

# ZE PAK

Bloomberg: ZEP PW Equity, Reuters: ZEEP.WA

## Hold, PLN 7.8

Maintained



Securities

04 December 2019, 07:30

### Dark green

We are maintaining our HOLD recommendation for ZE PAK and slightly upgrading the TP to PLN 7.8 from PLN 7.5/share. We are expecting very solid results in 2019 (EBITDA approx. PLN 350m) which will deteriorate by approx. PLN 60-70m at EBITDA level in 2020 on account of less favourable spreads between electricity prices and CO2 costs. Given the current valuation (P/E 4.2x, EV/EBITDA 2.4x, including the reclamation reserve), threats that arise primarily from the misaligned operating horizons of existing production assets and the generation portfolio as well as high emission levels are, in our opinion, balanced against the chances of a profitable green turn with respect to generation assets.

#### Weaker 2020 prospects: EBITDA expected to decline by approx. 19% y/y

ZE PAK's 2019 portfolio was largely put together in 3Q18 when the spread between CO2 costs and electricity prices was changing rapidly but was relatively high compared to previous years. We estimate this year's spreads for 2020 to be distinctly less attractive (by an average of approx. PLN 13-15/MWh) for the company which, given generation of approx. 5-5.5TWh (2020 volumes may be slightly lower since three 200MW units at Pątnów I will be shut down), may cause pressure on EBITDA at around PLN 65-85m. Meanwhile, compensation under terminated long-term contracts depends on the result generated by Pątnów II (and should be approx. PLN 25-35m higher y/y).

#### No breakthrough regarding new strip mines

The company has not received a positive decision regarding the new strip mine in Ościśłów yet, which may cause a fuel deficit problem in the future, primarily for the technically operational 464MW unit at Pątnów II. For now, Tomislawice is a deposit with all the permits and the longest planned production horizon (2030), while the Pątnów II unit could technically be operated until 2040. We think the board could consider increasing coal supply from external sources in the future (from its current minimal level).

#### A green turn = risk of lower dividends

The company's majority shareholder held a tender for shares in August 2019 (and increased its share by 6.6pp), declaring that ZE PAK was preparing a number of "capital-intensive and time-consuming" projects connected, among other things, with RES-based generation. This reduces our dividend expectations by 50%. On the other hand, these investments may prove interesting in terms of building the company's value; however, no details of the plan (apart from the 50MW biomass boiler in Konin) have been released yet.

PLN mn	2017	2018	2019F	2020F	2021F
Revenues	2,443	2,305	3,011	3,010	2,805
EBITDA	512	90	350	284	314
EBIT	290	-477	165	115	147
Net profit	183	-460	95	90	116
P/E	4.3	nm	4.0	4.2	3.2
P/BV	0.4	0.3	0.2	0.2	0.2
EV/EBITDA	2.1	5.1	0.9	0.8	0.1
EPS	3.61	-9.05	1.86	1.78	2.29
DPS	1.20	0.00	0.40	0.40	0.60
FCF	-	-	188	88	200
CAPEX	107	72	35	160	110

F - forecast by PKO BP Securities

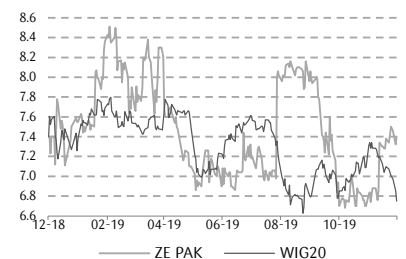
Key data	
Market price (PLN)	7.40
Upside	5%
No. of shares (mn)	50.80
Market Cap (PLNmn)	375.92
Free float	42%
Free float (PLNmn)	157
Free float (USDmn)	41
EV (PLNmn)	298.92
Net debt (PLNmn)	-77.17

Dividend	
Div yield	0.0%
Ex-div	-

Major Shareholders	% of shares
Zygmunt Solorz-Żak	58.20
OFE PZU Złota Jesień	9.10
OFE NN	8.90
-	-

Previous recomm.	Date & target price	
Hold	26-07-19	7.50
Hold	18-04-19	8.10

#### Price performance



	WIG20	Company
1 month	-4.7%	10.4%
3 months	-0.8%	-7.0%
6 months	-6.6%	7.2%
12 months	-9.3%	0.0%
Min 52 weeks PLN		6.68
Max 52 weeks PLN		8.51
Av. turnover/day PLN mn		0.26

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## Risk factors

- Regulatory environment (including the EU climate policy)
- Electricity prices on the dynamically changing market (capacity market from 2021, growing imports, potential freezing of 2020 electricity prices in the G tariff)
- Risk of production volumes, given a high share of overheads in the costs of mines
- Misalignment of the operating horizon of the power plant and the strip mine (including the risk of failure to obtain a mining permit)
- CAPEX and return on investment capital arising, among other things, from the “green turn”

## Valuation

Our valuation is based on the DCF model.

According to our calculations, the fair value of ZE PAK amounts to PLN 7.8 per share.

Our DCF model comprises a forecast of all the company's key parameters by 2025. In the second stage, we have assumed a 0% growth rate.

We have applied a WACC-based discount rate. The risk-free rate for PLN has been assumed at 3% which reflects the yield level of 10-year Treasury bonds. Beta has been assumed at 1.5x due to a heightened regulatory risk connected with the operation of ZE PAK (necessary licenses for mining new lignite deposits, EU regulations on CO<sub>2</sub>, environmental requirements). We have adopted an equity risk premium of 5%. We have discounted all free cash flows for the company as at 31 December 2019 and added net cash as well as accounted for the reclamation reserve.

DCF model								
PLN mn	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2025F<
EBIT	164.5	115.0	147.4	114.5	14.3	59.2	46.8	44.6
Tax rate	19%	19%	19%	19%	19%	19%	19%	19%
<b>NOPLAT</b>	<b>133.3</b>	<b>93.1</b>	<b>119.4</b>	<b>92.7</b>	<b>11.6</b>	<b>48.0</b>	<b>37.9</b>	<b>36.1</b>
CAPEX	35.0	160.0	110.0	135.0	135.0	105.0	35.0	150.0
Depreciation (adj. for leases)	179.5	162.8	160.3	157.6	155.8	153.2	147.8	150.0
Changes in working capital	89.3	7.5	-30.7	-0.1	-13.5	1.3	12.5	0.0
<b>FCF</b>	<b>188.5</b>	<b>88.4</b>	<b>200.3</b>	<b>115.3</b>	<b>45.8</b>	<b>94.9</b>	<b>138.2</b>	<b>36.1</b>
WACC	9.6%	9.6%	9.7%	9.7%	9.7%	9.7%	9.7%	
Discount ratio	0.00	0.91	0.83	0.76	0.69	0.63	0.57	
<b>DFCF</b>	<b>0.0</b>	<b>80.6</b>	<b>166.6</b>	<b>87.5</b>	<b>31.7</b>	<b>59.8</b>	<b>79.4</b>	
DFCF Sum - Phase I	505.7							
DFCF Sum - Phase II	217.7							
<b>Enterprise Value (EV)</b>	<b>723.4</b>							
Net debt (excl. leases)	-77.2							
Reclamation reserve	437.2							
Minorities	3							
<b>Fair value</b>	<b>360.1</b>							
Number of shares (million)	50.8							
Fair value per share as at 31.12.2019	7.1							
<b>Target price in 12 mths (PLN)</b>	<b>7.8</b>							
Current price	7.40							
Dividend	0.0							
Expected rate of return	5.0%							

Source: forecasts of PKO BP Securities

**Main valuation assumptions:**

- Units 3, 4 and 6 at the Pątnów I power plant are expected to shut down in 2020 (on average in mid-2020). We are expecting a decline in production volume to less than 4.7TWh in the medium term.
- Support from the capacity market is expected at PLN 510 in 2021-2024, while the compensation on account of terminating long-term contracts should reach a total of PLN 630m in 2019-2023.
- We are anticipating a gradual increase in CO2 prices from an average of EUR 25 in 2020 to EUR 30 in 2025. Practically the whole CO2 cost surplus is transferred to energy prices, similarly to the expected lower prices of hard coal in the medium term.
- EUR/PLN is forecast at 4.3.
- The mid-term cost inflation has been assumed at 2%.
- We are anticipating the execution of the Konin investment in 2020-21 and the construction of a new strip mine in Ościsłów, as well as a general overhaul of the Pątnów II power plant (including its adaptation to BAT requirements) in 2024.
- We are anticipating a successful reorganisation of the company's mining operations (including, in particular, a gradual reduction in the number of strip mines through shutting down Józwin (2021), Drzewiec (2021), and Adamów (2023): this is the main factor that will improve the company's results by 2024 despite the termination of compensation under long-term contracts in 2023.
- Our valuation was drafted according to pre-IFRS 16 requirements, which means that the costs of leasing reduce FCFF and that net debt does not include leasing liabilities.

**Peer analysis****Peers valuation**

Company	P/E			EV/EBITDA		
	2019F	2020F	2021F	2019F	2020F	2021F
PGE	6.6	7.6	4.7	3.9	3.9	3.3
Energa	5.2	4.5	4.3	4.1	4.2	4.2
Enea	4.0	3.5	2.7	3.2	3.1	2.7
Tauron	3.1	2.9	2.3	4.5	4.3	3.9
CEZ	15.1	12.3	12.7	6.7	6.2	6.2
Engie	13.8	12.3	11.1	6.6	6.3	6.0
Iberdrola	16.3	15.2	14.5	10.5	9.8	9.3
EDF	13.5	11.4	11.4	4.1	3.8	3.7
Innogy	29.5	28.0	24.3	10.6	10.5	10.0
E.ON	13.7	14.3	13.3	10.4	7.7	7.5
Verbund	28.0	22.3	21.0	14.8	12.5	11.9
RWE	17.3	14.9	11.1	7.6	5.0	4.3
<b>Median</b>	<b>13.7</b>	<b>12.3</b>	<b>11.2</b>	<b>6.7</b>	<b>5.6</b>	<b>5.1</b>
ZE PAK (PKO BP)	4.0	4.2	3.3	2.1	2.4	1.6
Premium/discount	-71%	-66%	-71%	-68%	-57%	-69%

Source: Bloomberg, PKO BP Securities

ZE PAK is traded at a significant discount to peers. We find the discount justified given the high share of support programmes in EBITDA, an emissions-intensive generation portfolio, and the higher cost of capital caused by regulatory risks.

## Financial Forecasts

Profit and loss account	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Sales of products, goods and materials	2,680	2,948	2,705	2,443	2,305	3,011	3,010	2,805	2,795
Costs of sold products, goods and materials	-2,452	-4,651	-2,241	-2,035	-2,628	-2,722	-2,772	-2,537	-2,562
Gross profit on sales	228	-1,703	463	408	-323	290	238	268	233
EBITDA	508	494	594	512	90	350	284	314	278
Selling costs	0	0	0	0	0	0	0	0	0
General administrative expenses	-4	-5	-4	-4	-4	-4	-4	-4	-4
Operating profit	148	-1,796	371	290	-477	165	115	147	114
Pre-tax profit	98	-1,833	308	259	-515	155	113	145	112
Income tax	-20	-47	-58	-75	52	-59	-21	-28	-21
Net profit (loss) attributable to non-controlling interest	-4	1	3	0	-3	1	1	1	1
Net Profit (loss)	82	-1,881	248	183	-460	95	90	116	90
Balance Sheet	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Fixed assets	5,686	3,714	3,705	3,451	2,968	2,818	2,809	2,753	2,724
Intangible assets	82	17	119	7	4	4	4	4	4
Tangible assets	5,300	3,475	3,394	3,285	2,791	2,641	2,632	2,576	2,547
Other long-term assets	304	221	191	160	173	173	173	173	173
Current assets	1,181	1,260	1,099	1,007	902	811	884	1,021	1,109
Inventories	237	158	105	98	109	113	115	105	106
Receivables	254	268	246	253	354	463	463	431	430
Cash and cash equivalents	451	460	427	358	341	137	209	387	475
Other short-term assets	240	374	321	298	97	97	97	97	97
Total Assets	6,867	4,974	4,804	4,458	3,870	3,628	3,693	3,774	3,833
Equity capital	3,820	1,885	2,090	2,210	1,687	1,781	1,851	1,947	2,007
Liabilities	3,048	3,089	2,715	2,248	2,184	1,847	1,841	1,827	1,826
Long-term liabilities	1,842	1,830	1,447	1,249	974	923	923	923	923
Loans and borrowings	867	925	588	303	59	9	9	8	8
Other provisions	975	905	859	946	915	915	915	915	915
Short-term liabilities	1,206	1,260	1,268	1,000	1,210	924	918	904	903
Loans and borrowings	349	387	422	350	361	52	52	48	48
Other provisions	502	636	543	504	694	694	694	694	694
Trade liabilities and other	368	513	427	396	598	598	598	598	598
Total Liabilities	6,867	4,974	4,804	4,458	3,870	3,628	3,693	3,774	3,833
Cash flow statement	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Cash flow on operating activity	414	467	536	479	367	192	252	314	255
Cash flow on investment activity	-550	-415	-184	-58	-61	-26	-151	-101	-126
Cash flow on financial activity	60	-24	-387	-447	-325	-360	-20	-24	-31
Indicators (%)	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
ROE	2.2%	-65.9%	12.5%	8.5%	-23.6%	5.5%	5.0%	6.1%	4.6%
Net Debt	765.0	850.6	582.5	294.1	79.0	-77.2	-148.3	-331.3	-419.4

Source: forecasts of PKO BP Securities

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min (max) 52 weeks: minimum (maximum) of the market share price during the previous 52 weeks

Capitalisation: product of the share market price and the number of shares

EV: sum of the company's capitalisation and net debt

free float (%): share of the total number of shares decreased by 5% stakes held by one shareholder and own shares held by the company in the total number of shares

Average trading/month: average trading per month calculated as total trading value over previous 12 months divided by 12

ROE: rate of return on equity

ROA: rate of return on assets

EBIT: operating profit  
 EBITDA: operating profit + depreciation and amortization  
 EPS: earnings per share  
 DPS: dividend per 1 share  
 CEPS: sum of net profit and depreciation and amortization per 1 share  
 P/E: quotient of share market price and EPS  
 P/BV: quotient of share market price and book value of one share  
 EV/EBITDA: quotient of capitalisation increased by the company's net debt and EBITDA  
 Gross sales margin: relation of gross sales profit to net sales proceeds  
 EBITDA margin: relation of the sum of operating profit and depreciation to net sales proceeds  
 EBIT margin: relation of operating profit to net sales proceeds  
 Net profitability: relation of net profit to net sales proceeds

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Issuer:	Reservation
ZE PAK	-

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The list below sets out all the recommendations drafted by PKO BP Securities in the last 12 months, within the scope of the "Analytic Coverage Support Pilot Programme".

Company	Recommendation	Date of reco.	Target price	Relevant Market Price*	Market cap. (PLN mn)	P/E			EV/EBITDA			Analyst
						2018	2019F	2020F	2018	2019F	2020F	
Asseco SEE	Buy	2019-07-19	20,50	16,8	1297,36	1297,4	9,5	15,1	13,7	4,0	7,7	Małgorzata Żelazko
Apator	Hold	2019-07-22	24,30	24,3	623,39	623,39	10,74	9,35	9,54	6,97	6,25	Piotr Łopaciuk
Mabion	Buy	2019-07-26	105,00	85,5	375,92	1385,80	nm	nm	18,76	0,00	0,00	Dawid Górczyński
ZE PAK	Hold	2019-07-26	7,50	7,0	375,92	nm	3,98	4,17	5,12	0,85	0,80	Andrzej Rembelski
Asseco SEE	Hold	2019-11-19	25,00	23,8	1297,36	9,51	15,06	13,73	4,01	7,66	6,87	Małgorzata Żelazko
ZE PAK	Hold	2019-12-04	7,80	7,4	375,92	nm	4,0	4,2	5,1	0,9	0,8	Andrzej Rembelski

\*at the time of publication