

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY (unchanged)

Target price (12M): HUF 1,747 (unchanged)

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Highlights

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PannErgy produced 341,604 GJ energy in Q2, which is 1.1% lower YoY, but it is 6.1% higher than the management's plan was for the quarter. Győr sold a historic seasonal record volume of heat, while Miskolc had a lower YoY production due to temporary technical issues. The company announced in June that the third Miskolc well that was originally planned to be completed by the start of the 2023/24 district heating season is now rescheduled and expected to be incorporated into the system by 30 September 2024. The main reasons for rescheduling: (A) finalisation of the grant instrument and (B) ongoing clarification of permission anomalies with the authorities. We note that the rescheduling has no effect on our valuation, and EBITDA forecast as we did not incorporate previously the impact of the new well. The management confirmed the expected fulfilment of the HUF 3.95-4.15bn EBITDA target range for the year. Our 2023 EBITDA forecast number remains unchanged at HUF 4.13bn. We maintain our BUY recommendation with the same target price (HUF 1,747) as before.

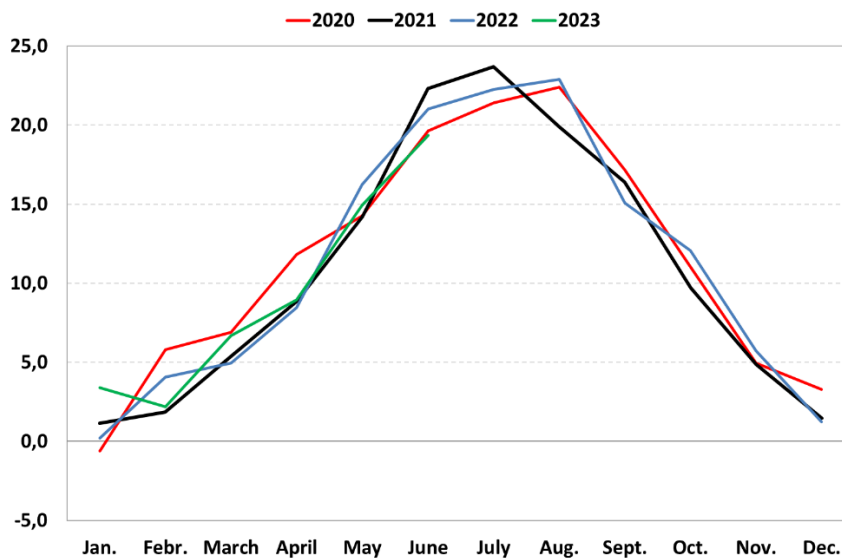
Main takeaways from the quarterly production report:

In the second quarter, PannErgy produced 341,604 GJ energy, which is 1.1% lower than a year earlier, but it is 6.1% higher than the management's plan was for this quarter (322,084 GJ). The good performance was primarily due to weather conditions and ongoing investments into increasing efficiency, operational safety and capacity expansion.

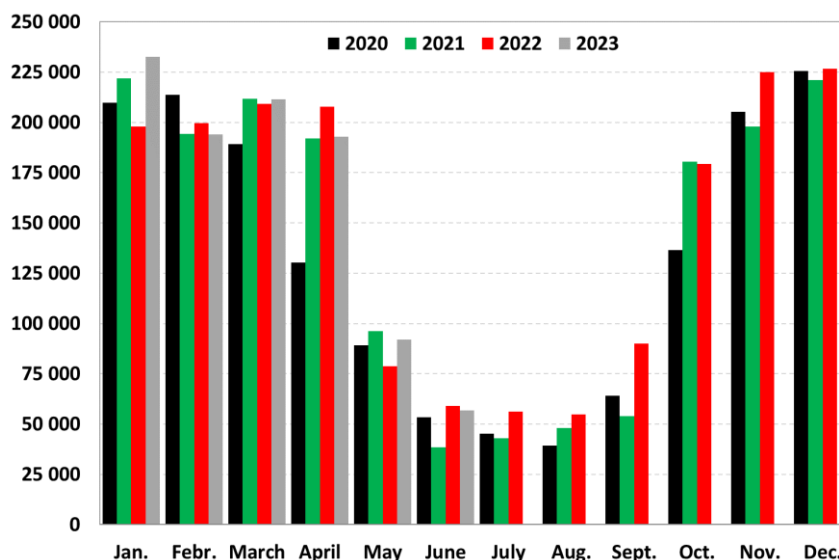
Regarding the performance of individual sites, Miskolc produced 138,873 GJ in Q2, a 10.4% decrease YoY, mainly due to temporary technical capacity constraints. At the same time, **production in Győr hit a historic seasonal record volume of 199,360 GJ in Q2, a 6.9% increase compared to the previous year.** The production report mentions that the improvement can be attributed to: (1) investment activity in recent periods, (2) weather conditions and (3) the commercial agreement with GYŐR-SZOL Zrt., which gives priority to geothermal energy over other alternatives. **Overall, the Győr project accounted for ~58% of heat sales volume in Q2, while the Miskolc project for ~41%** (in Q1 Győr accounted for ~56% of heat sales and Miskolc for ~42%).

The management confirmed that the company is expected to fulfil the consolidated HUF 3.95-4.15bn EBITDA target range in 2023 (+12.1% midpoint basis YoY), which was previously published. Our current 2023 EBITDA estimate is HUF 4.13bn, which is in line with management's guidance.

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



Consolidated heat sales (GJ)



Other notable highlights:

- 1) **GM resolutions:** the company held its AGM on 28th April. The GM accepted to place the company's earnings in the accumulated profit reserve, thus **the company does not pay any dividends this year**. The new share repurchase program was also accepted (see below).
- 2) **Treasury share transactions:** the company has spent (up to 16th July) HUF 155 million on share repurchases, which is 17.2% of the authorized amount under the program approved this year. Overall, this means that PannErgy purchased under the program 140,375 shares (~0.7% of total shares and ~0.9% of total non-treasury shares) for an average price of HUF 1,103 / share. The program is valid until 13th April 2024 with a limit on share repurchases of HUF 900 million at a price not exceeding HUF 1,670 and 25% of total shares (~21.76% at the moment).

- 3) **Rescheduling the third Miskolc well:** on 13th June, PannErgy announced that it plans to incorporate the 3rd production well in Miskolc into the system by 30 September 2024 (originally planned to complete by the start of the 2023/24 district heating season). The main reasons for rescheduling: (A) finalisation of grant (company was awarded a maximum nominal grant of HUF 994 million by the Ministry for Technology and Industry last year), which is still underway and (B) ongoing clarification with the authorities on permission anomalies raised by legal amendments, which entered into force in 2023. **We note that the rescheduling has no effect on our valuation and EBITDA forecast as we did not incorporate previously the impact of the potential 3rd Miskolc well into our calculations.**

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
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
02/01/2023	BUY	HUF 1,670	Equity note
18/01/2023	BUY	HUF 1,747	Equity note
27/03/2023	BUY	HUF 1,747	Equity note
17/04/2023	BUY	HUF 1,747	Equity note

Period	Recommendations	Percent of recommendation
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%
2023Q2	BUY	100%
	HOLD	0%
	SELL	0%

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

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