

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY (unchanged)

Target price (12M): HUF 1,670 (unchanged)

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Highlights

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PannErgy produced 201,170 GJ energy in Q3, which is 38.9% higher YoY, and it is 22.9% higher than the management's plan was for the quarter. The excellent performance is the result of favourable weather conditions, previous investment activities and the commercial agreement that the company concluded with GYŐR-SZOL, operator of the district heating system in Győr, which gives priority to geothermal energy over other energy source alternatives. Overall, this means that the company achieved record heat sales during both Q2 and Q3, and this now more than offsets the smaller production shortfall in Q1 relative to the 2022 target. Management reiterated again the expected fulfilment of the HUF 3.25-3.35bn EBITDA target range for the year and will update its public EBITDA target for 2023 in the Q4 production report. Our forecast number is HUF 3.32bn for 2022 EBITDA, which falls within the current range and HUF 3.49bn for 2023. We maintain our BUY recommendation with the same target price (HUF 1,670).

Main takeaways from the quarterly production report:

In the third quarter, PannErgy produced 201,170 GJ energy, which is 38.9% higher than a year earlier, and it is 22.9% higher than the management's plan was for this quarter (163,654 GJ). **The company achieved record Q3 heat sales** with this figure and the excellent performance was primarily due to favourable weather conditions (cooler than average September temperatures) and ongoing investments into increasing efficiency, operational safety, and capacity expansion.

Regarding the performance of individual sites, Miskolc produced 86,925 GJ energy in Q3, an increase of 22% YoY, mainly due to more favourable weather conditions and efficient operation. At the same time, **Győr sold a historic record volume of 112,734 GJ energy, a substantial 55.8% increase** compared to the previous year. This is the result of: (A) previous investment activities, (B) favourable weather conditions and (C) the commercial agreement that the company concluded with GYŐR-SZOL Zrt., which gives priority to geothermal energy over other alternatives. The smaller Szentlőrinc site produced 1,347 GJ, which is 29.3% higher than in the base period.

The company had a smaller production shortfall in Q1 relative to the 2022 target (-39,230 GJ), which is now more than offset by record Q2 and Q3 figures (+29,904 GJ and +37,516 GJ). As a result, **management confirmed the expected fulfilment of the consolidated HUF 3.25-3.35bn EBITDA target range for the year.** The company will update its public EBITDA target for 2023 in the Q4 2022 production report. Our estimated 2022 EBITDA is HUF

3.32bn, which is within the range provided by management and HUF 3.49bn for 2023, which reflects both higher expected heat sales volumes and administrative prices, but it does not incorporate the impact of the potential 3rd Miskolc well.

Other notable highlights:

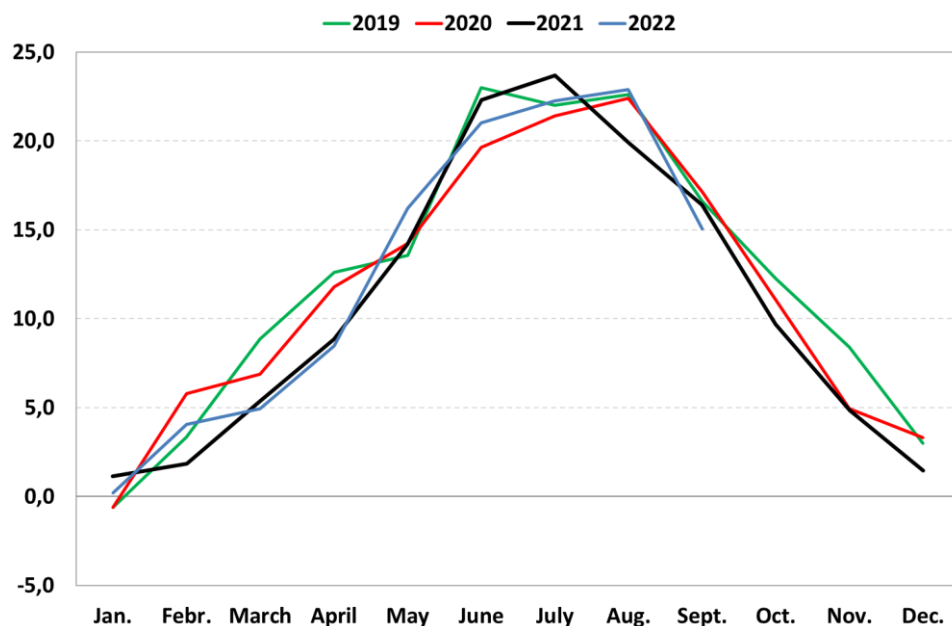
- 1) The **new administrative prices were set** for the period between 2022 October and 2022 December. The heat supply tariffs, unlike previous practice, have not been announced for a full year, but only for Q4 2022 and revision is expected thereafter. The new prices are shown in the table below:

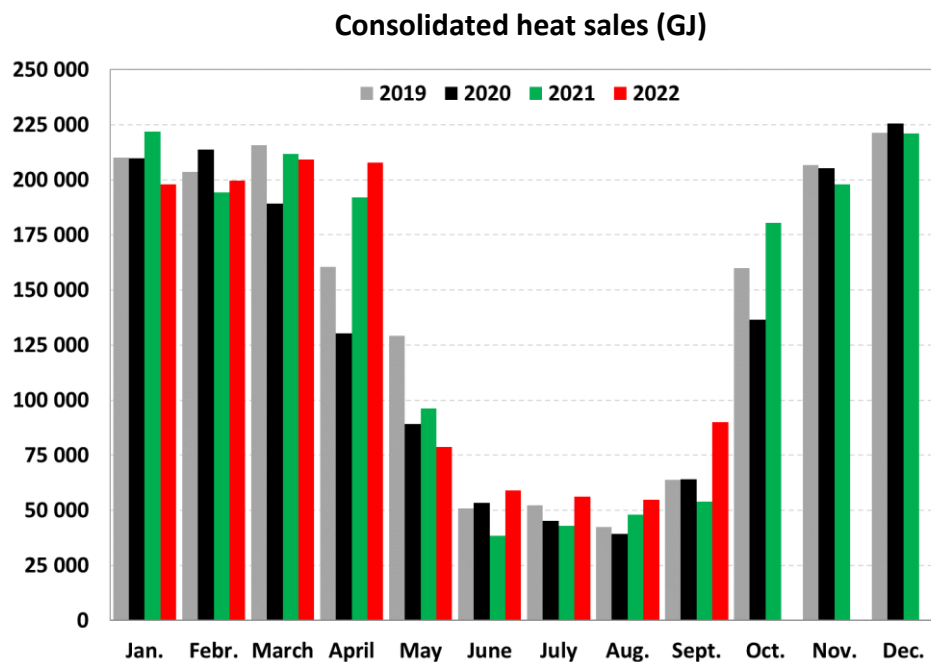
Location of the wells	Company names	in effect until 30 September 2022	in effect from 1 October 2022	Change
Szentlőrinc	Szentlőrinci Geothermal Ltd.	3 791 HUF/GJ	4 620 HUF/GJ	21,9%
Miskolc	Miskolci Geothermal Ltd.	2 650 HUF/GJ	3 176 HUF/GJ	19,9%
Miskolc	KUALA Ltd.	2 650 HUF/GJ	3 176 HUF/GJ	19,9%
Győr	Arrabona Geothermal Ltd.	3 397 HUF/GJ	4 023 HUF/GJ	18,4%

Source: Hungarian Official Gazette, issue 159/2022

- 2) **The company continued its share repurchase program and as of 14th October held 3,936,100 shares (19.68% of total shares).** The program is valid for the period 2 May 2022 – 13 April 2023 with a HUF 600 million limit. The company has spent so far HUF 263.5 million on share repurchases, which is ~44% of the authorized amount. Overall, this means that PannErgy purchased under the current program 256,200 shares (~1.3% of total shares and ~1.6% of total non-treasury shares) for an average price of HUF 1,029 / share.

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





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
16/07/2021	BUY	HUF 1,387	Equity note
06/09/2021	BUY	HUF 1,387	Equity note
06/10/2021	BUY	HUF 1,450	Equity note
18/10/2021	BUY	HUF 1,450	Equity note
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

Period	Recommendations	Percent of recommendation
2021Q3	BUY	100%
	HOLD	0%
	SELL	0%
2021Q4	BUY	100%
	HOLD	0%
	SELL	0%
2022Q1	BUY	100%
	HOLD	0%
	SELL	0%
2022Q2	BUY	100%
	HOLD	0%
	SELL	0%
2022Q3	BUY	100%
	HOLD	0%
	SELL	0%

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

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