

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY (unchanged)

Target price (12M): HUF 1,670 (unchanged)

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Highlights

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The new administrative prices were set, which are applicable from 2023 January, but they do not have an end of validity date this time, a decision, which is likely motivated by the considerable uncertainty regarding energy prices, so these could be adjusted on a more flexible basis if needed. In any case, there was a significant increase in heat tariffs applicable to PannErgy across all locations. However, the positive impacts will be mostly absorbed by higher electricity prices (more than 4.5x increase), hence the overall impact of the new administrative prices on profitability will be limited. As a result, we remain on the cautious side for now and maintain our 2023 EBITDA estimate of HUF 3.49bn, which does not include the impact of the 3rd Miskolc well. As such, we also maintain our HUF 1,670 / share price target and BUY recommendation.

Recent news:

- The new administrative prices that are applicable from 2023 January were set, but we note that unlike in previous cases, these now do not have an end of validity date. Heat supply tariffs are typically announced for a full year, which are usually applicable from October each year. Last year, however, the administrative prices were only set for the period between 2022 October and 2022 December, likely due to the extreme volatility in energy prices. We assume that the new prices do not have an end of validity date as there are still considerable uncertainties regarding energy prices, so these could be adjusted on a more flexible basis for the time being. The table shows below that a quite significant, 64.1% increase was made for the Miskolc site and 54.7% for the Győr site. The increase for Szentlőrinc is large as well, 45.4%, but the production site is small.

Location of the wells	Company names	in effect until 31 December 2022	in effect from 1 January 2023	Change
Szentlőrinc	Szentlőrinci Geothermal Ltd.	4 620 HUF/GJ	6 715 HUF/GJ	45,4%
Miskolc	Miskolci Geothermal Ltd.	3 176 HUF/GJ	5 211 HUF/GJ	64,1%
Miskolc	KUALA Ltd.	3 176 HUF/GJ	5 211 HUF/GJ	64,1%
Győr	Arrabona Geothermal Ltd.	4 023 HUF/GJ	6 225 HUF/GJ	54,7%

Source: Hungarian Official Gazette, issue 219/2022

- Management also notes that the significant increase in heat tariffs is primarily due to the official recognition of the more than 4.5x increase in the price of electricity required for geothermal heat generation. This means that higher administrative prices will have limited impact on profitability. The company will publish its 2023 EBITDA plan in its 2022 Q4 production report (expected on 13th January 2023).

- We have previously estimated the 2023 EBITDA at HUF 3.49bn, which does not incorporate the impact of the potential third Miskolc well as we await further information regarding project specifics such as capex requirements. The expected project completion is at some point this year before the start of the 2023/2024 district heating season. **Given most of the positive impacts related to the administrative price hikes will be absorbed by higher electricity prices (and possibly other cost increases due to inflationary pressures) we remain on the cautious side for now and maintain our 2023 EBITDA estimate.** As such, we maintain our HUF 1,670 / share target price and BUY recommendation as well.

Other news:

- 1) **Treasury share transactions:** the company has spent so far (up to 30th December) HUF 389.7 million on share repurchases, which is ~65% of the authorized amount under the current program. Overall, this means that PannErgy purchased under the current program 361,800 shares (~1.8% of total shares and ~2.3% of total non-treasury shares) for an average price of HUF 1077 / share. The current program is valid until 13th April 2023 and the limit on share repurchases is HUF 600 million at a price not exceeding HUF 1,400 and 25% of total shares (~20.2% at the moment).
- 2) The company has **recently reorganized its top management**, partly to optimize management operations related to projects, where PannErgy was recently awarded grants (Miskolc 3rd well and new Budapest project). As a result, Dénes Gyimóthy was replaced as CEO by István Jaksa, who has been working with PannErgy subsidiaries since 2010 in various technical management and project administration positions. At the same time, Dénes Gyimóthy took over from Balázs Bokorovics as Chairman. Going forward, Balázs Bokorovics will support the company as advisor to the Chairman.

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
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
06/10/2022	BUY	HUF 1,670	Equity note
15/10/2022	BUY	HUF 1,670	Equity note
23/11/2022	BUY	HUF 1,670	Equity note

Period	Recommendations	Percent of recommendation
2022Q1	BUY	100%
	HOLD	0%
	SELL	0%
2022Q2	BUY	100%
	HOLD	0%
	SELL	0%
2022Q3	BUY	100%
	HOLD	0%
	SELL	0%
2022Q4	BUY	100%
	HOLD	0%
	SELL	0%
2023Q1	BUY	100%
	HOLD	0%
	SELL	0%

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

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