

# EQUITY NOTE: PANNERGY NYRT.

**Recommendation: BUY**

**Target price (12M): HUF 1,204**

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## Highlights

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The Q3 production report does not contain any major news, but the management said that it maintained its EBITDA target for 2020. This shows that so far, the pandemic has not had major effect on the company, which is very rare nowadays. Pannergy's Q3 production it was 6.3% lower than a year ago, but third-quarter production is the smallest among the four quarters, so its effect is marginal. The report did not contain any negative information regarding maintenance or cost issue.

Finally, the new district heat sales prices were set: they remain the same for the Győr and Szentlőrinc sites, but it will be around 2.6% lower for the Miskolc site. **Our updated valuation reflects this fact and changed to HUF 1,204, from HUF 1,219.**

### Main takeaways from the Q3 production report

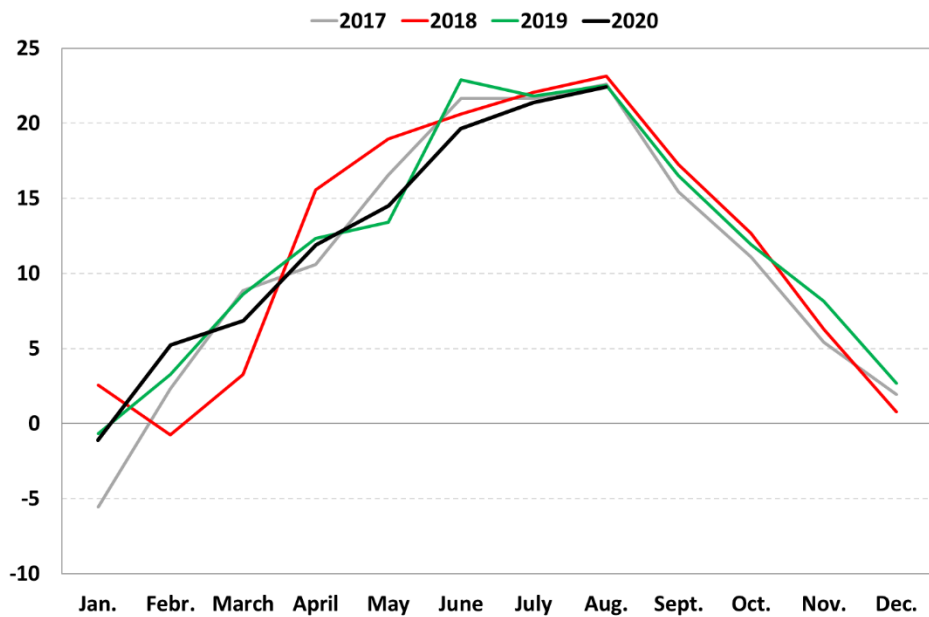
In the third quarter, Pannergy's production was 6.3% lower than in the previous year (148,598 GJ vs 158,552 GJ) and it was also 10% below the management's target. However, Q3 is the time of the year when heat sales are the lowest during the year, so its effect on the yearly production is not much. Despite the lower heat sales, the company maintained its yearly EBITDA target (HUF 2.53-2.6 billion) for 2020. This also proves that PannErgy is among the very few companies that hold up unscathed during the pandemic.

### District heat prices

Location of the wells	Company names	in effect until 30 September 2019	in effect from 1 October 2019	Change
Szentlőrinc	Szentlőrinci Geothermal Ltd.	3 654 HUF/GJ	3 654 HUF/GJ	0%
Miskolc	Miskolci Geothermal Ltd.	2 695 HUF/GJ	2 626 HUF/GJ	-2,6%
Miskolc	KUALA Ltd.	2 695 HUF/GJ	2 626 HUF/GJ	-2,6%
Győr	Arrabona Geothermal Ltd.	3 204 HUF/GJ	3 204 HUF/GJ	0,0%

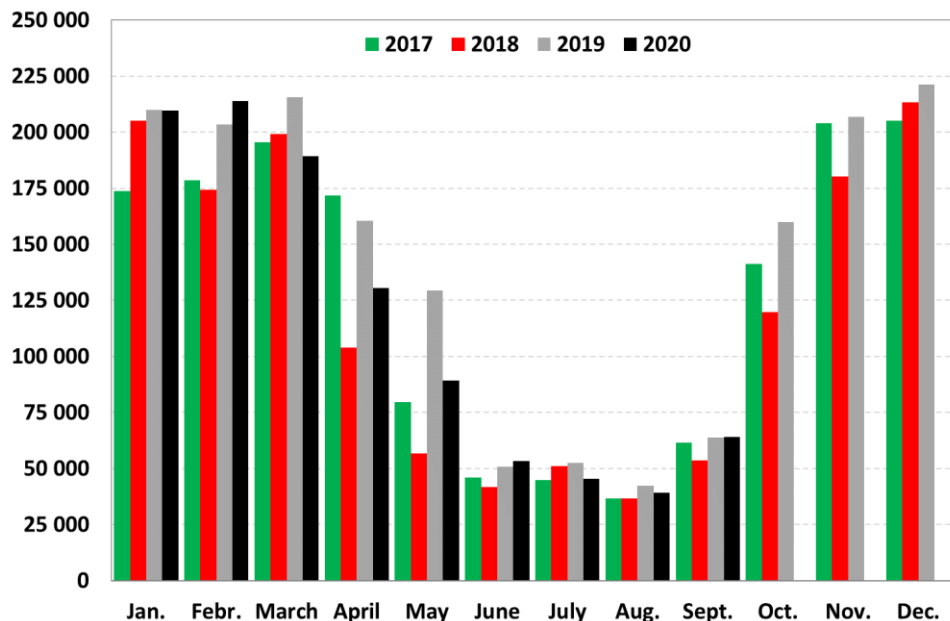
Source: Hungarian Official Gazette, issue 251/2020

Combined average monthly temperatures (°C) in Miskolc and Győr



Looking at the performance of the individual production sites, the output in Miskolc, at 69,955 GJ, was 4% lower than a year earlier. Additionally, Miskolc was the only site, where the new regulated heat sales tariffs will become 2.6% lower (2,626 vs 2,696 HUF/GJ). At the Győr site however, heat sales amounted to 77,140 GJ, down by 8.5% YoY. In Szentlőrinc, the output was about 16% higher than a year earlier. Finally, the Report does not contain any information regarding maintenance problems or factors that could have affected the cost structure. In this case, no news is good news. Finally, we updated our forecast with the somewhat lower heat prices in Miskolc, but its effect on the valuation is only marginal: it was reduced from HUF 1,219 to HUF 1,207.

Consolidated heat sales (GJ)



## Valuation

### Income statement

P/L Table consolidated (million HUF)	2017	2018F	2019F	2020F	2021F	2022F
Revenue from geothermal-heat	4 699	4 679	5 060	5 077	5 065	5 067
Other revenue	537	407	192	140	142	144
OPEX	3 012	2 903	2 982	3 183	3 204	3 233
from which: Depreciation	1 300	1 317	1 468	1 376	1 385	1 394
EBITDA	2 241	2 231	2 666	2 622	2 591	2 566
EBIT	923	906	1 198	1 246	1 206	1 172
EBT	626	525	782	663	1 043	1 053
Income Taxes	121	90	47	80	125	126
Non-controlling interest	17	1	0	0	0	0
Net income	488	434	728	583	918	927
EPS (HUF)	4	25	42	34	54	54

### Balance sheet

Balance sheet - consolidated (million HUF)	2016	2017	2018F	2019F	2020F	2021F	2022F
Non-current assets	22 282	21 633	22 780	23 177	21 721	20 256	18 813
Current assets	2 978	3 389	3 030	2 796	2 761	2 798	2 903
Total assets	25 259	25 022	25 810	25 973	24 482	23 055	21 715
Total equity	8 889	9 025	9 867	10 213	10 438	10 971	11 491
Non-current liabilities	13 479	13 066	12 256	11 910	10 401	8 541	6 681
Current liabilities	2 887	2 931	3 687	3 850	3 644	3 543	3 543
Total equity and liabilities	25 259	25 022	25 810	25 973	24 482	23 055	21 715

### Cash flow

Cash flow statement (million HUF)	2014	2015	2016	2017	2018F	2019F	2020F	2021F	2022F
Profit before taxes	-434	217	-131	451	525	782	663	1 043	1 053
Cash flow from operations	561	-173	775	1 895	2 266	2 601	2 182	2 526	2 321
Cash flow from investment	-2 248	-4 153	-1 632	-1 142	-2 766	-1 790	-313	-314	-220
Cash flow from financing activities	1 661	5 089	473	-201	320	-575	-1 495	-1 840	-1 640
Change in cash and cash equivalents	-26	763	-384	552	-180	236	374	372	461

### FCFF valuation

Valuation summary (million HUF)	2019 last year	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	Terminal year
Revenue from geothermal heat	5 060	5 077	5 065	5 067	5 069	5 071	5 117	5 219	5 324	5 430	5 539	5 649
EBITDA	2 666	2 622	2 591	2 566	2 462	2 436	2 426	2 396	2 413	2 428	2 443	2 491
Depreciation	1 468	1 376	1 385	1 394	1 099	1 108	1 117	834	839	839	839	839
Working capital sales	150	0	0	0	0	0	0	0	0	0	0	0
Capex	93	93	93	93	93	93	93	93	93	40	40	40
FCFF	2 279	2 380	2 354	2 332	2 206	2 184	2 177	2 116	2 131	2 198	2 210	2 253
WACC		7,7	7,7	7,7	7,7	7,7	7,7	7,7	7,7	7,7	7,7	9,2
PV(FCFF)		2 210	2 030	1 868	1 641	1 508	1 396	1 260	1 179	1 129	1 055	13 037

Share price estimation	
Enterprise value	28 313
Net debt ( - )	8 192
Equity value	20 121
Number of shares	17 150
Required return on equity	12,9
Target price for the next 12 M (HUF)	1325

## Relative valuation

Relative valuation			
Company name	Country	Market capitalization (billion HUF)	EV/EBITDA
Polaris Infrastructure	Canada	52,6	5,3
Ormat Technologies	USA	892,8	12,3
ARISE	Germany	43,5	9,3
ABO Invest	Germany	33,9	9,6
Northland Power	Canada	1591,7	11,0
Enel	Italy	27490,3	9,2
		<b>Average</b>	<b>9,4</b>
		<b>Median</b>	<b>9,5</b>

### Risks surrounding PannErgy's economic activity

- Price risk:** The administered price is set at a level that takes into account the cost of doing business and providing a fair profit. However, the administered price setting has inherent risks related to the administrative authority. Moreover, at the moment PannErgy provides heat at a lower cost than its peers (natural gas). However, if natural gas prices fall significantly, then consumers who do not have mandatory purchase agreement with PannErgy could switch to other sources of heat.
- Environmental risks:** Extreme weather conditions during the heating season could harm the company's profit target. If the winter season is too short or too cold – due to global warming or other extreme weather conditions – the costs are higher, as the output from the drilling wells drops.
- Operational risks:** Maintenance costs increased significantly at the Győr Project in 2016 due to scaling issues concerning the tubing and pumps, and this has reduced production. Although the problem was dealt with, we identify it as a source of risk in the future as well. This could be a risk to our depreciation forecast as well.
- Improving energy efficiency risk:** It is not necessarily a PannErgy-specific risk, but in the long term, the building of passive houses and the coming investment – which increases the energy efficiency of houses and flats – could decrease demand for heat.
- Pandemic risks:** Based on our current knowledge, covid-19 has no material effect on the company. However, the covid crisis and its economic effects may change rapidly and unpredictably in the future. This may pose some unforeseen risks for PannErgy as well.

**Notes:**

[The initiation report, which contains the assumptions of the models used, is available here.](#)

[The valuation methodology used in this present equity research note to determine our price targets and recommendations is available here. \(Also available in Hungarian\)](#)

This investment recommendation has not used proprietary models.

The risk warning, which includes the adequate explanations of the length of time of the investment to which the recommendation relates as well as a sensitivity analysis of the assumptions, is indicated in the part of this recommendation where the length of time and the risks of the investment are presented.

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OTP Bank Plc's recommendations and price targets history for PannErgy in the past twelve months:

Date	Recommendations	Target Price	Publication
15/12/2017	BUY	HUF 1,024	Initiation of coverage
16/01/2018	BUY	HUF 1,024	Equity note
13/02/2018	BUY	HUF 1,024	Equity note
21/03/2018	BUY	HUF 1,032	Equity note
17/04/2018	BUY	HUF 1,032	Equity note
17/07/2018	BUY	HUF 1,032	Equity note
03/08/2018	BUY	HUF 1,032	Equity note
04/09/2018	BUY	HUF 1,046	Equity note
02/10/2018	BUY	HUF 1,072	Equity note
16/10/2018	BUY	HUF 1,072	Equity note
16/01/2019	BUY	HUF 1,090	Equity note
25/03/2019	Under revision	-	Equity note
16/04/2019	Under revision	-	Equity note
30/04/2019	BUY	HUF 1,106	Equity note
16/07/2019	BUY	HUF 1,106	Equity note
04/09/2019	BUY	HUF 1,106	Equity note
16/10/2019	BUY	HUF 1,196	Equity note
16/01/2020	BUY	HUF 1,196	Equity note
30/03/2020	BUY	HUF 1,196	Equity note
15/04/2020	BUY	HUF1,196	Equity note
20/07/2020	BUY	HUF 1,196	Equity note
20/07/2020	BUY	HUF 1,216	Equity note

Period	Recommendations	Percent of recommendation
2017Q4	BUY HOLD SELL	100% 0% 0%
2018Q1	BUY HOLD SELL	100% 0% 0%
2018Q2	BUY HOLD SELL	100% 0% 0%
2018Q3	BUY HOLD SELL	100% 0% 0%
2018Q4	BUY HOLD SELL	100% 0% 0%
2019Q1	BUY HOLD SELL Under revision	93,5% 0% 0% 6,5%
2019Q2	BUY HOLD SELL Under revision	67% 0% 0% 33%
2019Q3	BUY HOLD SELL	100% 0% 0%
2019Q4	BUY HOLD SELL	100% 0% 0%
2020Q1	BUY HOLD SELL	100% 0% 0%
2020Q2	BUY HOLD SELL	100% 0% 0%
2020Q3	BUY HOLD SELL	100% 0% 0%

[The list of all recommendations made in the past 12 months is available here.](#)

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