

# EQUITY NOTE: PANNERGY NYRT.

**Recommendation: BUY**

**Target price (12M): HUF 1,387**

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## Highlights

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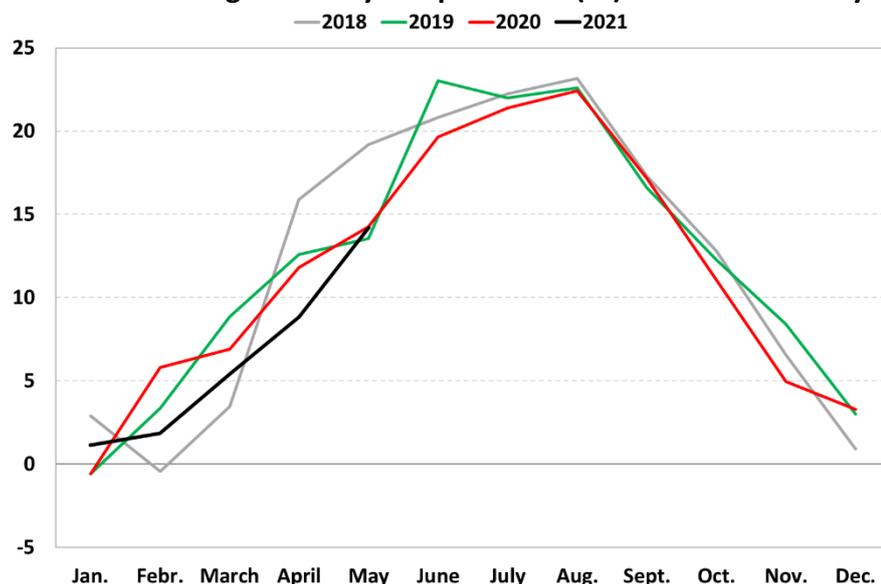
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Pannergy delivered a strong H1 performance aided by last year's administered price hikes, higher heat sales (partly due to base effects) and the implemented capacity enhancing measures. Production increased by 7.8%, while revenues were up by 8%. Net income amounted to HUF 664 million, considerably exceeding the HUF 106 million from a year ago, mainly due to FX-related effects (appreciation of the HUF in H1). We maintain our buy recommendation, with the same target price (HUF 1,387). Administrative prices will be set for the next 12 months around the end of this month, while the next Quarterly production report arrives in the middle of October.

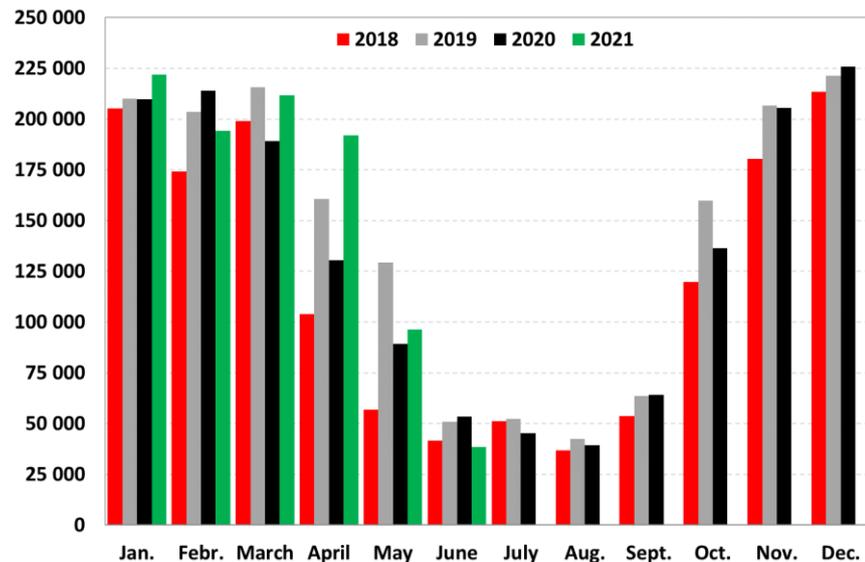
## Main takeaways from the H1 report

Pannergy delivered a strong H1 performance despite the harsh pandemic situation in Q1, showing that the company is immune to the negative economic consequences of the COVID-19. Overall production was 955 TJ (+7.8% YoY) which was above the management's expectations. Therefore output target (1.733 TJ) for 2021 seems achievable. Revenue was HUF 3.444 bn (+8% YoY), from which heat sales increased by around 10%. The increase stemmed from the higher production and the more favourable heat sales prices (which was set last September). From the overall revenue, the contribution of the Győr site was HUF 1.791 bn (+20% YoY). Besides the above-mentioned factors, the large 20% YoY increase is due to base effects as last year Audi decreased its production for a short time due to the pandemic.

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



Consolidated heat sales (GJ)



In Miskolc, overall revenue was HUF 1.124 bn, which is slightly worse than last year's revenue. In Szentlőrinc, revenue was almost the same as last year, while in Berekfürdő revenue was HUF 22 million, which is higher than the HUF 13 million a year ago. This was due to the implemented capacity-enhancing measures at that production site. Besides the revenue from heat sales, revenue from electricity sales (connected to two real estate) was HUF 424 million, almost the same as last year. Nevertheless, these revenues provide minimal profit, so they are not meaningful.

In H1, the direct cost of production increased by 4% (from HUF 2.416 bn to HUF 2.325 bn). Among the direct cost of production, maintenance, operation and facility management costs amounted to HUF 750 million (+19% YoY), while electricity charges increased by 9.8%. However, direct depreciation and cost of goods sold decreased somewhat. Due to the fact that direct costs increased less than sales, gross margin increased to 30% from 27% (to HUF 1.028 bn from HUF 0.872 bn) and gross cash flow increased by 6%.

Indirect costs amounted to HUF 258 million (+4% YoY), while net other revenue was HUF 42 million which is higher than the HUF -13 million last year. The most important item among the other revenue is the revenues related to funds granted for development (HUF 138 million).

Due to the above, the EBIT was HUF 812 million (+33% YoY), while EBITDA amounted to HUF 1560 million (+6.8% YoY).

Loss on financial transaction was HUF 85 million, which is considerable less than the HUF 506 million loss last year. The difference is almost entirely due to the FX effect. In H1 2020, the HUF depreciated almost 7.8% against the EUR, while this H1 the HUF appreciated around 3.8% against the EUR. Last year the exchange loss amounted to HUF 375 million, while this year the gain was HUF 71 million.

Overall, profit before tax was HUF 727 million, considerable above last year's HUF 106 million.

**Finally, the company reported that it expects the EBITDA to be around HUF 3-3.1 bn in 2022 and HUF 3.15-3.25 bn in 2023 due to the planned small-scale capacity enhancing measures.**

### Other news:

Pannergy continued its share-repurchasing program and bought 188,312 shares with an average price of HUF 822. Additionally as it was said before, the company decided to pay dividend (HUF 15 per share).

### Assessment

Overall Pannergy delivered a strong H1, while maintaining a rigorous cost control. We think that the increase in global gas prices could be an upside risk to the administrative heat sales price-setting process, which will be determined around the end of September. Additionally, as the virus situation intensifies in the US and other highly vaccinated countries, investors may turn to defensive stocks. This was highlighted by the ETF flows in August as well, where health care, consumer staples and utilities saw the highest flows. We think this environment may be supportive to Pannergy in the short run, as its operations are so far not effected by the negative economic consequences of the COVID-19.

Additionally if the HUF appreciate further against the EUR, this could be an upside risk to this year's net income. However, the change in FX is a one-time effect and it does not have a material impact on the valuation in the long-term.

P/L Table consolidated (million HUF)	2021H1	2020H1	2019H1	2018H1	2017H1	2016H1
Revenue	3 444	3 197	3 121	2 402	2 519	2 129
Net other revenue	42	-13	106	174	120	133
OPEX	2 374	2 572	2 447	2 104	2 196	2 155
From which:						
* SGA	258	247	233	237	297	475
* Depreciation	748	798	671	675	588	541
EBITDA	1 560	1 461	1 451	1 147	1 095	734
EBIT	812	612	780	472	443	107
EBT	727	106	618	33	381	-226
Income Taxes	83	13	15	9	26	22
Net income	644	93	603	24	355	-252
EPS (HUF)	37,17	5,01	32,90	1,60	19,77	-13,78

	2021H1	2020H1	2019H1	2018H1	2017H1	2016H1
EPS (HUF)	37,17	5,01	32,90	1,60	19,77	-13,78
EBITDA (HUFm)	1 560	1 461	1 451	1 147	1 095	734
Gross profit rate (%)	29,9%	27,3%	29,1%	22,3%	24,6%	21,1%
EBIT rate (%)	23,6%	19,1%	25,0%	19,7%	17,6%	5,0%
EBITDA rate (%)	45,3%	45,7%	46,5%	47,8%	43,5%	34,5%
ROE (%)	6,7%	0,9%	5,9%	0,3%	3,9%	-2,8%
ROA (%)	2,5%	0,4%	2,3%	0,1%	1,5%	-1,0%
ROS (%)	19,3%	2,8%	19,3%	1,0%	14,1%	-11,8%

### 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 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, 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
16/01/2020	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

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

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

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