EQUITY RESEARCH

22nd March 2018

Calamatta Cuschieri
INVESTMENT ADVISORS & STOCKBROKERS

Malita Investments p.l.c.

MALITA
INVESTMENTS

Executive Summary:

Following the announcement of Malita Investment plc (MLT) 2017 financial results, we re-affirm our BUY recommendation on the stock. After revisiting the inputs to our valuation model, our price target has been reduced from €1.03 to €0.94. The reason for the drop in price target was mainly due to a change from a terminal value approach, on the basis of the assumption that the affordable housing units would have remained on the Company's books after the expiry of the emphyteutical agreement with the Housing Authority, to a purely discounted cash flow approach over the 28 years duration of the agreement, since the properties will be returned back to the Authority upon expiry of the agreement.

Despite the downward revision in price target, we continue to remain optimistic about the future of the Company. The FY17 results have confirmed the Company's financial strength and commitment to engage in new projects. The Company's shares are also offering a comparatively low risk equity investment with potential capital appreciation, an attractive gross dividend yield of 4.3% (net 3.4%) and we expect the amount of dividends distributed to increase once the operations of the residential units commence. We recommend that investors add MLT to a well-diversified portfolio.

Company Update:

Dividend - MLT proposed a final net dividend of €2.7 million, which would result in a total annual net dividend of €4.1 million, with an increase of 20% year on year.

Revenue - The Company registered a revenue growth of 7% in FY17 with total revenue amounting to €7.5 million and exceeding our expectations of €7.2 million. We attribute this positive result to the additional rent for the Parliament building as a result of improvements carried out by MLT during the year and to the variable rent receivable from Valletta Cruise Port plc (VCP), which is experiencing growth in passengers from cruise liners.

Operating expenses - decreased by 13% since professional and technical fees were capitalised. These fees relate to two new projects. The first project relates to the development of 680 affordable housing units for the Housing Authority announced at the end of 2017. The emphyteutical deed with the Authority over the relevant sites has a term of 28 years. The development works will be financed through credit facilities obtained from the European Investment Bank and the Council of Europe Development Bank for a total amount of €53.7

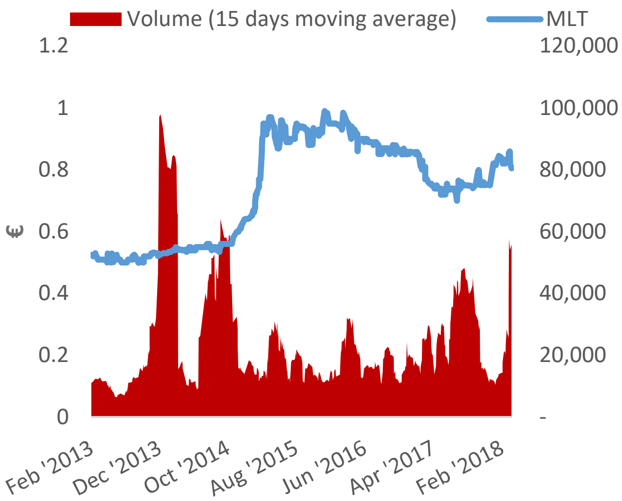
Stock Rating — Buy

Price target (1Yr) — **€0.94**

Country	Malta
Industry	Real Estate
Ticker	MLT
Price	€0.805
Upside / downside to PT	+16.2%
Market Cap	€119.2m
Shares Outstanding	148.1m
Free Float	20.3%
Gross Dividend Yield	4.3%
Net Dividend Yield	3.4%
Current P/E*	25.4x
Forward P/E **	27.4x

* excluding FV movement and deferred tax effect
** CC estimates

Price Movement	Exchange MSE
52-week Range	€0.70 - €0.86



Source: Malta Stock Exchange

Market Research

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million repayable in 25 years at a fixed rate estimated at 1.7%. The second project is currently in the final stages of valuation by the Company and no further details have been disclosed so far.

EBIT - MLT also reported a significant gain on the fair value (FV) of investment property of €16.7m mainly attributable to the Parliament Building and Open Air Theatre which until December 2016 were carried out at cost. EBIT Margin before FV movement increased from 93.6% to 94.8% as a result of the higher revenue and lower expenses for the year.

Finance costs - decreased in line with the repayment schedule of the two loans with the European Investment Bank and the Council of Europe Development Bank.

SWOT Analysis

Strengths

- ✓ Low risk and stable current revenue streams due to both the long term nature of the rent agreements and to the profile of its tenants (MIA, VCP and the GoM).
- ✓ Positive outlook of the property sector in Malta.
- ✓ The Company adopts a dividend policy which entails the distribution of 60% - 75% of net profits distribution.
- ✓ Low finance costs benefit the shareholders' returns.

Weaknesses

- × No diversification – the Group is only exposed to the Maltese property market.
- × Limited growth opportunities from current portfolio of properties.
- × Low liquidity of the stock.

Opportunities

- o The development of the new residential units is expected to further improve the Company's profitability**.**
- o Potential increase in VCP revenues (due to higher passengers' volumes or higher rental income) would have a positive impact on the rent receivable by MLT.
- o New project in final stages of evaluation.
- o Dividends expected to increase once the development works of the new properties are completed.

Threats

- ! Delays in the development of the new residential properties.
- ! Downturn in the property market possibly leading to a depreciation of the Company's assets.

Investment stance:

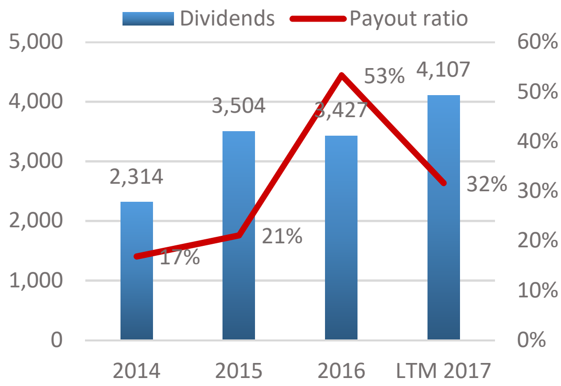
We are re-affirming our investment stance with a BUY recommendation on MLT and a price target of €0.94. The reason for the drop in price target from €1.03 to €0.94 was mainly due to a change from a terminal value approach, based on the assumption that the affordable housing units would have remained on the Company's books after the expiry of the emphyteutical agreement with the Housing Authority, to a purely discounted cash flow approach over the 28 years duration of the agreement, since the properties will be returned back to the Authority upon expiry of the agreement.

Despite the downward revision in price target, we continue to remain optimistic about the future of the Company. The current properties of the Company are located in prime locations and their rental income streams are secured through long-term rent agreements with low risk tenants. Furthermore revenues are expected to increase due to the additional rental income generated from the new Parliament building from mid-2017.

Upside potential is also given by the financial performance of VCP and the affordable housing project which we expect to come to fruition within 1.5 – 2.5 years. In the meantime the Company will be exposed to the risks associated with the development phase (mainly delays in the construction) which are, however, off-set by the low finance costs on the credit facilities granted by the European Investment Bank and the Council of Europe Development Bank at a fixed rate.

Furthermore the Company announced that they are in the final stages of evaluation of a new project which may potentially contribute to improve the Company's profitability. No details have been made available yet in this regard, hence our price target does not reflect this upside potential.

Additionally MLT shares are offering an attractive net dividend yield and we expect the amount of dividends distributed to increase once the operations of the residential units commence. In view of the above, we deem the shares to be undervalued in the current market environment and we suggest to add positions in MLT up and close to our price target.



Source: Company's audited financial statement

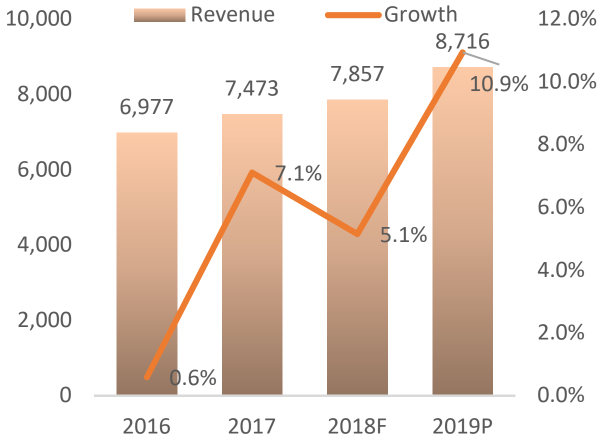
Investment Thesis Variables

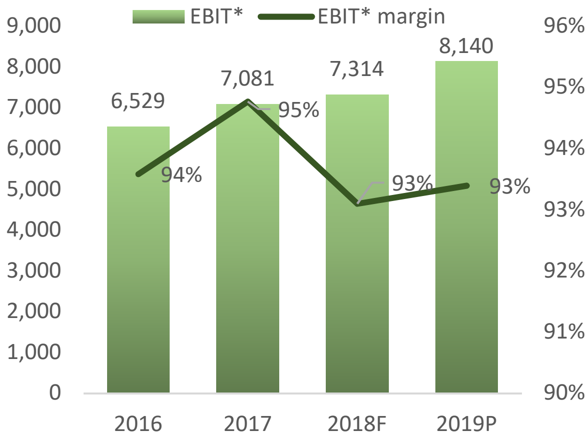
Consolidated results (incl. current operations and affordable housing project)

FY ending	2015A	2016A	2017A	2018F	2019P
	€'000	€'000	€'000	€'000	€'000
Revenue	**6,935.9**	**6,976.7**	**7,472.5**	**7,857.0**	**8,716.3**
EBIT before FV movements	**6,548.2**	**6,528.7**	**7,081.4**	**7,314.4**	**8,140.4**
EBIT[1]	**18,157.2**	**9,543.7**	**23,768.4**	**7,314.4**	**8,140.4**
Finance costs	(1,317.6)	(1,284.8)	(1,250.5)	(1,496.8)	(1,748.2)
Profit after tax	**16,577.1**	**6,423.8**	**13,344.1**	**4,428.72**	**4,939.44**
EPS	**0.112**	**0.043**	**0.090**	**0.030**	**0.033**

Source: Company's audited financial statement and CC estimates

[1] We did not assume any fair value movement in our projections





Source: Company's audited financial statement and HY report
** EBIT before fair value movements*

Current operations

FY ending	2015A	2016A	2017A	2018F	2019P
	€'000	€'000	€'000	€'000	€'000
Revenue	**6,935.9**	**6,976.7**	**7,472.5**	**7,857.0**	**8,015.8**
Operating expenses	(387.7)	(448.0)	(391.1)	(402.6)	(419.7)
EBIT before FV movements	**6,548.2**	**6,528.7**	**7,081.4**	**7,454.4**	**7,613.4**
Fair value movements	11,609.0	3,015.0	16,687.0	-	-
EBIT	**18,157.2**	**9,543.7**	**23,768.4**	**7,454.4**	**7,613.4**
Finance costs	(1,317.6)	(1,284.8)	(1,250.5)	(1,455.3)	(1,401.2)
Finance income	20.2	4.3	1.0	2.6	7.0
Profit Before Tax	**16,859.7**	**8,263.3**	**22,498.8**	**6,001.7**	**6,219.2**
Income tax expense	(282.7)	(1,839.5)	(9,154.7)	(1,397.3)	(1,445.2)
Profit after tax	**16,577.1**	**6,423.8**	**13,344.1**	**4,604.4**	**4,774.0**
EPS	**0.112**	**0.043**	**0.090**	**0.031**	**0.032**
Ratios					
Revenue growth	*2.7%*	*0.6%*	*7.1%*	*5.1%*	*2.2%*
EBIT margin (before FV movements)	*94.4%*	*93.6%*	*94.8%*	*94.8%*	*94.9%*
Net margin	*239.0%*	*92.1%*	*178.6%*	*58.6%*	*59.4%*

Source: Company's audited financial statement and CC estimates

- **Revenue –** expected to increase by 5.1% in FY18F and by 2.2% in FY19P mainly as a result of the additional rent receivable on the Parliament building from June 2017 as a consequence of the €7 million expense incurred by MLT for improvements to the building carried out during 2017.
- **Operating expenses –** assumed to increase by 4% each year, except for the ground rent payable to the GoM which increases by 5% every three years.
- **Fair value movements** – We did not consider any fair value movement in our valuation model.
- **EBIT margin (excluding fair value movements) –** expected at 94.8% in FY17 and at 94.9% in FY18.
- **Finance costs –** expected to increase in FY18 as a result of the investment in the Parliament improvements. We do not expect further increase in finance costs related to the current operations in the near future. Overall interest expenses are expected to increase as a consequence of the development works for the new residential units (see *'New residential units'* paragraph below).

New residential units

At the end of 2017 MLT entered into an emphyteutical agreement with the Housing Authority in relation to 16 sites whereby MLT will develop 680 affordable housing units.

The deed has a term of 28 years, after which the properties will be returned back to the Housing Authority. The development works will be financed through credit facilities obtained from the European Investment Bank and the Council of Europe Development Bank for a total amount of €53.7 million repayable in 25 years. An additional amount required to finance the VAT amount (estimated at approximately €9.7 million) on the project will be financed through a bank loan provided by a local bank.

FY ending	2018P	2019P	2020P	2021P
	€'000	€'000	€'000	€'000
Revenue	0.0	683.1	2,712.3	3,458.3
EBIT	(140.0)	527.0	2,512.9	3,241.4
Finance costs[2]	(41.5)	(347.0)	(710.2)	(1,106.2)
Profit before tax	(181.5)	180.0	1,802.8	2,135.2
Tax	0.0	(34.2)	(135.6)	(172.9)
Profit after tax	(181.5)	145.8	1,667.1	1,962.3
EPS	(0.001)	0.001	0.011	0.013

Source: CC estimates

- **Revenue** – the Company expects the units to be completed as follows:

Year	No. Units
2019	146
2020	385
2021	149
Total	680

  We estimated an average rent of €520 per unit, of which at least 80% would be subsidised by the GoM.
- **Operating costs** – comprise of the ground rent payable to the GoM on the 16 sites and other expenses like rent collection, which is expected to be outsourced to third parties.
- **Finance costs** – The project will be financed entirely through debt, primarily with the €53.7 million credit facility the European Investment Bank and the Council of Europe Development Bank at an interest estimated at 1.7% per annum and through a loan from a local bank for the VAT amount on the project's costs.
  We expect these credit facilities to be withdrawn between the second half of this year and 2021. We also assumed a moratorium period of three years.
- **Capex** – we considered an annual capital expenditure of €300k increasing by 4% each year.

Valuation

Our 1yr price target is €0.94. The price target is calculated using a Discounted Cash Flow (DCF) model applied separately to the current operations and to the affordable housing project. In both cases we used a free cash flow to the firm ("FCFF") approach to obtain the Enterprise value and deducted the net financial position to obtain the Equity Value.

[2] Finance costs may be capitalised during the development period (and therefore not feature in the Company's income statement), however, this accounting treatment would not affect the Company's cash flows which were used as the basis for our valuation.

Current operations - We used a cost of equity of 7.1% and a weighted average cost of capital (wacc) of 6.0%. The wacc reflects the Company's low financial leverage and finance costs as well as the low risk of the cash flow from current operations. We applied a 2.5% terminal value growth rate.

New residential units - We estimated a cost of equity of 8.8% and a wacc of 2.5%. The discount rates primarily reflect the construction risk associated with the project as well its high financial leverage and expected low finance costs. The Company explained that the project will be financed entirely through debt. We did not apply a terminal value since the Company explained that at the end of the 28 years emphyteutical agreement the properties will returned back to the Housing Authority.

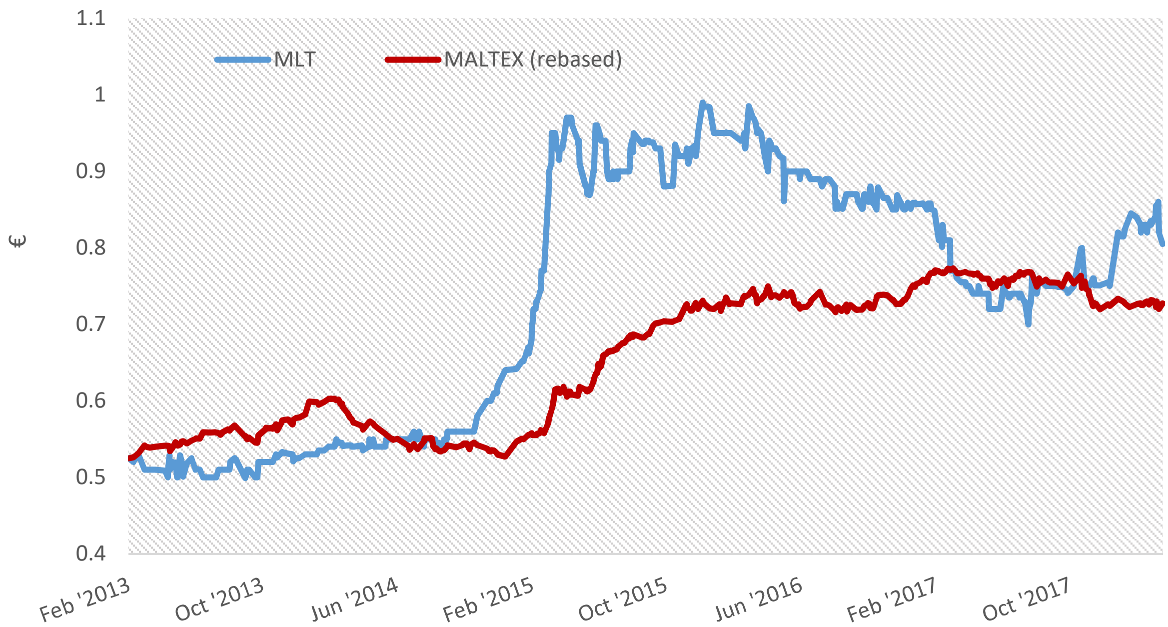
Key Financial Indicators

	2014	2015	2016	2017
	€ '000	€ '000	€ '000	€ '000
Income Statement				
Revenue	6,755	6,936	6,977	7,473
EBIT before FV movements	6,392	6,548	6,529	7,081
Operating Income (EBIT)	22,078	18,157	9,544	23,768
Net Income	13,721	16,577	6,424	12,984
EPS	0.093	0.112	0.043	0.088
Dividend / Share	0.016	0.024	0.023	0.028
Growth in Revenue	0.2%	2.7%	0.6%	7.1%
EBIT Margin before FV movements	94.6%	94.4%	93.6%	94.8%
Net Margin	203.1%	239.0%	92.1%	173.8%
Dividend growth	163.0%	51.4%	-2.2%	19.8%
Dividend Sustainable growth	12.0%	12.1%	2.7%	7.7%
Balance Sheet				
Cash and Cash Equivalents	4,478	4,534	3,427	1,049
Current Assets	4,850	4,910	3,828	2,120
Non-Current Assets	137,917	149,530	152,547	177,743
Total Assets	142,767	154,440	156,375	179,864
Current Liabilities	1,084	878	2,366	6,718
Non-Current Liabilities	46,604	45,313	42,687	52,397
Total Liabilities	47,688	46,191	45,053	59,115
Net Debt	35,457	35,404	35,102	43,025
Total Equity	95,079	108,248	111,322	120,748
Return on Common Equity	14.4%	15.3%	5.8%	3.8%
Return on Assets	9.6%	10.7%	4.1%	2.4%
Current Ratio	4.5	5.6	1.6	0.4
T. Liabilities / T. Assets	33%	30%	29%	35%
Net Debt / Total Equity	37%	33%	32%	32%
Cash Flows				
Cash from Operations	3,790	5,084	4,961	5,405
CAPEX (recurring)	(2.5)	(3.6)	(0.3)	(2.5)
Free Cash Flow	3,787	5,081	4,960	5,403
Net cash movement	(7,657)	56	(1,107)	(2,378)
Net Debt/CFO	9.4	7.0	7.1	8.0
CFO/EBIT before FV movements	59%	78%	76%	76%

Source: Company's audited financial statement

Historical Price

Reference	Date	Price	Price Target	Analyst	Recommendation
MLT	07.02.2018	€0.84	€1.03	Simon Psaila and Elisabetta Gaudiano	BUY
MLT	22.03.2018	€0.805	€0.94	Simon Psaila and Elisabetta Gaudiano	BUY



Source: Bloomberg

Glossary and Definitions

Income Statement	
EBITDA	EBITDA is an abbreviation for earnings before interest, tax, depreciation and amortisation. EBITDA can be used to analyse and compare profitability between companies and industries because it eliminates the effects of financing and accounting decisions.
Profit after tax	Profit after tax is the profit made by the Group during the financial year both from its operating as well as non-operating activities.
Profitability Ratios	
Operating profit margin	Operating profit margin is operating income or EBITDA as a percentage of total revenue.
Net profit margin	Net profit margin is profit after tax achieved during the financial year expressed as a percentage of total revenue.
Efficiency	
Return on Equity	Return on equity (ROE) measures the rate of return on the shareholders' equity of the owners of issued share capital, computed by dividing profit after tax by shareholders' equity.
Return on Assets	Return on assets (ROA) is computed by dividing profit after tax by total assets.
Equity Ratios	
Earnings per share	Earnings per share (EPS) is the amount of earnings per outstanding share of a company's share capital. It is computed by dividing net income available to equity shareholders by total shares outstanding as at balance sheet date
Cash Flow Statement	
Cash flow from operating activities	Cash generated from the principal revenue-producing activities of the Company, net of income tax and interest paid.
Cash flow from investing activities	Cash generated from the activities dealing with the acquisition and disposal of long-term assets and other investments of the Company.
Capital expenditure (CAPEX)	Funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment, net of disposals and excluding non-recurring items. It is often used to undertake new projects or investments by the firm.
Free cash flows (FCF)	FCF is a measure of a company's financial performance, calculated as operating cash flow minus capital expenditures. FCF represents the cash that a company is able to generate after spending the money required to maintain or expand its asset base.
Free cash flows to the firm (FCFF)	FCFF is a measure of financial performance that expresses the net amount of cash that is generated for a firm after expenses, taxes and changes in net working capital and investments are deducted. FCFF is essentially a measurement of a company's profitability after all expenses and reinvestments.
Free cash flow to equity (FCFE)	FCFE is a measure of how much cash is available to the equity shareholders of a company after all expenses, reinvestment, and debt are paid. FCFE is a measure of equity capital usage.
Balance Sheet	
Non-current assets	Non-current asset are the Group's long-term investments, which full value will not be realised within the accounting year. Non-current assets are capitalised rather than expensed, meaning that the Group allocates the cost of the asset over the number of years for which the asset will be in use, instead of allocating the entire cost to the accounting year in which the asset was purchased. Such assets include intangible assets (goodwill on acquisition), investment properties, and property, plant & equipment.
Current assets	Current assets are all assets of the Company, which are realisable within one year from the balance sheet date. Such amounts include inventory, accounts receivable, cash and bank balances.
Current liabilities	All liabilities payable by the Company within a period of one year from the balance sheet date, and include accounts payable and short-term debt.
Net debt	Borrowings before unamortised issue costs less cash and cash equivalents.

Non-current liabilities	The Company's long-term financial obligations that are not due within the present accounting year. The Company's non-current liabilities include bank borrowings and bonds.
Total equity	Total equity includes share capital, reserves & other equity components, and retained earnings.
Financial Strength Ratios	
Liquidity ratio	The liquidity ratio (also known as current ratio) is a financial ratio that measures whether or not a company has enough resources to pay its debts over the next 12 months. It compares a company's current assets to its current liabilities.
Interest cover	The interest coverage ratio is calculated by dividing a company's EBITDA of one period by the company's interest expense of the same period.
Net debt / Equity	Net debt / equity ratio is a debt ratio used to measure a company's financial leverage, calculated by dividing a company's net debt by its stockholders' equity. This ratio indicates how much net debt a company is using to finance its assets relative to the amount of value represented in shareholders' equity.

Explanation of Equity Research Ratings

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research

Disclaimer