

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY

Target price (12M): HUF 1,196

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Highlights

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Despite the covid-19 crisis, the management is confident it can achieve its production and EBITDA targets in 2020. The Q2 production report surpassed the management's expectations, but output was less than a year earlier, due to warmer weather in May and the modifications made at the Győr site. Additionally, the company refinanced all of its loans with long-term, fixed and low-interest-rate loans, which also include a HUF 1.5 billion cushion that can be used later if needed. Overall, we see no reason to change our BUY recommendation, with an unchanged target price of HUF 1,196.

Main takeaways from the Q2 production report

In the second quarter, Pannergy's production was around 10% above the managements' target (272,994 GJ vs 247,988 GJ) but it declined almost 20% YoY. This was due to higher average temperature in May, and lower output in Győr as the company turned the wells into a self-flow state due to higher-than-optimal temperature in Győr. The management still maintains this year's EBITDA target of HUF 2,53-2,6 billion, which is in line with our forecast.

Looking at the performance of the individual production sites, the output in Miskolc, at 135,753 GJ, was 11% lower than a year earlier, reflecting the higher average temperature in May. At the Győr site however, production was roughly the same as in Miskolc, but this represents 27% YoY decline. As the company notes, the well's yield production dropped (following the lower demand as average temperatures increased) but the cost per output ratio also fell, owing to near-zero electricity needs. Its effect must appear in the half-year report, which should give account of higher overall EBITDA margin, and most of its increase must come from the improved EBITDA margin at the Győr location.

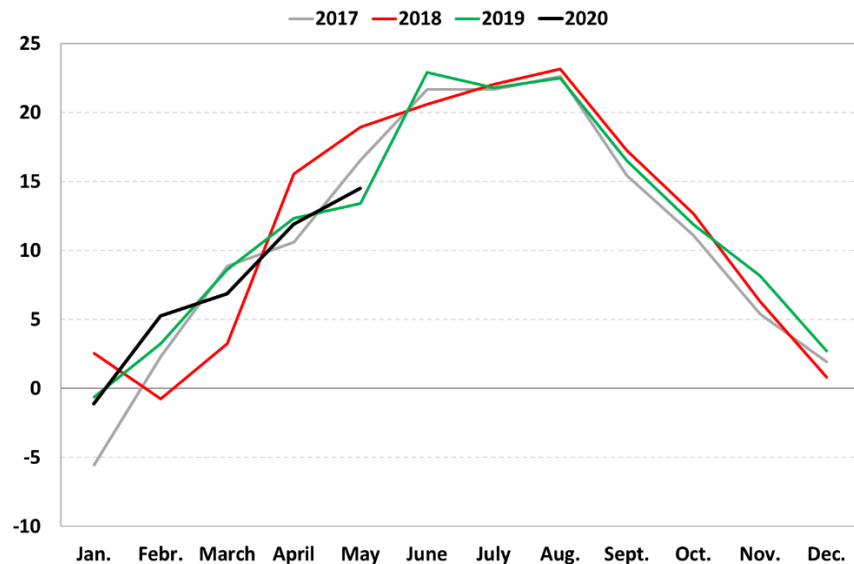
In Szentlőrinc, the output was about 10% less than a year earlier.

Other recent news:

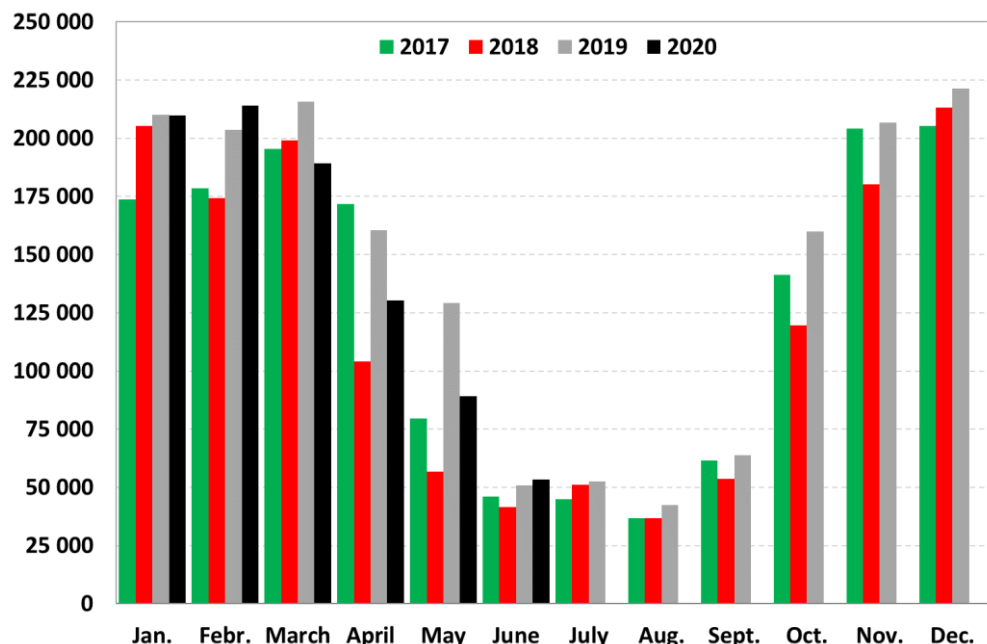
- **The company announced that it had refinanced all of its short-term and medium-term balloon loans (HUF 9.5 bn) with ten-year maturity loans worth of HUF 11 bn.** As the company notes, the HUF 1.5 bn difference could serve as a cushion against the negative effects of covid-19, if needed. Of this HUF 11 bn, HUF 8.25 bn is HUF-denominated, and the other HUF 2.75 bn part is EUR-denominated. The HUF part is a fixed-rate loan, while the EUR part is a variable-rate loan but with swaps it was converted to fixed-rate loan as well. Pannergy's

consolidated yearly debt repayment needs will decline by HUF 200 million, the announcement said. **Assessment:** The company took advantage of the favourable financing situation that arose due to the government's reaction to the covid-19 crisis. As the move means long-term, fixed and low-interest-rate financing, we deem it as an excellent move. Additionally, the HUF 1.5 bn cushion also provides the means for any difficulty arising from the pandemic or could serve as fresh financing for new investment. But it is yet to be seen how the company will use this in the future. Finally, with the new financing, the share of EUR loans will decline, therefore any future HUF depreciation will have a smaller negative effect on net income – through the increase in unrealized FX loss – than before. The effects will be reflected in the valuation and forecast when the half-year report comes out.

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



Consolidated heat sales (GJ)



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 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 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, the covid-19 virus 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
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
15/04/2020	BUY	HUF1,1196	Equity note

Period	Recommendations	Percent of recommendation
2017Q4	BUY	100%

	HOLD SELL	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%
2019Q3	BUY HOLD SELL	100% 0% 0%
2019Q4	BUY HOLD SELL	100% 0% 0%
2020Q1	BUY HOLD SELL	100% 0% 0%
2020Q2	BUY HOLD SELL	100% 0% 0%

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

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