

# EQUITY NOTE: PANNERGY NYRT.

**Recommendation: BUY (unchanged)**

**Target price (12M): HUF 1,908 (revised up)**

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## Highlights

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The 12M target price for PannErgy is increased from HUF 1,747 to HUF 1,908 and we maintain our BUY recommendation. This can be essentially attributed to the positive impact of significantly lower net debt figures and lower number of non-treasury shares due to the ongoing share repurchase program, which is somewhat offset by the new lower administrative prices and slightly higher WACC and capex figures. We note that the negative impact of lower administrative prices will be partially mitigated by correspondingly lower costs, hence this will have a limited but still slightly negative impact on profitability in our view, which reflects a conservative stance. The new target price is 9.2% higher than the previous one and ~45% higher than the current market price. We also note that management confirmed its EBITDA plan for 2023, which is HUF 3.95bn-4.15bn. Our number is HUF 4.08bn for 2023 (vs. HUF 4.13bn previously), which is within the range provided by management and HUF 3.83bn for 2024. The calculations do not incorporate the impact of the planned new Miskolc well yet. Furthermore, the company announced that the Ministry of Energy rejected PannErgy's grant application in relation to its planned project in the Budapest area. The news is negative as it was a potential growth opportunity, but we note that (A) the geothermal production well was to be established in an area not explored in detail and therefore success was not guaranteed and (B) we did not include any potential impacts into our calculations previously, hence it has no effect on the current valuation.

## Recent news:

- The new administrative prices that are applicable from 2023 October were set. The table below shows that heat prices have dropped significantly: for the Győr site by 27.8%, for the Miskolc site by 28.9% and for the smaller Szentlőrinc project by 29.5%. We note, however, that the previous administrative prices that were applicable between January-October were set in an environment characterized by extreme volatility and high natural gas and electricity prices. Since then, prices have dropped a lot, hence it was expected that new heat tariffs would likely follow this trend (ie. lower costs and lower regulated prices). Overall, we expect that the impact on profitability will be limited.
- The management confirmed the expected achievement of the 2023 consolidated EBITDA plan of HUF 3.95bn-4.15bn given the new heat tariffs.

Location of the wells	Company names	in effect until 30 September 2023	in effect from 1 October 2023	Change
Szentlőrinc	Szentlőrinci Geotermia Kft.	6 715 HUF/GJ	4 737 HUF/GJ	-29,5%
Miskolc	Miskolci Geotermia Kft.	5 211 HUF/GJ	3 703 HUF/GJ	-28,9%
Miskolc	Kuala Kft.	5 211 HUF/GJ	3 703 HUF/GJ	-28,9%
Győr	Arrabona Koncessziós Kft.	6 225 HUF/GJ	4 494 HUF/GJ	-27,8%

Source: Hungarian Official Gazette, issue 139/2023

- The company announced on 4<sup>th</sup> October 2023, that the Ministry of Energy rejected the grant that was awarded to PannErgy last year by the Ministry for Technology and Industry (HUF 1,623,052,750), which related to the boring of a geothermal production well near Budapest. The news is negative as it was a potential growth opportunity, but we note that (A) the geothermal production well was to be established in an area not explored in detail and therefore success was not guaranteed and (B) we did not include any potential impacts into our calculations previously, hence it has no effect on the current valuation.

### **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 1,908 share price from HUF 1,747 (+9.2%), the recommendation is maintained at BUY given the price target is well above the current market price.

- As mentioned, management confirmed the 2023 EBITDA range of HUF 3.95bn-4.15bn considering the new heat tariffs and the H1 EBITDA of HUF 2.265bn. The 2024 EBITDA plan was not published yet. Our EBITDA forecast is HUF 4.08bn for this year (vs. HUF 4.13bn previously), which is within the range provided by management and HUF 3.83bn for 2024. The latter figure reflects similar heat sales volumes compared to 2023, lower heat tariffs but somewhat lower costs as well. However, the calculations do not incorporate the impact of the new Miskolc well. PannErgy expects that the new production well can be implemented after the end of the 2023/2024 heating season and can be integrated into the system by 30 September 2024. This will be included into our valuation later, closer to the implementation date.
- We expect that next year's heat sales volumes will be similar to this year's volumes (~1790 TJ). Of course, the new Miskolc well, if integrated into the system by 30 September 2024, will add to this figure. We noted in our previous note (23 Nov 2022) that the new Miskolc well could initially provide ~70TJ / year added heat sale potential (approx. +9% to Miskolc production) based on previous management indication, which would be first fully realized in 2025. However, the initial ~70TJ added heat sale could be ramped up over time significantly (up to 120-160 TJ / year), but this will depend on the company's ability to find willing buyers.

- We also assume that the negative impact of the lower administrative prices will be partially mitigated by correspondingly lower costs as natural gas and electricity prices have significantly fallen this year (ie. lower electricity charges). Overall, in our view this will have a limited but still slightly negative impact on profitability, which reflects a conservative stance. We assumed a 1-year validity period in our calculations for current administrative prices (ie. until the end of September 2024).
- With inflation slowing down in recent months but in the context of a deteriorating economic outlook we have updated our WACC figures. Here we expect somewhat lower risk-free rates for future periods than previously but slightly higher market and liquidity premiums. Overall, this resulted in somewhat higher WACC figures. We have also raised slightly capex figures for future periods, which reflects cost inflation.
- We also note, that according to the H1 report the amount of net debt was significantly lower compared to EOY 2022 and the number of non-treasury shares are lower as well given the ongoing share repurchase program. These had a positive impact on the FCFF valuation. The lower net debt is the result of a combination of higher levels of cash and securities and lower debt (loan repayment and nonrealised FX gain on EUR-denominated loans due to HUF strength).
- Considering the above effects together, the FCFF valuation gave a HUF 1,908 share price.

Income statement						
P/L Table consolidated (million HUF)	2020	2021	2022	2023F	2024F	2025F
Revenue from geothermal-heat	4 906	5 323	6 238	9 904	7 685	7 838
Other revenue	132	215	380	370	370	370
OPEX	3 320	3 776	3 913	6 600	4 655	4 743
from which: Depreciation	1 660	1 595	1 716	1 765	1 765	1 765
EBITDA	2 735	2 878	3 612	4 077	3 832	3 895
EBIT	1 075	1 283	1 896	2 313	2 067	2 130
EBT	262	964	1 416	2 069	1 858	1 956
Income Taxes	25	67	106	248	223	235
Non-controlling interest	0	0	0	0	0	0
Net income	236	897	1 310	1 820	1 635	1 722
EPS (HUF)	14	56	83	117	105	111

Balance sheet						
Balance sheet - consolidated (million HUF)	2020	2021	2022	2023F	2024F	2025F
Non-current assets	23 634	22 933	22 695	21 650	19 856	18 078
Current assets	3 099	3 950	4 636	5 232	6 041	7 344
Total assets	26 733	26 883	27 331	26 883	25 897	25 422
Total equity	9 747	9 980	10 534	12 354	13 534	14 847
Non-current liabilities	14 441	13 704	12 669	10 858	9 046	7 235
Current liabilities	2 545	3 199	4 128	3 671	3 316	3 341
Total equity and liabilities	26 733	26 883	27 331	26 883	25 897	25 422

Cash flow statement						
Cash flow statement (million HUF)	2020	2021	2022	2023F	2024F	2025F
Profit before taxes	262	964	1 416	2 069	1 858	1 956
Cash flow from operations	1 238	2 859	1 868	3 531	4 022	3 693
Cash flow from investment	-1 639	-1 475	-2 106	-1 547	-747	-747
Cash flow from financing activities	-278	-774	-615	-2 477	-1 214	-1 214
Change in cash and cash equivalents	-679	610	-647	-493	2 061	1 732

FCFF valuation						
Valuation summary (million HUF)	2023F	2024F	2025F	2026F	2027F	Terminal year
Revenue from geothermal heat	9 904	7 685	7 838	7 993	8 151	8 314
EBITDA	4 077	3 832	3 895	3 959	4 024	4 105
Depreciation	1 765	1 765	1 765	1 765	1 765	1 765
Working capital sales	302	-400	28	28	28	28
Capex	950	200	200	200	200	200
FCFF	2 548	3 783	3 412	3 468	3 525	3 596
WACC	13,5	13,0	12,9	12,7	12,5	12,5
PV(FCFF)	2 244	2 949	2 354	2 124	1 919	18 279

Share price estimation	
Enterprise value	29 870
Net debt ( - )	7 469
Equity value	22 401
Number of shares	15 537
Required return on equity	17,0
Target price for the next 12 M (HUF)	1908

### ***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.

**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
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
18/07/2023	BUY	HUF 1,747	Equity note
20/09/2023	BUY	HUF 1,747	Equity note

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

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

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