

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY (unchanged)

Target price (12M): HUF 1,420 (unchanged)

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Highlights

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PannErgy produced 344,849 GJ energy in Q2, which is 5.5% higher YoY, and it is 9.3% higher than the management's plan was for the quarter. The excellent performance is partially related to the commercial agreement that the company concluded in March with GYŐR-SZOL, operator of the district heating system in Győr, which prioritizes geothermal heat over other energy source alternatives. Overall, this means that the company achieved record heat sales during the quarter, and this largely offset the smaller production shortfall in Q1 relative to the 2022 target. Management confirmed the expected fulfilment of the HUF 3.25-3.35bn EBITDA target range for the year. Our forecast number is HUF 3.28bn for 2022 EBITDA, which falls within the current range. We maintain our BUY recommendation with the same target price (HUF 1,420).

Main takeaways from the quarterly production report:

In the second quarter, PannErgy produced 344,849 GJ energy, which is 5.5% higher than a year earlier, and it is 9.3% higher than the management's plan was for this quarter (315,549 GJ). **The company achieved record Q2 heat sales** with this figure and the excellent performance was primarily due to the ongoing investments into increasing efficiency, operational safety, and capacity expansion.

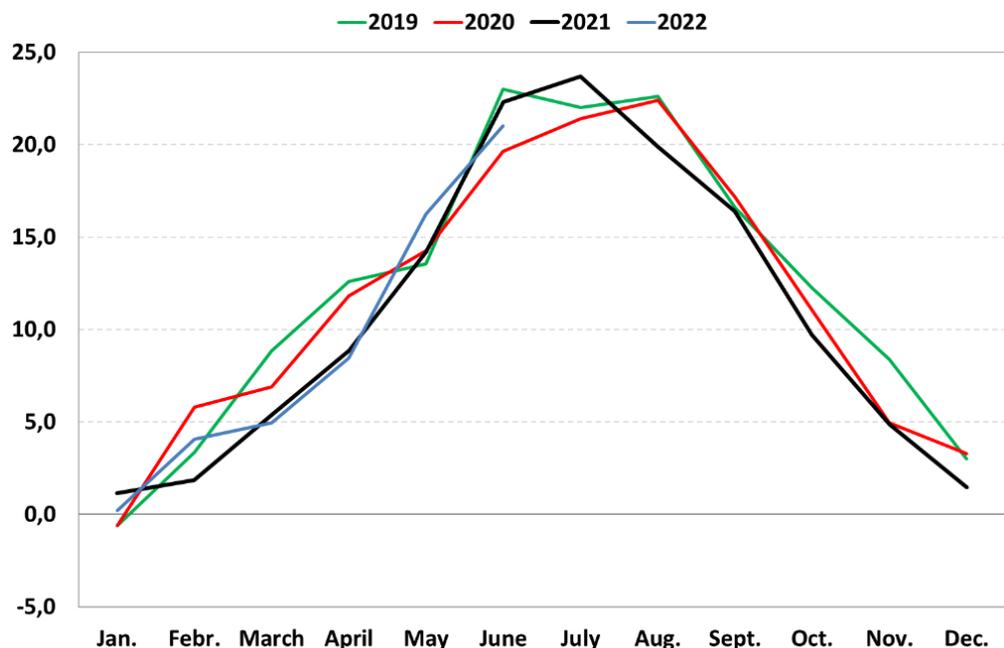
Regarding the performance of individual sites, Miskolc produced 154,988 GJ energy in Q2, a 4.9% decline YoY, mainly due to less favourable weather conditions in May. At the same time, **Győr sold a historic record volume of 186,540 GJ energy**, a 15.8% increase compared to the previous year. This is the result of: (A) previous investment activities and (B) the commercial agreement that the company concluded with GYŐR-SZOL Zrt., operator of the district heating system in Győr, which was announced on the 30th of March. According to this agreement the geothermal heat source will have priority over the energy source alternatives feeding into the district heating system in the future. This mainly affects heat demand outside the heating season, the surplus heat potential is approximately 25-25 TJ in Q2 and Q3 and 15 TJ in Q4. The smaller site at Szentlőrinc produced 2,969 GJ, which is 6.6% higher than in the base period.

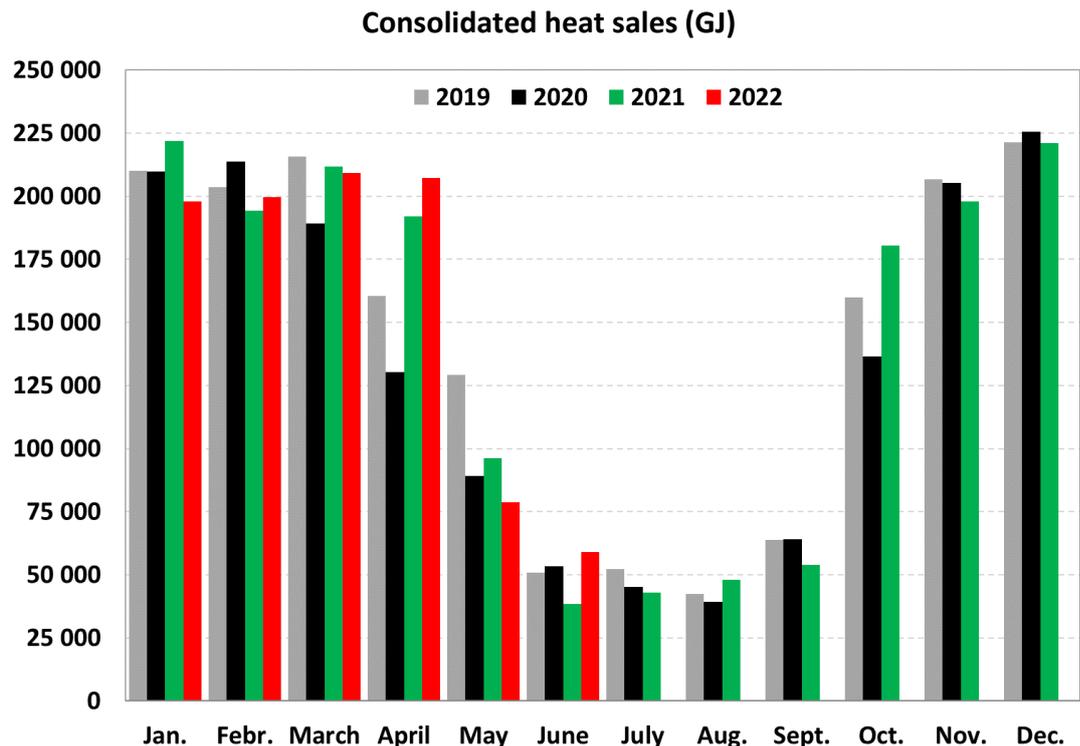
The company had a smaller production shortfall in Q1 relative to the 2022 target (-39,230 GJ), which was largely offset by the record Q2 figures (+29,300 GJ). It is no surprise therefore that the **management confirmed the expected fulfilment of the consolidated HUF 3.25-3.35bn EBITDA target range for the year**. Our estimated 2022 EBITDA is HUF 3.28bn, which falls within the company's target range.

Other notable highlights:

- 1) The company **paid gross HUF 18.11 / share dividends for FY21 (~1.8% dividend yield)**, a total of HUF 294 million (starting date of dividend payment was 14 July 2022).
- 2) PannErgy **confirmed on 8th June that the ownership of TT-Geotermia has been transferred to the acquiring party after payment of the required purchase price.** The company announced on April 5th that it concluded a sale and purchase agreement to sell its utility distribution system in Debrecen (TT-Geotermia), which owns some equipment and facilities that provide conventional utility distribution to PannErgy's properties held for utilisation and sale in Debrecen, as well as to several properties owned by third parties. The sale price was HUF 90 million. The transaction did not change the EBITDA plans, but as a result, TT-Geotermia is removed from the scope of consolidation.
- 3) The company **continued its share repurchase program and as of 17th July held 4,851,817 shares (23,04% of total shares) up by 116,600 shares (~0.5% of total shares and ~0.7% of total non-treasury shares) since April 30.** The AGM held on 29 April authorized management to purchase own shares up to HUF 600 million at a price not exceeding HUF 1,400 and 25% of total shares. The program is valid for the period 2 May 2022 – 13 April 2023 and PannErgy intends to purchase 2,200 shares / trading day until withdrawal. The company has spent so far HUF 116,5 million on share repurchases, which is ~19.4% of the authorized amount.

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





Risks surrounding PannErgy's economic activity

1. **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.
2. **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.
3. **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.
4. **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.
5. **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.

Any information relating to the date and time for the price mentioned in this recommendation is revealed in the part of the recommendation where the given price is indicated.

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

Date	Recommendations	Target Price	Publication
20/07/2020	BUY	HUF 1,216	Equity note
16/10/2020	BUY	HUF 1,204	Equity note
18/01/2021	BUY	HUF 1,204	Equity note
29/03/2021	BUY	HUF 1,387	Equity note
19/04/2021	BUY	HUF 1,387	Equity note
16/07/2021	BUY	HUF 1,387	Equity note
06/09/2021	BUY	HUF 1,387	Equity note
06/10/2021	BUY	HUF 1,450	Equity note
18/10/2021	BUY	HUF 1,450	Equity note
17/01/2022	BUY	HUF 1,450	Equity note
18/02/2022	BUY	HUF 1,450	Equity note
26/03/2022	BUY	HUF 1,420	Equity note
19/04/2022	BUY	HUF 1,420	Equity note

Period	Recommendations	Percent of recommendation
2021Q2	BUY	100%
	HOLD	0%
	SELL	0%
2021Q3	BUY	100%
	HOLD	0%
	SELL	0%
2021Q4	BUY	100%
	HOLD	0%
	SELL	0%
2022Q1	BUY	100%
	HOLD	0%
	SELL	0%
2022Q2	BUY	100%
	HOLD	0%
	SELL	0%

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

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