

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY

Target price (12M): HUF 1,204

18 January 2021

Highlights

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PannErgy produced 567,565 GJ energy in Q4 was, slightly less than the management had planned. The production report also detailed various small-scale capacity enhancement investment projects, which could lift the production and EBITDA in 2021. The management's production target for 2021 is 1,732,569 GJ and the EBITDA could be between HUF 2.8 and HUF 2.88 bn this year. Although our forecast is somewhat lower, Pannergy's EBITDA plan seems achievable and means an upside risk to our EBITDA forecast.

Overall, we are satisfied with the production report, which proves the management's intention to get the maximum out from the existing plants with efficiency improving measures. We maintain our BUY recommendation with the same target price (HUF 1,204) as before.

Main takeaways from the Q4 production report

In the fourth quarter, PannErgy produced 567,565 GJ energy, which is 3.5% less than a year earlier, and is almost 7.5% less than the management's plan was for the last quarter of 2020. Overall, 1,601,882 GJ heat was sold in 2020, 2.3% less than the management had expected. Most of the difference can be attributed to the lower production levels in Q2 and Q4.

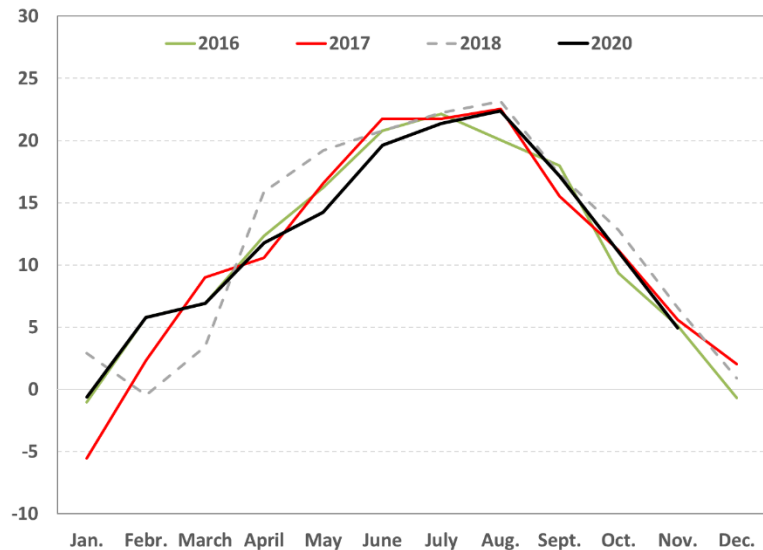
Regarding the performance of the individual sites, production in Miskolc hit 284,890 GJ, in 1.7% YoY decline, while in Győr it was 275,528 GJ, which is 5.3% lower than a year earlier. The smaller site at Szentlőrinc produced 16% more energy YoY in Q4.

The production report contains two important pieces of information:

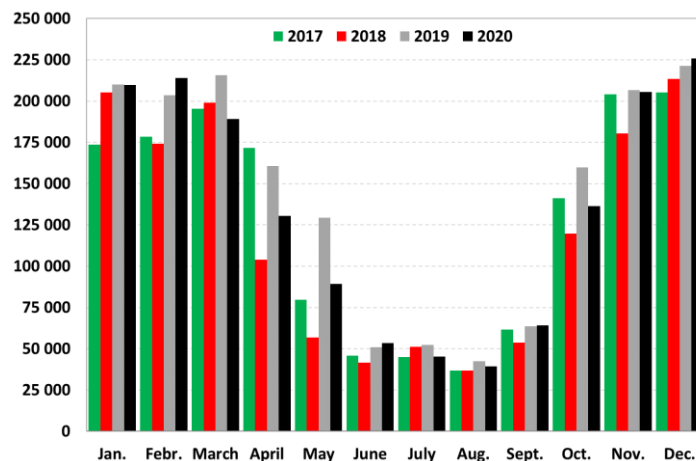
1. Due to various capacity enhancing measures in Győr and Miskolc, production could be 58-78TJ higher (overall yearly production could grow by 3.5-4.7%) in the future. The sources of these capacity increases are as follows:
 - a. a heat exchanger plant with a higher throughput-capacity towards the district heating service provider and the related engineering development in Győr
 - b. the capacity expansion project of the pump-equipped production well in Győr, and raising the flow temperature of both production wells by 1°C and 2°C
 - c. A decline in per-unit electricity consumption, owing to the transformation of the engineering system beside the production wells in Miskolc

- d. Reduction of the temperature loss on the heat exchanger, by transforming the heat exchanger at one of the production wells in Miskolc
2. Benefiting from mostly these investment projects and the resulting enhanced production capability, PannErgy's EBITDA could reach HUF 2.8-2.88 bn in 2021, which would be an 11% increase compared to 2020, the company said. Our forecast for the 2021 EBITDA is somewhat lower (2.591 bn HUF), but the recent information can be viewed as an upside risk to our forecast.

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 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 addressed, 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
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	HUF1,196	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

Period	Recommendations	Percent of recommendation
2017Q4	BUY HOLD SELL	100% 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%
2020Q3	BUY HOLD SELL	100% 0% 0%
2020Q4	BUY HOLD SELL	100% 0% 0%

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

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This document was finalized at 4:25:55 PM on 18 January 2021