

ZE PAK

Bloomberg: ZEP PW Equity, Reuters: ZEEP.WA

Sell, PLN 6.5

Downgraded from: Hold



Securities

24 April 2020, 07:30

The first critical year

2020 will be the first critical year for ZE PAK. The company hedged just part of its generation portfolio for 2020, but the environment has become more demanding. Therefore, we are expecting 2020 EBITDA to drop by over 50% y/y to PLN 190m. In 2025 we see another critical point – without LTC compensation and the Capacity Market, ZE PAK's EBITDA may plunge to just PLN 70-80m. We are downgrading our recommendation to SELL, with a TP of PLN 6.5.

2020 EBITDA will plummet by over 50%

ZE PAK did not fully hedge its 1YR FWD contracts in 2019 and counted on a better environment in 2020. Unfortunately, the situation has only got worse – power consumption decreased by 2% y/y in 1Q20, while wind farms generation increased (+11% y/y in 1Q20) as well as net imports (+58% y/y). It all puts the current margins under pressure – e.g. model spot CDS decreased from PLN 14/MWh in 2019 to PLN -30/MWh in 1Q20. All in all, we are expecting 2020 EBITDA to plummet by over 50% y/y to PLN 190m.

Old vices are still in place

The company has still not obtained a permit for the new strip mine in Ościstów – the management expects the output to be approx. 2.5mt annually in 2024-36 (31.3mt of reserves) compared to approx. 5-6mt annual coal consumption, according to our estimates. In addition, the current profitability is heavily supported by LTC compensation (around PLN 160m annually in 2021-23) and will also be increased by the Capacity Market (PLN 540m in 2021-24). It puts ZE PAK's results under a significant pressure in the long-term, should any new schemes do not emerge – we see it as complicated for the most polluting lignite-fired power plants.

No details of a green turn

We are still waiting for ZE PAK to present more details on its green turn. So far, the company has purchased a small hydroliser (5 MW) and signed a contract for the reconstruction of a 50MW boiler to biomass for PLN 90m. We see the green turn as challenging for the company – e.g. the construction of 100MW wind farms would cost approx. PLN 600-700m.

PLN mn	2018	2019	2020F	2021F	2022F
Revenues	2,305	2,878	2,820	2,529	2,507
EBITDA	90	394	190	298	239
EBIT	-477	-424	43	174	114
Net profit	-460	-445	30	137	89
P/E	nm	nm	12.9	2.8	4.4
P/BV	0.3	0.3	0.3	0.3	0.3
EV/EBITDA	5.1	1.7	3.0	1.6	1.7
EPS	-9.05	-8.76	0.59	2.69	1.75
DPS	1.20	0.00	0.00	0.20	0.30
FCF	-	-	112	93	86
CAPEX	72	35	100	170	135

F - forecast by PKO BP Securities

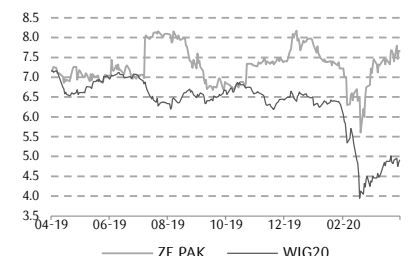
Key data	
Market price (PLN)	7.66
Upside	-15%
No. of shares (mn)	50.80
Market Cap (PLNmn)	389.13
Free float	39%
Free float (PLNmn)	152
Free float (USDmn)	36
EV (PLNmn)	567.74
Net debt (PLNmn)	-396.27

Dividend	
Div yield	0.0%
Ex-div	-

Major Shareholders	% of shares
Zygmunt Solorz-Żak	60.92
OFE PZU Złota Jesień	9.10
OFE NN	5.02
-	-

Previous recomm.	Date & target price	
Hold	04-12-19	7.80
Hold	26-07-19	7.50

Price performance



	WIG20	Company
1 month	15.7%	12.6%
3 months	-24.5%	-2.8%
6 months	-26.4%	11.3%
12 months	-31.3%	6.1%
Min 52 weeks PLN		5.60
Max 52 weeks PLN		8.18
Av. turnover/day PLN mn		0.13

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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, increasing share of RES)
- Risk of production volumes
- Misalignment of the operating horizon of the power plant and the strip mine (including the risk of a 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 6.5 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 2.5%, which reflects the yield level of 10-year Treasury bonds. Beta has been assumed at 1.2x due to a heightened regulatory risk connected with the operation of ZE PAK (necessary licences for mining new lignite deposits, EU regulations on CO₂, environmental requirements). We have adopted an equity risk premium of 6%. We have discounted all free cash flows for the company as at 31 December 2019 and added net debt adjusted for IFRS16 and CO₂ payments for 2019, as well as accounted for the reclamation reserve.

DCF model							
PLN mn	2020F	2021F	2022F	2023F	2024F	2025F	2025F<
EBIT	43.1	173.7	114.1	-36.3	-26.2	-39.3	37.1
Tax rate	19%	19%	19%	19%	19%	19%	19%
NOPLAT	34.9	140.7	92.4	-29.4	-21.2	-31.8	30.0
CAPEX	100.0	170.0	135.0	135.0	105.0	40.0	40.0
Depreciation (adj. for leases)	140.6	118.3	119.3	119.9	119.6	116.4	40.0
Changes in working capital	-36.7	-3.5	-9.0	-5.5	1.2	12.4	0.0
FCF	112.1	92.6	85.8	-39.0	-7.8	32.2	30.0
WACC	9.7%	9.7%	9.7%	9.7%	9.7%	9.7%	9.7%
Discount ratio	0.91	0.83	0.76	0.69	0.63	0.57	
DFCF	102.2	76.9	65.0	-26.9	-4.9	18.5	
DFCF Sum - Phase I	230.7						
DFCF Sum - Phase II	177.7						
Enterprise Value (EV)	408.4						
Net debt (excl. Leases, adj. for 2019 CO ₂ cost)	10.0						
Reclamation reserve	101.7						
Minorities	2						
Fair value	294.4						
Number of shares (million)	50.8						
Fair value per share as at 31.12.2019	5.8						
Target price in 12 mths (PLN)	6.5						
Current price	7.66						
Dividend	0.0						
Expected rate of return	-15%						

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 the decline in production volume to be less than 4.7TWh in the medium term.
- Support from the capacity market is expected at PLN 540m in 2021-2024, while the compensation on account of terminating long-term contracts should reach a total of PLN 490m in 2020-2022.
- We anticipate a gradual increase in CO2 prices from an average of EUR 21 in 2020 to EUR 26 in 2025. Practically the whole CO2 cost surplus is transferred to energy prices, similar to the expected lower prices of hard coal in the medium term.
- The EUR/PLN is forecast at 4.4-4.5.
- The mid-term cost inflation has been assumed at 2%.
- We anticipate the execution of the Konin investment in 2020-21 and the construction of a new strip mine in Ościslów, as well as a general overhaul of the Pątnów II power plant (including its adaptation to BAT requirements) in 2024.
- We anticipate a successful reorganisation of the company's mining operations, including in particular a gradual reduction in the number of strip mines.
- 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		
	2020F	2021F	2022F	2020F	2021F	2022F
PGE	9.0	3.2	3.5	3.4	2.5	2.7
Energa	6.0	6.0	-	4.5	4.4	4.2
Enea	2.8	2.1	2.8	2.8	2.5	2.6
Tauron	2.8	1.9	2.6	4.7	4.1	4.2
CEZ	11.5	13.0	12.5	5.6	5.8	5.6
Engie	10.5	8.5	7.8	5.5	5.1	4.8
Iberdrola	16.0	15.1	14.2	10.3	9.7	9.1
EDF	11.9	10.9	9.4	4.4	4.2	4.0
Innogy	28.7	26.2	21.2	10.7	10.4	10.2
E.ON	13.6	12.0	9.9	7.5	7.2	6.9
Verbund	24.4	25.6	24.3	12.7	12.7	12.5
RWE	15.2	12.5	12.6	5.2	4.6	4.5
Median	11.7	11.5	9.9	5.3	4.9	4.7
ZE PAK (PKO BP)	12.9	2.8	4.4	3.0	1.6	1.7
Premium/discount	11%	-75%	-56%	-44%	-66%	-63%

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 relatively higher cost of capital caused by regulatory risks.

Financial Forecasts

Profit and loss account	2015	2016	2017	2018	2019	2020F	2021F	2022F	2023F
Sales of products, goods and materials	2,948	2,705	2,443	2,305	2,878	2,820	2,529	2,507	2,399
Costs of sold products, goods and materials	-4,651	-2,241	-2,035	-2,628	-3,186	-2,659	-2,239	-2,279	-2,323
Gross profit on sales	-1,703	463	408	-323	-308	162	290	228	76
EBITDA	494	594	512	90	394	190	298	239	90
Selling costs	0	0	0	0	0	-192	-299	-239	-55
General administrative expenses	-5	-4	-4	-4	-5	-5	-5	-5	-5
Operating profit	-1,796	371	290	-477	-424	43	174	114	-36
Pre-tax profit	-1,833	308	259	-515	-440	38	171	111	-39
Income tax	-47	-58	-75	52	-6	-7	-32	-21	0
Net profit (loss) attributable to non-controlling interest	1	3	0	-3	-1	0	1	1	0
Net Profit (loss)	-1,881	248	183	-460	-445	30	137	89	-39
Balance Sheet	2015	2016	2017	2018	2019	2020F	2021F	2022F	2023F
Fixed assets	3,714	3,705	3,451	2,968	2,182	2,135	2,181	2,191	2,200
Intangible assets	17	119	7	4	59	59	59	59	59
Tangible assets	3,475	3,394	3,285	2,791	1,960	1,913	1,959	1,969	1,978
Other long-term assets	221	191	160	173	163	163	163	163	163
Current assets	1,260	1,099	1,007	902	936	952	994	1,066	999
Inventories	158	105	98	109	104	87	73	75	76
Receivables	268	246	253	354	229	224	201	199	191
Cash and cash equivalents	460	427	358	341	415	453	531	604	544
Other short-term assets	374	321	298	97	189	189	189	189	189
Total Assets	4,974	4,804	4,458	3,870	3,118	3,088	3,175	3,257	3,199
Equity capital	1,885	2,090	2,210	1,687	1,176	1,207	1,333	1,407	1,353
Liabilities	3,089	2,715	2,248	2,184	1,942	1,881	1,842	1,850	1,846
Long-term liabilities	1,830	1,447	1,249	974	988	940	936	936	934
Loans and borrowings	925	588	303	59	85	36	33	32	31
Other provisions	905	859	946	915	904	904	904	904	904
Short-term liabilities	1,260	1,268	1,000	1,210	953	941	906	914	912
Loans and borrowings	387	422	350	361	47	20	18	18	17
Other provisions	636	543	504	694	797	797	797	797	797
Trade liabilities and other	513	427	396	598	695	695	695	695	695
Total Liabilities	4,974	4,804	4,458	3,870	3,118	3,088	3,175	3,257	3,199
Cash flow statement	2015	2016	2017	2018	2019	2020F	2021F	2022F	2023F
Cash flow on operating activity	467	536	479	367	448	214	266	224	92
Cash flow on investment activity	-415	-184	-58	-61	19	-100	-170	-135	-135
Cash flow on financial activity	-24	-387	-447	-325	-356	-75	-16	-16	-17
Indicators (%)	2015	2016	2017	2018	2019	2020F	2021F	2022F	2023F
ROE	-65.9%	12.5%	8.5%	-23.6%	-31.1%	2.5%	10.8%	6.5%	-2.8%
Net Debt	850.6	582.5	294.1	79.0	-283.0	-396.3	-480.7	-553.9	-496.3

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	1536.07	9.5	10.0	15.6	4.0	7.3	8.0	Małgorzata Żelazko
Apator	Hold	2019-07-22	24.30	24.3	547.3	10.7	8.2	8.4	7.0	5.6	5.52	Piotr Łopaciuk
Mabion	Buy	2019-07-26	105.00	85.5	285.30	nm	nm	nm	0.00	0.00	0.00	Dawid Górzynski
ZE PAK	Hold	2019-07-26	7.50	7.0	389.13	nm	nm	12.9	5.1	1.7	3.0	Andrzej Rembelski
Asseco SEE	Hold	2019-11-19	25.00	23.8	1536.07	9.5	10.0	15.6	4.0	7.3	8.0	Małgorzata Żelazko
ZE PAK	Hold	2019-12-04	7.80	7.4	389.13	nm	nm	12.9	5.1	1.7	3.0	Andrzej Rembelski
Apator	Hold	2019-12-05	22.5	21.10	547.3	10.7	8.2	8.4	7.0	5.6	5.52	Piotr Łopaciuk
Mabion	Buy	2019-12-16	100.00	60.2	285.30	nm	nm	nm	0.00	0.00	0.00	Dawid Górzynski
Asseco SEE	Hold	2020-03-16	27.20	25	1536.07	9.5	10.0	15.6	4.0	7.3	8.0	Małgorzata Żelazko
ZE PAK	Sell	2020-04-24	6.50	7.66	389.13	nm	nm	12.9	5.1	1.7	3.0	Andrzej Rembelski

*at the time of publication