

EQUITY NOTE: PANNERGY NYRT.

Recommendation: BUY

Target price (12M): HUF 1,450

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Highlights

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PannErgy produced a record 599,497 GJ in Q4, which was slightly less than planned by management, mainly due to the outage in Miskolc from 2-11 November. Overall, 1,699,190 GJ heat was sold in 2021, 1.9% less than the target but 6.1% higher YoY. The company confirmed the expected fulfilment of the 2021 EBITDA target of HUF 2.8-2.88 bn. The management's production target for 2022 is 1,752,012 GJ (+3.1% YoY) and the EBITDA could be between HUF 3-3.1 bn this year (+7.4% YoY). In 2023, the EBITDA may grow to HUF 3.15-3.25 bn subject to the boring and commissioning of the third production well in Miskolc. Our forecast numbers are similar, HUF 3.11 bn for 2022 and HUF 3.12 bn for 2023. We maintain our BUY recommendation with the same target price (HUF 1,450) as before.

Main takeaways from the quarterly production report:

In the fourth quarter, PannErgy produced a record 599,497 GJ energy, which is 5.6% higher than a year earlier, however, it is 3.4% less than the management's plan was for the last quarter of 2021. The shortfall is primarily due to the outage in Miskolc from 2-11 November. Overall, 1,699,190 GJ heat was sold in 2021, 1.9% less than the management had expected but 6.1% higher YoY.

Regarding the performance of the individual sites, Miskolc produced 260,127 GJ energy in Q4, an 8.7% decline YoY, mainly due to the earlier mentioned outage. At the same time, production in Győr hit a total record volume of 330,520 GJ, a 20% increase compared to the previous year. The production report mentions that the improvement can be attributed to: (1) the return on investment activity in recent periods and (2) operational difficulties in the base period, including unscheduled repair works and protracted capacity expansion projects. The smaller site at Szentlőrinc produced 22,2% more energy YoY in Q4, amounting to 8,568 GJ.

The management confirmed the expected fulfilment of its 2021 EBITDA target of HUF 2.8-2.88 bn. The company's production target for 2022 is 1,752,012 GJ (+3.1% YoY) and the EBITDA could be between HUF 3-3.1 bn this year, an increase of approximately 7% compared to the 2021 target, which mainly reflects the effect of completed or in-progress capacity expansion and efficiency improving projects. We also note that the administrative prices set for the period between 2021 October and 2022 September are somewhat higher than previous figures, which could also help to achieve the higher EBITDA target.

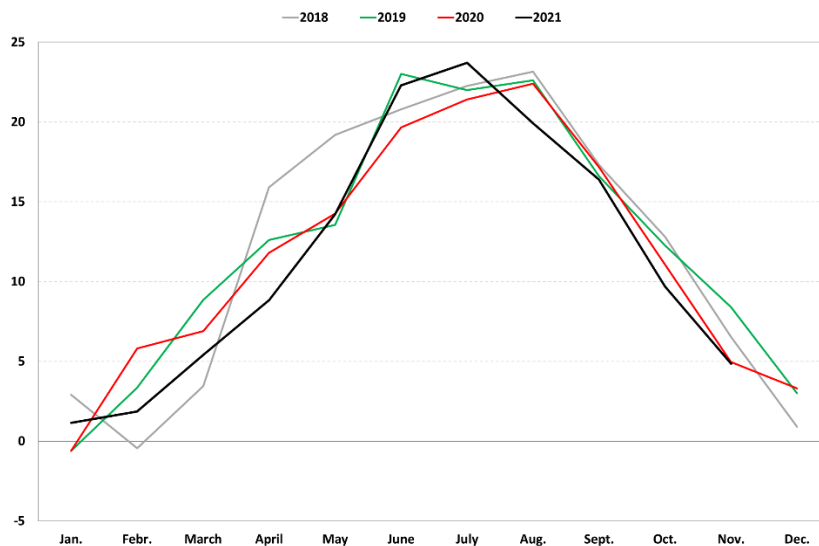
Location of the wells	Company names	in effect until 30 September 2021	in effect from 1 October 2021	Change
Szentlőrinc	Szentlőrinci Geothermal Ltd.	3 654 HUF/GJ	3 791 HUF/GJ	4%
Miskolc	Miskolci Geothermal Ltd.	2 626 HUF/GJ	2 650 HUF/GJ	0,9%
Miskolc	KUALA Ltd.	2 626 HUF/GJ	2 650 HUF/GJ	0,9%
Győr	Arrabona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

Source: Hungarian Official Gazette, issue 179/2021

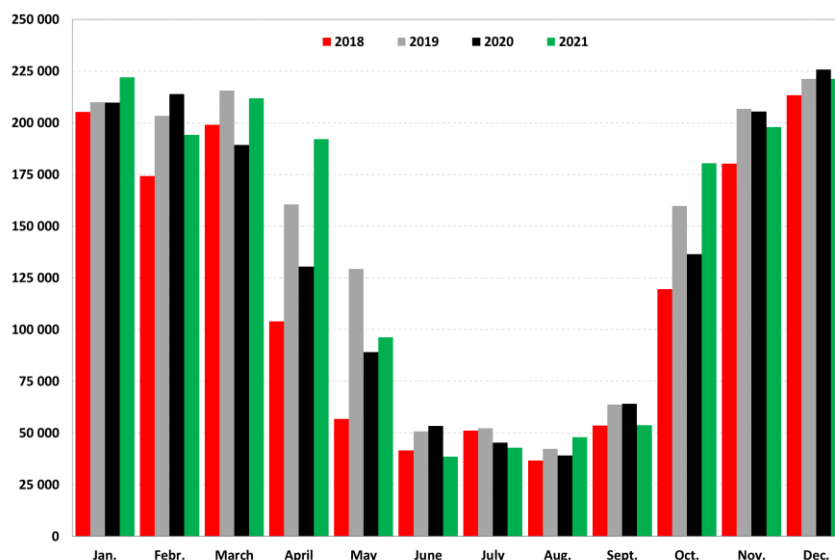
In 2023, the EBITDA may grow another ~5% YoY, the target range is between HUF 3.15-3.25 bn, which is subject to the boring and commissioning of the 3rd production well of the Miskolc Project this year. If the well is not implemented, the EBITDA target for 2023 is the same as it is for 2022.

The EBITDA targets for 2022 and 2023 are in line with the previously published preliminary targets by the company. Our forecast numbers are HUF 3.11 bn for 2022 and HUF 3.12 bn for 2023, which is very similar.

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 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
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
06/10/2021	BUY	HUF 1,450	Equity note
18/10/2021	BUY	HUF 1,450	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%
2021Q4	BUY	100%
	HOLD	0%
	SELL	0%

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

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