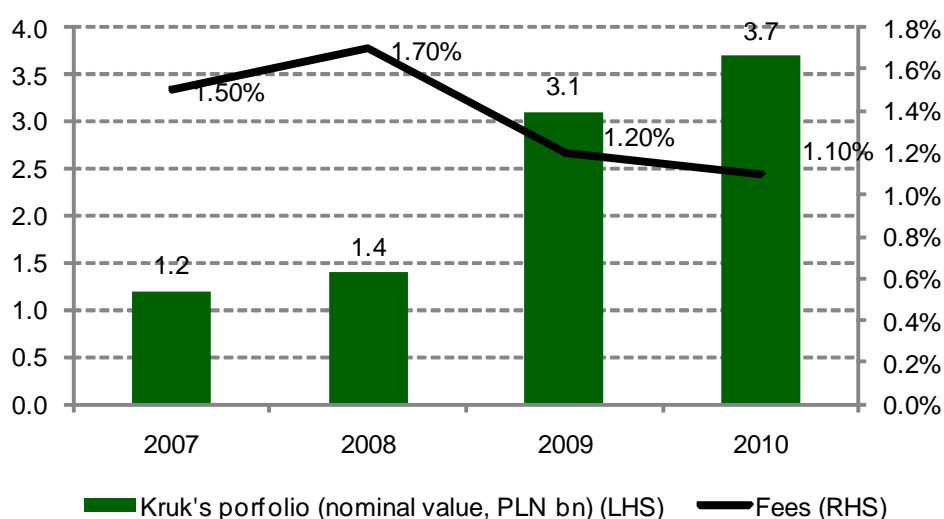
Following a few weeks/months of processing, any given portfolio is typically handed over for further recovery to another debt recovery company. It normally takes a few iterations (altogether, up to two years since the default date) and at least two or three external debt recovery companies are used before a portfolio is put up for sale.

Profitability and margins

Looking at Kruk’s historical financials, we have noted that the fee fell to 1.1-1.2% of the nominal value of portfolios processed in 2009/2010, from 1.5-1.7% in 2007/08. The drop is attributable to changes in the geographic mix of business and the improvement of the overall situation in the economy, and, in turn, better recovery rates and the lower fees that the outsourcing companies are willing to pay.

Kruk’s Romanian business, which we understand is characterised by lower recovery rates and somewhat lower fee levels, began in 2007, when it contributed a 3% share of Kruk’s total revenues from outsourcing services. This increased to 19% in 2010.

Fig. 22. Credit management – revenues and fees



Source: Company data

Debt purchasing

The market

While in the early years of the decade, credit management services dominated the debt collection market in Poland, 2003 and the change in the tax regulations on the taxation of

banking NPLs marked the vigorous start of the bad debts sale/purchase business. Banking consumer NPLs dominate the market, with a share of c.79%.

Kruk's debt purchase business

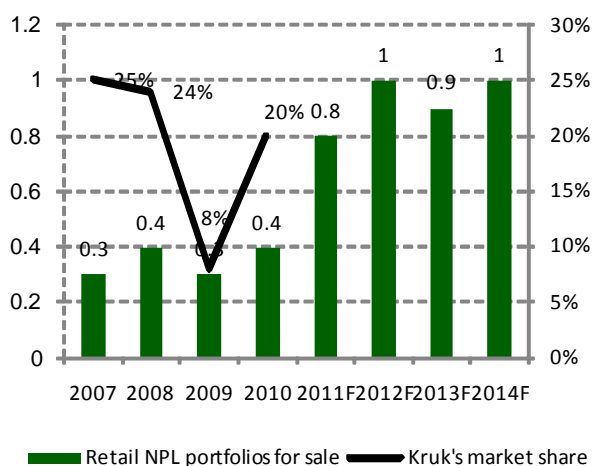
Kruk started to purchase bad debt portfolios in late 2002 and has since acquired over 140 such portfolios, with a nominal value of PLN 4.7bn in total. The portfolios acquired by Kruk consist of c.1.3m individual cases, implying an average 'ticket' size of c.PLN 3,600. Between 2007 and 2010, Kruk's market share in bad portfolio purchases was 20-25%, with 2009, when it slipped to 8%, being an exception. The drop to 9% was caused by funding constraints that bad debt purchasers faced, as well as the low prices they offered to banks (low visibility) and, hence, the low propensity of the latter to sell.

Fig. 23. Debt purchase – Kruk and the market

	2007	2008	2009	2010	2008-10 CAGR*
Market (nominal value, PLN bn)	2.0	4.3	4.0	5.6	14%
Poland	2.0	3.1	2.7	3.5	21%
Romania		1.2	1.3	2.1	32%
Average market prices (% of face value)	15%	13.0%	9%	11%	
Poland	15%	12%	11%	12%	
Romania		15%	6%	8%	
Market (at purchase price, PLN bn)	296	554	363	593	3%
Poland	296	375	291	427	13%
Romania		179	72	166	-4%
Kruk's market share	25%	19%	12%	33%	
Poland	25%	24%	8%	20%	
Romania		8%	27%	66%	
Portfolios purchased (fair value, PLN m)	79	104	43	194	68%
Poland	79	89	24	85	2%
Romania		15	19	209	273%

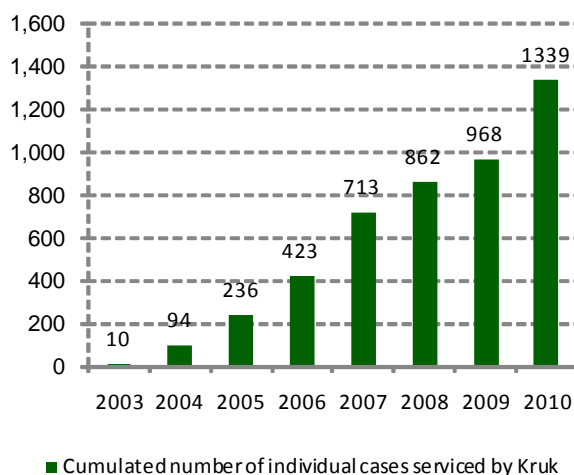
Source: Company data, DM BZ xWBK Research, *2009-10 CAGR for Romania and total values

Fig. 24. Kruk: market share in sold NPL portfolios;



Source: Company data, IBnGR

Fig. 25. Individual cases processed



Source: Company data, IBnGR

Operating model

The bad debt portfolios that are sold on the market typically consist of relatively seasoned (at least 18 months old) NPLs. The portfolios are usually a mix of various types of consumer receivables, such as cash, credit card and/or car loans.

The delinquent debts sold have typically already been subject to internal recovery activities by the sellers and have gone through a few iterations of outsourced recovery attempts. Often, Kruk itself has been involved in the earlier stages of the recovery process.

The bad debt packages are usually offered for sale through a tender process. Invitations to a tender are sent to the selected/interested parties and potential bidders are given detailed characteristics of the portfolio in question and/or a sample, to allow for a due diligence and quantitative analysis of the portfolios to be conducted.

This analysis is key to the profitable recovery of a portfolio as it allows for the assessment of the recovery rates and the thorough valuation of the portfolios. Kruk runs a complex statistical database/model, which is based on a few dozen key inputs/metrics. The model has been built and calibrated over the years, alongside Kruk gaining further experience during the provision of credit management services and from the recovery of the bad debts it purchased on its own book. Moreover, Kruk has participated in practically all of the tenders and evaluated nearly of all of the more than 800 bad debt portfolios sold in Poland to date – this has translated into a significant amount of expertise.

Kruk typically purchases portfolios from the companies it co-operates with in the area of credit management (fee-based recovery). This provides Kruk with better insight and, consequently, allows a more accurate assessment of the risks and adequate pricing.

Following the analysis of the data, estimated market conditions (key for recovery rates) are plugged into the valuation formulae and the final offer is presented to the seller.

Looking at Kruk's data, we have concluded that over 2007-10, the company paid between 11% and 15% of the nominal value of the overdue debts, on average. The prices were generally higher in 2007/08, but dropped considerably in 2009, due to uncertainty over the economic outlook and, hence, higher forecasting errors with regards to recovery ratios, limited access to funding and, lastly, potential sellers' resistance to sell at such low prices. 2010 brought a recovery of volumes sold and higher prices due to the growth of NPLs in the 2008-09 period, as well as an improved macro outlook.

Once the portfolio has been purchased, the full details of the debtors and the amounts in arrears are made available. Kruk revisits its assumptions and recalculates a number of parameters, including the fair value and IRRs. These are the key inputs for its revenue recognition in the P&L (only a part of the actual cash collection is recognised as revenue in the P&L, with the balance between the cash collected and the value implied by the IRR being the amortisation of the purchased portfolio). Recovery rates and, consequently, the fair value of each of the portfolios are recalculated each quarter upon the actual progress that has been made in the collection process. Relevant actual deviations and/or changes in assumptions are reflected through the portfolio revaluations and, in turn, gains/losses in the P&L.

The actual recovery process starts almost immediately. Following a review aimed at applying the most effective collection strategy, the portfolio accounts are assigned, sorted and prioritised upon inputs from the database, along with the duration of the delinquency, demographics, balance sizes and a handful of other indicators as the key metrics.

The collection team then starts with an initial call to obtain the debtor's location, financial situation, reasons for the delinquency and other relevant information. If a contact is unavailable, the team members attempt to locate the debtor using various techniques, including skip-tracing procedures.

Potential expansion into the corporate debt segment

Corporate debts are sold less often and, thus far, Kruk has participated in such tenders relatively rarely. However, the experience it has gained on servicing the portfolios acquired by foreign purchasers has prompted the company to look further into this segment. Kruk does not exclude buying already-serviced portfolios and/or tapping new opportunities that might appear on the market.

Amicable settlement makes the difference

Kruk benefits strongly from its credit management competencies and capacities (using the same IT system and database across all of its business units) and, hence, is able to achieve high recovery ratios. Yet, it was the introduction of its amicable solutions (debt reduction and/or repayment in instalments) on a mass scale in mid-2008 that brought a more meaningful improvement to its recovery rates.

Following the assessment of a debtor's ability to service the obligation, a settlement is negotiated, provided the debtor is responsive and willing to co-operate. If repayment of the full balance is not available, Kruk typically offers a settlement through monthly instalments.

Monthly instalment plans (best if confirmed by the debtor in writing rather than verbally), have been proven to translate into high settlement rates.

In contrast with the typical market practice of starting legal action almost immediately after the bad debt purchase, its new strategy has turned out to be a breakthrough in Kruk's relationship with the debtors. The change of attitude toward the debtors (as troubled consumers rather than repayment-evading individuals) and the introduction of debt restructuring tailored to the debtors' capacity on a massive scale has increased overall recovery rates by at least a dozen percent, on the company's estimates. Furthermore, the odds of repayment have increased by c.60%, compared with a verbal agreement, while, additionally, the stability of recoveries has improved vastly. So far, some 178k debt restructuring agreements have been signed, of which 25k are related to cases acquired in 2010. In 2010, as part of building up a positive image, Kruk made an unprecedented step in Poland (and unprecedented in Europe as well) – it advertised itself on TV.

In the event that the collection has not been obtained through the collection department or the debtor is not contactable, the opportunity for legal action is verified. Raven, Kruk's legal arm, pursues various collection strategies to secure payment. The introduction of an electronic court (*e-Sad*) and its electronic, simplified procedure (PL: *postepowanie upominawcze*) (EPU) in 2010, facilitated the mass filing of claims to court, dramatically reducing the time required for the issuance of a warrant of execution (PL: *nakaz*) and enforceability clause (PL: *klauzula wykonalnosci*), and has allowed for the considerable reduction of the cost of legal actions against debtors. In 2010 alone, nearly 56k cases were filed with the e-court.

Fig. 26. Kruk – time saved owing to EPU

Court proceedings	Time before filing in court	Court order	Enforceability clause
Standard	40 days	46 days	65 days
EPU	14 days	24 days	65 days
Difference in days	26 days	22 days	0 days

Source: Company data

Lastly, the now increasingly harsh consequences of being put into Kruk's credit agency database (ERIF BIG) as a delinquent payer is also playing a significant role in prompting the debtors to seek a settlement agreement with Kruk.

Total return averaged 223%

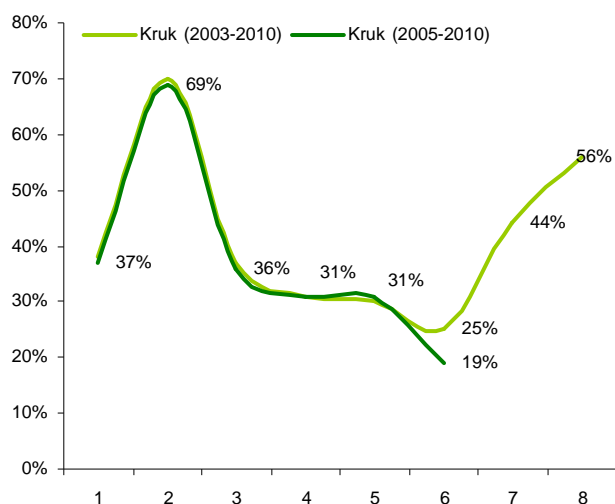
The overall process may take up to 10 years, looking at the experience of established competitors, such as Intrum Justitia. Kruk's experience so far is shorter, time-wise (its first portfolios were purchased in late 2002), but, nonetheless, its recovery rate (which, thus far, has averaged 2.23x) is comparable to, if not higher than, its peers. Recoveries are typically stronger at the beginning of the process period, with 100% of the price paid usually recovered within two years from the purchase date.

Fig. 27. Kruk – recovery rates (% of price paid) in each year since purchase

Year>	1	2	3	4	5	6	7	8	8+	Total
Kruk (2003-2010)	38%	70%	37%	31%	30%	25%	44%	56%		331%
Kruk (2005-2010)	37%	69%	36%	31%	31%	19%				223%
Intrum Justitia (reported)	59%	43%	29%	23%	18%	14%	11%	9%	20%	226%

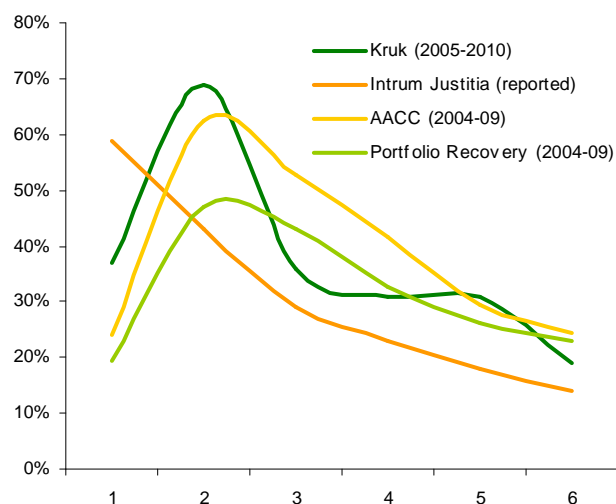
Source: Company data Intrum Justitia, DM BZ WBK Research

Fig. 28. Kruk: Recovery rates – Kruk and its peers)
% of price paid in a given year



Source: Companies' data, DM BZ WBK Research

Fig. 29. Recovery rates – Kruk and its peers
% of price paid in a given year



Source: Companies' data, DM BZ WBK Research

Revenue recognition in the P&L

The valuation of the acquired bad debt portfolios and the recognition of revenues from bad debt recoveries is in line with the premises of the regulations in IAS 39.

Kruk is therefore recognising in the P&L only a part of the actual cash recovered (equivalent to the IRR rate assumed and the opening balance of the bad debt portfolio for the period). The balance is recognised as a depreciation of the portfolio in the balance sheet.

Fig. 30. Kruk: recognition of cash recovered in the P&L (example)

Period	0	1	2	3
Price paid	100			
Assumed cash flows	-100	70	70	70
IRR assumed	49%			
OB		100	79	47
Cash in		70	70	70
P&L revenues (OB x 49%)		49	38	23
Amortisation (cash in less P&L revenues)		-21	-32	-47
CB		79	47	0

Source: Company data

Special tax treatment

The change in tax regulations back in 2004 allowed the banks to claim back the cost of the provisions on sold NPLs against tax paid, provided the bad debts are sold to special securitisation funds, licensed by the KNF, the financial market regulator. Kruk operates two such funds – Prokura NS FIZ and Prokulus NS FIZ – in Poland. According to Polish tax law, the funds themselves do not pay corporate tax and, instead, it is levied on the owners of the certificates issued by the funds. The certificates funds are purchased and held by a Luxembourg-registered subsidiary of Kruk (Secapital SaRL), itself a securitisation fund. Tax regulations in Luxembourg are favourable as they allow the claiming of dividends paid and/or capital redemption against tax. Secapital pays a dividend to Kruk and, due to the double taxation treaty between Poland and Luxembourg, the parent company effectively pays little, if any, tax on the profits from the debt purchase activity. Consequently, Kruk's effective tax rates in the past couple of years have been fairly small, or even positive.

ERIF – credit agency

In 2007, Kruk acquired ERIF BIG (ERIF), one of three licensed credit agencies in Poland, in order to build a proper platform for collecting, holding, processing and sharing data on delinquent individual and corporate payers. Unfavourable regulations governing data sharing held up the growth of the company somewhat but, nonetheless, the number of records has grown from 107k at YE08 to around 516k in 2010. A total of 13.5k customers, including banks, financial intermediary, insurance and telco companies, are using the database at present. Kruk believes that the increased number of records will attract more B2C companies, as well as SMEs that are seeking a reliable source for credit scoring, or merely a safety check on their potential counterparts. The company believes that these will become frequent users of the database, generating a steady flow of subscription revenues.

An amendment to data sharing law that finally came into force in June 2010 (the secondary owners of overdue liabilities may now input data into the database) allowed ERIF's business to re-start vigorously. Kruk is now able to put records of debtors that it acquired along with the bad debt portfolios and those serviced for the clients into the database. This has allowed Kruk to leverage the database and, by effectively turning it into a tool to support bad debt collection activity, it has already helped to improve recovery rates considerably. On the company's data, in 2010 alone, Kruk recovered around PLN 25m worth of bad debts, due to the fact that debtors have realised the sanctions of being recorded with ERIF.

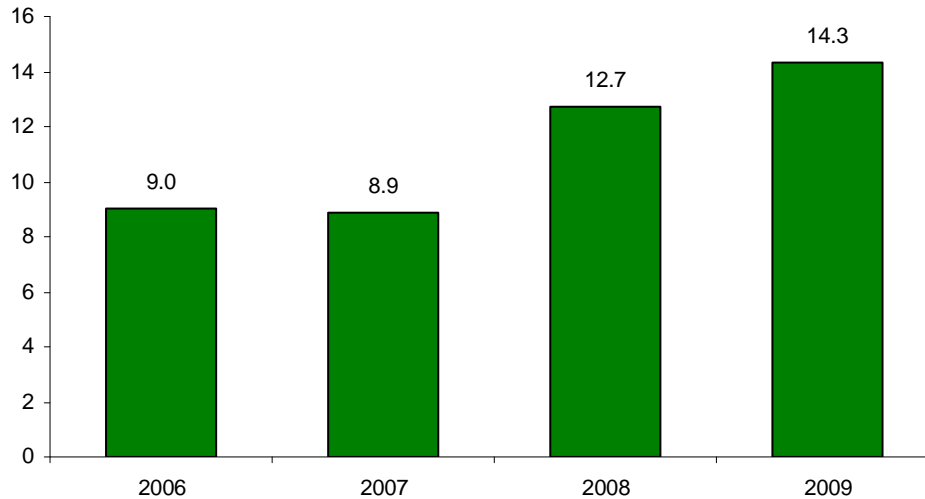
All-in-all, ERIF is a sound and prospective business on a stand-alone basis, and its strong synergies with Kruk's other businesses are another significant advantage for Kruk against its peers.

The market

Poland

Since YE06, the value of the Poland's total debt collection market has risen by about 60%, to PLN 14.3bn in 2009.

Fig. 31. Poland – market of debt collection services
PLN bn



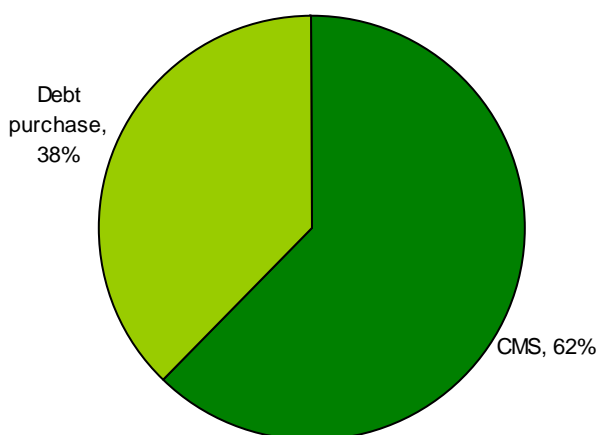
Source: IBnGR

The debt collection market in Poland can be divided into two segments:

- B2C – consumer debt collection (utility bills, bank loans, etc.)
- B2B – businesses' debt collection (mostly bank loans and trade payables)

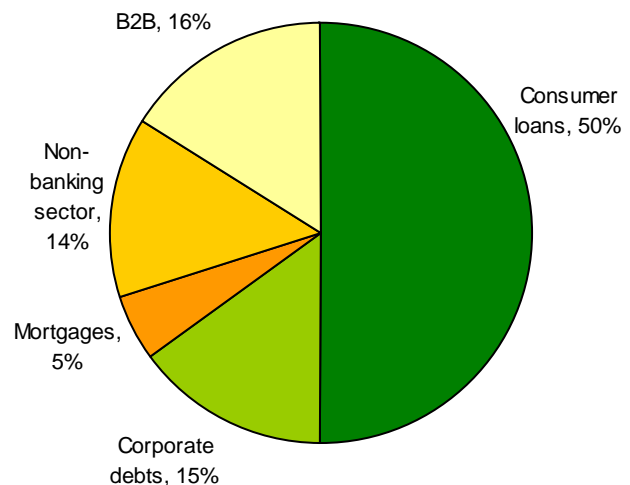
Moreover, companies in this industry can also be divided according to their business models. Some companies provide debt collection services for their clients, while others buy portfolios of overdue receivables from banks and B2C or B2B companies, and then collect the overdue loans on their own account. The outsourcing of the collection of delinquent receivables (credit management, or inkaso in Polish) is the most popular of the potential debt collection activities in Poland – this segment constituted 62% of the whole market in 2009.

Fig. 32. The Polish debt collection market by business line and type of debt (2009) In %



Source: IBnGR

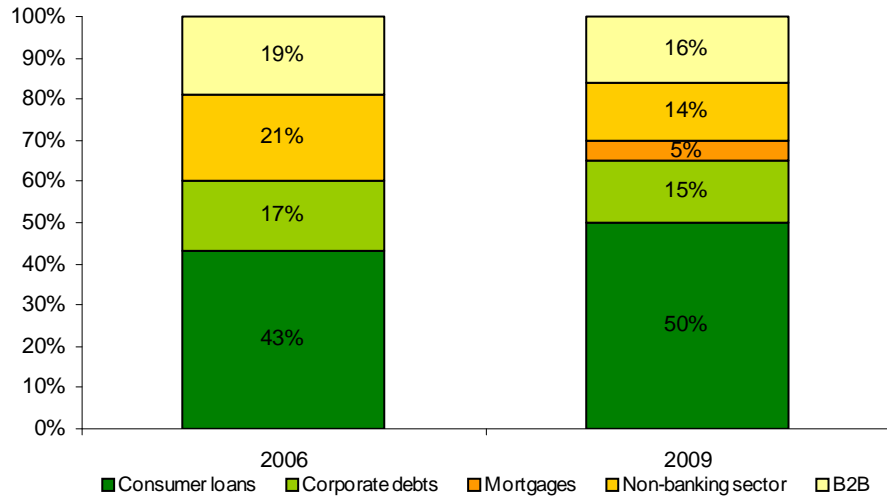
Fig. 33. Structure of the Polish debt In %



Source: IBnGR

Banks are the most important business providers for debt collection companies, with banking overdue loans accounting for approximately 70% of the total overdue receivables sold in 2009. The structure of the loans under the management of debt collection companies is changing as new financial products are being added to the list. Mortgages are a good example. In 2006, there were no overdue mortgages in the bad debt portfolios, while they accounted for 5% of the total market in 2009. However, the level of overdue mortgage payments is relatively small as Polish households are putting them first on their “to-pay” lists.

Fig. 34. Polish debt collection market by type of debt



Source: IBnGR

The consumer loans' share in the debt collection market has risen from 43% in 2006 to 50% in 2009 due to Poland's economic slowdown and rising unemployment rate. Historical patterns show that defaults in consumer loans typically increase first, once economic conditions worsen.

The structure of bad debts that are outsourced for collection is substantially different to the mix of bad debts sold.

In 2009, bank loans constituted 63% of the credit management market, with consumer loans being the single largest type of overdue receivable (57%). This compares with the 38% share of consumer loans in 2006. Furthermore, in 2009, there were no corporate overdue debts outsourced for collection.

Fig. 35. Poland – bad debt market by type (2009)

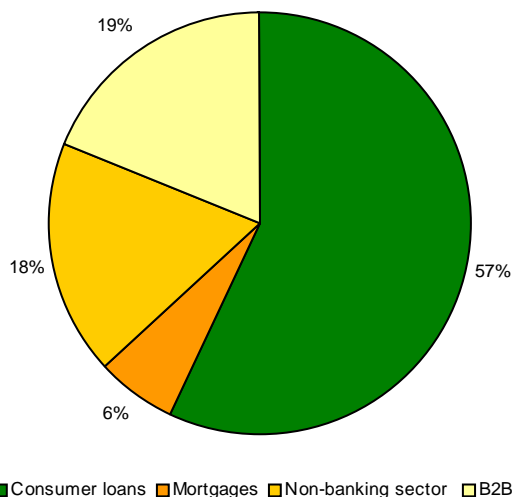
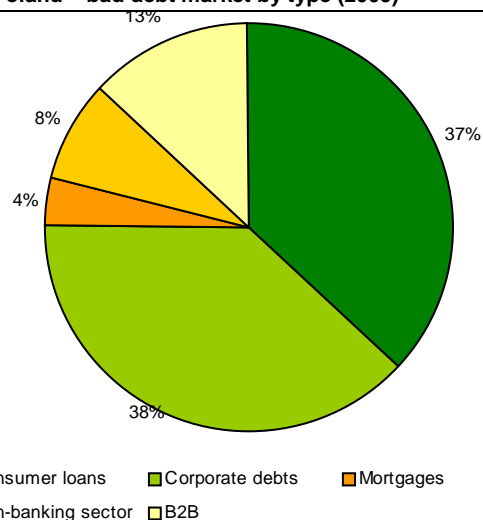


Fig. 36. Poland – bad debt market by type (2009)

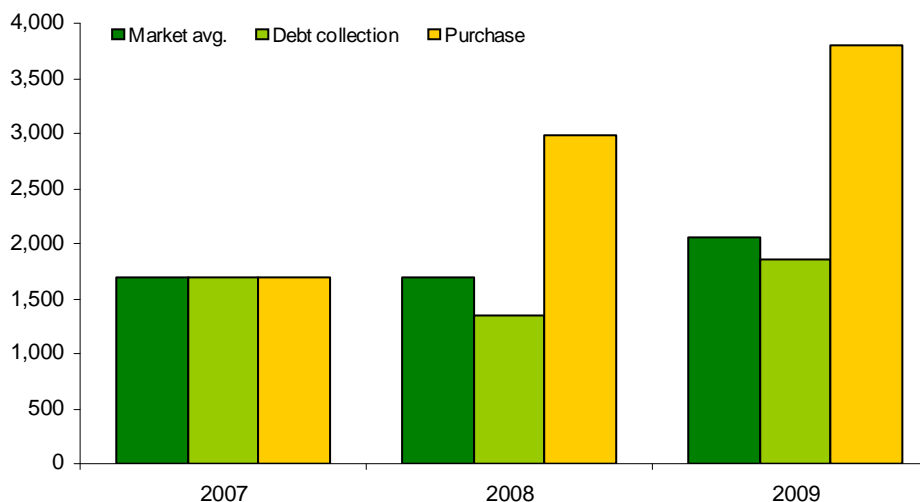


Source: Instytut Badań nad Gospodarką Rynekową

Source: Instytut Badań nad Gospodarką Rynekową

In the second business model – debt purchase – corporate debts constituted 38% of the total market in 2009, thus being almost as important as consumer loans. Again, this differs substantially once compared to 2006, when the share of corporate debt was at 34%, while consumer loans accounted for nearly half of the bad loans sold. The market data shows the growing interest of debt purchasers in corporate bad debts portfolios.

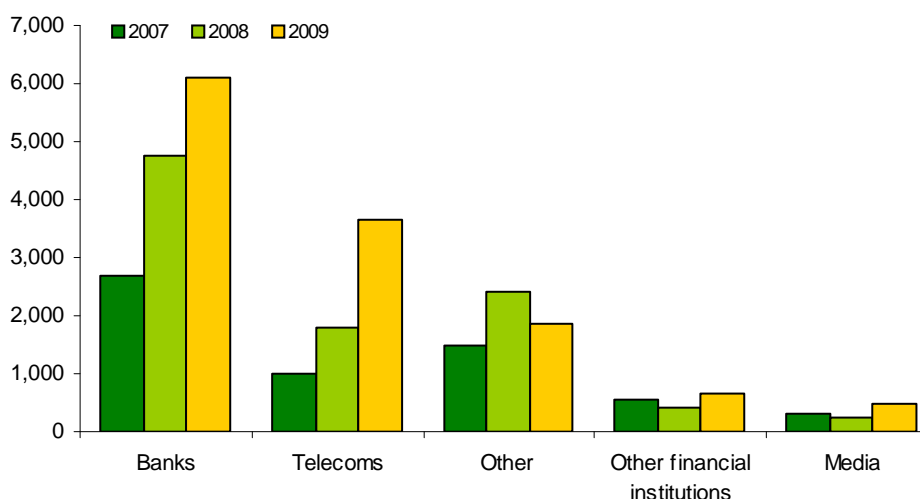
Fig. 37. Poland – the recovery of corporate receivables



Source: IBnGR

The average value of a debt case given to debt collection companies in Poland amounted to PLN 2,050 in 2009, and was up 21% more than it was in 2007. However, the average value of a case given to the credit management segment was only PLN 1,850 in 2009 (7% growth from 2007), while in the debt purchase segment it was as much as PLN 3,800 (124% growth from 2007). The higher average value of a single debt case in the purchase segment was the result of the bigger share of corporate debts in this segment.

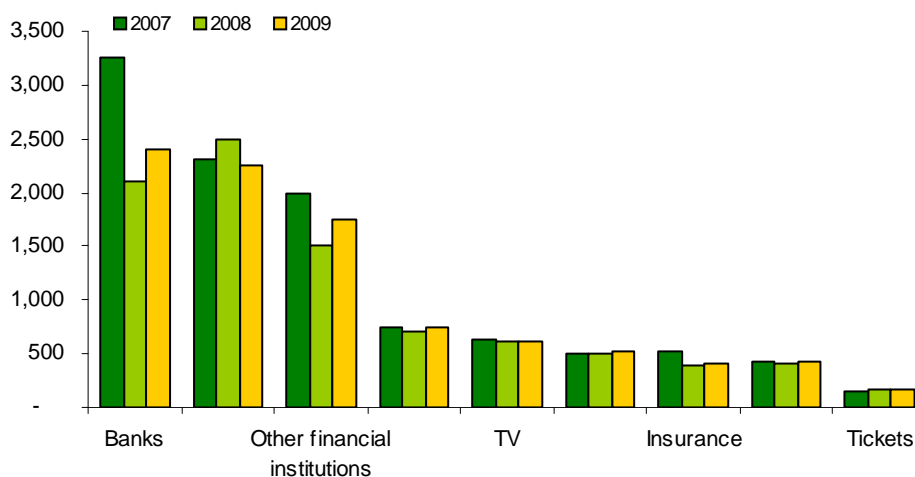
Fig. 384. Debt purchase – average portfolio purchased by selling party (PLN)



Source: Company data

In 2009, the average value of delinquent debt cases sold by the banks amounted to PLN 6,100, compared to PLN 2,700 in 2007. The second biggest average loan came from the telecoms sector, averaging PLN 3,650, up 265% from 2007. The average single-debt value from all other type of creditors was significantly lower, as per the chart below.

Fig. 39. The average value of overdue receivables by type, creditors



Source: IBnGR

Also, in the debt management segment, the largest average value of single debt cases came from the banks (PLN 2,400). This was, however, lower than the average of PLN 3,250 in 2007. The decreasing value of average bank debt was the result of the decreasing share of corporate debts, which are naturally much larger in value.

Romania

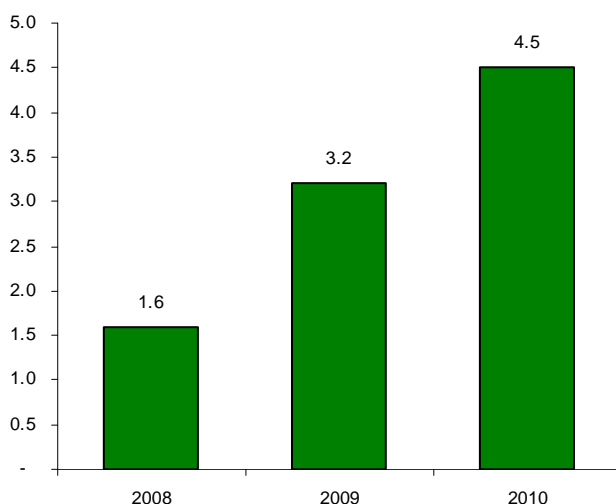
The bad debt collection market in Romania is smaller than in Poland (equivalent to c.PLN 4.5bn in 2009) and is characterised by the relatively low use of externally-provided recovery services.

2006-09 saw strong growth in lending, particularly in the consumer segment. 2010 brought a halt to this growth, with the loan book contracting by 6% following nearly 200% growth between YE06 and YE09. Consumer loans accounted for the majority of the retail book, unlike in Poland, where the book is dominated by mortgages (56%), with typical consumer loans representing 25%.

Following the period of strong growth in consumer lending, 2009 and 2010 brought a sudden deterioration in the quality of the book, with the retail NPL ratio hiking to nearly 10% at YE10 from a mere 3%, and the consumer book NPL ratio soaring to 14%, from almost 4%, respectively.

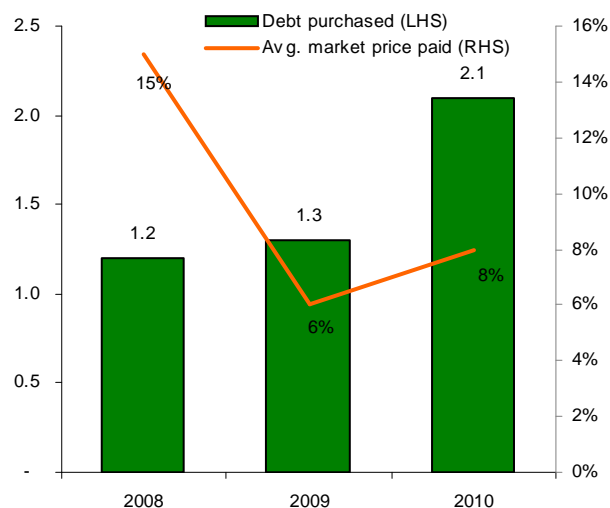
The rapidly deteriorating quality of the banking loan books prompted banks to increasingly outsource the collection of bad debt and, ultimately, to sell their bad debts. In 2010, all the major financial institutions were either outsourcing the collection of delinquent receivables and/or selling their overdue loans.

Fig. 40. Romania: debt collection market



Source: Company data, DM BZ WBK Research

Fig. 41. Romania: debt collection market



Source: Company data, DM BZ WBK Research

The penetration of loans to GDP is relatively low and, following the expected recovery of economic growth, the pace of consumer and corporate lending growth should recover. However, the pace of the recovery of the loan book quality is expected to be relatively slow, given the gradual improvement of the economic backdrop.

Fig. 42. CEE vs. Eurozone: saturations of the banking markets

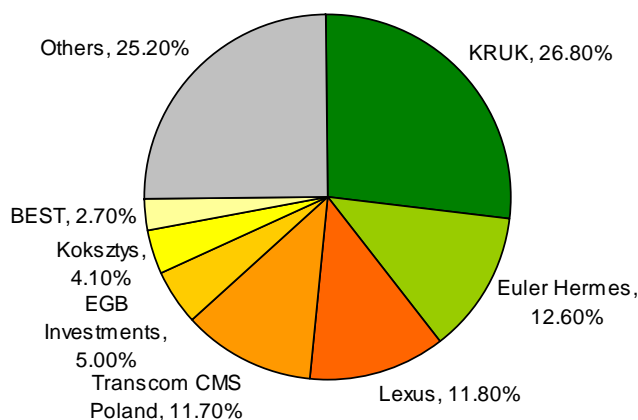
	Loans to households*	% of GDP	Loans to corporate*	% of GDP
Poland	415	29.4%	215	15.2%
Romania	102	20.2%	105	20.8%
Czech Republic	1,028	27.7%	780	21.0%
Hungary	8,610	31.1%	7,600	27.4%
Eurozone	5,180	56.4%	4,699	51.2%

Source: Central banks' data, DM BZ WBK Research, *latest available data, in local currency

Competition

The Polish debt collection market is fragmented, with a relatively large number of mid-sized players commanding a market share of around 10% each. The top-5 companies account for almost 70% of the market, according to IBnGR and Rzeczpospolita studies. Kruk is the biggest market player, with a 25% market share, with the next competitor commanding a 12.5% share.

Fig. 43. Poland – debt market – main players (2009)



Source: IBnGR, *Intrum Justitia, Ultimo and APS Poland were not included in this study due to lack of data

The biggest companies in the industry are the main drivers of growth for the debt-collection business in Poland, as they have the best know-how and, thus, are more successful in collecting debts than the small shops. The debt collection market in Poland is very competitive as large debt portfolios are bought in tenders. The biggest players dominate the purchase segment of the business as small companies cannot afford to buy the portfolios of debts due to funding constraints.

For the past couple of years, Kruk has consistently ranked No.1 in the market.

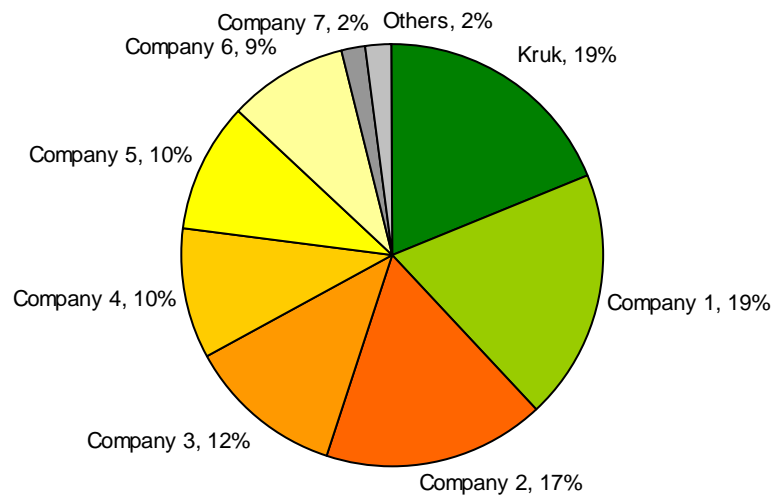
Fig. 44. Poland – ranking of debt collectors (market share)

2007		2008		2009	
Kruk	29.7%	Kruk	21.7%	Kruk	26.8%
Euler Hermes	16.9%	APS Poland	14.6%	Euler Hermes	12.6%
Lexus	11.4%	Euler Hermes	14.2%	Lexus	11.8%
Casus Finanse	5.6%	EGB Investments	11.0%	TranscomCMS Poland	11.7%
Presco	5.5%	Ultimo	9.3%	APS Poland**	10.6%
iCentrum***	4.7%	Lexus	9.3%	IntrumJustitia**	7.0%
Koksztyś	2.6%	Koksztyś	3.6%	EGB Investments	5.0%

Source: Rzeczpospolita, *Ultimo is not revealing its data, **estimates, ***currently, APS Poland

The debt collection market in Romania is far more concentrated than in Poland. The main seven companies control 96% of the market. Kruk and EOS are the biggest players in the Romanian debt-collecting market, with a 19% market share each.

Fig. 45. Romania – bad debt market – the main players (2009)



Source: Company data

Strategy/strategic issues

Having grown into a leading player in the domestic bad debt recovery market and the provider of the most comprehensive bad debt-related services, Kruk has now entered into a new, perhaps equally exciting, stage of its development. Its mid-term 2010-14E strategy is based on four pillars:

- The maintenance of its leading position in both the credit management and bad debt purchase segments of the market;
- Full participation in the growth of the market;
- Further foreign expansion; and
- The roll-out of new products.

Market outlook

We expect the supply of bad debts from banks in Poland to increase significantly in 2011 through to 2013 as NPLs seem to have peaked in both countries in 2010 and banks typically sell their bad debt portfolios after 18 months (or later) following a default.

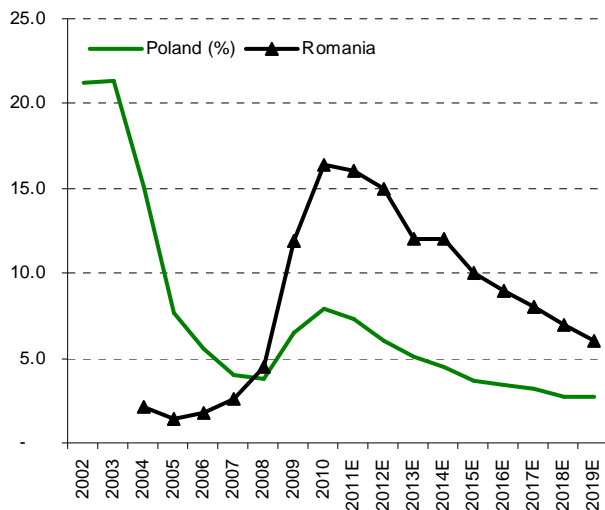
On our estimates, the nominal value of banking NPLs sold in Poland should total PLN 6.3bn in 2011 and PLN 7.5bn 2012 following the PLN 4.5bn sold in 2010. Assuming that there will be price inflation, it should translate into PLN 790m and PLN 1,005m worth of NPL sale transactions in 2011 and 2012, respectively. In Romania, we expect a more moderate growth in NPLs sold, with a total nominal market size in 2011 and 2012 (nominal terms) of PLN 2.5bn (PLN 229m and PLN 272m, respectively, in value paid). Given our assumption that Kruk's strong market share will remain at c.20% in Poland and 40% in Romania), this should translate into total outlays for NPL portfolios of PLN 464m in 2011 and PLN 4226m in 2012.

The debt service market should show more moderate growth and we expect it to be PLN 11.4bn in 2011, compared to PLN 11.4bn in 2010. Further out, the value of the market should fall to below the PLN 11bn mark, on our estimates. In Romania we assume relatively moderate growth of outsourcing services, with a 2011-14E CAGR of 2%.

The supply of NPLs should increase by 40% in Poland and 16% Romania in 2011.

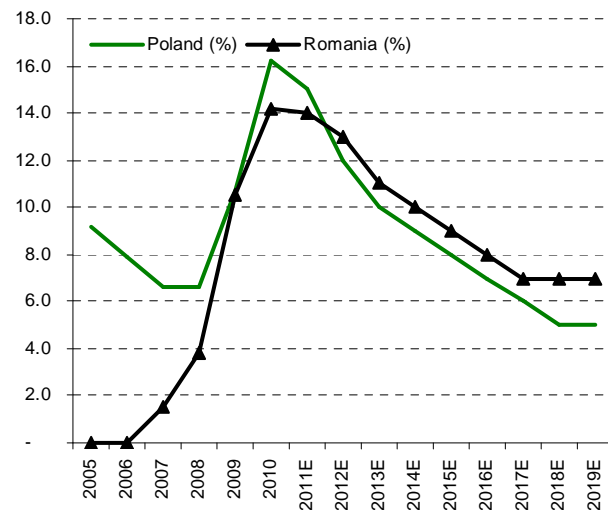
Following the drop in the value of NPLs sold in Poland in 2009 and 2010, 2011 and, more so, subsequent years should bring a substantial increase in the supply of banking bad debts on the market, our estimates suggest. In Romania, where the supply of NPLs has been uninterrupted, we expect the growth to be more gradual.

Fig. 46. NPLs in Poland and Romania
In %



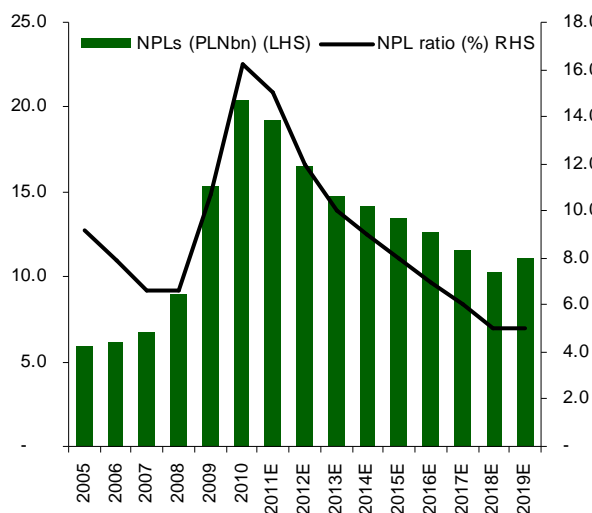
Source: Company data, NBP, NBR, DM BZ WBK Research

Fig. 47. NPLs in Poland and Romania
In PLNm



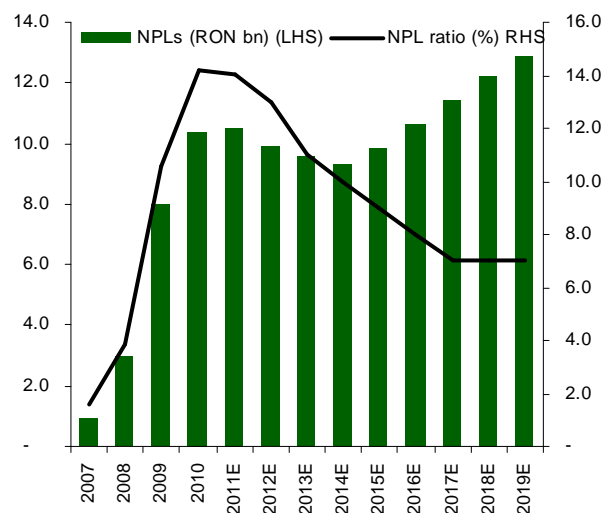
Source: Company data, NBP, NBR, DM BZ WBK Research

Fig. 48. Consumer segment NPLs and NPL ratios
In %



Source: Company data, NBP, NBR, DM BZ WBK Research

Fig. 49. Consumer segment NPLs and NPL ratios
In PLNm



Source: Company data, NBP, NBR, DM BZ WBK Research

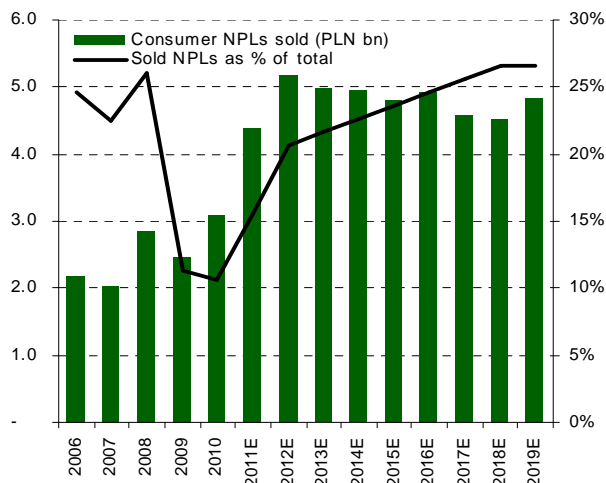
NPL formation is slowing but bad debt portfolios come to the market with a lag

NPL formation is clearly slowing in Poland and Romania, and the sector's NPL ratios seem to have peaked in late 2010. Yet the stock of overdue loans continues to grow for the time being. Going forward, the dilution effect of new lending and the ever-increasing, we expect, disposal of NPLs by banks should reduce both the NPL ratio and the stock of NPLs. The latter should, however, decline more slowly, or even grow, as we expect Romania to provide plenty of business opportunities for debt services companies.

Banks' propensity to sell NPLs should increase over time

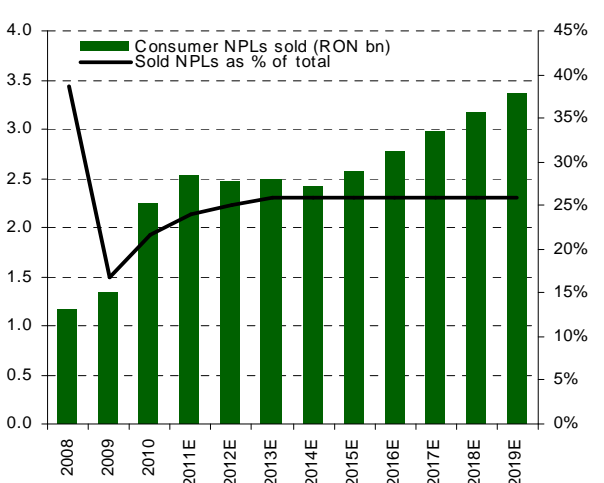
Accelerating lending activity, banks' greater focus on the more effective use of capital and, last but not least, the higher prices offered by the bidders should translate into a higher propensity of banks to outsource both the initial collection and, ultimately, to sell bad debts, we assume. Our estimates suggest that, while in 2009 and 2010 some 11% of defaulted consumer loans were sold (6-8% of mortgages), in 2011, this proportion may be as high as 16% (10% for mortgages), with subsequent years seeing the ratio of bad loans sold increasing to 21-23%. On our assumptions, PLN 6.3bn worth of nominal loans should be sold in Poland in 2011, following the PLN 4.5bn sold in 2010. Assuming an increase in prices paid, we estimate the total market value at PLN 790m in 2011 and PLN 1,005m in 2012 against PLN 458m in 2010.

Fig. 50. Consumer NPLs sold Poland
In %



Source: Company data, NBP, NBR, DM BZ WBK Research

Fig. 51. Consumer NPLs sold Romania
In PLNm



Source: Company data, NBP, NBR, DM BZ WBK Research

Fig. 52. Poland – the recovery of corporate receivables

In PLNm

(PLN m)	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
NPLs sold	3,679	2,990	6,865	4,731	4,534	6,290	7,476	7,504	7,869	7,695
Consumer	2,179	2,034	2,870	2,450	3,084	4,391	5,188	4,970	4,945	4,815
Mortgage			213	200	379	503	695	705	784	575
Corporate	1,500	956	3,782	2,081	1,072	1,396	1,593	1,829	2,140	2,305
NPL sold as % of NPLs										
Consumer	25%	23%	26%	11%	11%	16%	21%	22%	23%	24%
Mortgage	0%	0%	11%	6%	8%	10%	12%	12%	12%	12%
Corporate	11%	8%	27%	8%	4%	6%	8%	10%	13%	16%
Prices paid (% of face value)										
Retail	15.20%	14.50%	12.2%	11%	12.3%	15.0%	16.0%	17.0%	18.0%	19.0%
Corporate	3%	3%	6.5%	1.3%	3.0%	4.0%	4.0%	4.0%	4.0%	4.0%

Source: Company data, DM BZ WBK Research

In Romania, we expect a similar upward trend, but the growth rates are likely to be less steep than in Poland, with the nominal value of consumer NPLs sold in our forecast at RON 2.5bn (PLN 2.4bn) in 2011 and RON 2.5bn (PLN2.4bn) in 2012, after the RON 2.3bn (PLN 2.1bn) in 2010. In real money terms, this should equate to PLN 223m and PLN 272m for 2011 and 2012, respectively, after the PLN 166m of NPLs sold in 2010.

Fig. 53. NPLs sold in Romania – key assumptions

	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
Retail NPLs sold (RON m)	1,161	1,341	2,250	2,519	2,474	2,491	2,414	2,559
NPLs sold (% of total consumer NPLs)	39%	17%	22%	24%	25%	26%	26%	26%
Prices paid (% of face value)	15%	6%	8%	9%	11%	13%	15%	16%

Source: Company data, NBR, DM BZ WBK Research

Outsourcing market growth to moderate

Meanwhile, the banks should attempt to recover parts of the portfolios, in our opinion, and, following the in-house recovery attempts, outsource the collection activity.

Following the record PLN 11.4bn tendered for collection in Poland in 2010, we believe 2011 should see the market stabilising at above PLN 11bn market, with the subsequent three years bringing between ad drop to below PLN 11bn level, on our estimates. Banks' decreasing propensity to outsource (20% of consumer NPLs in 2015 vs. 25% in 2010, 19% of mortgage NPLs vs. 15%) is our key assumption here. For the non-banking business, we conservatively assume zero growth going forward.

In Romania, we expect the outsourcing market to grow by 2% for both 2011 and 2012, to PLN 4.6bn and PLN 4.7bn, respectively.

Fig. 54. Poland – market of credit management services

In PLNm

	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E
Total	5,429	5,207	8,900	11,400	11,405	10,628	9,874	9,539	8,489
Banking	2,600	2,142	5,664	8,000	7,409	6,547	5,810	5,412	4,633
o/w consumer loans	2,370	1,897	5,098	7,245	6,613	5,665	4,946	4,485	3,978
as % of NPLs	26%	17%	24%	25%	24%	23%	22%	21%	20%
o/w mortgage loans	230	245	566	755	796	881	864	927	656
as % of NPLs	17%	13%	18%	15%	15%	15%	14%	14%	13%
Non-banking	2,829	3,065	3,236	3,400	3,200	3,200	3,200	3,200	3,200

Source: Company data, IBnGR, DM BZ WBK Research

Financial forecasts

Our estimates suggest a 2011-13E EBITDA CAGR of 54%, following 49% over 2007-10, and an EPS compound growth rate of 43% (57%). We expect ROE of between 30% and 36% over 2011-13E and assume the start of dividend payments in 2013E (a 20% payout from 2012E profits, a dividend yield of 2.6%). We believe that subsequent years should bring higher payout ratios, with the dividend yield rising to 8.4% in 2014E.

Our model assumes a continuing improvement in the EBITDA margin (36% in 2013E vs. 28% in 2010), due to our assumption of maintained strong gross margins in Kruk's credit management services (c.40%) and an improving margin in its debt purchase business (up to 45% in 2013E from 40% in 2010). IRR of 52% and a total recovery rate on bad portfolios purchased of 222% are our key operating assumptions in the debt purchase segment.

Fig. 55. Kruk – snapshot of 2009-14E results

<i>In PLNm</i> (PLN m)	2009	2010	2011E	2012E	2013E	2014E
Revenues	129	164	279	404	476	548
yoy	24%	28%	70%	45%	18%	15%
Gross profit	57	75	140	194	238	278
yoy	20%	31%	87%	39%	22%	17%
Opex	-96	-122	-182	-271	-311	-356
EBITDA	35	47	99	137	171	200
yoy	27%	34%	112%	39%	24%	18%
EBIT	32	43	94	131	162	190
Net financial income	-4	-7	-24	-40	-44	-43
Net profit	23	36	68	89	115	142
Gross margin	44%	45%	50%	48%	50%	51%
EBITDA margin	27%	28%	35%	34%	36%	37%
EBIT margin	25%	26%	34%	32%	34%	35%
Tax rate	-14%	1%	-3%	-3%	-3%	-3%
Net (debt)/equity	-0.4	-0.8	-1.5	-1.3	-1.1	-0.8
Net cash from operations	89	125	240	375	436	525
Capex and acquisitions	-4	-7	-8	-11	-13	-15

Source: Company data, DM BZ WBK Research

Revenues

We expect Kruk to deliver a 35% CAGR in revenues over 2011-14E, following the 37% CAGR over 2007-10. Debt purchase should be the main driver, in our opinion, with an expected 43% annual compound growth rate (42% in 2007-10). We expect a contraction in credit management services (we forecast a negative 1% CAGR, following the 29% over 2007-10), as we assume a relatively flat market and Kruk to maintain a stable market share. We believe its new businesses – ERIF, the credit agency/data base, and Novum, cash loans – should deliver the strongest growth in revenues (a 74% CAGR, on our assumptions), but, starting from a lower base, they should continue to be a relatively small contributor to the overall top line, with an expected share of 4% in 2014E.

Fig. 56. Kruk – revenue assumptions
In PLNm

	2009	2010	2011E	2012E	2013E	2014E	2007-10 CAGR	2011-14E CAGR
Debtmanagement	42	44	47	45	43	42	29%	-1%
yoy	46%	6%	6%	-4%	-4%	-3%		
Debtpurchased	85	118	227	348	419	487	42%	43%
yoy	17%	39%	92%	53%	20%	16%		
Other	2	2	5	12	15	20	1%	74%
yoy	-22%	2%	146%	120%	25%	36%		
Total	129	164	279	404	476	548	37%	35%
yoy	24%	28%	70%	45%	18%	15%		

Source: Company data, DM BZ WBK Research

Opex

Opex growth should remain below that of revenues and, on our assumptions, the 2011-14E CAGR will stand at 31% vs. the 33% exhibited over 2007-10. The direct and indirect expenses of the two main segments – credit management and debt purchases – as well as the two new business lines, should, we expect, continue to be the main cost items, with their share in total opex expected to increase to above 60%. The growth in expenses of the debt purchase business (a 2010-14E CAGR of 40%) should be the largest contributor to the growth in total direct/indirect expenses and in opex overall, but this should be in parallel with the growth in the segment's revenues, in our opinion. The growth in SG&As should also decelerate (a 21% CAGR over 2011-14E vs. the 23% in 2007-10) and their proportion to revenues should decrease to 14% over 2012-14E from 17-16% in 2007-10, due to economies of scale and some cost optimisation activities (as declared by Kruk's management).

Fig. 57. Kruk – opex assumptions

	2009	2010	2011E	2012E	2013E	2014E	2007-10 CAGR	2011-14E CAGR
Direct/indirect expenses								
o/w debt management	-24	-26	-28	-27	-26	-25	-28	-27
yoy	24%	8%	8%	-4%	-4%	-4%	8%	-4%
o/w debt purchased	-46	-61	-108	-176	-204	-234	-108	-176
yoy	33%	32%	78%	62%	16%	15%	78%	62%
o/w other	-2	-3	-3	-7	-9	-12	-3	-7
yoy	-32%	87%	-8%	175%	23%	36%	-8%	175%
SG&A	-21	-28	-38	-55	-65	-75	-38	-55
yoy	12%	31%	35%	45%	18%	15%	35%	45%
as % of revenues	17%	17%	14%	14%	14%	14%	14%	14%
Depreciation	-3	-3	-4	-5	-6	-8	-4	-5
yoy	0%	18%	27%	20%	35%	30%	27%	20%
Total opex	-96	-122	-182	-271	-311	-356	-182	-271
yoy	23%	26%	50%	49%	15%	14%	50%	49%
as % of revenues	75%	74%	65%	67%	65%	65%	65%	67%

Source: Company data, DM BZ WBK Research

Margins/profitability

The assumed open 'operating jaws' should translate into a solid improvement in the EBITDA margin, which, on our estimates, should widen to 37% in 2014E, from 28% in 2010. This should stem largely from a drop in the share of SG&A in total expenses as the profitability of the debt purchase segment should, we expect, remain flat at 48% in 2014E. 'Other' business – Novum and ERIF – should post an impressive gross margin improvement, due to economies of scale (42% in 2014E, from a negative in 2010), but their overall contribution to the total gross profit should remain relatively small as we estimate their share in total gross profit to be a mere 3% in 2014.

Fig. 58. Kruk – profitability at a glance*In PLNm*

(PLN m)	2009	2010	2011E	2012E	2013E	2014E	2007-10 CAGR	2011-14E CAGR
Gross profit	57	75	140	194	238	278	140	194
o/w debt management	18	18	19	18	17	17	19	18
o/w debt purchased	39	57	118	172	215	253	118	172
o/w other	1	-1	3	4	6	8	3	4
Gross profit margin	44%	45%	50%	48%	50%	51%	50%	48%
o/w debt management	42%	41%	40%	40%	40%	41%	40%	40%
o/w debt purchased	46%	48%	52%	49%	51%	52%	52%	49%
o/w other	27%	-33%	50%	38%	39%	39%	50%	38%
EBITDA	35	47	99	137	171	200	99	137
EBITDA margin	27%	28%	35%	34%	36%	37%	35%	34%
EBIT	32	43	94	131	162	190	94	131
EBIT margin	25%	26%	34%	32%	34%	35%	34%	32%

*Source: Company data, DM BZ WBK Research***Cash generation should improve significantly**

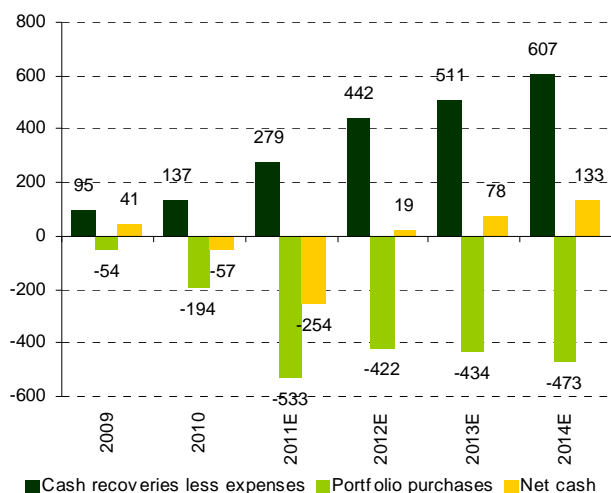
Our model shows that Kruk's operating cash flow ex-cash outlays for new portfolios should nearly treble between 2010 and 2014E. This should be mainly the result of the strong growth of the purchased debt portfolios and the cumulative effect of cash recoveries. In our model, we have conservatively assumed six-year cash recoveries from each of the purchased portfolios (in reality, the recoveries may continue until the eighth year); hence, our forecast period (2011-14E) should see a combined contribution from portfolios purchased back in 2005 through 2008, as well as from the newly-acquired portfolios.

The ongoing large bad portfolio purchases will, however, continue to deplete the cash generated (we expect negative cash until 2012) and require the company to take on more external funding. From 2013, when we assume a moderation in the growth of the purchases of bad debt portfolios, the debt purchase business should start to generate net cash, allowing for the reduction of external funding.

Leverage

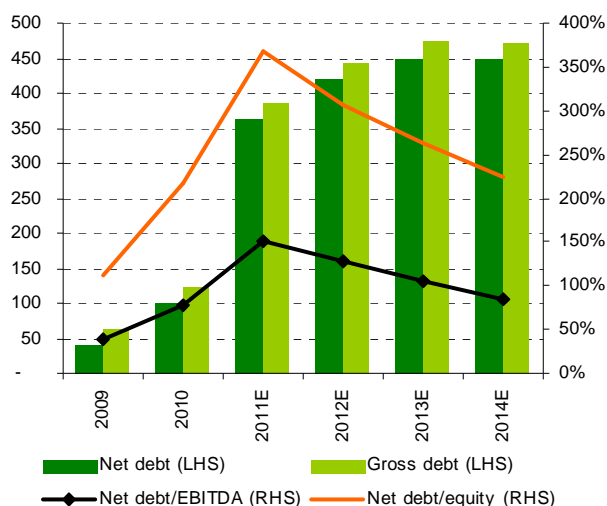
Our estimates show that Kruk should start repaying the debt from 2014 onward. Meanwhile, the much-improved cash generation and the strong growth in EBITDA and equity should reduce the indebtedness ratios to much lower levels. On our estimates, net debt to EBITDA should drop to 2.2x at YE14 from the peak of 3.7x at 2011E 2.2x at YE10, and net debt to equity to 0.8x from 1.5x, respectively. These assumptions do not include the planned expansion into Hungary.

Fig. 59. Kruk – cash flow in the debt purchase segment
In PLNm



Source: Company data, DM BZ WBK Research

Fig. 60. Kruk – cash flow in the debt purchase segment
In %



Source: Company data, DM BZ WBK Research

Dividend payout feasible from 2013 onwards

The assumed improving cash generation and falling indebtedness ratio should allow for dividend payouts starting in 2013, according to our model. We have conservatively assumed a low 20% payout ratio from the 2012 profits and a subsequent hike in the ratio to 40% in 2014. This implies an initial dividend yield of 2.6% in 2013 and 5.1% in 2014, but we note that the fast-falling gearing ratios should allow for more generous payouts, unless the new projects require strong cash injections.

Debt purchased/debt management service – operating assumptions

Below, we present the details of our operating assumptions. In our model, we have plugged in a 52% IRR, which is the outcome of our assumed recovery yield, identical to the actual yields for the 2005-10 period. These are more conservative than the average recovery rates on the portfolios purchased over 2003-10.

Fig. 61. Kruk: recovery rates (% of price paid recovered)

Year	1	2	3	4	5	6	7	8	8+	Total
Kruk (2003-2010)	38%	70%	37%	31%	30%	25%	44%	56%		331%
Kruk (2005-2010)	37%	69%	36%	31%	31%	19%				223%

Source: Company data, DM BZ WBK Research

Fig. 62. Debt purchase – operating assumptions

	2009	2010	2011E	2012E	2013E	2014E
Poland						
Consumer NPLs (PLN m)	15,284	20,429	19,268	16,493	14,707	14,162
Consumer NPL ratio	12%	17%	15%	12%	10%	9%
Consumer NPLs sold (PLN m)	2,650	3,463	4,894	5,883	5,675	5,729
% of NPLs	11%	11%	16%	21%	22%	23%
Price paid (% nominal)	11.0%	12.3%	15.0%	16.0%	17.0%	18.0%
Kruk's market share	8.3%	19.9%	40.5%	30.0%	30.0%	30.0%
Portfolios purchased (PLN m)	24	85	298	282	289	309
Corporate NPLs (PLN m)	25,561	26,954	23,260	19,910	18,293	16,463
Corporate NPL ratio	11.7	12.3	10%	8%	7%	6%
Corporate NPLs sold (PLN m)	2,081	1,072	1,396	1,593	1,829	2,140
% of NPLs	4%	6%	8%	10%	13%	16%
Price paid (% nominal)	1.3%	3.0%	4.0%	4.0%	4.0%	4.0%
Kruk's market share	37.2%	1.1%	20.0%	21.0%	22.0%	23.0%
Portfolios purchased (PLN m)	10	0	11	13	16	20
Total portfolios purchases in Poland	34	85	309	296	306	329
Romania						
Consumer NPLs (RON m)	8,000	10,355	10,498	9,897	9,582	9,286
Consumer NPL ratio	10.5%	14.2%	14.0%	13.0%	11.0%	10.0%
Portfolios sold (PLN m)	1,301	2,079	2,419	2,375	2,392	2,318
% of NPLs	17%	22%	24%	25%	26%	26%
Price paid (% nominal)	5.5%	8.0%	9.0%	11.0%	13.0%	15.0%
Kruk's market share	27.2%	65.8%	59.8%	35.0%	30.0%	30.0%
Portfolios purchased (PLN m)	109	84	130	91	93	104
Debt portfolios purchased (PLN m)						
OB	163	156	274	578	731	868
Portfolio purchases	54	194	533	422	434	473
Portfolio depreciation (cash back less P&L income)	-61	-76	-161	-270	-296	-353
CB	156	274	578	731	868	988
Portfolio recoveries (cash back)	145	189	387	618	715	840
P&L income	83	113	227	348	419	487
Direct costs	-34.2	-39.8	-71.7	-117.3	-135.9	-155.5
as % of recoveries	24.4%	20.1%	18.5%	19.0%	19.0%	18.5%
Indirect costs	-11.8	-20.7	-36.8	-58.7	-67.9	-78.1
as % of recoveries	8%	10%	19,268	16,493	14,707	14,162
			15%	12%	10%	9%
Gross profit	39	57	4,894	5,883	5,675	5,729
ROI	26%	28%	16%	21%	22%	23%

Source: Company data, DM BZ WBK Research

Of our operating assumptions in the debt management service segment, the key ones are Kruk's unchanged market share in both Poland and Romania (26.5% and 15.8%, respectively), the flat blended fee of 1.3% and the fixed level of costs (58% of revenues).

Fig. 63. Debt management service – operating assumptions
In PLNm

	2009	2010	2011E	2012E	2013E	2014E
Poland - NPLs outsourced for processing	5,664	8,000	7,409	6,547	5,810	5,412
% NPLs outsourced	23%	24%	22%	21%	20%	19%
Non-banking bad debts outsourced for processing	3,236	3,400	3,200	3,200	3,200	3,200
Total bad debts outsourced	8,900	11,400	11,405	10,628	9,874	9,539
Kruk's market share	26.5%	26.5%	24.5%	24.5%	24.5%	24.5%
Romania - NPLs outsourced	3,209	4,545	4,636	4,729	4,823	4,920
Kruk's market share	15.8%	15.8%	15.0%	15.0%	15.0%	15.0%
Revenues from debt service (consumer)	36.7	39.3	42.2	40.6	39.2	38.4
Fee (%)	1.2%	1.1%	1.2%	1.2%	1.2%	1.2%
Corporate revenues	5.1	4.9	4.4	4.0	3.6	3.2
Direct/indirect expenses	-24.0	-25.8	-28.0	-26.8	-25.7	-24.8
Expenses as % of revenues	-58%	-59%	-60%	-60%	-60%	-60%
Gross profit	18	18	19	18	17	17

Source: Company data, DM BZ WBK Research

Recent developments

1Q results

Kruk's 1Q11 results saw earnings nearly double (up 97% yoy), a 134% yoy growth in EBIT and a 124% growth in EBITDA. Compared with the 59% yoy growth in revenues, these figures confirmed a strong operating leverage potential for Kruk's business. The EBITDA margin improved from 25.8% in the same period last year to 36.4%, while the EBIT margin went from 23.1% to 34%.

Fig.64. Kruk: 1Q results at a glance

In PLNm

Kruk	1Q10	1Q11	yoy	2010	2011E	yoy
Revenues	33.4	53.2	59%	164.3	278.7	70%
o/w debt management	11.0	9.7	-12%	44.1	46.6	6%
o/w portfolios acquired	22.0	42.9	95%	118.1	226.8	92%
o/w other	0.2	0.6	199%	2.2	5.3	146%
Direct and indirect expenses	-18.3	-25.3	38%	-89.5	-139.1	55%
o/w debt management	-5.8	-6.2	5%	-25.8	-28.0	8%
o/w portfolios acquired	-12.0	-18.4	53%	-60.8	-108.5	78%
Gross profit	15.1	27.8	85%	74.7	139.6	87%
<i>gross profit margin</i>	<i>45.2%</i>	<i>52.3%</i>	<i>16%</i>	<i>45.5%</i>	<i>50.1%</i>	<i>10%</i>
o/w debt management	5.2	3.5	-32%	18.2	18.6	2%
<i>gross profit margin</i>	<i>47%</i>	<i>36%</i>	<i>-23%</i>	<i>41%</i>	<i>40%</i>	<i>-3%</i>
o/w portfolios acquired	10.0	24.5	145%	57.2	118.3	107%
<i>gross profit margin</i>	<i>45%</i>	<i>57%</i>	<i>26%</i>	<i>48%</i>	<i>52%</i>	<i>8%</i>
SG&A	-5.9	-8.2	38%	-28.1	-37.9	35%
EBITDA	8.6	19.3	124%	46.6	98.5	112%
<i>EBITDA margin</i>	<i>26%</i>	<i>36%</i>	<i>41%</i>	<i>28%</i>	<i>35%</i>	<i>25%</i>
EBIT	7.7	18.1	134%	42.6	93.8	120%
<i>EBIT margin</i>	<i>23%</i>	<i>34%</i>	<i>47%</i>	<i>26%</i>	<i>34%</i>	<i>30%</i>
Net financials	-0.4	-3.9	930%	-7.0	-23.9	240%
Pre-tax profit	7.3	14.2	94%	35.6	69.9	96%
Tax	-0.2	-0.1	-31%	0.5	-2.1	-508%
Tax rate (%)	0.0	0.0	-65%	0.0	0.0	-308%
Net profit	7.2	14.0	0.9	36.1	67.8	88%
Net debt	101.4	134.9	33%	362.1		-100%
Portfolios purchases (balance sheet)	263.2	307.0	17%	578.0		-100%
Poland						
Revenues	24.3	32.3	33%			
Direct and indirect expenses	-15.3	-20.9	37%			
Gross profit	9.0	11.3	26%			
Gross profit margin	37%	35%	-5%			
Romania						
Revenues	9.1	20.9	130%			
Direct and indirect expenses	-2.6	-4.4	71%			
Gross profit	6.5	16.5	153%			
Gross profit margin	72%	79%	10%			

Source: Kruk, DM BZ WBK Research

The purchased debt segment was the main growth driver, with P&L revenues up 95% yoy (PLN 43m, or 81% of total revenues) and gross profit was up 145% (PLN 24.5m). The segment's gross margin stood at 46%, against 30% in 1Q10. This strong growth came from a combination of significant portfolio purchases back in 2010 (PLN 194m, following PLN 54m spent in 2009) and improving recoveries. Totalling PLN 66m, the latter were up 61% yoy. Kruk commented that, while the performance of the older

portfolios generally this year have been roughly in line with expectations, more recently acquired portfolios have shown better-than-expected performance, implying the probability of upward revaluations should the trend prove to be sustainable.

Kruk continued the expansion of its portfolio of bad debts with PLN 739m worth of nominal debts acquired for PLN 69m in 1Q11 (implied average price of 9.4%), which compares with figures of PLN 501m and PLN 36m (7.2%), respectively, in the same period last year. In contrast to last year, Romanian bad debts represented the bulk of purchased liabilities this year. Subsequent months brought significant purchases in Poland (see below), however. The company says that it sees an upward trend in the price of bad debts in Poland. This is in line with the company's and our expectations. Surging prices for overdue telecom bills, a good proxy for bad debt prices, are good evidence of the trend. Currently at 27–30% of face value, these were in the 21–24% range in the same period last year. As for the market overall, Kruk maintained its earlier forecast that PLN 4.9bn worth of retail NPLs will be sold in Poland this year (in line with our forecasts) and PLN 4.3bn worth of corporate bad debts (DM BZ WBK: PLN 1.4bn). No explicit forecasts for the Romania market were given, but the company commented that banks continue to sell their NPLs, while prices are rising in line with expectations.

In contrast, the debt management services segment saw a yoy contraction in revenues (down 12%), gross profit (down 32%) and gross margin (36.3% vs. 47%) owing to weak markets in Poland (negative impact of few new consumer loans made by banks) and Romania. Kruk's management maintained its earlier guidance of a flat market in Poland this year (PLN 11.6bn vs. PLN 11.4bn last year; DM BZ WBK: PLN 11.5bn) saying that it expects a pick-up in consumer lending later in the year. In Romania, the market is expected to remain weak, owing to the anticipated continuation of low growth in new consumer loans (down 5% yoy to end of March).

Large portfolio purchases

Kruk completed purchase transactions for large consumer NPL portfolios from BRE Bank (nominal value of PLN 621m) and PKO BP (PLN 542m) in May and June. While the first portfolio was acquired for 15.6% of its par value, the second, we estimate, was purchased for approximately 17% of par. Along with the PLN 1.1bn bad debt portfolio sold by Kredyt Bank, these portfolios are the largest ever sold on the Polish market. Their scale put most of Kruk's fund-constrained competitors in a relatively unfavourable position. With relatively large blocks of NPLs expected to be sold by Polish banks this and next year, this should further cement Kruk's advantage over most of its competitors. As for the Kruk's own funding capacity, we estimate that the PLN 200m net new debt (bonds and banking loans) that we believe will have to be drawn this year to fund the forecast PLN 453m outlays for NPL portfolios, will take the company's net debt/equity ratio to 1.25x at YE11 from 0.92x at the end of March and 0.77x at YE10. Not only is this a relatively low level in itself, more importantly it is comfortably below the upper limit of 1.75x imposed by current debt covenants.

The portfolios purchased in Poland year to date represent 70% of our full year estimates. According to the company's own information, both were due to start being processed in late June/early July. Since they were acquired earlier than was assumed, both portfolios should start generating proceeds ahead of schedule, thus potentially inflating the recovery rate in the first one. However, given the peculiarity of accounting for revenues from acquired bad debt portfolios, these accelerated purchases will largely be reflected in cash flow statements rather than P&L.

Entry into the Czech Republic

As announced during its IPO, Kruk entered a new foreign market in 2Q11. In April, the company acquired 100% of Czech Riberifa s.r.o., a small bad debt processor, which complimented the submission of a binding offer to acquire CZK 1bn worth of bad debts (nominal value) in the Czech Republic and EUR 12.8m of liabilities in Slovakia from one of its banks.

The agreement is expected to be concluded by YE11, with the actual transfer of portfolio ownership some time in 4Q11. Economic rights to the portfolio may, however, be transferred to Kruk ahead of this, allowing for a recognition of proceeds in late 3Q11 or early 4Q11.

Following the name change from Riberifa s.r.o. to Kruk International s.r.o., the company is to be expanded in order to facilitate further expansion into the Czech NPL market. In our forecasts we assume the Czech business to have a neutral impact on 2011's results and a marginally positive (but growing) impact further out, with assumed outlays for purchases of PLN 35m in 2012 and 2013 following an estimated PLN 25m in 2011.

Financial statements and forecasts

INCOME STATEMENT

(PLN m)	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Debt management	20	29	42	44	47	45	43	42
Debt purchased	41	72	85	118	227	348	419	487
Other	2	3	2	2	5	12	15	20
Total revenues	64	104	129	164	279	404	476	548
Direct and indirect expenses								
o/w debt management	-15	-19	-24	-26	-28	-27	-26	-25
o/w debt purchased	-18	-35	-46	-61	-108	-176	-204	-234
o/w other	-1	-2	-2	-3	-3	-7	-9	-12
Total direct and indirect expenses	-34	-56	-72	-90	-139	-210	-238	-270
Gross profit from debt management	5	9	18	18	19	18	17	17
Gross profit from debt purchased	23	38	39	57	118	172	215	253
Gross profit from other	1	0	1	-1	3	4	6	8
Gross profit	29	48	57	75	140	194	238	278
SG&A	-15	-19	-21	-28	-38	-55	-65	-75
Depreciation	-3	-3	-3	-4	-5	-6	-8	-11
Total opex	-52	-78	-96	-122	-182	-271	-311	-356
Net other income/expenses	0	-1	-1	0	-3	-2	-2	-3
EBITDA	14	27	35	47	99	137	171	200
EBIT	11	25	32	43	94	131	162	190
Net financial cost/income	-2	-8	-4	-7	-24	-40	-44	-43
Profit before taxes	9	16	27	36	70	91	118	147
Income tax	0	0	-4	1	-2	-3	-4	-4
Net profit	9	16	23	36	68	89	115	142

Source: Kruk, DM BZ WBK Research

GROWTH RATES

YoY (%)	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Total revenues		63%	24%	28%	70%	45%	18%	15%
Total direct and indirect expenses		65%	27%	25%	55%	51%	14%	13%
Gross profit		62%	20%	31%	87%	39%	22%	17%
SG&A		27%	12%	31%	35%	45%	18%	15%
Total opex		50%	23%	26%	50%	49%	15%	14%
EBITDA		96%	27%	34%	112%	39%	24%	18%
EBIT		122%	28%	34%	120%	40%	24%	17%
Net financial cost/income		263%	-48%	60%	240%	66%	11%	-2%
Net profit		89%	42%	54%	88%	31%	30%	24%

Source: Kruk, DM BZ WBK Research

BALANCE SHEET

(PLN m)	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Shareholders equity	49	76	100	132	240	329	426	534
Net (debt)/cash	-65	-82	-39	-101	-362	-421	-450	-447
Gross debt	76	107	63	122	385	444	473	471
Capital Employed	114	158	139	233	603	750	876	981
Non-current assets	18	21	15	19	25	32	39	47
Inventories	0	1	1	0	1	1	1	1
Receivables	7	8	10	11	12	13	13	14
Payables	-4	-19	-27	-49	-52	-58	-66	-76
Short-term investments	93	152	155	264	645	731	868	988
Other current assets/(liabilities)	1	-4	-15	-12	-27	32	20	17
Working Capital	97	137	124	215	578	718	836	945
Total assets	134	212	208	318	711	846	981	1,106

CASH FLOW

(PLN m)	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Debt purchased - cash recoveries	61	117	141	198	387	618	715	840
Debt purchased - cash cost	-18	-35	-46	-60	-108	-176	-204	-234
Debt management - net cash	5	9	18	18	19	18	17	17
Other	-16	-27	-28	-30	-60	-88	-101	-106
Change in Working Capital	-1	8	7	3	2	4	8	8
Net Cash from Operations	31	72	92	129	240	375	436	525
Capex and Acquisitions	-12	-7	-4	-7	-8	-11	-13	-15
Portfolios purchases - cash cost	-82	-104	-54	-194	-533	-422	-434	-473
Free Cash Flow	-63	-38	34	-72	-301	-58	-11	37
Change in debt	53	29	-45	57	263	59	29	-2
Share issuance	0	11	0	0	41	0	0	0
Dividends paid	0	0	0	0	0	0	-18	-34

Source: Kruk, DM BZ WBK Research

KEY RATIOS

	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Gross profit margin	46%	46%	44%	45%	50%	48%	50%	51%
o/w debt management	27%	32%	42%	41%	40%	40%	40%	41%
o/w debt purchased	57%	52%	46%	48%	52%	49%	51%	52%
o/w other	32%	16%	27%	-33%	50%	38%	39%	39%
EBITDA margin	22%	26%	27%	28%	35%	34%	36%	37%
EBIT margin	18%	24%	25%	26%	34%	32%	34%	35%
Net margin	14%	16%	18%	22%	24%	22%	24%	26%
Effective tax rate	1%	-3%	14%	-1%	3%	3%	3%	3%
Dividend payout	0%	0%	0%	0%	0%	20%	30%	40%
ROE	20%	26%	27%	31%	36%	31%	30%	30%
NOPAT/Capital employed (ROCE)	9.7%	16.0%	22.8%	18.5%	15.6%	17.5%	18.5%	19.3%
Net debt/Equity	-132%	-107%	-39%	-77%	-151%	-128%	-106%	-84%
Net debt/EBITDA	-4.7	-3.0	-1.1	-2.2	-3.7	-3.1	-2.6	-2.2

VALUATION MULTIPLES

EPS	0.6	1.1	1.5	2.3	4.1	5.2	6.8	8.4
Fully diluted EPS	0.6	1.1	1.5	2.3	4.0	5.1	6.5	8.1
BVPS	3.4	4.8	6.3	8.6	14.2	19.5	25.2	31.6
Fully diluted BVPS	3.4	4.8	6.3	8.6	14.0	18.9	24.1	30.2
DPS	0.0	0.0	0.0	0.0	0.0	0.0	1.0	2.0
FCFS	-4.3	-2.6	2.1	-4.7	-18.3	-3.4	-0.7	2.2
P/E (x)	66.6	36.5	26.9	17.2	9.7	7.6	5.9	4.7
FCF yield	-11%	-6%	5%	-12%	-46%	-9%	-2%	5%
P/Book (x)	11.8	8.3	6.3	4.6	2.8	2.1	1.6	1.3
EV/EBITDA (x)	53.0	27.7	20.5	16.7	10.5	8.0	6.6	5.6
EV/Sales (x)	11.6	7.3	5.6	4.7	3.7	2.7	2.4	2.0
Div. yield (%)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	2.6%	5.1%
Net debt/EBITDA (x)	-4.7	-3.0	-1.1	-2.2	-3.7	-3.1	-2.6	-2.2
Net debt/Equity (x)	-1.3	-1.1	-0.4	-0.8	-1.5	-1.3	-1.1	-0.8
# shares (EOP)	14.5	15.8	15.8	15.3	16.9	16.9	16.9	16.9
# shares (EOP, fully diluted)	14.5	15.8	15.8	15.3	17.2	17.4	17.7	17.7
# shares (avg.)	14.5	15.0	15.8	15.5	16.5	16.9	16.9	16.9
# shares (avg., fully diluted)	14.5	15.8	15.8	15.3	16.8	17.3	17.5	17.7

Source: Kruk, DM BZ WBK Research

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- 2) comparative,
- 3) mid-cycle.

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The mid-cycle valuation is based on long-term averages for the two-year forward consensus P/E and EV/EBITDA multiples for the members of the peer group. The methodology is aimed calculating a fair, through the cycle value of cyclical stocks. It's outcome may however deviate substantially from the market's value of an analysed stock at either a peak or trough of the cycle.

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EBIT – earnings before interest and tax
EBITDA – earnings before interest, taxes, depreciation, and amortization
P/E – price-earnings ratio
EV – enterprise value (market capitalisation plus net debt)
PEG - P/E to growth ratio
EPS - earnings per share
CPI – consumer price index
WACC - weighted average cost of capital
CAGR – cumulative average annual growth
P/CE – price to cash earnings (net profit plus depreciation and amortisation) ratio
NOPAT – net operational profit after taxation
FCF - free cash flows
BV – book value
ROE – return on equity
P/BV – price-book value

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