

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY

Target price (12M): HUF 1,387

19 April 2021

Highlights

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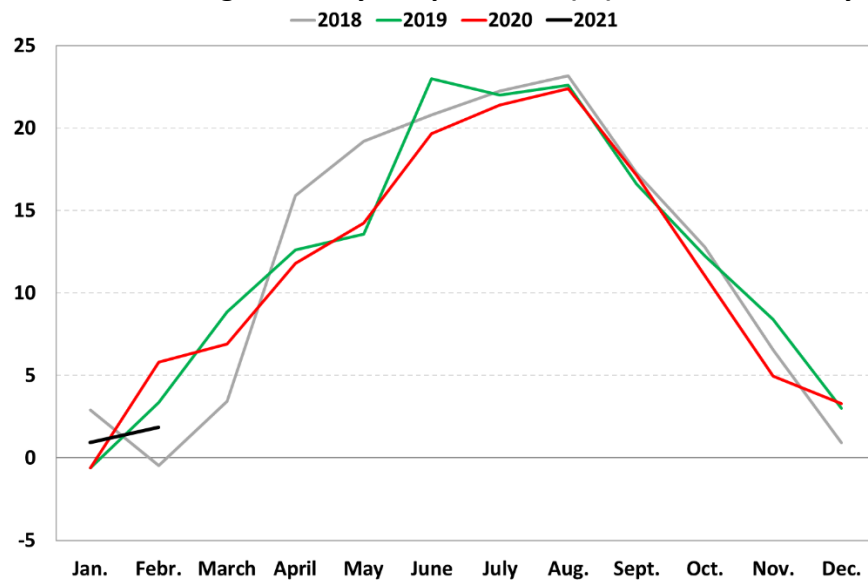
The company published its first quarter production report and one day later the General Meeting was held. Concerning the production report, Q1 production was 2.5% higher than a year ago, but was somewhat below the management's target due to negative weather effect. Overall, this was a neutral production report. Concerning the General Meeting, dividend payment and a continuation of the share repurchase program was announced. Pannergy will pay HUF 15 per share dividend, which is roughly equivalent to a 1.8% current dividend yield. The allocated amount to the share repurchase program is HUF 600 million and it can be used if the share price is below HUF 950. To sum it up, the dividend payment and a share repurchases are very good news. **Due to the fact, that the dividend payment has only a very minor effect on the valuation and the share price on which the repurchases are made are hardly predictable, we will build it into the valuation as the time goes by, therefore next time after the half year report. Overall, the valuation was left unchanged at the current HUF 1,387 per share.**

Highlights of the quarterly production report

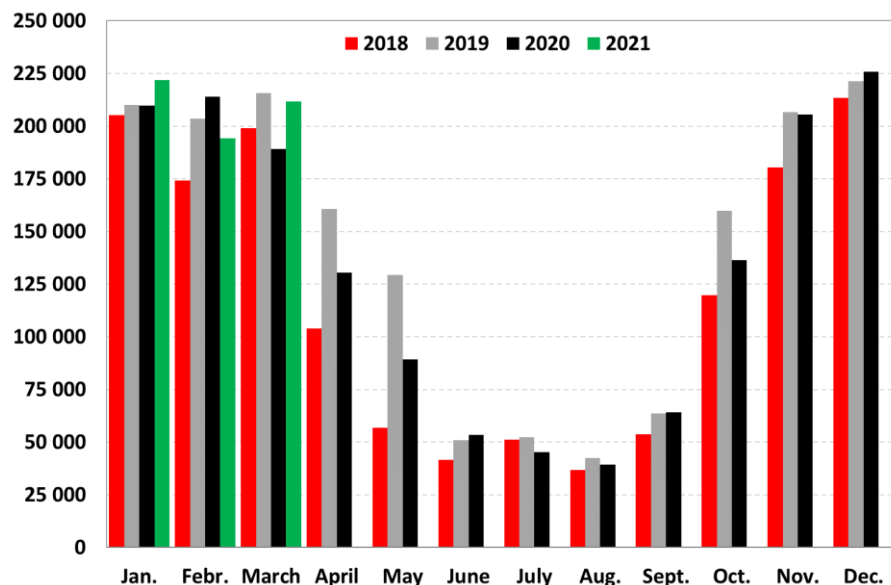
In the first quarter of 2021, overall production was 627,901 GJ (+2.5% YoY). This is somewhat lower than the management's target (660,769 GJ) was for Q1. Despite the lower than expected production in Q1, the management reiterated that the EBITDA target for 2021 is HUF 2.8-2.88 billion.

Looking at the individual production sites, in Miskolc heat sales amounted to 273,892 GJ (-8.8% YoY) due to weather effects. In Győr, productions was 344.891 GJ (+13.8% YoY). The good numbers in Győr – despite the negative weather effects in Q1, reflects the positive effects of capacity-enhancing measures taken in last year. In Szentlőrinc, production was 8,500 GJ, almost the same as last year.

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



Consolidated heat sales (GJ)



Dividend and share repurchases programme

At the General Meeting, dividend payment and a new share repurchases programme was accepted. The company wanted to pay dividend last year, but due to the pandemic, it was postponed.

The amount of the dividend will be HUF 252,823,080 or HUF 15/share. This is equivalent to a 1.8% dividend yield. Additionally, Pannergy will continue its share repurchase programme as well. The overall amount will be HUF 600 million and the company will buy back shares if the share price is between HUF 1 and 950.

Overall, the dividend and share repurchases are very good news, because it can signal that the company arrived at a more mature phase, which could appeal for new investors. Additionally, utility companies are mainly held for their dividends (or as a defensive play in times of uncertainty), therefore paying dividends definitely increases the company's perceived attractiveness. The main question now, that how the future dividend payment will evolve.

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
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
18/01/2021	BUY	HUF 1,204	Equity note
29/03/2021	BUY	HUF 1,387	Equity note

Period	Recommendations	Percent of recommendation
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%
2021Q1	BUY HOLD SELL	100% 0% 0%

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

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