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**FINANCIAL RATIO ANALYSIS OF REAL ESTATE
COMPANIES IN ESTONIA: A COMPARATIVE STUDY OF PRO
KAPITAL GRUPP AND AS MERKO EHITUS 2015 - JUNE 2021**

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I hereby declare that I have compiled the thesis independently and all works, important standpoints and data by other authors have been properly referenced and the same paper has not been previously presented for grading. The document length is 10,508 words from the introduction to the end of conclusion.

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ABSTRACT

The Covid-19 pandemic and subsequent lockdowns have adversely affected many industries including real estate companies. Property sales and other revenues such as rental income have been affected due to the pandemic. To analyse the impact of Covid-19 on real estate companies, this study, therefore, aims to compare the financial performance of two major Estonian real estate companies (Pro Kapital Grupp and AS Merko Ehitus) before and during Covid-19 pandemic. Data for the analysis was obtained from respective companies' annual reports from 2015 to June 2021. Financial ratio analysis method was used to answer the research question if there are any repercussions on the financial performance before and during Covid-19 pandemic. Ratios regarding liquidity, profitability, solvency and activity were calculated and analysed to identify the strengths and weaknesses of each company and compare their financial positions. The results show that efficient use of assets coupled with adequate profit margin ensured better performance for AS Merko Ehitus. It also has fundamentally strong financials and a better position compared to Pro Kapital Grupp which was in loss for 5 out of 7 years since 2015, due to insufficient liquidity, low efficiency, disproportionate operating cost and inconsistent ratios. Decrease in sales during Covid-19 pandemic curtailed both companies' liquidity, profitability, and efficiency. The findings from the study may help readers in better understanding the financial statements and comparing financial positions of both companies for prudent decision making.

Keywords: Financial ratio analysis, Real estate companies in Estonia, Covid-19

INTRODUCTION

The statement “Ninety percent of all millionaires become so through owning real estate” said by American industrialist Andrew Carnegie expresses the sheer magnitude of the real estate market (Block, 2011, p. 33). Real estate is a vital component of GDP, it plays the crucial role of facilitating trade in an economy by developing commercial spaces as well as satisfying the basic human need of shelter by building residential properties. A downturn in the real estate industry can potentially have adverse effects on the financial sector, construction, and ultimately increase the unemployment rate (Maier, *et al* 2009). Since the beginning of Covid-19 outbreak, real estate projects have been hindered by construction delays, projects halts and decrease in rates of return (Gujral, *et al* 2020). In Estonia, sales revenue from real estate activities shrunk by -28.3% in Q2 2020 compared to corresponding figure in 2019 (Riigikogu, 2020). Financial ratio analysis is an ideal tool to ascertain the impact of such downturns, besides evaluating the overall performance of a company. It helps in identifying the strengths and weaknesses of an entity regarding core financial aspects such as revenue, profitability, solvency etc. (Lan, 2012).

This thesis focuses on the financial ratio analysis of two prominent real estate companies in Estonia, Pro Kapital Grupp and AS Merko Ehitus. Pro Kapital Grupp was selected because of its financial crunch which existed even before the Covid-19 pandemic. It was adversely affected due to a decrease in cash inflows from its investment in subsidiary Tallinna Moekombinaat, operator of T1 mall. T1 mall was declared bankrupt in June 2021. The onset of the Covid-19 pandemic added more to this woe. To understand the impact of the financial issues and for a logical comparison, a second company was selected with scalable operations, AS Merko Ehitus, which also had slow sales due to the Covid-19 pandemic. Merko Ehitus has been a profitable company and has its operations in three major Baltic cities, Tallinn, Riga, and Vilnius.

Financial ratio analysis can express financial values clearly and concisely to all stakeholders (Babalola, *et al* 2013). Further, it helps in identifying the trends in financial performance viz. positive or negative trends (Rashid, 2018). The aim of this research is, therefore, to evaluate the financial performance of two major real estate companies in Estonia, before and during the Covid-

19 pandemic, by conducting a financial ratio analysis and comparing the outcomes to derive meaningful conclusions. The study also focuses on improving theoretical and practical knowledge about ratio analysis and incorporating this in evaluating the strengths and weaknesses of the selected companies. To obtain the best results, the author has formulated the following research questions.

1. How can financial ratio analysis be used to examine and compare the financial performance of two major real estate companies before and during the Covid-19 pandemic?
2. Do real estate companies achieve financial stability regarding liquidity, profitability, working capital, asset debt management, and solvency before and during the Covid-19 pandemic?
3. What are the financial strength and weaknesses of both companies before and during the Covid-19 pandemic?

The research follows a quantitative research method. The study consists of financial ratio calculations and compare the results of both companies for the period 2015 to June 2021. The financial data is collected from the financial statements of respective companies. The analysis was conducted based on liquidity ratios, profitability ratios, activity ratios, and solvency ratios, for the period 2015 to June 2021. The specific period was selected to understand the changes in financial performance over time and analyze the impact of the pandemic on the financial stability of the companies. Even though the 2021 financial year is still ongoing, the first six months data is included in this study to examine whether any significant impacts on the financial performance of both companies when new waves of Covid-19 come back to Europe.

The paper consists of theoretical and empirical parts divided into 5 chapters. The first chapter is an introduction followed by an overview of the real estate market in general and information about Pro Kapital Grupp and AS Merko Ehitus. The second unit is regarding financial ratio analysis, which explains the theoretical aspects and formulas used in this study. The subsequent section consists of calculation, analysis, and comparison of the selected financial ratios of both companies. The final unit comprises conclusions based on the analysis, references used in the study and appendices consisting of financial statements and financial ratios of both companies.

1. OVERVIEW OF REAL ESTATE MARKET

Real estate is a major component of a country's economy (Hu, *et al* 2001). It is derived from the Latin word "real" meaning actual and the French word "estat" meaning status. Real estate has existed since tribal times. Over time it has flourished into a promising business venture and is quite often regarded as a safe investment since property prices seldom depreciate. Further, the property prices in general keep up with the market situations such as inflation due to which the price drop is unlikely to happen thereby, guaranteeing the investor a return over the initial price paid (Hudson, *et al* 2005). Due to these reasons, various methods of property trade are in practice such as flipping, which is the immediate resale of real estate property after necessary maintenance. Reselling land and building have evolved as one of the most profitable avenues (Depken, *et al* 2009).

The price of a real estate property is dependent on various factors such as demographic of the region which includes factors like age and socio-economic status of the population. The property market will improve if the demographic factors are favorable. Another factor is taxes and duties levied by the government, higher the property taxes, lesser the incentive for people to invest. The third factor is the overall economic status of a country. The demand for real estate increases if the country is economically stable and is open to attracting more foreign investments. The employment to population ratio is one of the relevant factors affecting real estate prices. The better off the people the more likely they can afford better housing. Moreover, the budget of a country also plays a crucial role in determining real estate prices. If the government is allocating sufficient resources to development sector along with subsidies for construction materials, it would boost the construction sector in the country. (Graana, 2020)

The real estate market in EU has been on a steady rise since 2016. House prices have increased by 4.6% year-on-year average, which is more than the wages and GDP growth. Hungary, Portugal, Czech Republic, Ireland and Netherlands are the top 5 countries in terms of increase in housing prices. In terms of gross rental yield, Ukraine, Montenegro, Ireland, Romania and Poland are the top countries. An investor in rental properties would be driven by the rental income. (Roser, 2020)

Estonia is also a flourishing market for real estate. Real estate in Estonia largely benefited from the growth of IT sector. Since 1990s the real estate market in Estonia has shown bullish trends, mainly due to an increase in demand for housing properties. Estonian economy grew 8% between 2000 to 2006. During this period the unemployment decreased from 14% to 4%. Between 2006 and 2008, the property prices rapidly decreased due to strict credit criteria and increased interest rate (Kolbre, *et al* 2006). The economy was affected by 2008 global recession. However, it recovered in 2011 with a staggering 7.6% increase. Between 2012 and 2016 the economy grew consistently at a rate of 2.5% annually. The dwelling price index in Estonia increased by 4.8% in 2020 following year-on-year rises of 8.2%, 5.7%, 4.9%, 7.7% for the years 2019, 2018, 2017 and 2016 respectively (Statistics Estonia, 2021). The average price per square meter for apartments increased by 4.9% reaching 2924 EUR in 2020 (Ober Haus, 2021). Foreign investment in Estonia is incentivized and is promoted in association with local authorities. Gross rental yields throughout the nation have increased more particularly in the capital city Tallinn.

Table 1. Annual Price increase by property types in Estonia

Property Type	2020	2019	2018
Apartments	4.1%	9.2%	5.7%
Houses	6.5%	5.8%	5.6%

Source: Author's table based on data from Global Property Guide (2021)

The Covid-19 pandemic has caused slowdowns in the real estate market and GDP at large. Estonian economy is managing the pandemic comparatively better and the economy is anticipated to revive in the following years. "Estonia's economy contracted by about 2.9% in 2020, in contrast to the previous year's 5% expansion, due to the Covid-19 pandemic", according to European commission. Since the second half of 2020 the real estate sector is improving. Some companies reported improvement in sales during the second half of 2020 (European Commission, 2021).

1.1. Pro Kapital Grupp

Pro Kapital Grupp is an Estonian real estate development company that was established in the year 1994. The company has experience of over 26 years in the field of property development. It is one of the oldest and major players in the real estate development market in Estonia and Baltic states. The company has its presence in three Baltic states viz, Estonia, Latvia and Lithuania. Over the

years, Pro Kapital Grupp has a total developed area of 250,000 m² (Pro Kapital Grupp, 2021). It focuses on developing commercial buildings, residential properties, developing business areas and building maintenance. Moreover, the company also owns and runs a hotel in a German resort town Bad Kreuznach, near Frankfurt.

The company functions with a vision “to develop timelessly distinctive buildings with an impeccable quality that anticipate people’s needs and expectations” and a mission that “we believe the real value of real estate lies in the experiences and well-being it brings to people. We build better living environments where people feel good”. The company gives adequate prominence to people’s quality of life in urban city development (Pro Kapital Grupp, 2015).

The company is currently traded in the main list of Nasdaq Tallinn since November 2019, under the symbol PKG1T. However, it was initially listed in November 2012 under the secondary list of Tallinn’s stock exchange. The company is also listed on Frankfurt’s stock exchange since March 2014. At the 2020-year end, the company had a share capital of 11 million euros. During this period the Pro Kapital Grupp’s share was trading between 0.68 EUR and 1.39 EUR. During the period from 2015, the company paid dividends only once, in 2017. In 2020 company had written off its loss of 26 million EUR using retained earnings from previous years. As of 2020, the company had 84 employees, with an employee turnover of 12% in Baltics. Pro Kapital Grupp’s workforce also comprises of women including 4 managers and three-fourths office staffs.

Table 2. Major shareholders of Pro Kapital Grupp as on 31.12.2020

Shareholder	Number of shares	%
Raiffeisen Bank International AG	31,010,717	54.70%
Clearstream Banking AG	11,372,980	20.06%
Nordea Bank ABP/Non-Treaty Clients	4,787,996	8.45%
Svalbork Invest OÜ	3,759,620	6.63%

Source: Pro Kapital Grupp annual report 2020

Pro Kapital Grupp has undertaken 7 large-scale projects. The company’s development projects in Tallinn include residential projects Kristiine city and Kalaranna district, commercial spaces T1 Mall of Tallinn and Ülemiste 5. The company holds 93% of ownership in T1 Mall. During the financial year 2020, the company sold a total of 3319 m² of residential properties in Estonia, Latvia

and Lithuania. Covid-19 affected Pro Kapital Grupp's rental income adversely. During 3 quarters of 2020, many shops remained closed which decreased the company's rental income by 41% and 58% dip in revenue from hotel due to Covid-19 restriction imposed by German Government. In June 2020 AS Tallinna Moekombinaat, which is a subsidiary of Pro Kapital Grupp operating T1 mall, was declared bankrupt. Even though T1 mall is still operating its daily business, the rental income is less mainly due to inoccupancy of the floor space (AS Pro Kapital Grupp annual report, 2020).

1.2. AS Merko Ehitus

AS Merko Ehitus is a major construction company consisting of its subsidiaries in Estonia, Latvia, Lithuania and Norway. It is the biggest listed construction company in the Baltics. The company was established in November 1990. As of 2020, the company has developed over 8500 residential units in Tallinn, Tartu, Riga and Vilnius and over 900 apartments are under construction stage. Merko group focus mainly on residential real estate ventures. The company thoroughly studies the market situation such as real estate demand in Baltic states and ease of obtaining construction permits before initiating real estate projects. AS Merko Ehitus undertakes construction service and real estate development projects such as general construction, electrical construction, road construction and civil engineering.

The company was listed in Nasdaq Tallinn under main list in August 2008 and is traded under the symbol MRK1T. The market capitalisation on Merko Ehitus was 167.4 million EUR as on the 2020 closing date. The average trading price during 2020 was 8.80 EUR, 10.60 EUR and 6.56 EUR being the highest and lowest values respectively. The main investor in the company is AS Riverito with 12,742,686 shares comprising 71.99% of the total shares as of 31st December 2020. The company has a financial objective to distribute between 50% to 70% of annual profit as dividend to its shareholders. In 2020 the company had a total of 666 employees in all three countries of which 67% were in Estonia. Estonian subsidiary, AS Merko Ehitus Eesti was the biggest taxpayer of labour taxes among the construction market for 3 consecutive years. The company also received many awards for its remarkable developments, one of the notable recognitions in 2020 was the Baltic real estate awards 2020 for best urban space renewal project in connection with Noblessner Home port.

Merko Ehitus also ensures after sales customer satisfaction by conducting surveys. There are different markers such as customer loyalty index, satisfaction with design, quality, living environment etc. Based on surveys conducted among apartment buyers, company reported that the average customer loyalty index on a scale of -100 to +100 was 66 and for other factors on a scale of 10 average score was 7.7. Giving due care to customer satisfaction is an added benefit to company's performance over the years. As of 2020-year end, 225.1 million EUR worth of order bookings were secured which is 59% more than the 2019 figure. Some of the notable contracts signed by Merko Ehitus in 2020 are construction contracts with Tallinn School of Music and Ballet, Mustamäe medical campus, renovation contract of Tallink city hotel and Nordic hotel forum and even a contract to design and build infrastructure facilities for NATO base located in Latvia. To mitigate Covid-19 health risks, the company ensured safety of its employees as well as introduced a safe process to buy apartments (AS Merko Ehitus annual report 2020).

2. FINANCIAL RATIO ANALYSIS

This chapter deals with the theoretical aspects of financial ratios and analysing financial ratios. It will also explain the ratios applied in this study and how to draw conclusions based on the computed value.

Ratio analysis is a commonly used tool for analysing financial statements. Mathematically a ratio shows relation between two values with the same unit. Likewise, a financial ratio shows the relationship between two financial figures. The financial ratios are generally percentage values or as times. In many situations a single financial value alone may not be beneficial in drawing meaningful conclusions. However, if the single value is expressed in relation to another number, it will provide more precise information which can be further interpreted. Financial ratios are analysed for decision making purposes by investors, creditors, regulatory authorities and other stakeholders. (Babalola, *et al* 2013)

Financial ratios can also be used to compare different companies regardless of their sizes. The important aspect of ratio analysis is interpreting the computed values. The ratios generally indicate the effect of cash flows on financial statements. By scrutinising the computed ratios, a financial analyst can understand a company's financial performance. For example, if the current ratio is very high compared to other companies from the same sector, it implies that the company is not efficiently utilising its current assets (Goel, 2015). The ratio analysis can be used to predict a company's future regarding its profitability, risk and growth analysis, solvency, liquidity, operating performance and profitability (Rashid, 2018). Ratio analysis is the easiest method to evaluate a company's financial risk concerning liquidity and profitability (Hampton, 2011).

Ratio analysis is widely used for financial analysis because it facilitates the analyst in predicting the future financial prospects by evaluating previous years and present financial performance of an entity. An important application of ratio analysis is trend analysis which is studying the past business patterns (Goel, 2015). It provides information about the historical performance of a company. Trend analysis can also be used to calculate growth and as a planning and forecasting

tool for budget preparation. This is very beneficial in planning cash requirements for the future. Ratios can be calculated using the company's financial statements published in annual reports or can be obtained from reputed databases such as Bloomberg, Reuters or any other financial information portals. The ratio computation might slightly vary from one company to another based on their accounting policy. That is why it is very important to go over the notes, auditor's report and other key points from annual reports. While comparing financial performance of different companies it is necessary to use the same formulas (Robinson, *et al* 2009).

To evaluate the financial performance, horizontal analysis is performed for the period 2015 to June 2021, using Pro Kapital's and Merko Ehitus's financial statements published in the respective companies' annual reports. Horizontal analysis enables comparison of financial statements for different financial years and examine the changes between the years. Comparing the financial ratios for the period between 2015 to June 2021 enables effective analysis and thorough understanding about past trends, current financial performance as well as making a prudent forecast about the future of both companies.(Shala, *et al* 2021)

The financial ratios and ratio analysis are performed by internal and external users. Internal users comprise accounting and finance department of a company to evaluate financial strengths and weaknesses. They have access to more recent updates and in-depth details about the financials. Therefore, internal analysis is more precise. On the other hand, external users consist of creditors, shareholders, financial analysts etc., who use financial statements published by the company to compute the ratio. External users usually do not have access to recent and detailed financial information unlike internal users. (Hampton, 2011)

2.1. Liquidity Ratios

A company's capability to meet short-term financial liabilities is regarded as its liquidity. An optimum level of liquidity ensures sufficient working capital and more growth potentials. Better liquidity also ensures the fundamental accounting assumption of going concern. Going concern means the business will continue its operations for a foreseeable future (Hardies, *et al* 2019). A company with working capital deficit has an increased risk of bankruptcy since it may not be able to cover its short-term liabilities (Goel, 2015). The standard liquidity level varies based on industry type. Optimum liquidity levels can be computed for a company based on its past working capital

requirements, its present position and expected future funding demands. Larger companies tend to manage their liability configuration better than small entities. Liquidity analysis should also include contingent liabilities. Unlike majority financial values, contingent liabilities will be disclosed in the footnotes to financial statements (Robinson, *et al* 2009). Liquidity ratios computed and analysed in this study are current ratio and quick ratio.

2.1.1. Current Ratio

Current ratio measures the ability of a firm to fulfill its short-term liabilities incurred, by using its total current assets. Current assets comprise of assets that are estimated to be used or converted to revenue within one financial year and current liabilities are liabilities accrued or arising within one year. In this ratio, current assets are mentioned with reference to current liabilities (Husna, *et al* 2019). If the book values of current assets and current liabilities are equal, the current ratio would be one. A ratio of 2:1 is usually regarded as an ideal current ratio (Goel, 2015). A company may choose appropriate standard value based on its past performance, targets and industry standards. Previous studies state that entities with a smaller current ratio potentially indicate insufficient working capital to settle short term liabilities. On the other hand, a high current ratio is usually regarded as a bad sign since it may be caused by ineffective cash and inventory management (Wardana, 2015).

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Source: Goel, 2015

2.1.2. Quick Ratio

The quick ratio is a more strict approach to compute liquidity. The computation is similar to current ratio just that it excludes inventory from the numerator, current assets. It is a more conservative because the ratio only considers balance sheet items under current assets which can be converted to cash immediately. Inventory is relatively less liquid compared to other current assets. Also, the company may not fetch a selling price equal to the carrying amount if inventories were to be sold immediately. Current assets such as prepayments viz, tax, employee benefits are also excluded since they are costs incurred for the present period but paid ahead of the accrual date. However, such prepayments are virtually impossible to be converted back into cash. Quick ratio is alternatively known as acid-test ratio. A higher quick ratio indicate that the company has appropriate liquidity. In circumstances where inventory is not liquid, quick ratio would be a better tool compared to current ratio to evaluate liquidity (Robinson, *et al* 2009).

$$\text{Quick ratio} = \frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}}$$

Source: Hampton, 2011

2.2. Profitability Ratios

Profit maximisation is the primary objective of every business. By using profitability ratios, the analyst can evaluate the revenue generated by a business for a given period and check if the main operating activities of the business are able to yield profit for the firm. It can also be used to identify the operational potentials of the entity in generating profit. Profitability ratios are classified into two categories viz, returns and margins. Returns are a measure of firm's efficiency to yield returns for the shareholders whereas margins indicate how efficiently a company can turn each unit of sales to profit (Goel, 2015). Profitability is dependent on various factors such as production costs, profit margin, asset turnover, fixed expenses etc. Sales approach and investment approach are the two kinds of approaches to evaluate profitability ratios (Husain, *et al* 2020).

This study will use three types of profitability ratios viz, Return on Assets, Return on Equity and Net profit margin to calculate and analyse the profitability of Pro Kapital Grupp and AS Merko Ehitus.

2.2.1. Return on Assets

Return on assets (ROA) is used to analyse the extent to which assets were able to contribute towards net income. The ratio is directly proportional to income generation, a high ratio indicates higher income is produced by a given quantity of assets. ROA is theoretically the product of total asset turnover and return on sales, substituting the corresponding formulas, we get the formula as net income divided by total average assets. ROA is a key profitability ratio since it has an impact on value of the firm. Higher profitability facilitates the company prospects to its potential investors (Husna, *et al* 2019). A decrease in ROA can happen due to less turnover which may be a result of inefficient asset management, insufficient profit margin or in some cases due to both reasons.

$$\text{Return on Assets} = \frac{\text{Net Income}}{\text{Average Assets}}$$

Source: White, *et al* 2002

2.2.2. Return on Equity

Return on Equity (ROE) is a useful ratio for investors to gauge the profitability of a company. ROE is used to calculate the proportion of net income generated from shareholders' fund. Shareholders can evaluate if the company is using owners fund efficiently. A Higher ROE is always desirable since it signifies that the company is effectively generating profits from equity capital (Robinson, *et al* 2009). Standard ROE ratio might vary from one industry to another and within the industry as well, based on the company's capital structure. A company that has large amounts of leverage will have increased ROE compared to companies financed mainly through equity (Vasigh, *et al* 2019). ROE is the quotient of net income and average equity.

$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Average Equity}}$$

Source: Robinson, *et al* 2009

2.2.3. Net Profit Margin

Net profit margin evaluates the profit earned from each Euro sale. It calculates the percentage of profit after deducting all related expenses such as interest, dividend, tax etc. Profit margin is computed by dividing net profit by net sales. A higher profit margin ratio is preferred since it implies the company's capacity to generate profit also covering expenses such as tax and non-operational expenses.

$$\text{Net Profit Margin} = \frac{\text{Net Profit}}{\text{Net Sales}}$$

Source: Mulyadi, *et al* 2020

2.3. Activity Ratios

Activity ratios measure the capacity of an entity's assets in profit generation. Activity ratios are key aspects in analysing the overall efficiency of business performance. Activity ratios can be used to scrutinise both current assets and non-current assets. Activity ratios are also important in analysing liquidity. Inefficient asset management will result in an increase in expenses and a subsequent decrease in revenue. For example, if the company holds excess inventory, the expenses such as warehouse rent, maintenance etc. will further increase. With regard to real estate, this might even affect the sale price since the real estate prices fluctuate based on market conditions. The activity ratios measure an entity's efficiency in managing its daily business affairs such as

inventory management, creditors and receivables management. The activity is calculated using balance sheet items in denominator and items from income statement in numerator. The activity ratios used in this study are working capital turnover ratio and total asset turnover ratio (Robinson, *et al* 2009).

2.3.1. Working Capital Turnover Ratio

Working capital is the difference between current assets and current liabilities. Working capital turnover ratio portrays the efficiency of a company in generating revenue using its working capital. A higher working capital turnover ratio means the entity is able to generate better revenue through working capital. Working capital is a key component in determining a firm's health. It evaluates the net position of company's liquid assets. However, excess current assets are not a good sign since it could block funds that could otherwise be used to make better investments. In certain circumstances, if the current liabilities are more than current assets, the working capital of a company can be zero or negative. In such cases, using asset turnover ratios would be more appropriate (Fazzari, *et al* 1993). Working capital turnover ratio is determined by dividing sales by average working capital.

$$\text{Working Capital Turnover Ratio} = \frac{\text{Sales}}{\text{Average Working Capital}}$$

Source: Robinson, *et al* 2009

2.3.2. Total Asset Turnover Ratio

The total asset turnover ratio is used to measure the company's efficiency in revenue generation with its available assets. It shows revenue generated from each euro investment in average assets. It is computed by dividing sales by average assets. Like working capital turnover ratio, a higher total asset turnover ratio is a sign of efficiency and company is efficient in managing its assets. Total asset turnover ratio includes both current assets and fixed assets. Ineffective working capital management can adversely affect the asset turnover ratio. A low asset turnover ratio is a sign of poor asset management and capital-intensive production methods. Companies with newly acquired assets will generally have less asset turnover ratio (Robinson, *et al* 2009).

$$\text{Total Asset Turnover Ratio} = \frac{\text{Sales}}{\text{Average Total Assets}}$$

Source: Goel, 2015

2.4. Solvency Ratio

The solvency ratios are used to analyse if a company would be able to cover its long-term liabilities. Solvency ratio is a good tool to evaluate debt in capital structure of a company and to calculate if the company has sufficient revenue to settle expenses like interest and other non-current liabilities viz, lease and rental costs. Solvency ratios are a good indicator of a company's risk profile. Solvency ratios are broadly classified into two viz, debt ratios and coverage ratios. Debt ratios are oriented towards balance sheet, providing insights about proportion of debt relative to equity while coverage ratios are based on income statement. The solvency ratio calculated and analysed in this study is debt-to-equity ratio (Robinson, *et al* 2009).

2.4.1. Debt to Equity Ratio

Debt to equity ratio is used to calculate the proportion of debt capital and equity capital. It is determined by dividing total debt by total shareholders' equity. If the debt and equity of an entity are equal, debt-equity ratio would be one. A high ratio indicates the company used external borrowing to fund its growth. A higher debt-equity ratio increases the risk due to insufficient solvency. On the other hand, a lower debt-equity ratio indicates the company is not making use of high profits to its advantage by raising optimum borrowed fund. A ratio of 2:1 is regarded as an ideal debt-equity ratio

$$\text{Debt to Equity Ratio} = \frac{\text{Total Debt}}{\text{Total Equity}}$$

Source: Goel, 2015

3. FINANCIAL RATIO ANALYSIS OF PRO KAPITAL GRUPP AND AS MERKO EHITUS (2015 – JUNE 2021)

In this chapter, we will analyse and compare the selected liquidity, profitability, activity and solvency ratios of Pro Kapital Grupp and AS Merko Ehitus for the period 2015 to June 2021.

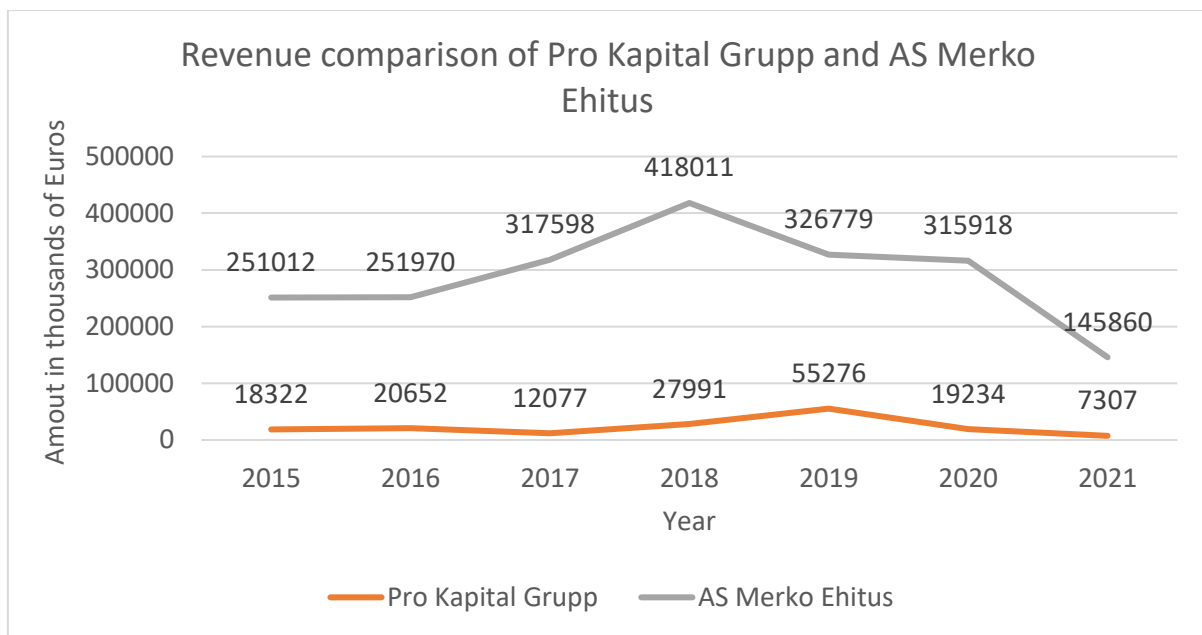


Figure 1. Revenue comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)
Source: Based on appendix 1 and 3

Comparing the revenue generated by both companies for the selected period between 2015 to June 2021, it is evident that AS Merko Ehitus has a better position. AS Merko Ehitus has shown a consistent revenue growth from 2015 to 2018. Pro Kapital also had a relatively consistent revenue generation till 2019. Between 2018 and 2019, Pro Kapital’s revenue increased owing to a spike in residential properties and rental income from T1 mall. Based on the financial data analysed, 2018 was the best year in terms of revenue for Merko Ehitus while for Pro Kapital Grupp it was 2019. Covid-19 impacted both companies’ sales, this is also reflected in the revenue post 2019.

Revenue of AS Merko decreased by 21.8% in 2019 followed by a 3.3% dip in 2020, thereby reaching a revenue level of EUR 315.9 million compared to EUR 418 million in 2018. In the first six months of 2021, the company was only able to sell 145 apartments and 6 commercial spaces compared to 369 apartments and 4 commercial spaces during the corresponding period in 2020. However, the company increased its income from construction services by 35.7% compared to the first 6 months of 2020. Pro Kapital was only able to sell 3 apartments in 2020, substantially lower than the 2019 sale of 133 apartments. Adding to the woes, the rental income reduced from EUR 9.5 million in 2019 to EUR 5.6 in 2020. The occupancy level in company's hotel venture, PK Parkhotel Kurhaus fell by 28% resulting in a revenue decrease of 58% compared to 2019 (Pro Kapital and AS Merko Ehitus annual reports 2020).

3.1. Liquidity Ratio Analysis

The current ratio and quick ratio for the period 2015 to June 2021 were computed for both the companies. Using liquidity ratios, we can ascertain the company's ability to meet short term liabilities. Value greater than 1 is generally regarded as a good financial indicator (Goel, 2015).

3.1.1. Current Ratio

Table 3. Current Ratio of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Current Ratio	2015	2016	2017	2018	2019	2020	2021 (q1&q2)
Pro Kapital Grupp	1.35	1.23	2.19	2.37	0.42	0.5	4.18
AS Merko Ehitus	3.2	2.43	2.25	2.22	2.44	2.68	2.37

Source: Data from appendix 5

During the period between 2015 to June 2021 AS Merko Ehitus maintained a healthy level of current ratio. The current ratio values are above 2 for 7 consecutive years. From this data we can conclude that, for the studied duration, AS Merko Ehitus has been capable to settle its short-term financial obligations. On the other hand, Pro Kapital Grup had been inconsistent in terms of current ratio, with values plummeting to 0.42 and 0.50 between the years 2019 and 2020 respectively. However, the first four years from 2015 have shown sufficient liquidity with values reaching 2.37

in the year 2018 followed by substantial decrease in the following years indicating company's inability to meet short term liabilities. This fall in current ratio is due to a corresponding increase in short term advances. During this tenure, the company had managed to settle loans amounting to 1.4 million euros. However, it eventually had to refinance 27.9 million euros in the form of non-convertible bond liabilities. Further due to restructuring process in connection with its insolvent subsidiary AS Tallinna Moekombinaat and violations in the loan terms, advance amounting to 75.4 million euros were reclassified as short-term debt in the year 2019. In essence, the bankruptcy proceedings and negative cash flows from Pro Kapitals groups subsidiary AS Tallinna Moekombinaat added to the financial woes of the company since 2019. In the first 6 months of 2021, followed by repayment of bank loan amounting to EUR 2.8 million and redemption of convertible bonds, Pro Kapital was able to improve the current ratio to 4.18, which is the highest current ratio for the company during the selected period. During this period company also had inventory amounting to EUR 67.9 million compared to EUR 45.3 million in the corresponding previous period. Inventory primarily constituted of projects which are under construction.

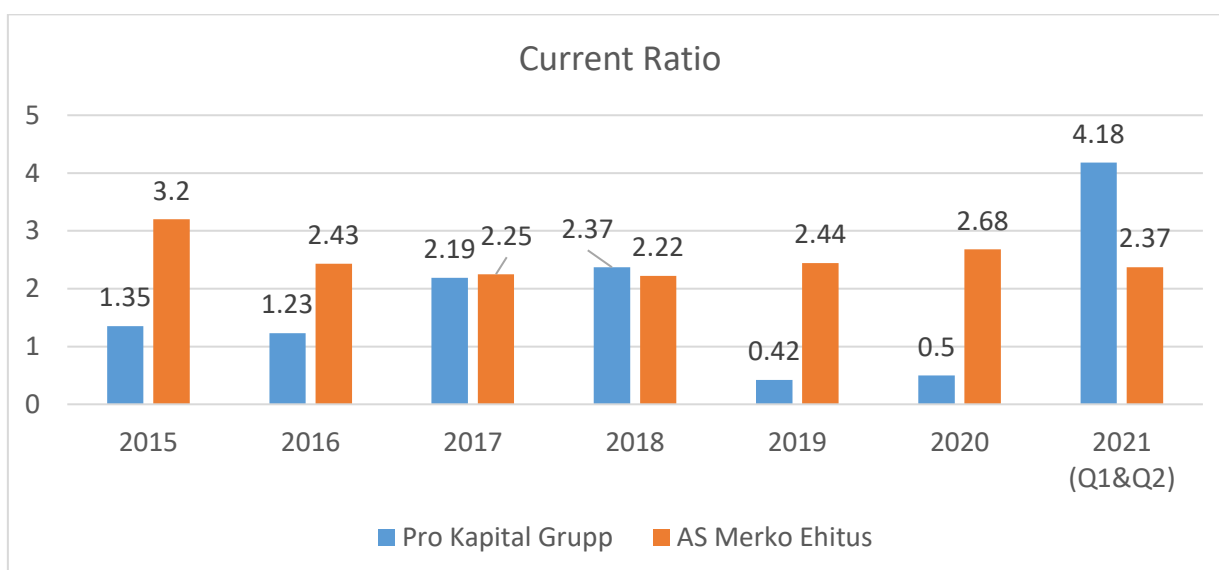


Figure 2. Current ratio comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Source: Data from appendix 5

Comparing the current ratio of both companies for the period from 2015 to June 2021 shows that AS Merko Ehitus was always able to maintain a ratio above 2. The values of Pro Kapital Grupp show drastic differences, for example in 2018 current ratio was 2.37 in the following year it fell to 0.42. The highest current ratio was 4.18 by Pro Kapital Grupp during first 6 months of 2021. Based

on the current ratio analysis, we can conclude that AS Merko Ehitus had a better position with regard to liquidity since it was able to maintain the ideal ratio is 2:1 and has been capable of paying its short-term liabilities between 2015 to 2021. (Goel, 2015).

3.1.2. Quick Ratio

Table 4. Quick ratio for Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Quick Ratio	2015	2016	2017	2018	2019	2020	2021 (q1&q2)
Pro Kapital Grupp	0.53	0.5	0.62	0.34	0.1	0.08	0.75
AS Merko Ehitus	1.2	0.95	1.11	1.1	0.76	1.04	0.91

Source: Data from appendix 5

The Quick ratio is also used to assess the ability of a company to meet its short-term financial obligations. Like current ratio, the ideal value should be more than 1. Comparing both companies, we can conclude AS Merko Ehitus has fundamentally strong liquidity. This can be attributed to AS Merko's systematic inventory planning by evaluating market conditions and buying land with future development potential. The current ratio and quick ratio tend to have a directly proportional relation. This means that an increase in current ratio for a given year also increases quick ratio and vice-versa. For the entire duration of study spanning from 2015 to June 2021, Pro Kapital Grupp's quick ratio value has always remained below 1. During the period after 2017, the significant increase in short term liabilities and excess inventory level factored towards the liquidity problems of Pro Kapital Grupp.

AS Merko Ehitus has performed better in terms of liquidity. Both their current ratio and quick ratio were preferable than Pro Kapital Grupp. The years after 2018 saw the downfall of Pro Kapital Grupp regarding liquidity. This was partly due to various financial restructuring due to bankruptcy of T1 Mall, which increased short term liabilities and thereby decreasing working capital. Even though the Covid-19 pandemic slowed down sales of commercial and housing properties, the impact is not significant for both these companies. The financial woes for Pro Kapital persisted even before the pandemic. During the first 2 quarters of 2021, Pro Kapital was able to improve its quick ratio to 0.75 compared to 0.08 in 2020, by decreasing its current liabilities through repaying creditors and redeeming bonds. The company also raised bank loan, this increased cash and bank

balance for the period. The quick ratio of Merko Ehitus had a marginal decrease in 2021, 0.91 against the 2020 value of 1.04. This was due to the accruals in terms of trade payables and employee benefits.

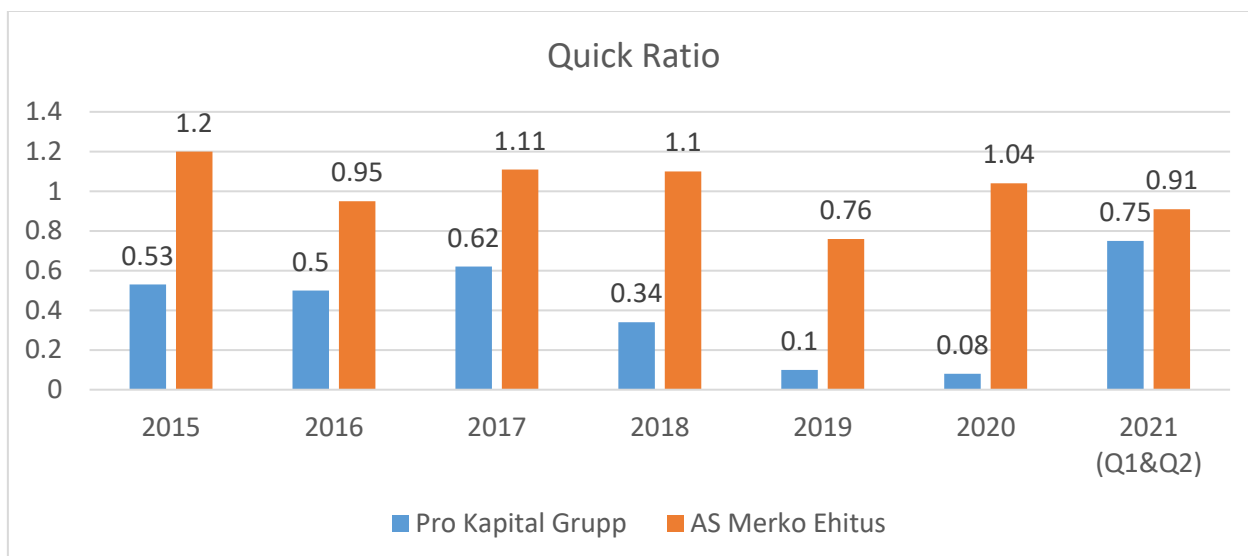


Figure 3. Quick Ratio Comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Source: Data from appendix 5

From the quick ratio computation, Merko Ehitus has value above 1, 4 out of 7 years. Contrary to that Pro Kapital’s quick ratio remained below 1 for the entire period between 2015 to June 2021 indicating excess current liabilities than current assets. Based on the quick ratio values, we can infer that Merko Ehitus maintained a better position in terms of liquidity compared to Pro Kapital Grupp.

3.2. Profitability Ratio Analysis

Profitability ratios used in the analysis are Return on Assets (ROA), Return on Equity (ROE) and Profit Margin. Profitability ratios are used to evaluate a business’s capacity to earn returns from trading activities, investments and equity. The selected ratios were computed and following results were derived.

3.2.1. Return on Assets (ROA)

Table 5. Return on Assets ratio for Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Return on Assets	2015	2016	2017	2018	2019	2020	2021 (q1&q2)
Pro Kapital Grupp	1.57%	-2.95%	-0.60%	8.59%	-12.80%	-30.50%	17.49%
AS Merko Ehitus	4.27%	2.67%	6.12%	7.10%	5.98%	8.35%	3.61%

Source: Data from appendix 5

As seen from table 5 above, AS Merko Ehitus maintained a better position in terms of Return on Assets, for the period 2015 to June 2021. This implies that Merko Ehitus is using its assets efficiently to generate profit compared to Pro Kapital Grupp. Pro Kapital Grupp reported profit only 2 out of 7 times, between 2015 and June 2021. This is reflected in company's ROA as well. The years of 2018 and first half of 2021 were the only times company had positive ROA. From 2015 to 2017, company did manage to marginally improve in terms of ROA. During this period, company also raised its total assets by increasing investment property. An investment property is an investment made by a real estate firm with an intention to gain profit from rent or an increase in market value of the property. (Pro Kapital Grupp Annual report 2020)

During the period from 2019 and 2020, ROA dropped to -13% and -31% respectively. This can be attributed to the poor performance of T1 mall, causing loss in revaluation of investment property leading to negative operating results. In this regard, Covid-19 pandemic has severely affected Pro Kapital Grupp by slowing its sales and decreasing revenue from their rental and hotel operations. AS Merko Ehitus has shown consistent ROA. ROA in 2015 was 4% while as of 2020, the value has increased to 8%. The lowest ROA was 3% for the period between 2015 and June 2021. Covid-19 pandemic didn't affect AS Merko's business activities drastically.

The company has always followed the strategy of analyzing market situations and ensuring proper demand-supply cycle. The sales increased by the end of 2020 which also exceeded corresponding sales in 2019, which is the reason why company attained 8% ROA during 2020. During the first 6 months of 2021, Pro Kapital's ROA recovered from -13% to 17%. This can be attributed to the profit generated after 2 consecutive years and provisioning for the devaluation of the investment

property during 2019 which amounted to EUR 43.1 million, thereby controlling the operating expenses to only EUR 49,000 for current year. The reduced sales for first 2 quarters adversely impacted Merko Ehitus's ROA. The ROA decreased from 8% in 2020 to 4% in 2021. The decrease in sales during the first 6 months of 2021 has resulted in decreased ROA. But in 2021, even though revenue was less for Pro Kapital Grupp compared to previous years, the company was able to generate profit in the form of financial income, because of derecognizing its subsidiary Tallinna Moekombinaat.

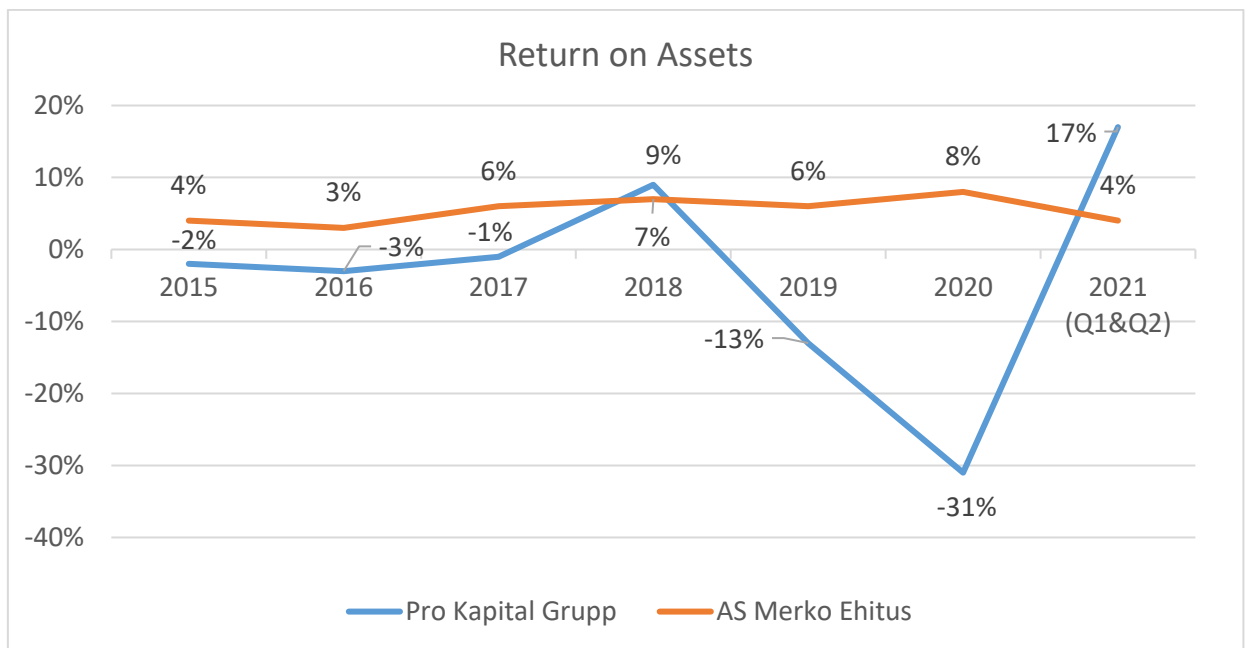


Figure 4. ROA comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – 2021 June)
Source: Data from appendix 5

Based on the results from Return on Assets ratio, it is evident that Merko Ehitus has a better position in terms of ROA, due to its higher sales and more net income when compared with Pro Kapital Grupp. Merko Ehitus's ROA was relatively stable and was positive for the entire period from 2015 to June 2021. Whereas Pro Kapital Grupp's ROA was subject to extreme fluctuations. Hence, we can conclude, Merko Ehitus was efficiently using its assets to generate profits.

3.2.2. Return on Equity (ROE)

Table 6. ROE ratio for Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Return on Equity	2015	2016	2017	2018	2019	2020	2021 (q1&q2)
Pro Kapital Grupp	-2.38%	-4.92%	-1.17%	19.69%	-33.86%	-146.56%	120.91%
AS Merko Ehitus	7.55%	4.70%	12.06%	14.31%	12.17%	15.41%	6.27%

Source: Data from appendix 5

For Pro Kapital Grupp, ROE remained negative 5 out of 6 years for the selected period. This is due to the loss incurred during the years from 2015, except 2018 where the company had generated profit. This can be attributed to the gain from change in fair value of investment property by 1.7 million euros. The span between 2015 and 2018 had shown improvements in the ROE, for instance in 2016 ROE was -5% and in 2017 it increased to -1% and 20% in 2017 and 2018 respectively. This shows for each euro invested the Pro Kapital Grupp generated 20 EUR profit in 2018. In 2019 and 2020 ROE drastically decreased from -34% to -147%. This was due to the increase in operating expense. Primary reason for the increase is loss incurred from fair value adjustments of investment properties and management's decision to write off loss amounting to 26.9 million EUR for the financial year 2019 with retained earnings.

Like ROA, ROE of AS Merko Ehitus has been consistent for the selected time frame. In 2015 ROE was 8% but the value decreased to 5% in 2016 and then increased to 12% in the subsequent year. The drop in 2016 was due to marginal increase in revenue compared to 2015 and increase in cost of sales caused by increased material costs and administrative expenses. From 2016 to 2018 the ROE of AS Merko Ehitus increased linearly from 5% to 14%. In 2019 the ROE dropped to 12%, matching the corresponding figure in 2017. During the first half of 2021, the sales revenue was low compared to previous years. Similar pattern on ROA can be noticed for ROE as well, with ROE decreasing for Merko Ehitus while that of Pro Kapital increasing and reaching an all-time high of 121%.

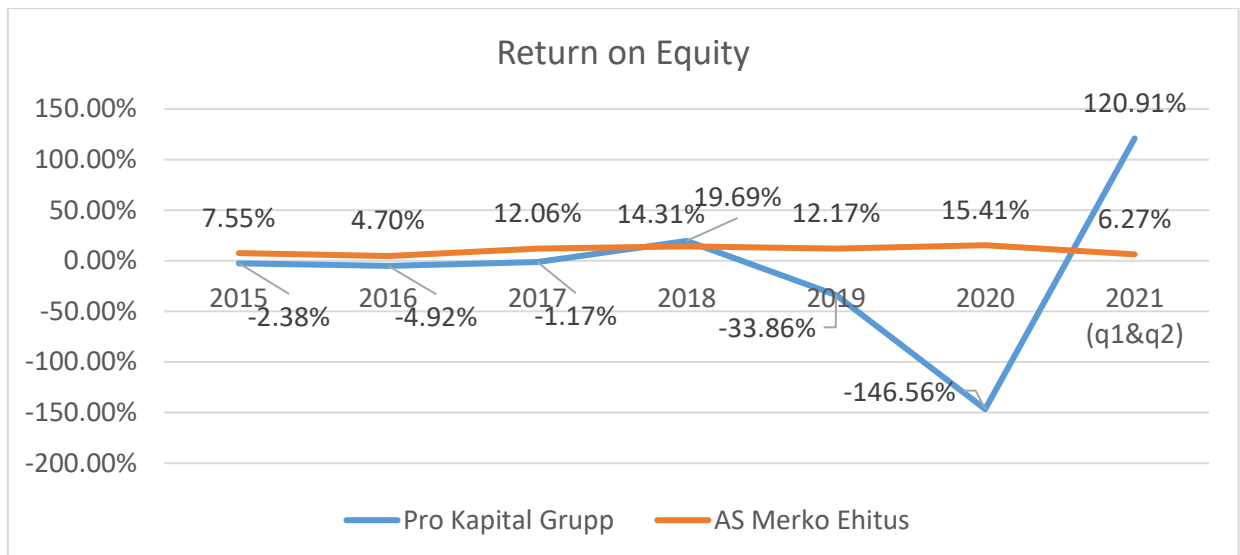


Figure 5. ROE ratio comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)
Source: Data from appendix 5

Based on ROE values, we can conclude that for selected period between 2015 to June 2021, on average AS Merko Ehitus generated better returns for its shareholders compared to Pro Kapital Grupp whose ROE was subject to extreme fluctuations. For the period, ROE of AS Merko Ehitus is more than its ROA. This implies that company relies on borrowed fund to finance the purchase of assets.

3.2.3. Net Profit Margin

Table 7. Net Profit Margin for Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Net Profit Margin	2015	2016	2017	2018	2019	2020	2021 (q1&q2)
Pro Kapital Grupp	-10.97%	-19.49%	-7.89%	64.51%	-52.78%	-309.12%	364.02%
AS Merko Ehitus	3.92%	2.38%	4.96%	4.64%	5.05%	7.12%	6.60%

Source: Data from appendix 5

Net profit margin is an indicator of overall profitability of a company. Surprisingly Pro Kapital Grupp reported the highest net profit margin for the selected time frame, with 364% during first 2 quarters of the financial year 2021. Net profit margin for AS Merko Ehitus for the corresponding period was only 7%. The net profit margin of 364% indicates that company earned 364 EUR of

profit for every euro received through sales. Pro Kapital Grupp has issues with profitability for the selected time frame except in 2018. The increased profit during 2018 is due to gain from change in fair value of investment property. 5 out of 7 years had negative profit margins. The years from 2018 to 2020 saw the profit margin drastically falling from 65% to -309% this was partly due to huge amount paid as interest expense for advances and bonds decreased sales during 2020 also added to the woes. However, during the first half of 2021, the net profit margin phenomenally increased to 364% due to an increase in finance income.

AS Merko Ehitus had a constant profit margin for the selected period from 2015 – 2020. Even though the profit margin for AS Marko Ehitus remained positive for the selected tenure, the profit margin is less which means the projects are not overpriced. During this period the cost of sales was 90% of sales revenue on average. The average net profit margin for the period 2015 to 2020 is 5%. The highest profit margin reported was 7% in 2020, from this we can understand that for every 1-euro sale, the AS Merko Ehitus yielded a profit of 7 EUR. For the period from January to June 2021, due to decrease in sales, profit margin decreased marginally.

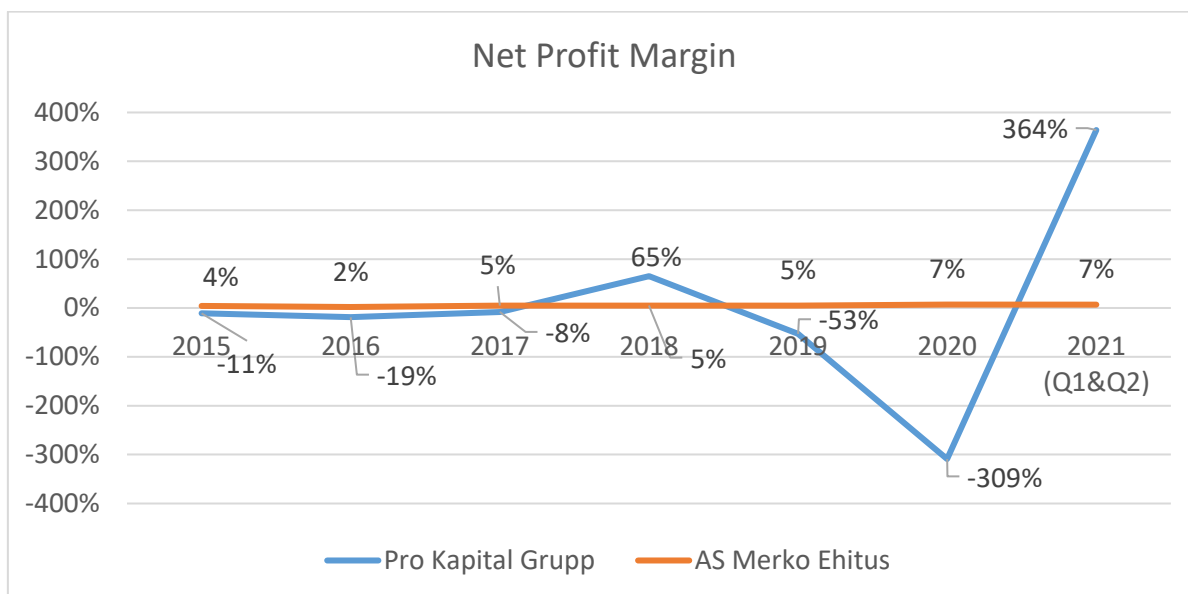


Figure 6. Net Profit Margin comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Source: Data from appendix 5

For the selected time frame from 2015 to June 2021, AS Merko Ehitus had positive profit margin for 7 years consecutively whereas Pro Kapital Grupp has had only twice. From the values it is evident that both companies are not charging excess margin on sale price. Out of the 2 companies,

Merko Ehitus had better position in terms of Net Profit Margin for the entire period when compared to Pro Kapital.

3.3. Activity Ratio Analysis

The activity ratios used in the study are working capital turnover and asset turnover. The activity ratios are used to determine if the assets are being used efficiently to create revenue. It gives a general overview about efficiency of the firm. (Monea, 2009)

3.3.1. Working Capital Turnover

The working capital turnover ratio is used to analyze if the company is making optimum usage of its working capital to generate sales and growth. It shows how much profit is generated for every 1 EUR invested in working capital. The following tables show the working capital turnover ratios of Pro Kapital Grupp and AS Merko Ehitus for the period 2015 to June 2021.

Table 8. Working Capital Turnover ratio for Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Working Capital Turnover Ratio	2015	2016	2017	2018	2019	2020	2021 (q1&q2)
Pro Kapital Grupp	27.59	4.24	0.72	0.81	-3.39	-0.27	-2.41
AS Merko Ehitus	2.06	2.11	2.55	3.23	2.41	2.32	1.13

Source: Data from appendix 5

The highest working capital turnover reported of the two companies in 27.59 by Pro Kapital Grupp for the year 2015. During 2015 Pro Kapital Grupp had relatively fewer liabilities. However, in 2019 and 2020 company incurred high amount of liabilities, due to the statutory decision to convert advances from long term liabilities to short term. The impact can be seen in the ratios for this period, 2019 and 2020 where working capital turnover ratio is negative. Although, the first four years from 2015 to 2018 had positive values, it was showing a downward trend. For the highest working capital turnover by Pro Kapital Grupp in 2015, company generated 27.59 EUR profit for every euro investment in working capital. During the first half of 2021, the Working capital ratio

plummeted to -2.41. The actual working capital for the period is positive however, average current assets is lower than average current liabilities for the period.

The consistent trend of AS Merko Ehitus can be seen in working capital turnover ratio as well, with the ratio hovering around 2.5 for the period 2015 – 2020. The company first demonstrated increasing working capital turnover ratios from 2.06 to 3.23 in 2015 and 2018 respectively after that in 2019 and 2020 corresponding ratios were 2.41 and 2.32. Due to decrease in sales, the working capital ratio decreased in 2021. The best working capital turnover ratio for AS Merko Ehitus was in 2018 where the company generated a profit of 3.23 EUR for each euro invested in working capital.

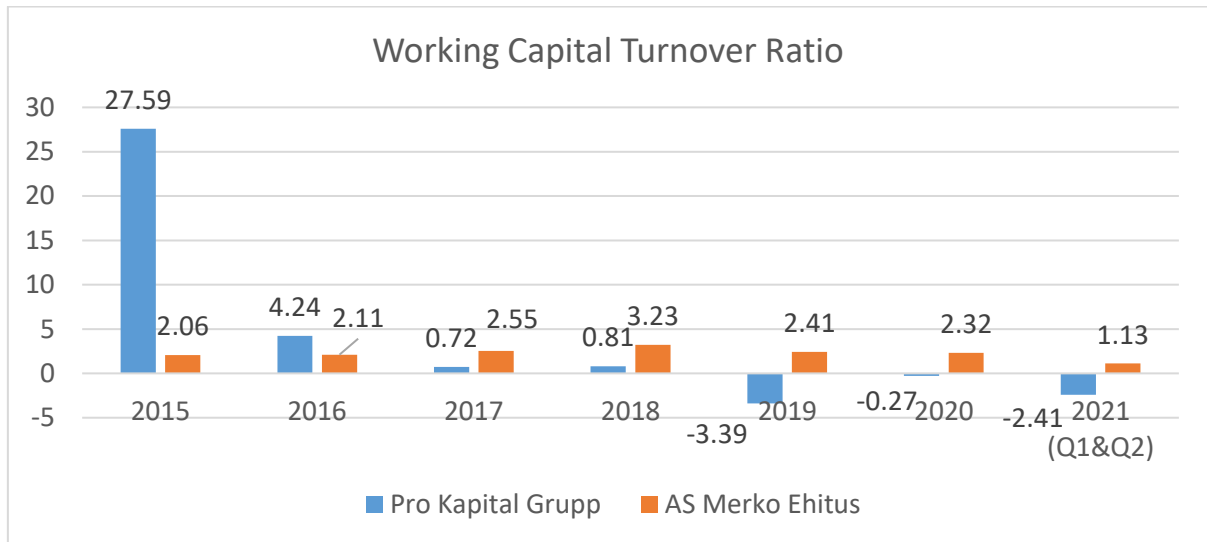


Figure 7. Working Capital Turnover Ratio comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Source: Data from appendix 5

Based on the working capital turnover ratio evaluation, we can conclude that AS Merko Ehitus is better and consistent in managing working capital compared to Pro Kapital Grupp. The ratio was consistently above 1 for Merko Ehitus for the selected period. Hence, we can infer that the Merko Ehitus was efficiently using its working capital to generate revenue.

3.3.2. Asset Turnover Ratio

The asset turnover ratio evaluates profit generated from every 1 EUR investment in assets by a company. The following tables show the asset turnover ratios for Pro Kapital Grupp and AS Merko Ehitus for the period 2015 to June 2021.

Table 9. Asset Turnover ratio for Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Asset Turnover Ratio	2015	2016	2017	2018	2019	2020	2021 (q1&q2)
Pro Kapital Grupp	0.14	0.15	0.08	0.13	0.24	0.1	0.05
AS Merko Ehitus	1.09	1.12	1.23	1.53	1.19	1.17	0.55

Source: Data from appendix 5

As seen from table 9, asset turnover ratios for both companies is nearly consistent for the selected period. Between 2015 to June 2021, Pro Kapital Grupp's asset turnover ratio remained below 1, which indicates assets were not being used efficiently. Investment property comprises a major portion of assets in Pro Kapital, which includes commercial spaces held for generating rental income such as T1 mall. However, limited cash inflows from such investments have proved the inefficient use of fixed assets possessed by the company. The best asset turnover ratio for Pro Kapital Grupp was during 2019 where the profit generated was 0.24 EUR for each euro invested in its assets.

For AS Merko Ehitus, a major part of assets comprises inventories, which are residential and commercial buildings held for sale. From the computed asset turnover ratio for the selected period, it is evident that the company has efficiently used its assets since all values are above 1. The asset turnover ratio increased during the first four years from 2015. In 2015 it was 1.09 and in 2016 it slightly increased to 1.12. In 2017, there was a further increase to 1.23 followed by 1.53 in 2018 which was the highest during the selected time. The company generated a profit of 1.53 from every 1 EUR investment in assets during 2018. In the following years, it slightly reduced to 1.19 and 1.17 in 2019 and 2020 respectively. The asset turnover ratio further dropped to 0.55 during first 6 months of 2021 due to decrease in sales.

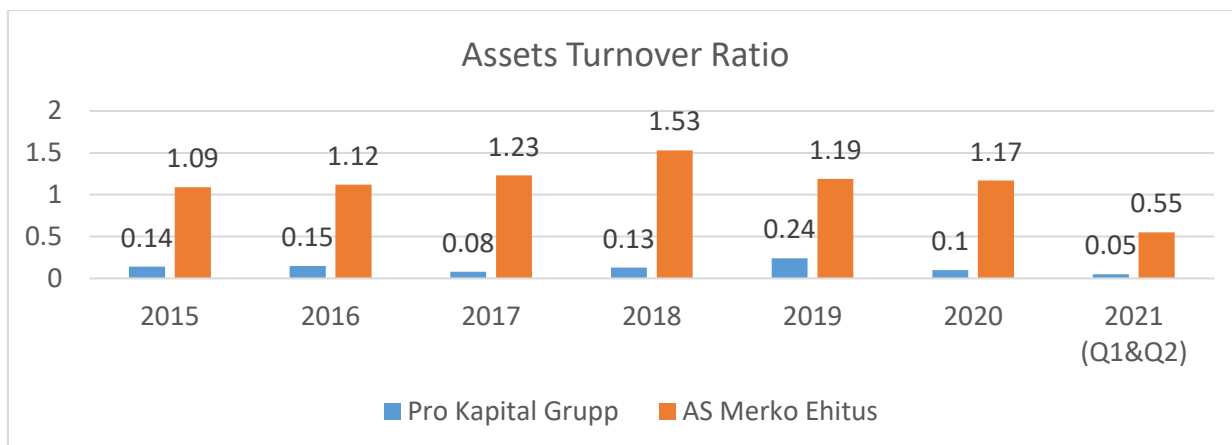


Figure 8. Asset Turnover ratio comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Source: Data from appendix 5

From the assets turnover ratio analysis, we can infer that Merko Ehitus had values above 1 for 6 consecutive years but the value was below 1 in 2021 due to Covid-19 pandemic which decreased the sales. Whereas Pro Kapital's value remained below for the entire period. Hence, we can conclude that of the 2 companies, AS Merko Ehitus was efficiently using its assets to generate revenue.

3.4. Solvency Ratio Analysis

Debt to equity ratio was used to measure the solvency of Pro Kapital Grup and AS Merko Ehitus. It is used to analyze if the shareholders equity will be adequate to provide external debts and financial stability in long term.

3.4.1. Debt to Equity Ratio

Table 10. Debt to Equity ratio for Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Debt to Equity Ratio	2015	2016	2017	2018	2019	2020	2021 (q1&q2)
Pro Kapital Grupp	0.52	0.68	0.93	1.18	1.98	16.13	3.78
AS Merko Ehitus	0.77	0.76	0.94	1.01	1.04	0.78	0.76

Source: Data from appendix 5

For the selected period from 2015 to June 2021, AS Merko Ehitus has had debt to equity ratio below 1, 4 out of 6 times while Pro Kapital Grupp has only 3 out of 6. In general, first 3 years had an ideal debt equity ratio for both the companies. Pro Kapital Grupp had an average of 3.57, with lowest value of 0.52 in 2015 and highest of 16.13 in 2020. The sudden hike in 2020 is due to the rapid decrease in total equity and increase in liabilities with respect to previous years. This indicates the use of external borrowing to fund the operations of the company. This also infers that the company has a debt of 16.13 EUR for 1 euro equity.

AS Merko Ehitus has had its ratio below 1 for 4 years between 2015 and 2020. Debt equity ratio in 2015 was 0.77 which slightly decreased to 0.76 in 2016 and increased to 0.94 and 1.01 in the subsequent years 2017 and 2018 respectively. The riskiest value is noted during 2019 where it reached 1.04. It means company had 1.04 EUR debt for every euro in equity. However, in the following year 2020 debt equity ratio returned to a desirable value of 0.78.

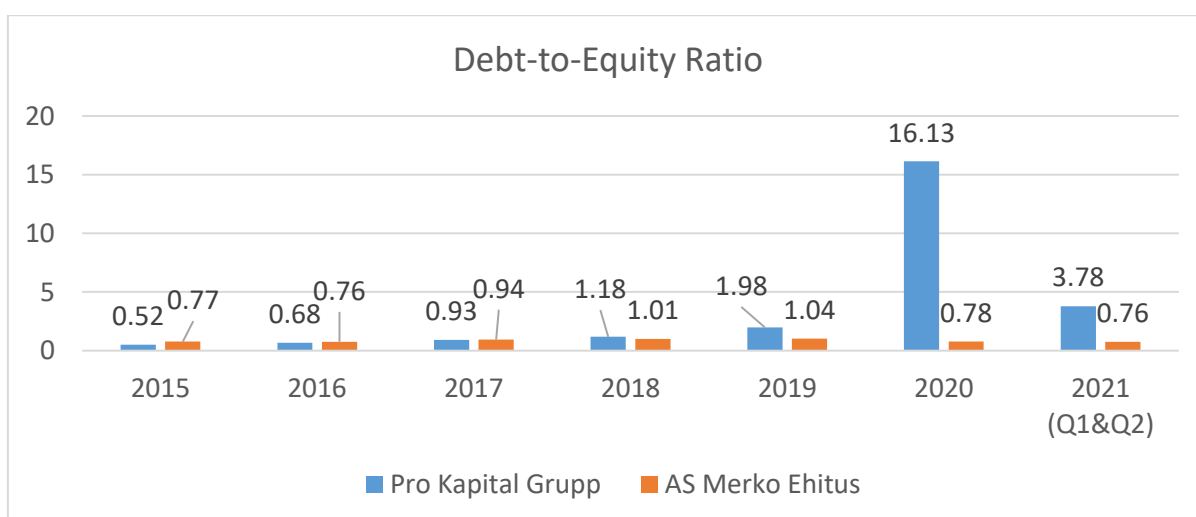


Figure 9. Debt to Equity ratio comparison of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Source: Data from appendix 5

Based on the debt-to-equity ratio evaluation we can conclude that AS Merko Ehitus is a safer investment since it has an ideal debt equity ratio for 4 out of 6 years while debt equity ratio of Pro Kapital Grupp indicates it is a riskier investment. Between the 2 companies, Pro Kapital had the highest and lowest values, 16.13 during the year 2020 and 0.52 in 2015 respectively. The ratio also reveals Pro Kapital is relatively more leveraged hence making it a risky investment.

DISCUSSION AND CONCLUSION

Due to urbanisation, increase in business activities and rapid improvement in the economic status of Estonia, real estate market has flourished since the 90's. Development of major cities in the region has also boosted demand for residential and commercial property development. However, the pace of property development has been adversely affected due to Covid-19 pandemic. To understand the impact of Covid-19 on property development, this study was conducted with an aim to evaluate the financial performance of Pro Kapital Grupp and AS Merko Ehitus using financial ratio analysis and comparing the outcomes before and during Covid-19 pandemic for the period 2015 to June 2021. Data for the analysis was obtained from financial statements of Pro Kapital Grupp and AS Merko Ehitus between the financial years 2015 to June 2021, which was prepared in accordance with IFRS.

The first research question was “How can financial ratio analysis be used to examine and compare financial performance of two major real estate companies before and during Covid-19 pandemic?” Financial ratio analysis depends on the data from financial statements in prior years and it is used to evaluate a company's retrospective performance and its current financial position. The ratio analysis helps in better understanding of values presented in financial statements and their relationship with one another. It enables the stakeholder to identify low performing aspects of the entity and comparing one company to another. Two scenarios, financial position before and during Covid-19 pandemic, were analysed in this study. The period from 2015 to 2019 corresponds to pre Covid-19 performance and 2020 to June 2021 relates to the business during Covid-19.

In general, both companies generated less revenue during Covid-19 period, which adversely affected the ratios such as liquidity, profitability and activity compared to values before Covid. Between the two companies, the consequences of the pandemic were more severe for Pro Kapital Grupp, resulting in factors such as undesirable level of liquidity, negative profit margin and high leverage. On the other hand, for the period before pandemic, both companies reported more sales. However, unproportionable operating cost and cost of sales generated loss for Pro Kapital Grupp for the years 2015, 2016, 2017 and 2019. Whereas Merko Ehitus had a stable performance and

ideal ratios indicating fundamentally strong financials of the company. Based on the analysis conducted for the period 2015 to June 2021, we can conclude that financial ratio analysis is an effective tool to analyze the financial performance of real estate companies during and prior to Covid-19 pandemic.

The second question was “Do real estate companies achieve financial stability regarding liquidity, profitability, working capital, asset-debt management and solvency before and during the Covid-19 pandemic?” The liquidity ratios analyzed in this study were current ratio and quick ratio. AS Merko had current ratio above 2 for the entire duration and quick ratio above 1 for 5 out of 7 years. Whereas current ratio of Pro Kapital was above 1 for 5 out of 7 financial years and quick ratio below 1 for the entire period which indicates insufficient liquidity to meet short term liabilities.

AS Merko Ehitus was able to maintain ideal liquidity ratios before Covid-19 however, the ratios were adversely affected by the decreased sales during Covid-19 pandemic. On the other hand, Pro Kapital Grupp has had inconsistencies regarding liquidity ratios even before the pandemic. AS Merko Ehitus has had a better position in terms of liquidity compared to Pro Kapital Grupp. Regarding profit margin, Merko Ehitus was able to maintain a positive margin since 2015 compared to Pro Kapital whose profit margin was subject to extreme fluctuations in the last 6 years. Only 2 out of 7 years yielded positive profit margin for Pro Kapital due to its increased operating expenses. Hence, we can conclude AS Merko Ehitus achieved financial stability in terms of profitability, before and during Covid-19 contrary to Pro Kapital whose profitability ratios were negative both before and during the pandemic.

Merko Ehitus has had a better position in terms of working capital management as well. Working capital turnover ratio has shown decreasing trend for both companies since 2019 due to externalities such as Covid-19 pandemic. Since 2019 working capital turnover ratio for Pro Kapital Grupp has been negative indicating excess current liabilities over assets and loss incurred by the company during respective financial years. Therefore, AS Merko Ehitus has achieved stability regarding working capital before and during the pandemic, compared to Pro Kapital Grupp which couldn't achieve an adequate ratio. Merko Ehitus was also able to efficiently use its assets to generate revenue compared to Pro Kapital whose assets turnover ratio was below 1 since 2015. Decreased sales in 2021 have adversely affected asset turnover of both companies. AS Merko was able to achieve financial stability in this regard before and during Covid-19 compared to Pro Kapital whose asset turnover ratio was not desirable for the entire duration of the study. The debt-

to-equity ratio of Merko Ehitus has remained stable before and during the pandemic. A higher debt to equity ratio indicates the company is highly leveraged and thereby increasing the risk. The average ratio of Merko Ehitus is below 1, making it a safer investment option compared to Pro Kapital which was unable to achieve desirable debt-to-equity ratio between 2015 to June 2021.

The final research question was “What are the financial strengths and weaknesses of both companies before and during the Covid-19 pandemic?” The financial ratio analysis of Pro Kapital and Merko Ehitus for the period 2015 to June 2021 helps in understanding the pros and cons of both companies before and during Covid-19. Between the two companies, Merko Ehitus has had better position and fundamentally strong financials for the studied duration. Decreased revenue during pandemic adversely affected profitability, liquidity, activity and solvency of both companies in the first half of 2021. The impact was more evident on Pro Kapital which had financial crunches even before Covid-19 due to high operating costs and unfavorable returns from its investment in T1 mall. Merko Ehitus was able to maintain favorable financials before Covid. The company had desirable levels of revenue prior to pandemic. Due to its sound liquidity and profitability along with proper planning, the financial impact was less pronounced during pandemic.

Even though financial ratio analysis is an ideal tool for evaluating company performance, it has some limitations. According to Faello (2015), the commonly regarded limitation is window dressing and quality of financial statements. To portray better results, companies may manipulate the financial statements. The author also mentioned that discrepancies in comparing the financial ratios of different companies may occur due to variation in accounting policies adopted each company. For example, one company may choose written down value method for depreciation while other might use straight line method. Too much emphasis on a particular ratio rather evaluating all related ratios, can potentially lead to misleading conclusions (Lesakova, 2007).

This study throws light on financial stability of Pro Kapital Grupp and AS Merko Ehitus, for the period 2015 to June 2021. The study highlights the key financial merits and demerits of both companies. The notable advantages of AS Merko Ehitus are its stable financial performance, optimum ratios and desirables levels of revenue. The average debt-to-equity ratio of 0.87 for the period shows that the company is a relatively safe investment. The companies have notable differences in terms of liquidity and profitability. The liquidity analysis reveals Merko Ehitus has had adequate liquidity level while that of Pro Kapital indicates that the company has issues

regarding its liquidity before and during Covid-19. The profitability ratios, that is ROE, ROA and net profit margin also shows significant differences. Pro Kapital Grupp has extremely fluctuating and negative profitability ratios for 5 years during the studied period, which shows inefficient use of its assets to create revenue.

The result from the study will enable company management, existing shareholders and prospective investors to evaluate and compare the financial statements of both companies in order to have a better understanding about the performances for decision making purposes. Financial ratios and its analysis performed in this study provides an insight about both the companies' financial position to its investors regarding past trends and current performance in terms of liquidity, profitability, efficiency and solvency. It also shows how efficiently the entities are using its assets and funds to generate revenue. The findings shed light the financial performance and positions of both companies in which the potential investors can make the investment decision. Further studies may conduct a qualitative study to find out how pandemic news influenced the buying decisions of real estate investors. The author wants to suggest a study on the topic "Comparative study on the financial impact of Covid-19 on real estate companies in Estonia and other Baltic states". The outcomes from the study may help real estate companies to identify the new trends in property demand affected by unforeseeable pandemic situations.

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APPENDICES

Appendix 1. Income statement of Pro kapital Grupp (2015 - June 2021)

(in thousands of euros)

Particulars	2021 (Q1 & Q2)	2020	2019	2018	2017	2016	2015
Revenue	7307	19234	55276	27991	12077	20652	18322
Cost of sales	-5494	-12459	-39467	-18415	-7516	-14598	-13874
Gross profit	1813	6775	15809	9576	4561	6054	4448
Marketing expenses	-239	-621	-728	-1336	-822	-518	-466
Administration expenses	-2463	-6154	-6013	-5427	-5256	-5396	-5250
Other operating income	1508	478	95	18839	4114	254	3353
Other operating expenses	-49	-43586	-24341	-169	-800	-703	-661
Operating profit	570	-43108	-15178	21483	1797	-309	1424
Finance income	53810	4	4	4	6	13	13
Finance cost	-27753	-15998	-14019	-3473	-3352	-3512	-2606
Profit (loss) from sale and liquidation of subsidiary	0	0	0	0	0	0	0
Profit (loss) from joint ventures	0	0	0	0	0	0	0
Profit (loss) before tax	26627	-59102	-29193	18014	-1549	-3808	-1169
Income tax	-28	-354	21	42	596	-217	-841
Profit (loss) for the year	26599	-59456	-29172	18056	-953	-4025	-2010

Source: Pro Kapital Grupp Annual reports 2015 – June 2021

Appendix 2. Balance sheet of Pro Kapital Grupp (2015 – June 2021)

(in thousands of euros)

Particulars	2021 (Q1 & Q2)	2020	2019	2018	2017	2016	2015
Assets							
Current Assets							
Cash and bank balances	13842	9393	10616	7040	10317	5382	6392
Current receivables	967	1797	1475	2928	4888	4475	1608
Inventories	67967	58352	41031	59331	38024	14144	12438
Prepaid corporate income tax	0	0	0	0	0	0	0
Total Current Assets	82776	69542	53122	69299	53229	24001	20438
Non-Current Assets							
Non-current receivables	23	3517	2297	216	37	42	48
Property, plant and equipment	6648	6745	7128	7128	7435	18336	17103
Right-of-use assets	266	357	519	0	0	0	0
Investments in joint ventures	0	0	0	0	0	0	0
Investment property	35038	98512	147365	168145	114140	99660	92457
Deferred income tax assets	0						
Intangible assets	354	375	372	324	317	275	277
Total Non-Current Assets	42329	109506	157699	175813	121929	118313	109885
Total Assets	125105	179048	210821	245112	175158	142314	130323

Source: Pro Kapital Grupp Annual reports 2015 - June 2021

Appendix 2. Continuation

(in thousands of euros)

Particulars	2021 (Q1 & Q2)	2020	2019	2018	2017	2016	2015
Liabilities and equity							
Current Liabilities							
Current debt	1262	107581	111759	10328	6738	8261	8004
Payables and prepayments	17952	30077	12715	17646	17315	10728	6795
Taxes liabilities	111	458	1155	357	132	547	264
Short-term provisions	475	459	267	852	170	5	87
Total Current Liabilities	19800	138575	125896	29183	24355	19541	15150
Non-Current Liabilities							
Non-current debt	67085	27255	10871	112009	62527	38040	27054
Non-current payables	2577	2295	1013	1039	3437	804	837
Deferred tax liabilities	1133	1170	1348	2004	2058	3360	3503
Long-term provisions	82	182	127	139	99	365	347
Total Non-Current Liabilities	70877	30902	13359	115191	68121	42569	31741
Total liabilities	90677	169477	139255	144374	92476	62110	46891
Equity							
Share capital in nominal value	11338	11338	11338	11338	11338	10854	10841
Share premium	5661	5661	5661	5661	5661	1816	1669
Statutory reserve	1134	1134	1134	1082	1082	1082	1082
Revaluation reserve	2984	2984	3262	3262	3256	9462	9462
Foreign currency differences	0	0	0	0	0	0	0
Retained earnings	-8031	47647	49744	76771	59950	55191	58743
Total equity attributable to owners of the Company	34428	13086	71139	98114	81287	78405	81797
Non-controlling interests	0	-3515	427	2624	1395	1799	1635
Total equity	34428	9571	71566	100738	82682	80204	83432
Total liabilities and Equity	125105	179048	210821	245112	175158	142314	130323

Source: Pro Kapital Grupp Annual reports 2015 - June 2021

Appendix 3. Income Statement of AS Merko Ehitus (2015 – June 2021)

(in thousands of euros)

Particulars	2021 (Q1 & Q2)	2020	2019	2018	2017	2016	2015
Revenue	145860	315918	326779	418011	317598	251970	251012
Cost of sales	- 128622	- 272169	- 291958	- 384962	- 286747	- 232961	- 228044
Gross profit	17238	43749	34821	33049	30851	19009	22968
Marketing expenses	-1830	-4212	-4260	-3285	-3215	-3281	-3230
Administration expenses	-5706	-13412	-12988	-12304	-11289	-10076	-8907
Other operating income	1314	2320	2983	3527	3793	2466	1943
Other operating expenses	-93	-2979	-1318	-1115	-601	-399	-278
Operating profit	10923	25466	19238	19872	19539	7719	12496
Finance income	3	1	3	8	4	46	120
Finance cost	-444	-866	-684	-696	-849	-649	-786
Profit (loss) from sale and liquidation of subsidiary		-144	0	-62	14	0	0
Profit (loss) from joint ventures		0	1766	653	64	163	-138
Profit (loss) before tax	10482	24457	20323	19775	18772	7279	11692
Income tax	-856	-1954	-3833	-375	-3020	-1275	-1857
Profit (loss) for the year	9626	22503	16490	19400	15752	6004	9835

Source: AS Merko Ehitus Annual reports 2015 – June 2021

Appendix 4. Balance sheet of AS Merko Ehitus (2015 – June 2021)

(in thousands of euros)

Particulars	2021 (Q1 & Q2)	2020	2019	2018	2017	2016	2015
Assets							
Current Assets							
Cash and bank balances	21713	47480	24749	39978	39210	33544	39905
Current receivables	62902	32657	50413	76183	75844	45566	24854
Inventories	136605	126332	166226	117992	118421	123364	109090
Prepaid corporate income tax	315	306	104	224	492	617	421
Total Current Assets	221535	206775	241492	234377	233967	203091	174270
Non-Current Assets							
Non-current receivables	22797	17979	11094	10391	17163	15371	16419
Property, plant and equipment	14611	14521	11919	9715	9665	12838	13442
Right-of-use assets	0	0	0	0	0	0	0
Investments in joint ventures	2357	2354	2498	732	79	434	284
Investment property	13872	13922	14047	13771	15719	4108	4371
Deferred income tax assets	842	0	0	0	0	0	0
Intangible assets	733	711	777	671	497	673	879
Total Non-Current Assets	55212	50140	40335	35280	43128	34749	36818
Total Assets	276747	256915	281827	269657	277095	237840	211088

Source: AS Merko Ehitus Annual reports 2015 – June 2021

Appendix 4. Continuation

(in thousands of euros)

Particulars	2021 (Q1 & Q2)	2020	2019	2018	2017	2016	2015
Liabilities and equity							
Current Liabilities							
Current debt	9279	13649	20725	19900	24218	21485	5525
Payables and prepayments	77814	55846	69585	77016	74972	56259	43266
Taxes liabilities	731	1202	812	381	413	278	711
Short-term provisions	5720	6347	7976	8100	4569	5637	5013
Total Current Liabilities	93544	77044	99098	105397	104172	83659	54515
Non-Current Liabilities							
Non-current debt	28493	15409	43001	24266	35138	24516	25660
Non-current payables	3586	4026	3491	2179	1789	2061	1159
Deferred tax liabilities	1739	3001	1682	1481	1259	1122	788
Long-term provisions	0	0	0	0	0	0	0
Total Non-Current Liabilities	33818	22436	48174	27926	38186	27699	27607
Total liabilities	127362	99480	147272	133323	142358	111358	82122
Equity							
Share capital in nominal value	7929	7929	7929	7929	7929	7929	7929
Share premium	0	0	0	0	0	0	0
Statutory reserve	793	793	793	793	793	793	1200
Revaluation reserve	0	0	0	0	0	0	0
Foreign currency differences	-798	-814	-710	-721	-702	-645	-663
Retained earnings	137383	145320	122326	123756	122150	114713	117232
Total equity attributable to owners of the Company	145307	153228	130338	131757	130170	122790	125698
Non-controlling interests	4078	4207	4217	4577	4567	3692	3268
Total equity	149385	157435	134555	136334	134737	126482	128966
Total liabilities and equity	276747	256915	281827	269657	277095	237840	211088

Source: AS Merko Ehitus Annual reports 2015 – June 2021

Appendix 5. Financial Ratios of Pro Kapital Grupp and AS Merko Ehitus (2015 – June 2021)

Current Ratio							
Years	2015	2016	2017	2018	2019	2020	2021(Q1&Q2)
Pro Kapital Grupp	1.35	1.23	2.19	2.37	0.42	0.5	4.18
AS Merko Ehitus	3.2	2.43	2.25	2.22	2.44	2.68	2.37
Quick Ratio							
Years	2015	2016	2017	2018	2019	2020	2021(Q1&Q2)
Pro Kapital Grupp	0.53	0.5	0.62	0.34	0.1	0.08	0.75
AS Merko Ehitus	1.2	0.95	1.11	1.1	0.76	1.04	0.91
Return on Assets							
Years	2015	2016	2017	2018	2019	2020	2021(Q1&Q2)
Pro Kapital Grupp	1.57%	-2.95%	-0.60%	8.59%	-12.80%	-30.50%	17.49%
AS Merko Ehitus	4.27%	2.67%	6.12%	7.10%	5.98%	8.35%	3.61%
Return on Equity							
Years	2015	2016	2017	2018	2019	2020	2021(Q1&Q2)
Pro Kapital Grupp	-2.38%	-4.92%	-1.17%	19.69%	-33.86%	-146.56%	120.91%
AS Merko Ehitus	7.55%	4.70%	12.06%	14.31%	12.17%	15.41%	6.27%

Source: Author's calculation based on appendix 1, 2, 3 and 4

Appendix 5. Continuation

Net Profit Margin							
Years	2015	2016	2017	2018	2019	2020	2021(Q1&Q2)
Pro Kapital Grupp	-10.97%	-19.49%	-7.89%	64.51%	-52.78%	-309.12%	364.02%
AS Merko Ehitus	3.92%	2.38%	4.96%	4.64%	5.05%	7.12%	6.60%
Working Capital Turnover Ratio							
Years	2015	2016	2017	2018	2019	2020	2021(Q1&Q2)
Pro Kapital Grupp	27.59	4.24	0.72	0.81	-3.39	-0.27	-2.41
AS Merko Ehitus	2.06	2.11	2.55	3.23	2.41	2.32	1.13
Asset Turnover Ratio							
Years	2015	2016	2017	2018	2019	2020	2021(Q1&Q2)
Pro Kapital Grupp	0.14	0.15	0.08	0.13	0.24	0.1	0.05
AS Merko Ehitus	1.09	1.12	1.23	1.53	1.19	1.17	0.55
Debt-to-Equity Ratio							
Years	2015	2016	2017	2018	2019	2020	2021(Q1&Q2)
Pro Kapital Grupp	0.52	0.68	0.93	1.18	1.98	16.13	3.78
AS Merko Ehitus	0.77	0.76	0.94	1.01	1.04	0.78	0.76

Source: Author's calculation based on appendix 1, 2, 3 and 4

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