

Monday, January 08, 2018 | special comment

PKN Orlen – Forecast Of 2017 Q4 Results

Rating: sell | target price: PLN 81.80 | current price: PLN 107.35

PKN PW; PKN.WA | Gas & Oil, Poland

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Ahead of PKN Orlen's 2017 Q4 earnings announcement, slated for January 25th, the following are our expectations as to the Company's performance in the period. At a projected PLN 2 billion, the adjusted LIFO-based EBITDA is set to show year-over-year contraction of 17% from a low year-ago base (with Unipetrol operating at partial capacity during Q4'16) due to worsened market conditions in Downstream, combined with a stronger zloty and a number of unplanned outages on petrochemical facilities. The reported EBITDA figure will receive a lift from LIFO effects of an estimated PLN 0.6bn, coupled with gains on foreign-exchange adjustments, and fulfil nearly 100% of our estimate for the quarter. Nevertheless we would take year-on-year EBITDA shrinkage as a sign that 2018 market expectations for PKN could be overestimated given base effects and the current market conditions.

PKN reported that its model refining margin for Q4 2017 came in at 22.3 zlotys per barrel, a significant fall from the year-ago level of PLN 32.5 due to rapid contraction experienced in December. At the same time, the quarterly product output will have increased by an estimated 5% thanks to higher capacity utilization by refineries in Poland and Lithuania. Based on this, after factoring in the rebound in wholesale margins registered in Q4 2016 thanks to the partial elimination of illegal fuel trade in Poland, we estimate that the adjusted Downstream EBITDA for Q4 2017 will reach PLN 1.04bn compared to PLN 1.5bn in the same period the previous year. The reported EBITDA figure may receive a boost of some PLN 0.6bn from LIFO effects owed to a surge in the prices of crude oil.

In Petrochemicals, we predict that the adjusted LIFO-based EBITDA will come in at PLN 0.6bn compared to PLN 0.29bn in Q4 2016 and PLN 0.85bn in Q3 2017. The expected expansion on a year-over-year basis was led by a higher polyolefin volume after the restart of a Czech steam cracker, and the contraction on a quarter-on-quarter basis is attributed to a series of outages experienced by PKN's petrochemical facilities, including the olefin and PTA lines and the fertilizer unit, underpinned by worsened market conditions (benchmark margins and exchange rates).

In the Retail segment, a continuation of the positive trends observed in the previous quarters will result in a 5% year-on-year increase in sales volumes (compared to y/y growth of 6.7% in the three quarters prior), and stable profit margins (in Q3'17 margins showed a y/y dip caused by base effects). As a result, the segmental EBITDA will post 5% year-on-year growth to PLN 0.46bn.

The fourth-quarter core EBITDA in Upstream is expected to come in at about PLN 93m compared to PLN 128m in Q4 2016 and PLN 53m in the quarter before. The 15% fall on a year-over-year basis was due to a 20% drop in natural gas prices in Canada, and a decreased share in total sales of liquid hydrocarbons (down to 40% in 9M'17 from 44% in 9M'16), offsetting the positive impacts of higher volumes and crude prices.

General expenses in Q4 will be higher than in the preceding quarters, in line with regular seasonal patterns.

PKN Orlen is expected to recognize a gain of PLN +0.24bn on financing activity in Q4 2017, stemming from FX gains on euro-denominated debt and on oil payables.

Summary Q4 2017 expectations

| (PLN m) | Q3'16 | Q4'16 | Q1'17 | Q2'17 | Q3'17 | Q4'17E | Y/Y | 2017E | YTD/2017E |
|---------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|-------------|--------------|------------|
| Revenue | 21,083 | 22,902 | 22,875 | 23,025 | 24,730 | 25,128 | 10% | 94,537 | 101% |
| EBITDA | 2,311 | 3,339 | 2,838 | 2,701 | 2,890 | 2,649 | -21% | 10,986 | 101% |
| Downstream | 1,054 | 2,527 | 1,735 | 900 | 1,566 | 1,639 | -35% | 5,643 | 103% |
| of which LIFO effects | 82 | 508 | 513 | -304 | -96 | 596 | 17% | 700 | 101% |
| Retail | 618 | 434 | 372 | 564 | 609 | 462 | 6% | 2,036 | 99% |
| Petrochemicals | 729 | 594 | 804 | 1,305 | 840 | 621 | 5% | 3,633 | 98% |
| of which LIFO effects | 5 | 18 | 6 | -40 | -11 | 20 | 11% | 0 | - |
| Upstream | 59 | 56 | 79 | 82 | 11 | 93 | 66% | 295 | 90% |
| Unattributed | -149 | -272 | -152 | -150 | -136 | -166 | -39% | -621 | 97% |
| LIFO-based EBITDA (adj.) | 1,776 | 2,461 | 2,156 | 2,755 | 2,749 | 2,033 | -17% | 9,846 | 98% |
| D&A | 537 | 550 | 562 | 581 | 616 | 616 | 12% | 2,382 | 100% |
| EBIT | 1,774 | 2,789 | 2,276 | 2,120 | 2,274 | 2,033 | -27% | 8,604 | 101% |
| LIFO-based EBIT (adj.) | 1,239 | 1,911 | 1,594 | 2,174 | 2,133 | 1,417 | -26% | 7,464 | 98% |
| Financing activity | 153 | -299 | 263 | 3 | -214 | 245 | - | 233 | 127% |
| Pre-tax income | 1,927 | 2,490 | 2,539 | 2,123 | 2,060 | 2,278 | -9% | 8,837 | 102% |
| Net income | 1,527 | 1,789 | 1,920 | 1,541 | 1,603 | 1,795 | 0% | 6,610 | 104% |

Source: PKN Orlen, E - estimates by Dom Maklerski mBanku;

List of abbreviations and ratios contained in the report.

EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
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