

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY (unchanged)

Target price (12M): HUF 1,670 (revised up)

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Highlights

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The 12M target price for PannErgy is increased from HUF 1,420 to HUF 1,670. This can be essentially attributed to the positive impact of higher expected sales volumes and administrative prices, which is somewhat offset by increased costs due to inflation and energy prices, as well as higher WACC and Capex. The new target price is ~17.6% higher than the previous one and slightly more than 60% higher than the current market price. We also note that management confirmed its EBITDA plan for 2022, which is HUF 3.25-3.35bn. Our number is HUF 3.32bn for 2022 and HUF 3.49bn for 2023.

Recent news:

- The new administrative prices were set for the period between 2022 October and 2022 December. The heat supply tariffs, unlike previous practice, are not announced for a full year, but only for Q4 2022 and revision is expected thereafter. The table shows below that a relatively large, 18.4% increase was made for the Győr site and 19.9% for the Miskolc site. The increase for Szentlőrinc is even larger, 21.9%, but the site production is small. As a result, management confirmed its EBITDA plan for 2022, which is HUF 3.25-3.35bn.

Location of the wells	Company names	in effect until 30 September 2022	in effect from 1 October 2022	Change
Szentlőrinc	Szentlőrinci Geothermal Ltd.	3 791 HUF/GJ	4 620 HUF/GJ	21,9%
Miskolc	Miskolci Geothermal Ltd.	2 650 HUF/GJ	3 176 HUF/GJ	19,9%
Miskolc	KUALA Ltd.	2 650 HUF/GJ	3 176 HUF/GJ	19,9%
Győr	Arrabona Geothermal Ltd.	3 397 HUF/GJ	4 023 HUF/GJ	18,4%

Source: Hungarian Official Gazette, issue 159/2022

- Share capital decrease:** the company's AGM decided on the reduction of the share capital on 29 April 2022. As a result, the number of PannErgy ordinary shares decreased from 21,054,655 to 20,000,000. Concurrently, the subscribed capital is reduced from HUF 421 million to HUF 400 million. The number of treasury shares was reduced by 1,054,655. **At the end of September 2022, the company had 3,915,300 treasury shares (19.58% of total shares).**
- Treasury share transactions:** 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 (up to 30 September) HUF 241.7 million on share repurchases, which is ~40% of the authorized amount.** Overall, this means that PannErgy purchased under the current program 235,400 shares

(~1.2% of total shares and ~1.5% of total non-treasury shares) for an average price of HUF 1,027 / share.

Updated valuation:

We updated our valuation for PannErgy to incorporate recent changes in the economic and interest rate environment, administrative prices and H1 results. **Overall valuation is increased to HUF 1,670 share price from HUF 1,420 (+17.6%), the recommendation is maintained at BUY given the target price is well above the current market price.**

- The management's EBITDA target for 2022 is HUF 3.25-3.35bn and previously guided HUF 3.35-3.45bn for 2023 in the annual report published on March 22. The latter is, however, conditional on the deepening and commissioning of the third production well of the Miskolc project. In the event of a failure to deepen the well, the EBITDA plan is HUF 3.3-3.4bn. We note, however, that the 2023 target was published before the March 30 announcement regarding the agreement with Győr-Szol Plc. that ensures priority to geothermal energy supply for the town (surplus heat potential of 25 TJ in Q2 and Q3 and 15 TJ in Q4). **Our number is HUF 3.32bn for 2022, which is within the range provided by management and HUF 3.49bn for 2023, which reflects both higher expected heat sales volumes and administrative prices**, but it does not incorporate the impact of the potential 3rd Miskolc well.
- This alone would significantly increase the FCFF valuation, but the positive impact of higher expected sales volumes and heat tariffs was somewhat mitigated by increased costs due to inflation and energy prices, as well as higher WACC given the continued monetary tightening (some of this was already reflected in our previous calculations). We calculated with somewhat higher Capex costs as well for the same reason. It is also worth highlighting that heat tariff changes take into account cost increases as well, which may be significant given the ongoing energy crisis and other inflationary pressures that Europe faces (e.g., higher gas and electricity prices, wage increases). **This could potentially mean even higher administrative prices and revenues for the company but a higher cost base as well.** This is especially important in the context that current tariffs are only valid for Q4 2022.
- We also note, that according to the H1 report **the amount of net debt was somewhat lower compared to EOY 2021 and the number of non-treasury shares are lower** given ongoing share repurchase program. These also had a positive impact on the FCFF valuation.
- **Considering the above effects together, the FCFF valuation gave a HUF 1,670 share price.** We have not used relative valuation for our target price estimate, but international peer data is disclosed.

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.

Appendix:

Income statement						
P/L Table consolidated (million HUF)	2019	2020	2021	2022F	2023F	2024F
Revenue from geothermal-heat	5 060	5 070	5 583	5 981	6 604	6 472
Other revenue	192	132	215	258	235	235
OPEX	2 982	3 320	3 776	3 653	3 634	3 607
from which: Depreciation	1 468	1 660	1 595	1 515	1 515	1 515
EBITDA	2 666	2 735	2 878	3 322	3 491	3 386
EBIT	1 198	1 075	1 283	1 807	1 976	1 871
EBT	782	262	964	1 540	1 709	1 604
Income Taxes	47	25	67	185	205	192
Non-controlling interest	0	0	0	0	0	0
Net income	728	236	897	1 355	1 504	1 411
EPS (HUF)	45	14	55	84	94	88

Balance sheet						
Balance sheet - consolidated (million HUF)	2019	2020	2021	2022F	2023F	2024F
Non-current assets	23 177	23 634	22 933	22 172	21 437	19 903
Current assets	2 796	3 099	3 950	3 857	4 161	5 015
Total assets	25 973	26 733	26 883	26 029	25 599	24 917
Total equity	10 213	9 747	9 980	10 583	11 749	12 784
Non-current liabilities	11 910	14 441	13 704	12 508	10 812	9 117
Current liabilities	3 850	2 545	3 199	2 938	3 037	3 016
Total equity and liabilities	25 973	26 733	26 883	26 029	25 599	24 917

Cash flow statement						
Cash flow statement (million HUF)	2019	2020	2021	2022F	2023F	2024F
Profit before taxes	782	262	964	1 540	1 709	1 604
Cash flow from operations	2 601	1 238	2 859	2 988	3 112	3 143
Cash flow from investment	-1 790	-1 639	-1 475	-1 564	-1 564	-614
Cash flow from financing activities	-575	-278	-774	-1 096	-1 082	-1 082
Change in cash and cash equivalents	236	-679	610	328	466	1 447

FCFF valuation

Valuation summary (million HUF)	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	Terminal year
Revenue from geothermal heat	5 981	6 604	6 472	6 602	6 732	6 865	7 000	7 138	7 279	7 423	7 425
EBITDA	3 322	3 491	3 386	3 423	3 458	3 463	3 498	3 532	3 566	3 599	3 637
Depreciation	1 515	1 515	1 515	1 515	1 515	1 424	1 424	1 424	1 424	1 424	1 424
Working capital sales	367	112	-24	-24	-24	-24	-24	-24	-24	-24	-24
Capex	950	950	150	150	150	150	150	150	150	150	150
FCFF	1 788	2 192	3 035	3 068	3 098	3 092	3 123	3 153	3 182	3 212	3 245
WACC	9,7	9,7	9,7	9,7	9,7	9,7	9,7	9,7	9,7	9,7	9,3
PV(FCFF)	1 631	1 823	2 302	2 122	1 955	1 779	1 638	1 509	1 389	1 278	14 393

Share price estimation	
Enterprise value	31 819
Net debt (-)	8 895
Equity value	22 924
Number of shares	16 084
Required return on equity	17,1
Target price for the next 12 M (HUF)	1670

International peer data

Company name	Country	Market capitalization (billion HUF)	EV/EBITDA
Polaris Infrastructure	Canada	98,9	8,4
Ormat Technologies	USA	2105,5	16,9
ARISE	Germany	101,1	15,3
ABO Invest	Germany	59,8	10,5
Northland Power	Canada	3068,8	10,1
		Average	12,2
		Median	10,5

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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Date	Recommendations	Target Price	Publication
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
19/07/2022	BUY	HUF 1,420	Equity note
02/09/2022	BUY	HUF 1,420	Equity note

Period	Recommendations	Percent of recommendation
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%
2022Q3	BUY	100%
	HOLD	0%
	SELL	0%

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

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