

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY

Target price (12M): HUF 1,450

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Highlights

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With the announcement of next year's administrative prices, we updated the valuation and incorporated the effects of recent changes in the macro environment and the announcements by Pannergy as well. The new target price is HUF 1,450, which is around 4.5% higher than the previous and almost 60% higher than the current market price.

Recent news:

- **The new administrative prices were set for the period between 2021 October and 2022 September.** The table below show that a relatively large, 6% increase was made for the Győr site, and a minor almost 1% for the Miskolc site. The 4% increase in Szentlőrinc is nice, but the site production is small. The increase in heat prices could help to achieve the management EBITDA targets for the coming years (see later).

Location of the wells	Company names	in effect until 30 September 2021	in effect from 1 October 2021	Change
Szentlőrinc	Szentlőrinci Geothermal Ltd.	3 654 HUF/GJ	3 791 HUF/GJ	4%
Miskolc	Miskolci Geothermal Ltd.	2 626 HUF/GJ	2 650 HUF/GJ	0,9%
Miskolc	KUALA Ltd.	2 626 HUF/GJ	2 650 HUF/GJ	0,9%
Győr	Arrabona Geothermal Ltd.	3 204 HUF/GJ	3 397 HUF/GJ	6,0%

Source: Hungarian Official Gazette, issue 179/2021

- **Pannergy announced it concluded an investment credit facility agreement worth of HUF 2.85 billion.** The credit agreement is for priority development and expansion investment projects, planned to be concluded in the next two year. The average interest rate will be somewhere between 2-2.5%, which is a steal considering that the 10-year yield government bond yield is currently 3.5% and inflation is around 5%. **Finally, Pannergy also stated that this news has no effect on the previously announced EBITDA targets because the effect of the planned investment had been already taken account.**

Updated valuation:

We updated our valuation for Pannergy. Overall the valuation is increased to 1,458 HUF from HUF 1,376 (+5.9%), the recommendation is maintained at BUY as this target price is well above the current market price. **The FCFF valuation resulted in a HUF 1,423 share price, while the relative valuation gave a HUF 1,477 share price, so the final valuation is HUF 1,450.**

FCFF valuation:

Due to many changes surrounding the macro environment and the many small announcement from Pannergy, the valuation changed at many places, but only a small extent.

- The management's EBITDA target for 2021 is HUF 2.8-2.88 bn for this year, HUF 3-3.1 bn for 2022 and HUF 3.15-3.25 bn for 2023. Our numbers are HUF 2.9 bn for 2021, HUF 3.11 bn for 2022 and HUF 3.12 bn for 2023, which is very similar. The difference mainly could come from the exact timing of the planned capacity enhancing measures. Our updated values reflect the increase in administrative prices and the positive effect of the already announced investments as well.
- Alone this would increase the FCFF valuation, but its effect was somewhat mitigated by the increase in WACC. This is mainly due to the fact that we used a 3% risk-free rate before for the interim 10-year period. However, considering the rate hike cycle of the MNB, the ending of the QE, the weak HUF and the inflation risks, we feel that a higher 3.5% risk free rate (10 year government bond yield) is more appropriate, but this risks are pointing to an even higher level. On the plus side the interest rate of the loans decreased somewhat due to the refinancing of the loan outstanding, which is also incorporated in the forecast.
- For 2022 and 2023, we calculated with a higher Capex spending, reflecting the planned capacity enhancement measures. However, the final size and its distribution between the years is not exactly known currently, therefore, it could be subject to material change later.

Considering the above effects together, the FCFF valuation gave a HUF 1,423 share price.

Relative valuation:

In the last relative valuation the average EV/EBITDA for the peers was around 10.6. The table below shows that it increased from 10.6 to 18.9, but it is mainly due to the huge increase for ARISE. We looked at the company and its EBITDA fall significantly due to COVID, but expected to return to normal levels until 2023. Therefore, its current EV/EBITDA is meaningless. Additionally, we also present the average and median number for utilities companies (as Pannergy itself is a utility company) for the Eurozone and Eastern Europe. The average EV/EBITDA numbers are between 10.2 and 13, while the median values are smaller (6.5-10.7). Based on the EV/EBITDA values from a broader comparison, we think that the median EV/EBITDA value from the closed peers without ARISE is the best representation currently and it is somewhere between the average EV/EBITDA values of the Western and Eastern utility companies. **With this value (11.1), the relative valuation gives a HUF 1,477 share price estimate.**

Relative valuation			
Company name	Country	Market capitalization (billion HUF)	EV/EBITDA
Polaris Infrastructure	Canada	83,0	4,8
Ormat Technologies	USA	1184,6	14,7
ARISE	Germany	48,6	52,2
ABO Invest	Germany	42,0	10,9
Northland Power	Canada	2174,7	11,1
Falck	Denmark	732,0	15,5
		Average	18,2
		Median	12,9
		Average w/o Arise	11,4
		Median w/o Arise	11,1

Index	Region	EV/EBITDA	
		Average	Median
Stoxx 600 Utilities	Eurozone	13,0	10,7
Stoxx 300 Utilities	Eastern Europe	10,2	6,5

Other tables:

Income statement						
P/L Table consolidated (million HUF)	2018	2019	2020	2021F	2022F	2023F
Revenue from geothermal-heat	4 152	5 060	5 070	5 485	5 649	5 761
Other revenue	407	192	132	29	172	150
OPEX	2 903	2 982	3 320	3 624	3 717	3 792
from which: Depreciation	1 317	1 468	1 660	1 475	1 475	1 475
EBITDA	2 231	2 666	2 735	2 899	3 113	3 128
EBIT	906	1 198	1 075	1 424	1 638	1 654
EBT	525	782	262	1 142	1 356	1 371
Income Taxes	90	47	25	137	163	165
Non-controlling interest	1	0	0	0	0	0
Net income	434	728	236	1 005	1 193	1 207
EPS (HUF)	25	44	14	61	73	73

Balance sheet						
Balance sheet - consolidated (million HUF)	2018	2019	2020	2021F	2022F	2023F
Non-current assets	22 780	23 177	23 634	22 149	21 254	20 359
Current assets	3 030	2 796	3 099	3 403	4 265	4 618
Total assets	25 810	25 973	26 733	25 552	25 519	24 977
Total equity	9 867	10 213	9 747	9 493	10 435	11 343
Non-current liabilities	12 256	11 910	14 441	13 440	12 472	11 004
Current liabilities	3 687	3 850	2 545	2 619	2 612	2 630
Total equity and liabilities	25 810	25 973	26 733	25 552	25 519	24 977

Cash flow statement						
Cash flow statement (million HUF)	2018	2019	2020	2021F	2022F	2023F
Profit before taxes	525	782	262	1 142	1 356	1 371
Cash flow from operations	2 266	2 601	1 238	2 197	2 801	2 826
Cash flow from investment	-2 766	-1 790	-1 639	-751	-1 001	-1 001
Cash flow from financing activities	320	-575	-278	-1 039	-750	-1 217
Change in cash and cash equivalents	-180	236	-679	407	1 050	608

Valuation summary (million HUF)	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	Terminal year
Revenue from geothermal heat	5 485	5 649	5 761	5 875	5 991	6 109	6 230	6 353	6 479	6 607	6 739
EBITDA	2 899	3 113	3 128	3 165	3 202	3 217	3 254	3 290	3 326	3 361	3 428
Depreciation	1 475	1 475	1 475	1 475	1 475	1 414	1 414	1 414	1 414	1 414	1 414
Working capital sales	86	30	20	20	20	20	20	20	20	20	20
Capex	500	750	750	100	100	100	100	100	100	100	100
FCFF	2 142	2 137	2 160	2 842	2 874	2 880	2 912	2 944	2 976	3 007	3 066
WACC	7,7	7,7	7,7	7,7	7,7	7,7	7,7	7,7	7,7	7,7	9,3
PV(FCFF)	1 988	1 841	1 728	2 110	1 981	1 843	1 730	1 623	1 523	1 429	13 599

Share price estimation	
Enterprise value	31 395
Net debt (-)	10 767
Equity value	20 628
Number of shares	16 426
Required return on equity	13,3
Target price for the next 12 M (HUF)	1423

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.

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OTP Bank Plc's recommendations and price targets history for PannErgy in the past twelve months:

Date	Recommendations	Target Price	Publication
16/01/2020	BUY	HUF 1,196	Equity note
30/03/2020	BUY	HUF 1,196	Equity note
15/04/2020	BUY	HUF1,196	Equity note
20/07/2020	BUY	HUF 1,196	Equity note
20/07/2020	BUY	HUF 1,216	Equity note
16/10/2020	BUY	HUF 1,204	Equity note
18/01/2021	BUY	HUF 1,204	Equity note
29/03/2021	BUY	HUF 1,387	Equity note
19/04/2021	BUY	HUF 1,387	Equity note
16/07/2021	BUY	HUF 1,387	Equity note
06/09/2021	BUY	HUF 1,387	Equity note

Period	Recommendations	Percent of recommendation
2020Q4	BUY	100%
	HOLD	0%
	SELL	0%
2021Q1	BUY	100%
	HOLD	0%
	SELL	0%
2021Q2	BUY	100%
	HOLD	0%
	SELL	0%
2021Q3	BUY	100%
	HOLD	0%
	SELL	0%

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

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