



## A non-renewable dividend source

ZE PAK is a vertically integrated private energy company with a generation portfolio focused on lignite-based assets. Given its exposure to this emissions-intensive fuel, dynamically growing CO<sub>2</sub> prices and the potential growth of the RES sector are crucial for the company. A rather strong balance sheet (with ND at the end of 2019 anticipated at zero) is noteworthy as it may permit the payment of a hefty dividend (DY 11%) but the potential CAPEX on new strip mines or adaptation to environmental protection standards may limit it in the medium term. There is also a significant risk connected with the not-so-green generation portfolio and pending legal procedures (derogations for generation units, new licences). We are issuing a HOLD recommendation for ZE PAK with TP at PLN 7.5 per share.

### Capacity market and long-term contract compensations will support revenue

587MW of ZE PAK's generation capacities were qualified for the capacity market; the finalised auctions for 2021-2023 should ensure the company an additional revenue of PLN 375m. As a result of the planned EU regulations, a great majority of the company's capacities will only be permitted to take part in the auctions for 2024. In addition, the company still has approx. PLN 600-650m in compensations on account of terminating long-term contracts for Pątnów II to be recognised until 2023. After these two support programmes are terminated, the company's EBITDA will decline by approx. 50% compared to its average results from 2019-2023.

### Growing CO<sub>2</sub> prices, cheaper hard coal and the increasing importance of RES

Changes in the European system for CO<sub>2</sub> emission allowances resulted in a dynamic hike in their prices which are now traded as high as EUR 30 (while the average in 2017 was below EUR 6). Lignite is the most emissions-intensive source of energy. In addition, low ARA coal prices are a harbinger of a decrease in the price of hard coal in Poland which will result in the greater competitiveness of generation units using that fuel (which are currently shaping energy prices in Poland). The development of the RES segment (with RES installations having the marginal cost of generation at close to zero is expected in the medium term.

### A strong balance sheet and hefty dividends

Our attention is drawn to the relatively strong balance sheet with ND potentially around zero at the end of 2019. We expect this to allow the company to start paying out dividends again (DY is anticipated at approx. 11%). They may be curbed in the medium term by potential investment outlays; however, ZE PAK is also considering investing in the biggest PV installation in Poland with a forecast production volume of approx. 70GWh/year which will cost PLN 200m.

PLN mn	2017	2018	2019F	2020F	2021F
Revenues	2,443	2,305	2,949	2,847	2,925
EBITDA	512	90	323	280	406
EBIT	290	-477	150	120	245
Net profit	183	-460	101	84	184
P/E	4.3	nm	3.5	4.3	1.9
P/BV	0.4	0.3	0.2	0.2	0.2
EV/EBITDA	2.1	5.1	1.1	1.1	0.6
EPS	3.61	-9.05	1.99	1.64	3.61
DPS	1.20	0.00	0.80	0.80	1.20
FCF	-	-	98	103	131
CAPEX	107	72	115	160	220

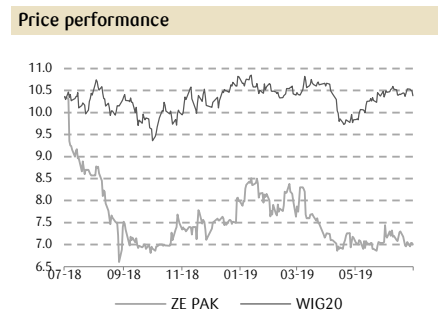
F - forecast by PKO BP Securities

Key data	
Market price (PLN)	7.00
Upside	7%
No. of shares (mn)	50.80
Market Cap (PLNm)	355.60
Free float	48%
Free float (PLNm)	172
Free float (USDmn)	45
EV (PLNm)	356.59
Net debt (PLNm)	0.83

Dividend	
Div yield	0.0%
Ex-div	-

Major Shareholders	% of shares
Zygmunt Solorz-Żak	51.60
OFE PZU Złota Jesień	9.10
OFE NN	8.90
-	-

Previous recomm.	Date & target price	
Hold	18-04-19	8.10
Buy	19-10-18	8.10



	WIG20	Company
1 month	0.3%	-0.8%
3 months	-2.1%	-2.8%
6 months	-3.7%	-12.4%
12 months	2.2%	-32.2%
Min 52 weeks PLN		6.60
Max 52 weeks PLN		10.36
Av. turnover/day PLN mn		0.27

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## Risk factors

- Power supply and demand
- Energy prices
- Regulatory environment
- Fuel costs and deliveries, cost of lignite mining
- Capital expenditure

## Valuation

Our valuation is based on the DCF model.

According to our calculations, the fair value of ZE PAK amounts to PLN 7.5 per share.

Our DCF model lasts until 2040 (the expected shutdown of Pątnów II) and it is in this time horizon that we have forecast all of the company's key parameters.

We have applied a WACC-based discount rate. The risk-free rate for PLN has been assumed at 3.2% which reflects the yield level of 10-year Treasury bonds. Beta has been assumed at 1.5x due to the high 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
EBIT	150.3	120.3	245.1	227.4	198.3
Tax rate	19%	19%	19%	19%	19%
<b>NOPLAT</b>	<b>121.8</b>	<b>97.5</b>	<b>198.5</b>	<b>184.2</b>	<b>160.6</b>
CAPEX	115.0	160.0	220.0	190.0	175.0
Depreciation	172.2	159.5	160.8	163.3	164.4
Changes in working capital	80.8	-5.6	8.8	19.3	15.2
<b>FCF</b>	<b>98.2</b>	<b>102.5</b>	<b>130.6</b>	<b>138.2</b>	<b>134.8</b>
WACC	10.2%	10.2%	10.2%	10.2%	10.2%
Discount ratio	0.00	0.91	0.82	0.75	0.68
DFCF	0.0	93.0	107.5	103.2	91.4
DFCF Sum - Phase I	395.2				
DFCF Sum - Phase II	406.4				
Enterprise Value (EV)	801.6				
Net debt	0.8				
Reclamation reserve	437.2				
Minorities	3				
<b>Fair value</b>	<b>360.3</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>7.5</b>				
Current price	7.00				
Dividend	0.0				
Expected rate of return	7.3%				

Source: forecasts of PKO BP Securities



## Comparative valuation

### Peers valuation

Spółka	P/E			EV/EBITDA		
	2019F	2020F	2021F	2019F	2020F	2021F
PGE	6.8	7.3	4.3	4.0	4.0	3.2
Energa	4.6	4.3	3.9	4.2	4.0	3.9
Enea	3.9	3.6	2.5	3.6	3.4	2.9
Tauron	2.6	2.5	1.9	4.3	4.1	3.5
CEZ	15.5	12.9	13.7	6.4	5.9	6.0
Engie	13.4	12.0	11.0	6.1	5.8	5.6
Iberdrola	16.5	15.4	14.5	9.4	8.8	8.3
EDF	16.2	12.2	11.0	4.1	3.7	3.6
Innogy	28.2	25.5	21.9	10.8	10.4	9.9
E.ON	13.8	13.4	12.8	5.7	4.5	4.3
Verbund	32.1	24.4	23.1	16.9	14.0	13.3
RWE	23.9	13.9	10.4	12.9	6.4	5.7
<b>Median</b>	<b>14.6</b>	<b>12.5</b>	<b>11.0</b>	<b>5.9</b>	<b>5.2</b>	<b>4.9</b>
ZE PAK (PKO BP)	3.5	4.3	1.9	1.1	1.3	0.9
Premium/discount	-76%	-66%	-82%	-81%	-75%	-82%

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, the 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	2,949	2,847	2,925	3,059
Costs of sold products, goods and materials	-2,452	-4,651	-2,241	-2,035	-2,628	-2,673	-2,603	-2,559	-2,713
Gross profit on sales	228	-1,703	463	408	-323	276	243	366	346
EBITDA	508	494	594	512	90	323	280	406	391
Selling costs	-4	-5	-4	-4	-4	-4	-4	-4	-4
General administrative expenses	-149	-111	-109	-119	-124	-121	-119	-117	-114
Operating profit	148	-1,796	371	290	-477	150	120	245	227
Pre-tax profit	98	-1,833	308	259	-515	126	104	229	211
Income tax	-20	-47	-58	-75	52	-24	-20	-43	-40
Net profit (loss) attributable to non-controlling interest	-4	1	3	0	-3	1	1	2	2
Net Profit (loss)	82	-1,881	248	183	-460	101	84	184	169
Balance Sheet	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Fixed assets	5,686	3,714	3,705	3,451	2,968	2,911	2,911	2,971	2,997
Intangible assets	82	17	119	7	4	4	4	4	4
Tangible assets	5,300	3,475	3,394	3,285	2,791	2,734	2,734	2,794	2,820
Other long-term assets	304	221	191	160	173	173	173	173	173
Current assets	1,181	1,260	1,099	1,007	902	691	719	805	895
Inventories	237	158	105	98	109	111	108	106	113
Receivables	254	268	246	253	354	453	437	450	470
Cash and cash equivalents	451	460	427	358	341	29	76	151	215
Other short-term assets	240	374	321	298	97	97	97	97	97
Total Assets	6,868	4,974	4,804	4,459	3,871	3,602	3,630	3,775	3,893
Equity capital	3,820	1,885	2,090	2,210	1,687	1,788	1,831	1,974	2,082
Liabilities	3,048	3,089	2,715	2,248	2,184	1,814	1,799	1,801	1,810
Long-term liabilities	1,842	1,830	1,447	1,249	974	919	919	919	919
Loans and borrowings	867	925	588	303	59	4	4	4	4
Other provisions	975	905	859	946	915	915	915	915	915
Short-term liabilities	1,206	1,260	1,268	1,000	1,210	895	880	883	891
Loans and borrowings	349	387	422	350	361	26	24	25	26
Other provisions	502	636	543	504	694	694	694	694	694
Trade liabilities and other	355	238	303	146	155	175	162	163	171
Total Liabilities	6,868	4,974	4,804	4,459	3,871	3,602	3,630	3,775	3,893
Cash flow statement	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
Cash flow on operating activity	414	467	536	479	367	194	249	337	315
Cash flow on investment activity	-550	-415	-184	-58	-61	-106	-151	-211	-181
Cash flow on financial activity	60	-24	-387	-447	-325	-390	-43	-40	-60
Indicators (%)	2014	2015	2016	2017	2018	2019F	2020F	2021F	2022F
ROE	2.2%	-65.9%	12.5%	8.5%	-23.6%	5.8%	4.6%	9.7%	8.4%
Net Debt	765.0	850.6	582.5	294.1	79.0	0.8	-47.1	-122.1	-184.4

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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A PKO BP Securities recommendation is based on at least two out of four valuation methods: DCF (discounted cash flow model), ratio analysis method (comparing the values of basic market ratios with similar ratios of other companies representing a given sector), sum of the parts of assets method (SOTP) and discounted dividends model. A disadvantage of the DCF and the discounted dividends model is their high sensitivity to adopted assumptions, including, in particular, those pertaining to determining the residual value. Furthermore, the discounted dividends model cannot be applied to the valuation of companies without a determined dividend policy. The advantages of both these methods include their independence from current market valuations of peer companies. On the other hand, the advantage of the ratio analysis is the fact that it is based on a measurable market valuation of a given sector. Its disadvantage lies in the risk that at any given time, the market might not value peer companies correctly. The sum of the parts method (SOTP) consists in summing up the values of various assets of the company, calculated using one of the above methods.

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A BUY recommendation means that the recommendation author thinks that company shares have the potential for at least a 10% price growth.

A HOLD recommendation means that the recommendation author thinks that company shares have the potential for growth between 0 and a 10%.

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Issuer:	Reservation
ZE PAK	-

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The time and date of the first distribution of the Recommendation are identical with the time and date of delivering this Recommendation in electronic form to customers.



Whenever this Recommendation quotes a price for the financial instrument, it will be understood as the closing price from the last trading day.

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	908,15	9,5	12,3	11,8	4,0	5,6	5,1	Małgorzata Żelazko
Apator	Hold	2019-07-22	24,30	24,3	711,19	10,56	9,36	9,51	6,88	6,47	6,22	Piotr Łopaciuk
ZE PAK	Hold	2019-07-26	7,00	7,0	355,60	nm	3,51	4,26	5,12	1,11	1,10	Andrzej Rembelski

\*at the time of publication