

# EQUITY NOTE: PANNERGY NYRT.

**Recommendation: BUY**

**Target price (12M): HUF 1,106**

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## **Highlights**

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Thanks to the favourable weather conditions and the sale of a property in the Csepel district of Budapest, this year Pannergy's EBITDA could be close to HUF 2,500 million, surpassing the management's HUF 2,320-2,380 mn target – unless weather conditions change unfavourably in the rest of the year. Despite the better-than-expected production data, no upgrade was made on the model, because most of the improvement is due to temporary factors and the property sale would have only little effect on our valuation.

Concerning the quarterly production report, Q2 heat sales amounted to 340,628 GJ, exceeding the management's expectations of 266,304 GJ heat sales. The higher-than-expected performance owes a lot to significantly lower average temperatures in April and May than in the previous years; they were closer to the 2-8°C average daily temperature, which can be considered optimal for Pannergy.

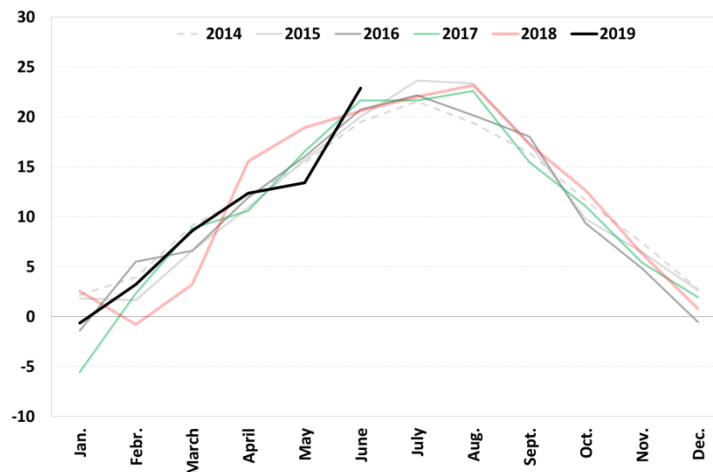
Overall, the production report did not refer to any worrisome news, like additional maintenance need of the wells. This, as always, is reassuring news. We will have a more detailed view on the cost side when the half year report will come out.

### **Main takeaways from the production report:**

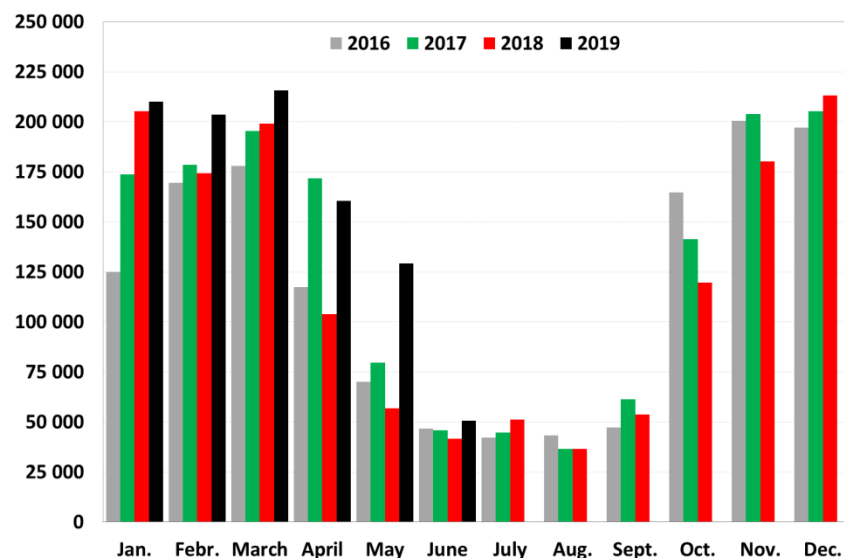
Pannergy presented a very robust production report for Q2 2019. Benefiting from favourable weather conditions in Q2, heat sales amounted to 340,628 GJ, which is 68% higher than it was Q2 2018. It significantly exceeded the management's Q2 2019 target of 266,304 GJ. Looking at average monthly temperatures, we see that temperatures in April and May were significantly lower than in previous years, which was favourable for heat sales as the winter season was extended. The optimal temperature for Pannergy's heat sales is 2-8°C. (Lower or higher temperatures could increase costs or reduce demand from consumers). In April and May the average temperature was closer to the optimal level, therefore heat sales could significantly increase.

That could help exceed the management's production (1,630,108 GJ) and EBITDA (HUF 2,320-2,380 million) targets for 2019. The favourable weather effect (assuming that the rest of the year will be close to the management's expectations) may boost revenue by HUF 200 million, and EBITDA could be almost HUF 100 million higher. However, this does not have any effect on our valuation because we have already incorporated the stronger production at the Győr site, and we deem the weather effect as a temporary factor, as we did in previous quarters.

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



### Consolidated heat sales (GJ)



### Other news:

**Share-purchase programme:** In Q2, the announced share repurchase programme went ahead as planned. Pannergy has bought back 49,000 shares since the start of the programme (2 May 2019) at an average price of HUF 714.

**Purchase of the third reinjection well at Miskolc:** The parameters of the final deal are very close to the numbers announced at the first time. Therefore this was incorporated in our forecast.

**PannErgy has sold its property in Csepel, Budapest:** This sale yielded PannErgy HUF 375 million income and HUF 68 million profit. Due to the transaction net debt will decrease around HUF 300 million, which could increase firm value per share by around HUF 20. Since that would be only very minor increase, we postpone the upgrade of our model, until the half-year report, which will give a more detailed view on the evolution of the cost side in the past 6 month. The half year report expected to come out at 03/09/2019.

### ***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 costumers 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 profit target of the company. 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 taken care of, 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.

**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

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%

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

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