

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY

Target price (12M): 1,196 HUF

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Highlights

Equity Analyst:
Dániel Módos

Phone:
+36 1 301 2810

Email:
modosd@otpbank.hu

Overall, the Q1 2020 report showed that production was 1.5% lower than the management had expected. Most of the decline took place in March, when the production site in Győr shifted to a more cost-effective mode with lower output, in preparing for the above-average temperature which can reduce demand. The production at the Miskolc and Szentlőrinc sites broadly came as expected.

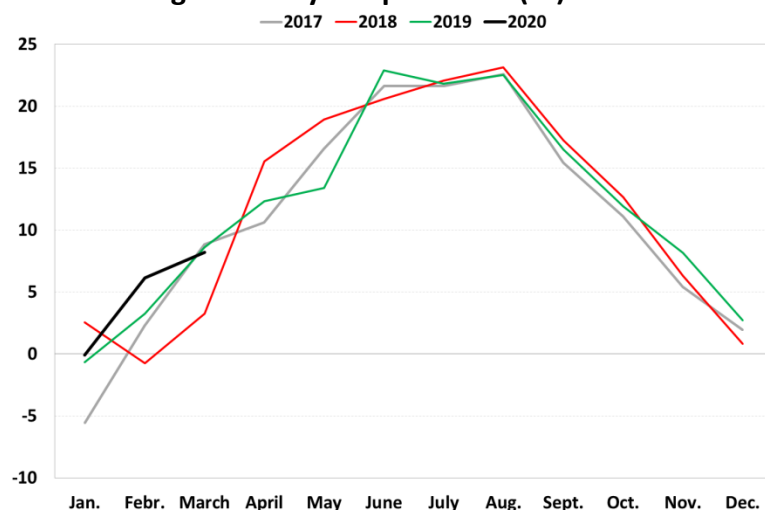
The production report contains no information that would warrant a change in recommendation; therefore the BUY recommendation holds with an unchanged target price of HUF 1,196.

Main takeaways from the Q1 production report

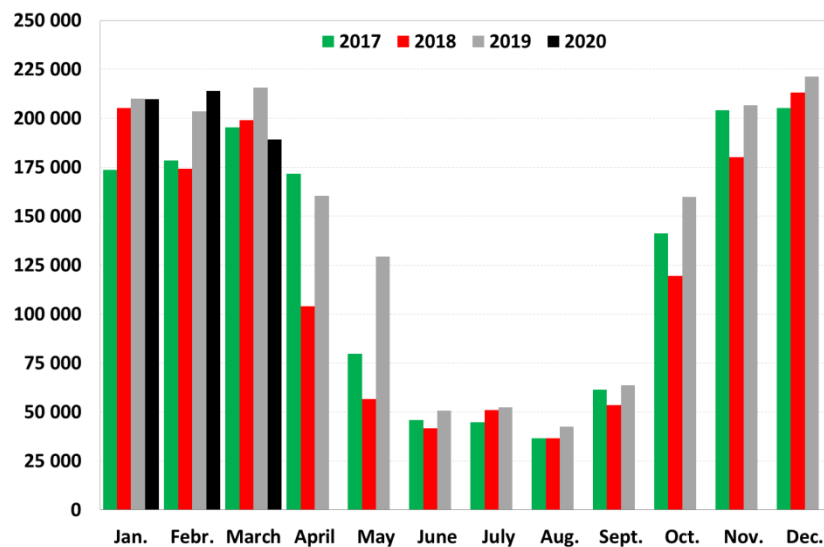
Due to the above-average temperature in March, Pannergy's Q1 2020 production report slightly undershot the management's expectation. The monthly figures for January and February came broadly in line with last year's output, while data for March reflect 12% fall.

Looking at the production sites in detail, output in Miskolc hit 300,312 GJ, in a 2% increase compared to Q1 2019. In Győr, output fell by 7% in year/year comparison. In March, the company turned the wells into a self-flow state due to higher-than-optimal temperature in Győr. Therefore, their yield production decreased (following the lower demand as average temperatures increase) but the cost per output also fell, owing to lower electricity needs. The output in Szentlőrinc was 4% higher than a year earlier.

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



Consolidated heat sales (GJ)



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 costumers 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 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.
- 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, the COVID-19 virus has no material effect on the company. However the situation concerning the virus 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
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

Period	Recommendations	Percent of recommendation
2017Q4	BUY	100%
	HOLD	0%
	SELL	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%

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

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This document was prepared by:

Dániel Módos

Senior Equity Analyst

OTP Research

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