Tuesday, February 18, 2014 | update

PKN Orlen: buy (reiterated)

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

Refinery rebound highlighting full value of other segments

Refining fundamentals are starting to improve after months of weak crack spreads, and we believe this is a structural improvement rather than a short-term rebound (as reflected in a narrower Brent-WTI spread, rising demand, low diesel stocks, and a widening Urals-Brent spread). For PKN Orlen, the recovery is additionally supported by local factors like the geographic premium, a waning grey market, and lower costs of biofuels. In this environment, the refining business is set to deliver upside surprises which will highlight the true worth of the other operations which today are being undervalued. Retail has been posting strong fuel margins and rising profits from FMCG sales for several quarters now, and petrochemicals will continue to generate high margins going forward in our view, contrary to consensus expectations (thanks to delayed launches of new capacity combined with increasing demand and rising prices of gas in the USA). With all this in mind, we are reiterating a buy rating for PKN with the price target set at PLN 52.3.

Improving refining macro

Gasoline cracks are starting to rebound after the downturn observed in H2 2013. As new pipelines put an end to the bottlenecks at Cushing, the Brent-WTI pricing spread is under increasing downward pressure which results in lower capacity utilization rates at US refineries (as reflected in declining net exports). This, combined with record-low diesel inventories and increasing demand, is driving refining margins in Europe. Further, an increased availability of heavy crude blends is driving up the Urals-Brent spread beyond the levels seen last year. Last but not least, PKN is benefitting from an expanding local geographic premium (thanks to a shrinking grey market and low retail prices), falling costs of biofuels (ca. PLN 150m), and restored cogeneration subsidies (PLN 80m).

Underestimated retail

Low prices at the pump have been supporting PKN's retail margins since Q3 2013. Today, this effect is also underpinned by rising volumes, a shrinking grey market (new regulation, closures of noncompliant fuel stations), and increasing convenience sales. We expect retail to account for nearly 25% of PKN's consolidated EBITDA in 2014. Measured using the EV/EBITDA ratio attributed to CST Brands (a spun-off retail unit of Valero), the implied enterprise value of PKN's retail segment figures to PLN 12-13bn, which is more than half of the current EV valuation of the Company as a whole.

Petrochemicals poised for upside surprises

New capacity coming on line in low-cost regions (USA, Middle East) was supposed to put pressure on PKN's petrochemicals business in the next few years. Meanwhile, a lot of these projects have been either put on hold or delayed, prompting IHS to downgrade its annual new supply projections for 2014-2017 by 0.8 million tons (10%) in the last six months. At the same time, demand for petrochemicals is showing signs of recovery, suggesting it may outstrip supply this year. Finally, naphtha-based facilities are seeing their margins expand thanks to a rapid rise in US gas prices which are driving petrochemicals prices.

(PLN m)	2012	2013	2014F	2015F	2016F
Revenue	120,101.6	113,853.0	112,543.9	122,209.8	125,057.4
EBITDA	4,284.5	2,503.0	4,948.3	5,320.8	5,732.1
EBITDA margin	3.6%	2.2%	4.4%	4.4%	4.6%
EBIT	2,024.4	333.0	2,653.2	2,922.9	3,438.3
Net profit	2,344.8	176.0	1,904.3	2,164.9	2,678.1
DPS	0.00	1.50	1.40	1.82	3.09
P/E	7.6	100.7	9.3	8.2	6.6
P/CE	3.8	7.6	4.2	3.9	3.6
P/BV	0.7	0.7	0.7	0.6	0.6
EV/EBITDA*	6.1	10.5	5.4	4.7	4.1
DYield	0.0%	3.6%	3.4%	4.4%	7.5%

*incl. sales of strategic reserves

Current price	PLN 41.45
Target price	PLN 52.30
MCap	PLN 17.7bn
Free float	PLN 12.8bn
ADTV (3M)	PLN 82.97m

Ownership

State Treasury	27.52%
Aviva OFE	5.08%
ING IFE	5.02%
Others	62.38%

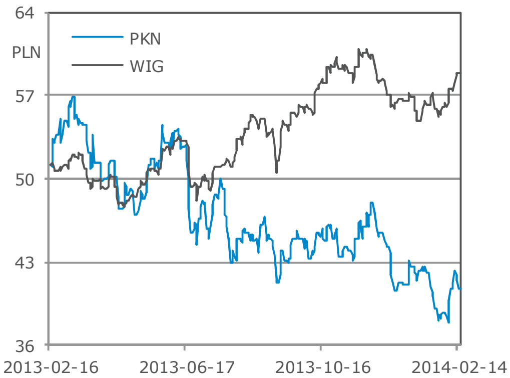
Sector Outlook

Refining margins in H2 2013 were under pressure from a downturn in gasoline cracks caused by record output produced in the US on the back of high Brent -WTI spreads. Today, margins are starting to recover, and the removal of bottlenecks on the Cushing-Houston pipeline will reduce the competitive advantage of US refiners. Increasing demand adds further to the positive outlook.

Company Profile

PKN Orlen is the largest refinery in the CEE region with 30mmt of annual crude processing capacity. The Company is also a chemicals and petrochemicals producer through its subsidiary operations (Anwil). In 2005, PKN Orlen acquired the Czech refiner Unipetrol, and in 2006 it took over the Lithuanian refinery Mazeikiu Nafta.

PKN vs. WIG



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Q4 2013 results, outlook for 2014

PKN Orlen's reported EBIT as well as EBIT after adjustment for LIFO inventory accounting in Q4 2013 came in line with our expectations and consensus estimates. It is worth noting the one-time events that influenced the quarterly earnings which included a write-off of a Latvian shelf exploration project (-PLN 89m), an acquisition gain on TriOil (+PLN 83m), a provision for tax risks faced by the refinery in Trzebinia (-PLN 61m), and a write-off of certificates of origin (-PLN 66m). The net effect of these one-offs was a charge of PLN 168m which, however, was more than offset by a gain of ca. PLN 200m on cheaper crude inputs. By operating segment, Refining posted an upside surprise with LIFO-adjusted EBIT remaining flat at the Q3 level despite a deterioration in crack spreads.

Q4 2013 results by operating segment

(PLN m)	4Q'12	1Q'13	2Q'13	3Q'13	4Q'13
EBIT	-738	341	-137	617	-489
Refining	-875	-34	-562	143	-727
of which LIFO effect	-487	-69	-412	328	-535
Retail	98	37	282	361	235
Petrochemicals	257	412	238	243	169
of which LIFO effect	-26	16	-27	34	-3
Chemicals*	10	100	85	7	60
Unattributed	-228	-168	-176	-127	-226
LIFO EBIT adjusted	543	394	446	255	49
D&A expenses	576	538	535	541	556
EBITDA	-162	879	398	1 158	67
Financing activity	65	-225	-127	204	-7
Pre-tax profit	-673	116	-264	821	-496
Net profit	-276	149	-207	655	-422

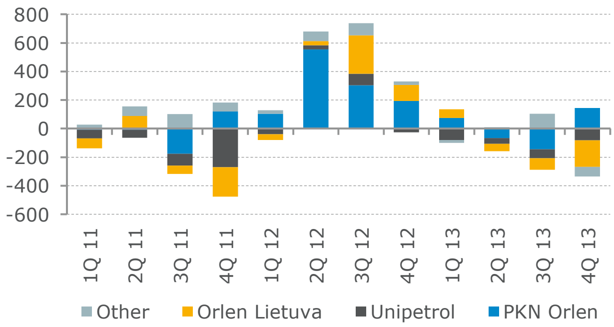
*results of Anwil separated out from the consolidated statements as per estimates of Dom Maklerski mBanku
Source: PKN Orlen

PKN recognized a small loss of PLN 7m on financing activity in Q4, contrary to expectations of a PLN 96m gain, due to lower-than-expected FX gains (PLN 103m vs. PLN 140m) and higher-than-expected interest expenses (PLN 105m actual vs. PLN 35m forecasted compared to a quarterly average of PLN -42m posted in the three quarters prior). The spike in Q4 interest payments was caused by back taxes owed by the Trzebinia Refinery, and these expenses are going to return to normal in the future quarters. Fourth-quarter operating cash flow totaled PLN 1.5 billion (an effect of changes in working capital), facilitating a reduction in net debt to PLN 4.6 billion even after the PLN 0.5bn spent on the TriOil acquisition.

Refining

PKN's Refining segment generated an annual core LIFO EBIT loss of PLN 348 million in 2013 after a year-on-year downturn by a whopping PLN 2.1 billion driven by shrinking crack spreads which were not offset by a 2.7% expansion in sales volumes. The Urals/Brent pricing differential plus margins on finished products were about USD 2.6/Bbl lower on average in 2013 than in the year before. After taking into account changes in the USD/PLN exchange rate, the contraction in the light-heavy spread and cracks was responsible for an estimated PLN 1.7bn of the year-on-year EBIT drop; the remaining PLN 400m loss was probably an effect of weaker geographic and distribution premiums stemming from a rampant "grey" market (VAT avoidance) combined with lower COO revenues as a result of discontinued cogeneration subsidies. This is the conclusion we drew based on a 2013 LIFO EBIT breakdown by PKN Group members, with Orlen Lietuva, which serves as a litmus test for market margins, experiencing a downturn in H2 2013 relative to H2 2012, and the Polish refineries posting falling margins already in H1 2013 despite much slower deterioration in the macro conditions.

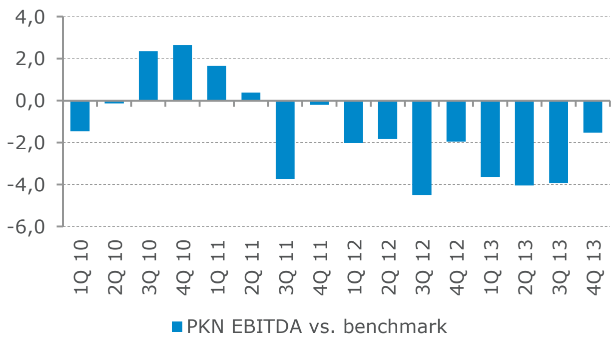
LIFO EBIT of PKN refineries (PLN m)



Source: PKN Orlen, Dom Maklerski mBanku

The extent to which local factors impact PKN's earnings is demonstrated in the diagram below, showing deviations from benchmark EBITDA experienced by the refinery in Płock which is the main margin driver for the whole segment. The deviations observed in 2013 were much stronger than in 2012 (except Q3 when record benchmarks could not be passed onto customers), but in Q4 the gap started to narrow as a possible sign of an upcoming recovery in geographic premiums and an effect of lower biofuel costs and a downtrend in crude prices (which usually allows PKN to post higher LIFO margins by postponing adjustments to sales prices).

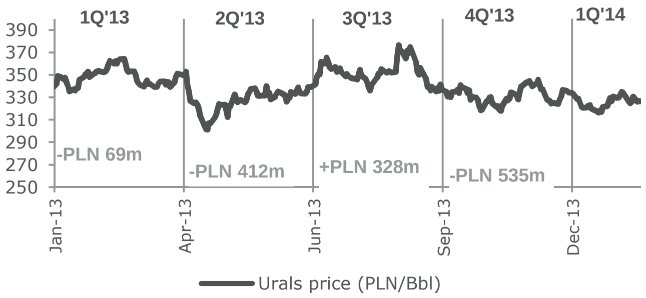
PKN EBITDA vs. benchmark (USD/Bbl)



Source: PKN Orlen, Dom Maklerski mBanku

PKN's profits in 2013 were severely impacted by inventory adjustments (which generated a loss to the tune of PLN 688m). Even though the average price of crude oil in the period decreased by just a little under USD 3/Bbl, the losses were exacerbated by a strong zloty and the sharp crude downturn occurring in Q2 which could not be made up for later due to lower inventories. For 2014, we project inventory gains of ca. PLN 0.3bn even after the loss expected in the first quarter. This projection is based on mBank's assumption that the zloty will weaken 6% vis-à-vis the dollar by the end of 2014. Another assumption is that Brent prices will remain steady at ca. USD 110/Bbl, though it carries a wide margin for error depending on the political situation in Iran, production in the USA (where local output is replacing imports and the Brent/WTI spread has narrowed) and Iraq, and resumption of supplies from Libya. Also shaping the oil market will be the US government's decision as regards exports of resources.

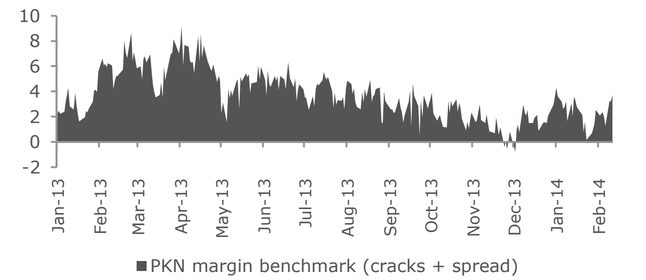
Impact of LIFO inventory adjustments on refining profits vs. prices of Urals crude (PLN/Bbl)



Source: Bloomberg, Dom Maklerski mBanku

Crack spreads achievable by PKN refineries have remained weak so far this year, implying weak Q1 results despite a high Urals/Brent differential. That said, the first quarter is the least significant season from the standpoint of annual earnings, and we believe PKN can deliver our annual PLN 0.8bn LIFO EBIT forecast this year thanks to a rebound expected in the second and third quarter. We present our case at more length below, using the key assumptions of the average annual refining margin increasing by USD 1.2/Bbl and the differential expanding by USD 0.5/Bbl in 2014.

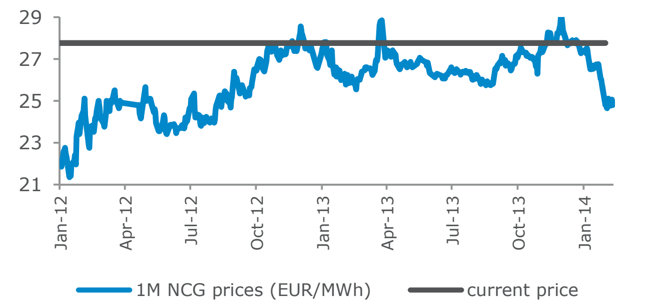
PKN refining margins + Urals/Brent spread (USD/Bbl)



Source: Bloomberg, Dom Maklerski mBanku

Also supporting our positive outlook is the impending deregulation of the Polish market for natural gas (including through interconnector capacity auctions). PKN refineries alone use about 1.1 billion cubic meters of gas a year, so a price reduction by just a few percent sets them up to save between PLN 60 and 110 million a year (German gas prices are currently 9% lower than Polish prices). Looking at the current trends in European gas prices, we believe these savings may be at the top end of this range. Further, restoration of subsidies for cogeneration plants (expected in Q2) can provide a ca. PLN 80m boost to this year's Refining EBIT (the extra revenue on a whole-year basis should reach PLN 100m).

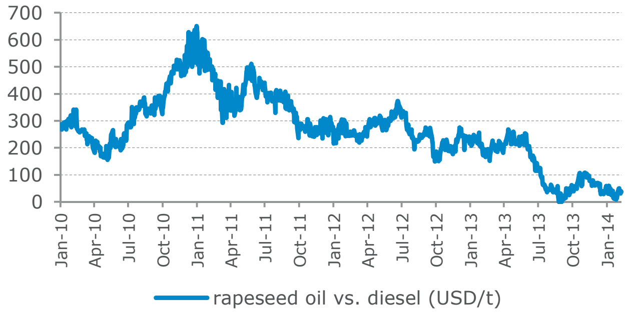
German gas prices vs. Polish wholesale tariff (EUR/MWh)



Source: Bloomberg, Dom Maklerski mBanku

Adding further to our optimistic view of the refining industry for the coming year are expectations of a decrease in the costs of fulfilling biofuel quotas led by falling prices of rapeseed and hence also of rapeseed oil. PKN's profits to date have been affected by biofuels cutting into the sales volumes of petroleum products, combined with a negative price spread between diesel and biodiesel. Today, however, the losses incurred on purchases of bio-components have narrowed to just USD 30 a ton (YTD average) from USD 256/t in 2012 and USD 133/t in 2013. Since the national bio-quota for 2014 has been kept at the 2013 level, on annual purchases of an estimated 460,000 tons, we estimate that PKN can save as much as PLN 140-160m this year (not taking into account rising volumes).

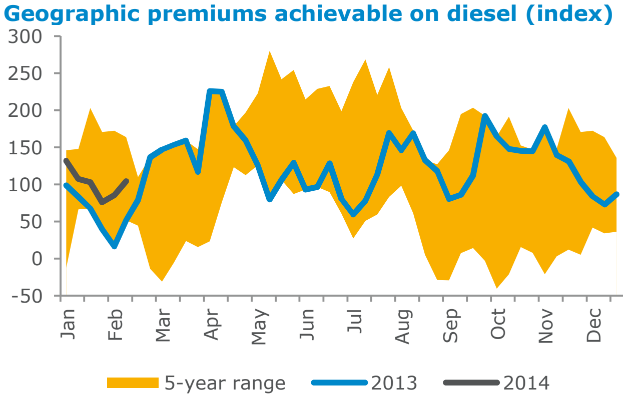
Price spread between rapeseed oil and diesel (USD/t)



Source: Bloomberg, Dom Maklerski mBanku

Further, we expect PKN to generate increasing geographic premiums going forward after the rebound observed a few weeks ago based on "spot" data (calculations using wholesale prices presented on PKN's Website). The improvement is owed to new regulation designed to crack down on VAT fraud in fuel sales (the oil industry is pushing for even more stringent measures including mandatory licenses and a tying of VAT payments with excise taxes and strategic reserves). The curtailment of the grey market should also promote an increase in distribution margins through minimized pressure from unfair competition, driving refinery profits by as much as several hundred million zlotys. Distribution margins are additionally supported by the high profitability of PKN fuel stations and their increased potential to pass any extra charges onto end customers thanks to low retail prices of fuel.

Geographic premiums achievable on diesel (index)



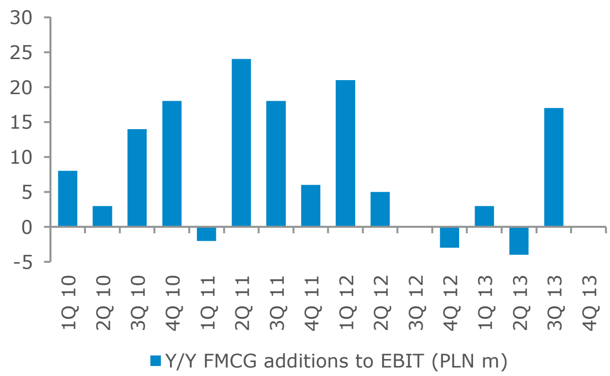
Source: Bloomberg, Dom Maklerski mBanku

A major development for PKN's refining business is the upcoming passing into law (expected in the next few months) of new strategic reserve legislation which will allow the Company to unlock about PLN 2.5 billion of the cash currently locked in inventories over a period of 3-4 years (oil companies will gradually transfer 30% of strategic oil reserves to a government-run agency by 2017). The government's formula for charging reserve fees from oil companies is still unknown. One possibility is that the strategic reserve agency will want to charge enough to cover the costs of financing and maintenance of the reserves as well as the total repurchase costs, in which case the charges to PKN and others would temporarily go sharply up during buyback period. However, being a sort of a tax, these charges will most likely be passed on to end fuel buyers depending on the market situation. We think the reserve fee costs will be passed through in full, otherwise they will have a painful impact on service station operators, wholesalers, etc. For PKN, the reduction in oil stocks can have a positive effect on EBIT starting in Q1 2015 through the use of older, cheaper crude inputs.

Retail

PKN's Retail EBIT increased to PLN 915m in 2013 from PLN 647m in 2012 on steady sales volumes (+0.7%) driven by expanding retail margins generated by service stations in Poland as well as Germany (where EBIT showed y/y growth by PLN 30m). Convenience-store sales displayed a slow rise of just PLN 16m despite an increase of over 35% in the number of food service locations due to weaker FMCG sales as a result of an economic slowdown, a general retail sales slump in Poland, and increasing competitive pressures from discount stores. However, the latest statistics for personal spending and consumption in Poland are looking better, which bodes well for PKN's convenience and food sales in 2014. As for fuel sales, the outlook is good as well given the low prices at the pump.

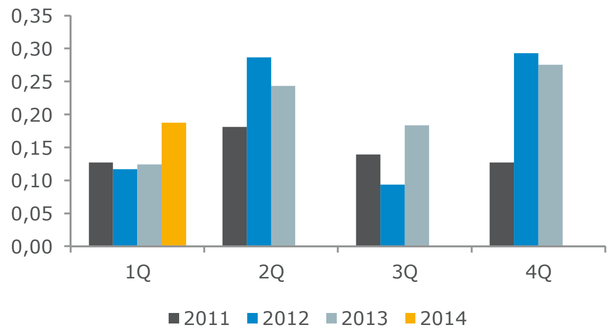
Y/Y change in FMCG sales contributions to EBIT



Source: PKN Orlen, Dom Maklerski mBanku

Moreover, the average margin on retail fuel sales is about PLN 0.07 per liter higher year to date than last year. Higher margins, combined with the grey market clampdown, should lead to continued growth in the profitability of PKN's service stations which today are forced to compete with sites that buy fuel wholesale cheaper than they would have to pay directly to refiners by "omitting" VAT. If our predictions come true, we believe PKN can post EBIT in excess of PLN 1 billion from Retail this year.

Volume-weighted retail margins on diesel and gasoline (PLN/liter)*



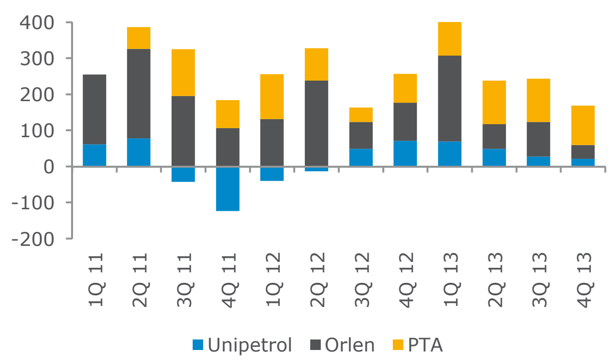
*weights based on structure of PKN sales
Source: PKN Orlen, Eurostat, Dom Maklerski mBanku

Note that PKN's strategy for Retail pegs annual EBITDA between 2013 and 2017 at PLN 1.5bn, about the same as our own projections. That said, we see potential for upside surprises if fuel prices remain at the levels seen today. We expect Retail to account for nearly 25% of PKN's consolidated EBITDA in 2014. Measured using the EV/EBITDA ratio attributed to CST Brands (a spun-off retail unit of Valero), the implied enterprise value of PKN's retail segment figures to PLN 12-13bn, which is more than half of the current EV valuation of the Company as a whole.

Petrochemicals

EBIT in the Petrochemical segment came up to PLN 1.3bn in 2013 (with LIFO effects contributing just PLN 20m), of which PLN 252m was provided by Anwil. The contributions of the different product lines were more even than in 2012 when the bulk of the annual EBIT came from olefins (supported by strong margins on aroma compounds). 2013 brought an improvement (driven by higher margins on polymers) in the profits generated by Unipetrol and BOP (which in the diagram below is presented jointly with PKN). Even stronger growth (+PLN 121m) was posted by the PTA line which increased sales volumes by 15% despite maintenance downtime, and which benefitted from higher margins. Olefins continued to make strong contributions to EBIT as well, though mostly in the first quarter. Despite stable margin benchmarks, profits from the remaining lines were not as high, due among others to lower margins on aromas (for example the contraction in the margin on butadiene alone is estimated at PLN 140m). Aromas are a major EBIT driver given that their annual sales volumes average 380,000 tons.

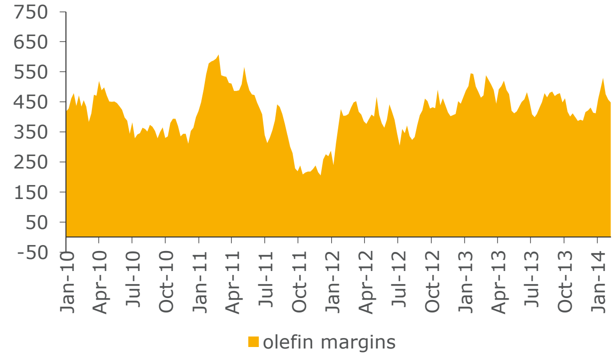
Petrochemicals EBIT * by product line (PLN m)

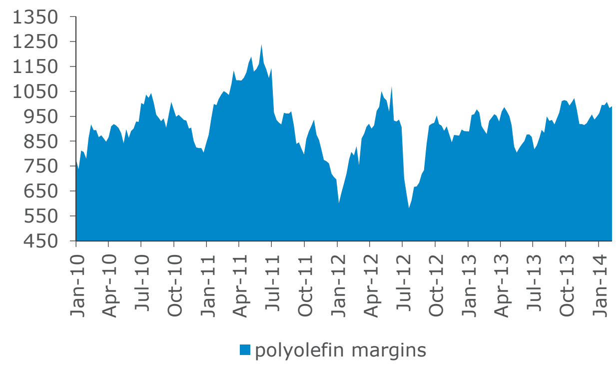


*excluding Anwil
Source: Bloomberg, PKN Orlen, Dom Maklerski mBanku

Macro conditions in the petrochemicals sector have been stable for several months, and no seasonal reductions in buyer inventories were observed by producers at the end of last year. Margin benchmarks are back on an upward path after a slight downslide last November. Going forward, we believe a recovering global economy will tighten the demand and supply balance in petrochemicals even though producers are planning fewer maintenance shutdowns this year. The market for aromas also continues to expand, but we nevertheless assume conservatively than this year's margins will not match last year's levels boosted by Q1 spikes. That said, it is worth noting that the spread between the key aromatic compound benzene and its feedstock naphtha is now back to the year-ago levels. With all this in mind, taking into account the weaker butadiene margins and more costly facility maintenance, we predict that 2014 EBIT from Petrochemicals (ex. Anwil) will post a small decline this year to an estimated PLN 0.96bn from PLN 1.06bn last year.

Benchmark margins by petrochemicals group (USD/t)

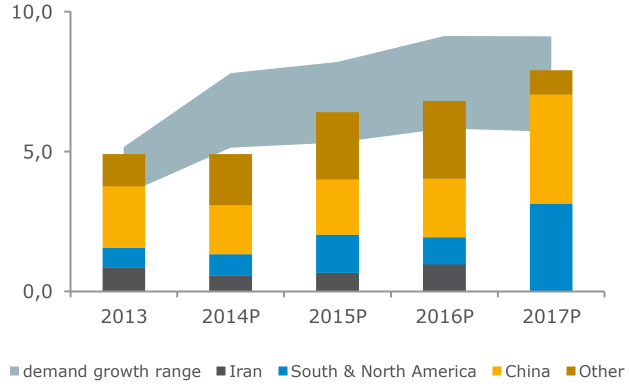




Source: Bloomberg, Dom Maklerski mBanku

The global petrochemical industry has extensive capacity-building plans for the coming years, however, the current status of most of these projects suggests their impact on the demand-supply balance will remain marginal for the next few years. In fact, there is growing conviction that the consensus projections for capacity additions are overestimated given the expected project cancellations in Asia and the Middle East, and the likely delays in the mega-facilities based on cheap local gas supplies planned in the US caused by protracted environmental procedures. The delays and cancellations suggest that that the growing supply will not exceed demand which statistically increases at 1.0-1.5x the rate of global GDP, itself showing signs of acceleration. Nevertheless, even though we do consider the market projections to be overly pessimistic, we assume conservatively for valuation purposes that the profitability of PKN's petrochemicals business will deteriorate in the next few years due to competitive pressures on margins.

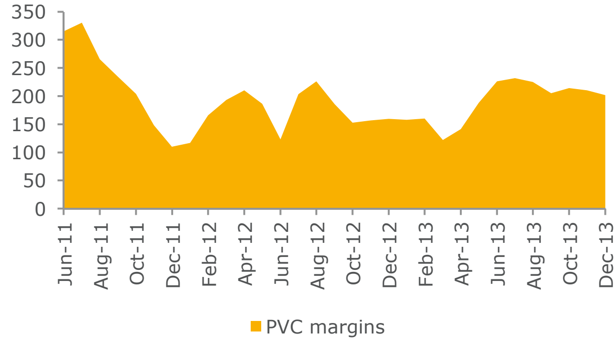
Planned ethylene capacity (mmt) vs. demand projections*

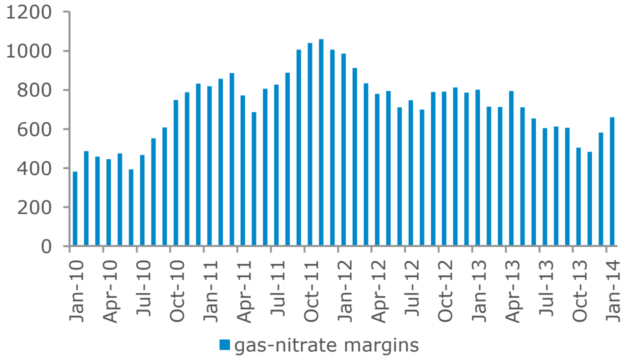


*demand range projected based on historical correlations as growing at 1.0-1.5 times the rate of GDP growth
Source: IHS, Dom Maklerski mBanku

PKN's fertilizer arm Anwil generated better-than-expected financial results in 2013 thanks to a 15% increase in volumes, improved margins on PVC, and stable margins on local fertilizer sales (achieved despite falling global benchmarks), all of which made up for a severe shrinkage in caprolactam margins and a shutdown of the Czech Spolana facility due to flooding. For 2014, we project a decline in Anwil's EBIT to an estimated PLN 235m from PLN 252m in 2013 due to an expected continuing contraction in fertilizer margins from a high H1 2013 base. On the upside, margins on PVC should improve, and profits will not be affected by costs of flood damage removal (ca. PLN 40m in Q3'13).

Benchmark margins on PVC (USD/t) and ammonium nitrate (PLN/t)





Source: Bloomberg, Grupa Azoty, Dom Maklerski mBanku

TriOil acquisition

PKN finalized a 100% takeover of Canada's TriOil Resources in Q4 2013. The price was an equivalent of PLN 535m, and the total value of the transaction including TriOil's net debt came up to PLN 700m. TriOil is a light oil producer which uses hydraulic fracturing technology. Its assets are mainly based in Canada, and its 2P reserves are estimated at 20 million barrels, half of which is crude oil (the EV/2P ratio implied by the transaction is USD 11.7/bbl). TriOil's daily output is currently 4000 barrels of oil equivalent, and it is constantly rising (the 2012 average was 2100 boe/d), expected to reach just under 6000 boe/d in 2014 and 7000 boe/d by year-end 2015. Over 60% of production is crude oil and natural gas liquids. TriOil's 2013 operating cash flow is estimated at CAD 57m, with CAPEX at ca. CAD 93m (PKN has not revealed the company's financial results for 2013). It plans to match OCF with CAPEX by 2015.

Annual earnings forecast for TriOil

(CAD m)	2012	2013F	2014F	2015F	2015F
Revenue	50.1	87.5	116.4	146.7	163.0
Production (boe/d)	2,128	3,800	5,000	6,300	7,000
Gas (boe/d)	565	1,520	2,000	2,520	2,800
Oil (boe/d)	1,563	2,280	3,000	3,780	4,200
EBIT	7.2	26.3	34.9	44.1	49.1
one-time events	-1.8	0.0	0.0	0.0	0.0
EBITDA	25.3	52.6	69.6	87.8	97.6
margin	50%	60%	60%	60%	60%
Net profit	10.9	24.7	32.9	41.9	48.0

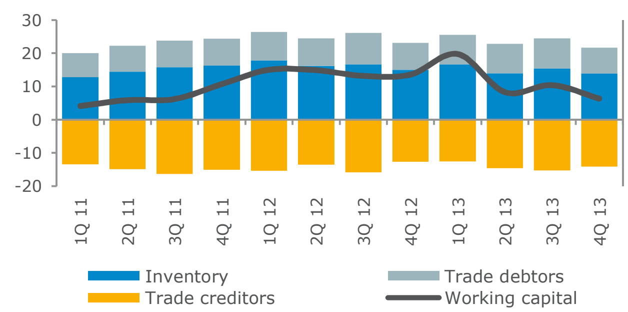
Source: TriOil Resources, Dom Maklerski mBanku

The acquisition of TriOil is consistent with PKN's strategy and potentially a very promising move (higher output with a high share of crude, hydrofracking know-how, EV/2P valuation below market median). It is not going to provide a major boost to PKN's earnings for several years (2014 contribution to EBITDA is expected to be 4%), but it provides a platform for further expansion in upstream, if only through acquisitions of further concessions on the American continent. For the time being, however, our valuation model allows only for organic expenditures in this area.

Balance sheet and CAPEX forecast

PKN managed to reduce its net debt by an impressive PLN 2.1 billion to PLN 4.6 billion in 2013 (adjustments to foreign-currency debt had a neutral effect on debt) thanks to strong cash flow from operations which amounted to PLN 5.67 billion, though a large portion of this amount was provided by changes in working capital which decreased by PLN 2.9 billion in the course of the year.

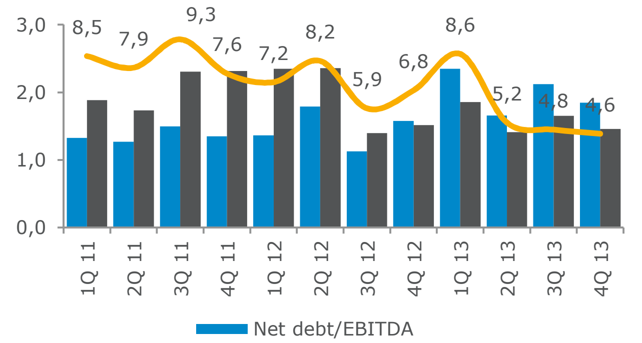
Working capital breakdown (PLN bn)



Source: PKN Orlen, Dom Maklerski mBanku

The lower working capital was due mainly to a huge increase in trade payables (+PLN 1.4bn) attributable to greater usage of trade credit combined with standard delays in quarterly payments put off from Q4'13 to Q1'14. The delays mean cash outflow of about PLN 200-300m this quarter to address the past due bills (crude oil, payments to contractors). Changes in inventories were also positive in 2013 (generating cash flow of PLN 1.2bn), thanks mainly to lower crude prices and the "sale" of strategic reserves which replaced the stock ticket contract expired in Q1'13. Consequently, in spite of unfavorable macro conditions, the ratio of net debt to LIFO-adjusted EBITDA as of 30 June 2013 was a safe 1.5x. Moreover, the total of the net debt reported by PKN is exclusively funding strategic petroleum reserves whose book value as reported in the FY2013 balance sheet approximated PLN 7.2bn (a further PLN 2.2bn in ticket contracts is maintained off the balance sheet, and this is included in the net debt value used in our valuation model).

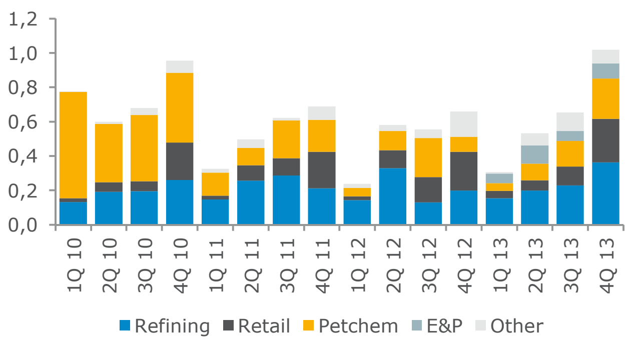
Net debt - EBITDA (PLN bn) ratio



Source: PKN Orlen, Dom Maklerski mBanku

We expect PKN to maintain a healthy balance sheet in 2014 although Q1 may see relatively weak cash flow due to payments of the trade payables mentioned above and a purchase of a PLN 1.2bn strategic reserve batch set for resale in Q2. We project annual 2014 operating cash flow at PLN 4.3bn despite slightly negative contributions from changes in working capital. At the same time, PKN is planning to increase capital expenditures this year to PLN 3.8bn from PLN 2.9bn in 2013. The CAPEX budget consists 53% of development projects (PLN 1bn allocation to a heat and power plant, PLN 0.3bn to Canada production, and PLN 0.2bn each to Poland drilling, retail expansion, petrochemicals, and refineries). The remaining PLN 1.8bn is replacement investment which this year includes denitrogenation and desulfurization units (PLN 0.3bn). PKN wants to eventually reduce replacement expenses to 60% of D&A, i.e. PLN 1.3bn. The Company will make a decision on whether to build a gas-fired power plant in Płock in mid-2014.

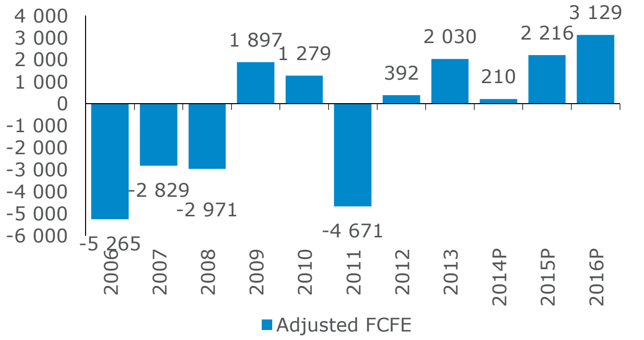
Quarterly CAPEX by operating segment (PLN bn)



Source: PKN Orlen, Dom Maklerski mBanku

Our 2013-2017 CAPEX forecast for PKN is PLN 14.1bn, which is less than the budget set forth in PKN's latest strategy update, but note that the Company's PLN 22.5bn target includes a contingent allowance of about PLN 6.9bn earmarked for potential future projects undertaken on an ad-hoc basis. Further, we believe PKN may scale back the medium-term CAPEX plans in a few months as it downgrades its ambitious EBITDA target of PLN 6.3bn in 2013-17, currently well above our own projection of PLN 4.8bn. Moreover, our forecasts for PKN do not factor in the medium-term exploration expenses (except those planned in 2014) that the Company estimates at PLN 2.4bn through 2017, the reason being that we are skeptical about the success potential of the first stage of shale gas prospecting. Adjusted for these expenses, PKN's CAPEX plan is more or less in line with our forecasts.

FCFE projection (PLN m)



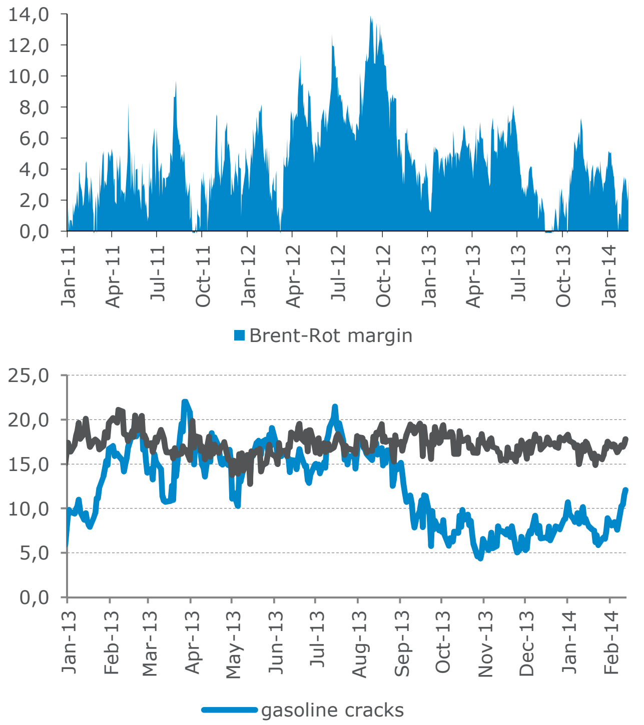
Source: PKN Orlen, Dom Maklerski mBanku

PKN stands by its usual dividend policy which assumes shareholder distributions from standalone annual profits (PLN 618m in 2013), saying only that the path to achieving the 5% dividend yield target does not necessarily have to be linear. The maximum 2014 per-share dividend implied by these parameters would be PLN 1.44, but the Management Board's recommendation will be announced after first-quarter results. Thanks to its strong liquidity position, expected to be reinforced even further as of 2015 by the cash unlocked from strategic reserves, PKN will be able to offer increasing distributions to shareholders in the coming years.

Refining margins will eventually bounce back

After a very successful 2012, refiners experienced a slump in refining margins in 2013 contrary to expectations of a rebound after years of decline. While we did not think that crack spreads would continue to break new records (being aware of the one-time events driving their growth), but we did expect their stabilization at levels much higher than those recorded in 2009-2011. This expectation was based on improving demand, low stocks of finished petroleum products, capacity shutdowns, the natural cyclical variations experienced by the industry, and the caps placed on oil prices. While our predictions looked more or less accurate in the first few months of 2013, the peak summer travel season, which is typically the high season for refinery earnings, proved to be a big disappointment. In the third quarter, crack spreads were not only lower than in the same period in 2012 (understandable base effects), but they also shrunk relative to the quarter before. Combined with a negative Urals/Brent spread, this forced us to make downward revisions to our FY2013 projections for the refining sector. The worsened earnings outlook was confirmed by even stronger deceleration in the fourth quarter. At the same time, however, looking at the factors that shape refinery profits and the events that led to last year's deterioration, we have not changed our optimistic profitability outlook for the industry for the years ahead.

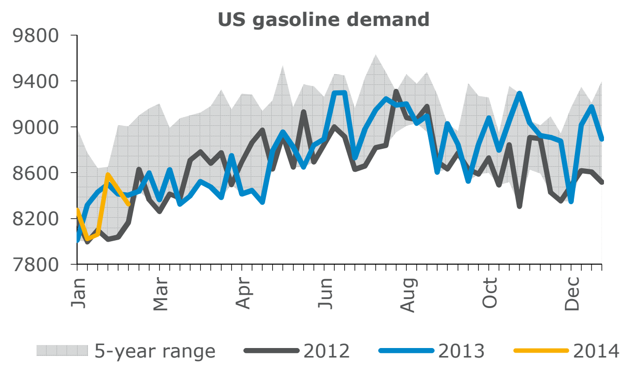
Benchmark cracks and fuel margins (USD/Bbl)



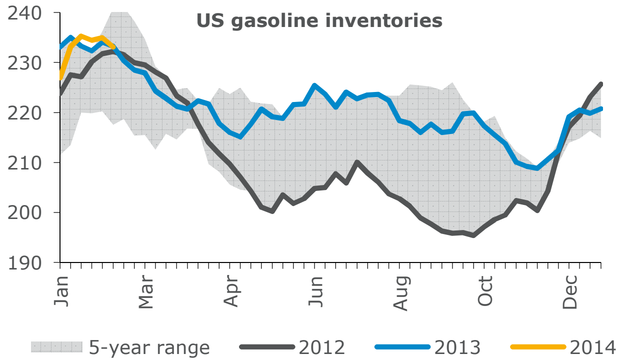
Source: Reuters, Bloomberg, Dom Maklerski mBanku

The weakness in refining margins observed in the last few months was not equally severe across all products. Gasoline cracks were a major source of pressure after a sharp downturn in September which could be attributed mainly to weak US data (again showing year-on-year drops in gasoline usage), resulting in inventory buildup to levels close to the upper end of the five-year range. The fourth quarter brought a gradual recovery in usage which in the end proved 4% higher in 2013 than in the year before. At the same time, however, inventories persisted at levels close to the upper end of the five-year range, and freezing weather put a damper on gasoline demand again towards the end of the year.

US gasoline demand (mbbl/d)



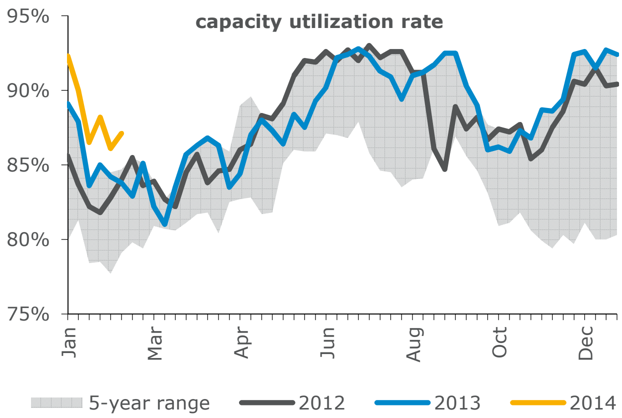
US gasolineinventories (mmbbl)

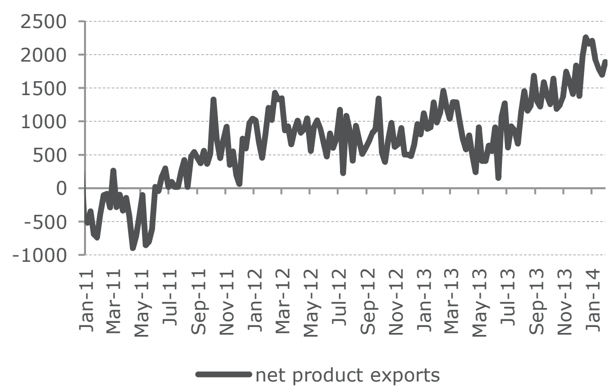


Source: Bloomberg, Dom Maklerski mBanku

Adding to the pressure has been an oversupply of finished petroleum products as US refiners increased capacity utilization to record levels in October well above the high end of the five-year range. The resulting boost in exports of gasoline and distillates has severely affected the demand-supply balance in Europe and produced an oversupply of gasoline.

US refinery CUR, net exports of petroleum products (mboe/d)

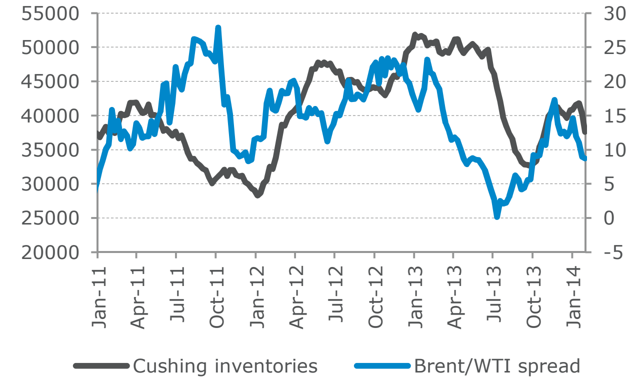




Source: EIA, Dom Maklerski mBanku

The factor responsible for the rise n US production was the Brent-WTI pricing spread which rebounded to double-digit levels after coming close to zero in July, driven by higher-than-expected quantities of locally extracted crude oil and a consequent inventory buildup at Cushing. Refiners decided to make the most of the cheap feedstock and raised their operating rates, even if at the expense of margins. After the launch of the southern leg of the Keystone pipe with daily capacity of 700 mboe, the WTI blend started to catch up with Brent in January, and as of today the price spread is about USD 8-9/Bbl. We expect further contraction in the months ahead, especially considering the launch of new capacity on the Seaway pipeline (also ca. 700mboe/d) planned for June as a result of which the capacity of the Cushing-Gulf line will outstrip that of the shale-Cushing line, allowing the hub to relieve bottlenecks. The availability of the cheaper WTI blend, despite an exports ban, will also put downward pressure on prices of crude imported into the US (the increase in North American crude output projected for 2014 will be much stronger than the expected growth in demand). As a result, the discount to Brent will narrow to low single digits. In fact, the narrowing is already underway as reflected in the levels of net product exports and inventories.

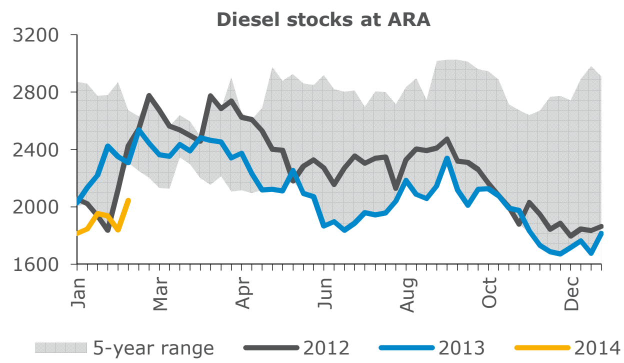
Brent-WTI spread (USD/Bbl) vs. Cushing inventories (mbbl)



Source: EIA, Bloomberg, Dom Maklerski mBanku

The decreasing spread can normalize the situation in the gasoline market and bring margins back to levels seen in H1'13. The improvement will be supported by recovering demand which in the US has been on the rise since Q3 (most recent data have been affected by cold weather). Also helping is the reduced biofuels mandate set by the US Environmental Protection Agency for 2014 which makes more room for regular gasoline. Demand for fuels is also on the rise in Europe (with diesel usage up 4% in Germany), including in the south. It is worth noting that the European diesel market is well balanced at the moment, and ARA inventories are at all-time lows. Diesel margins remain stable despite increased capacity at exports-oriented Russian refineries.

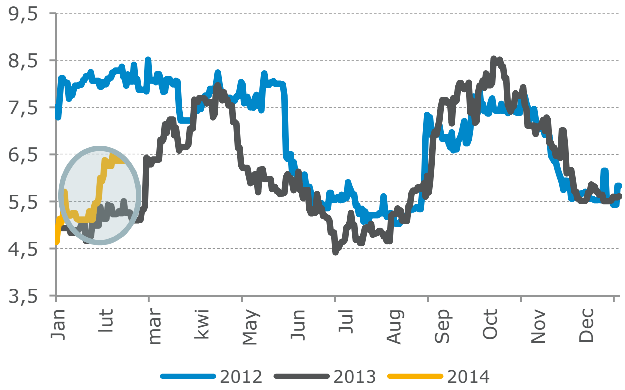
Diesel inventories at ARA ports (mbbl)



Source: Reuters

In the short term, refinery crack spreads may receive a boost from accelerated maintenance shutdowns as some refiners decided to wait out the margin slump by commencing seasonal maintenance earlier than usual (see diagram below). Similar rescheduling in 2012 had a strong effect on margin levels, and we expect the same this year, especially if demand recovers at the rate we think.

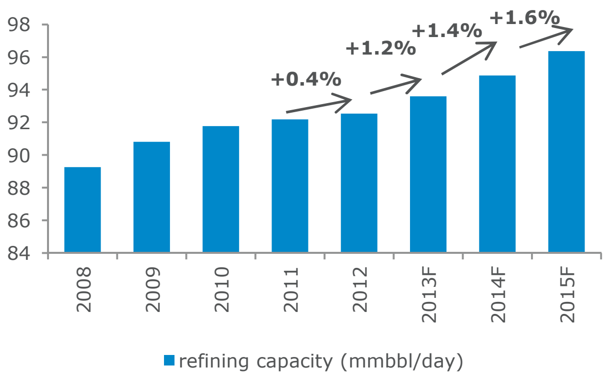
Global maintenance downtime (mmbbl/d)

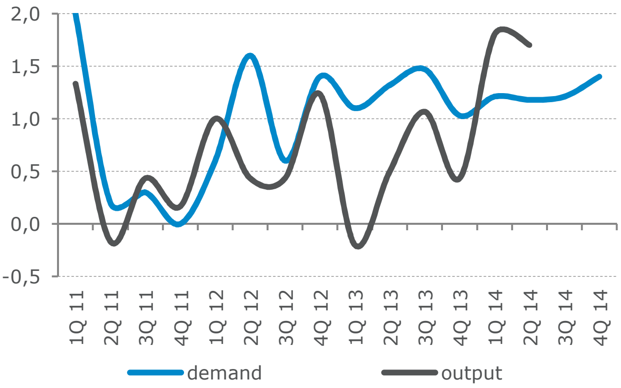


Source: Bloomberg, Dom Maklerski mBanku

As for future capacity additions, the available schedules for the next few years do not indicate a possibility of disruptions in the global demand-supply balance. The International Energy Agency expects 1.3mmbbl per day of new capacity additions in 2014, to be absorbed in full by growing demand (expected by IEA to increase at a daily rate of 1.25mmbbl); to boot, a major portion of these projects are scheduled for completion in the fourth quarter. Finally, because Chinese refineries have to adjust their operating rates to local export restrictions even as their capacities increase, China is at no risk of becoming a net exporter of petroleum any time soon.

Net capacity additions, Changes in global refinery output vs. oil demand (mmbbl)

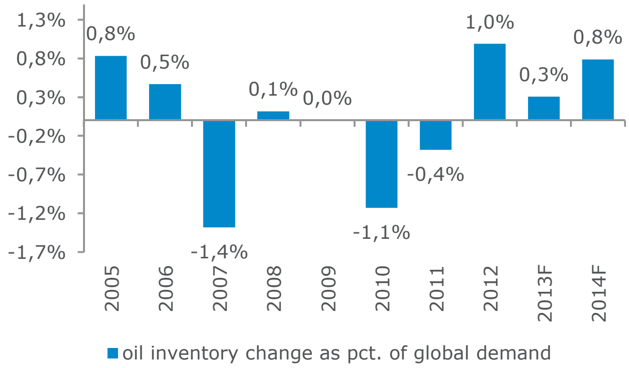




Source: Bloomberg, Dom Maklerski mBanku

Further backing our positive outlook for the oil industry this year are crude prices which should keep prices at the pump low as well as ensuring low costs of refinery inputs. 2014 will be the third consecutive year of a global oversupply of crude stemming from weaker demand from China and, more importantly, from growing production driven by the widespread of alternative energy in Canada and the US (where production from alternative sources increased by 8% and 20%, respectively, in 2013), and limited growth in Russia (+1% y/y). The oil surplus produced in 2013 would have been even higher if Iraq had achieved its 5% production growth target (missed because of pipeline bombings and failure to reach a deal with Kurdistan), and if Libya had been able to continue drilling (production in Libya ground to a halt in September 2013 due to worker strikes and escalating violence, removing as much as 1mmbbl of oil per day from the market).

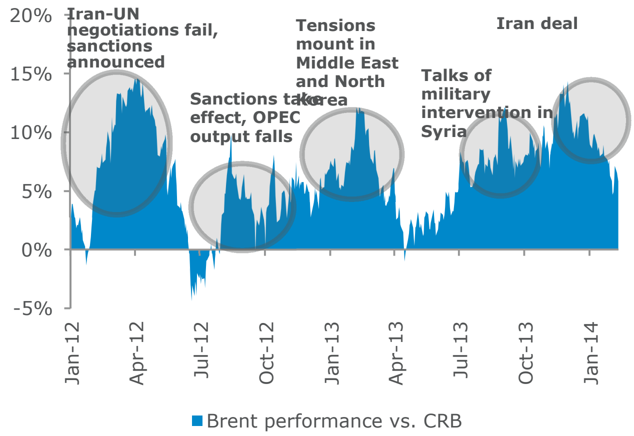
Forecast of changes in global inventories as percentage of consumption



Source: Bloomberg, EIA, Dom Maklerski mBanku

IEA projects assuming stable output from OPEC that global demand in 2014 will exceed daily supply by 0.7mmbbl, implying an increase in inventories by 255mmbbl (equivalent to 6% of monitored stocks in OECD countries). Based on these projections, we assume for valuation purposes that prices of crude oil will remain stable in the coming years. Note, however, that prices are bound to decrease, and the geopolitical risk premium to narrow, if Iran sanctions are lifted and the situation in Libya calms.

Oil prices vs. CRB commodity futures price index



Source: Bloomberg, Dom Maklerski mBanku

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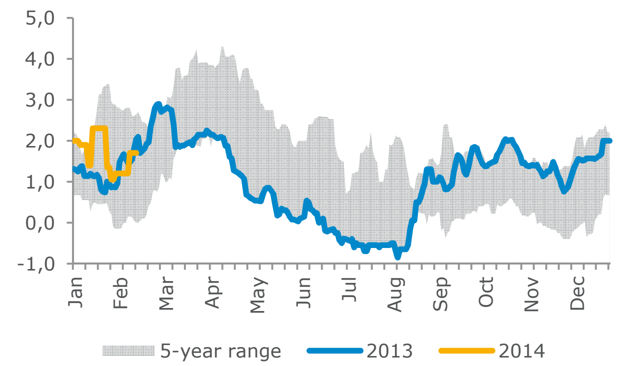
Urals-Brent spread returns to normal

The Urals/Brent spread remained in the negative territory for most of the third quarter of 2013 in a turn of events which was surprising to most even considering seasonal patterns. This gave rise to theories that the narrowing of the discount in the Russian blend was structural and permanent. Having analyzed the relationship between Brent and Urals from a number of different angles, we were led to question these theories and to maintain our long-term average annual price spread forecast for the two crude types at ca. USD 1.5/bbl. These forecasts were backed by the economic aspects of refining, the availability of crude oil, and the geopolitical factors that were shaping the market at the time, and they were proven correct in the last few months of the year when the spread rebounded, at times reaching levels close to the upper end of the five-year range.

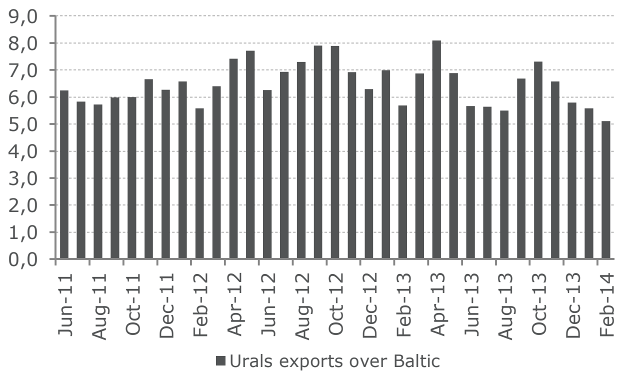
Urals/Brent vs. 5-year range



Source: Bloomberg, Dom Maklerski mBanku

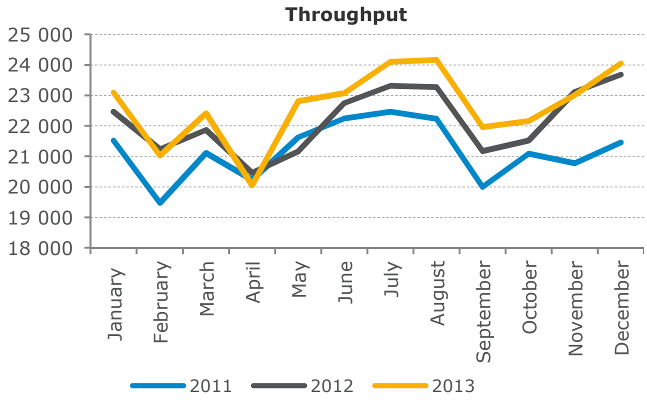
One important conclusion from last year's price movements is that the trend lines connecting local highs and lows reached during the year had steeper angles stemming from one-time events (embargo on Iran oil, production stoppage in Libya, the bombings of the Kirkuk-Ceyhan pipeline) combined with increased capacity in Russia and the seasonal fluctuations in the utilization ratios of this capacity which influence the availability and prices of Urals at Baltic ports. For example, shipments of Russian oil from the ports of Primorsk and Ust-Luga between May and August 2013 (when the Urals/Brent spread was tight) were over 1.1 million tons lower than in the same period the year before.

Russian crude export volumes over the Baltic (mmt)



Source: Bloomberg

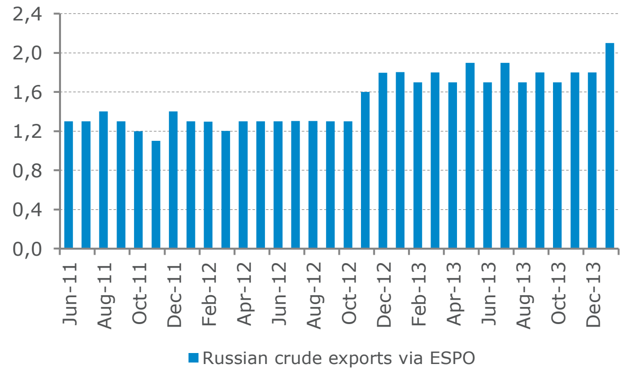
Russian refinery throughput



Source: Reuters, Bloomberg, CDU-TEK, Dom Maklerski mBanku

This year, the availability of Urals at Primorsk has so far been lower than at the same time last year, among others because Russia has increased exports to China via the ESPO pipeline. However, the discount to Brent has not been affected too much thanks to increased deliveries via the Druzhba pipeline and Ust-Luga, combined with the fact that Russia's exports to the east are still relatively insubstantial.

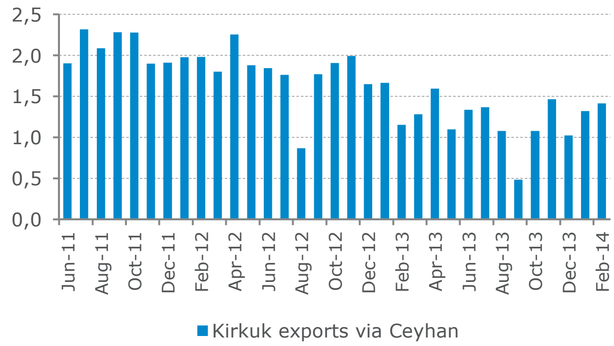
ESPO pipeline volume flow (mmt)



Source: Bloomberg

Another factor shaping Urals prices is the availability of other blends, most notably the Kirkuk blend produced in Iraq. Monthly shipments of Kirkuk from the Turkish port of Ceyhan were 0.5mmt lower on average in Q3 2013 than the year before as a result of a continuing ban on use of the pipeline by Kurdish producers, and a series of bomb attacks which halted flows. This mattered because the increasing Iraqi output was supposed to make up for the Iran embargo (-3mmt/month). Meanwhile, competition for heavy Russian crude heightened in the Mediterranean Sea.

Kirkuk exports oil via Ceyhan port (mmt)

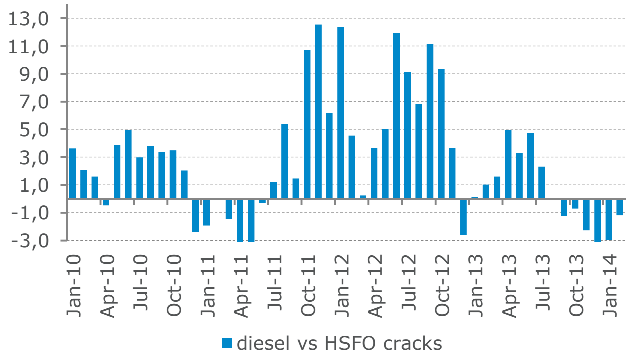


Source: Bloomberg

The situation has improved since, however, as Iraq took measures to improve security along the pipeline and made advances in its negotiations with Kurdistan (the parties were able to agree on more details of their exports/imports deal). Moreover, the sanction relief offered to Iran, even if it did not directly raise the export limits, has made trade with Iran easier for oil buyers, putting downward pressure on the prices of other heavy crudes.

As for the economic aspects of processing different types of crude, they have to do with the margins achieved on the refinery slate recoverable from each blend, as seen clearly in the following diagram. In the period from April to June 2013, when the Urals-Brent spread was reaching bottom, we saw relatively favorable spreads between the cracking margins yielded by diesel and high-sulfur fuel oil which allowed refiners to accept higher prices of heavy crude blends. After the situation shifted in September, some refiners decided to adjust their sources of crude supplies (for example, Lotos in Q3 used up to 25% and 12% on average of crude blends other than Urals as feedstock). This supported the Urals discount toward the end of the year. Today, the margins achievable on different products still support this discount as a warm European winter has reduced crack spreads on HSFO.

Diesel vs. HSFO crack spreads (USD/Bbl)



Source: Bloomberg, Dom Maklerski mBanku

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Valuation

Using DCF analysis and relative valuation, we set our nine-month price target for PKN stock at PLN 52.30 per share.

(PLN)	weight	price
Relative Valuation	50%	50.8
DCF Analysis	50%	47.0
	valuation	48.9
	9M Target Price	52.3

DCF Analysis

Assumptions:

- Cash flows are discounted to their present value as of the end of January 2014. Equity value calculations factor in net debt as of 31 December 2013 adjusted for crude reserves sold under a ticket contract (PLN 2.4bn).
- Macroeconomic assumptions are as set out above.
- The depreciation and amortization expenses projected for FY2023 are higher than CAPEX, prompting a D&A revision to PLN 2.4bn when calculating terminal value.
- The sales and EBITDA margin used to calculate FCFTV to terminal value is as forecast for FY2023. FCF is adjusted for cash flow from E&P activity (TriOil) to reflect the expected depletion of current 2P reserves.
- We assume that FCF after FY2023 will grow at an annual rate of 1%. The risk-free rate is 4.5%, and beta is 1.0.

Additional assumptions

(USD/Bbl)	2011	2012	2013	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F
Brent crude	111.0	111.9	108.8	110.0	110.0	110.0	110.0	110.0	110.0	110.0	110.0	110.0
Urals crude	109.4	110.6	107.8	108.5	108.5	108.5	108.5	108.5	108.5	108.5	108.5	108.5
Urals-Brent spread	1.7	1.3	1.0	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
PKN margin benchmark	2.0	5.1	2.8	4.0	4.0	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Refinery output (mmt)												
Orlen	14.5	15.2	15.2	15.0	15.7	15.7	15.7	15.7	15.7	15.7	15.7	15.7
Unipetrol	3.9	3.9	3.6	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9	3.9
Orlen Lietuva	9.0	8.5	9.0	8.5	9.0	9.0	9.0	9.0	9.0	9.0	9.0	9.0
Petrochemicals output (mt)	3292	3454	3381	3425	3425	3425	3425	3425	3425	3425	3425	3425
Chemicals output (mt)	1776	1779	1789	1789	1789	1789	1789	1789	1789	1789	1789	1789
Chemicals Petchem												
PVC margin (EUR/t)	644	593	381	403	447	493	505	495	495	509	517	517
Olefin margin (USD/t)	402	401	455	432	432	432	373	348	348	385	404	404
HDPE+LDPE margin (USD/t)	1010	905	1004	975	975	975	890	854	854	907	935	935
PP margin (USD/t)	1054	866	934	906	906	906	824	789	789	840	866	866
PTA margin (USD/t)	453	284	277	290	290	290	290	290	290	290	290	290

FX assumptions	2011	2012	2013	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F
USD/PLN	2.97	3.26	3.16	3.06	3.23	3.25	3.25	3.25	3.25	3.25	3.25	3.25
EUR/PLN	4.12	4.19	4.20	4.03	3.90	3.90	3.90	3.90	3.90	3.90	3.90	3.90

DCF Model

(PLN m)	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2023+
Revenue	112,544	122,210	125,057	125,610	126,319	126,951	127,736	128,414	128,946	129,486	129,486
change	-1.1%	8.6%	2.3%	0.4%	0.6%	0.5%	0.6%	0.5%	0.4%	0.4%	0.0%
EBITDA	4,948.3	5,320.8	5,732.1	5,492.0	5,389.7	5,189.6	5,419.2	5,558.1	5,539.2	5,508.7	5,508.7
EBITDA margin	4.4%	4.4%	4.6%	4.4%	4.3%	4.1%	4.2%	4.3%	4.3%	4.3%	4.3%
D&A expenses	2,295.1	2,397.9	2,293.8	2,323.8	2,339.3	2,349.3	2,379.3	2,422.3	2,372.7	2,328.6	2,280.0
EBIT	2,653.2	2,922.9	3,438.3	3,168.2	3,050.4	2,840.3	3,039.9	3,135.8	3,166.6	3,180.1	3,228.7
EBIT margin	2.4%	2.4%	2.7%	2.5%	2.4%	2.2%	2.4%	2.4%	2.5%	2.5%	2.5%
Tax on EBIT	504.1	555.3	653.3	602.0	579.6	539.7	577.6	595.8	601.6	604.2	613.5
NOPLAT	2,149.1	2,367.5	2,785.1	2,566.2	2,470.8	2,300.7	2,462.3	2,540.0	2,564.9	2,575.9	2,615.3
CAPEX	-3,720	-2,920	-2,280	-2,280	-2,280	-2,280	-2,280	-2,280	-2,280	-2,280	-2,280
Working capital	-261	618	541	930	-69	-62	-77	-66	-52	-53	-52
Equity investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
FCF	463	2,463	3,340	3,540	2,461	2,308	2,485	2,616	2,605	2,572	2,446
WACC	8.4%	8.6%	8.9%	9.2%	9.1%	9.1%	9.1%	9.2%	9.2%	9.2%	9.0%
discount factor	92.9%	85.5%	78.5%	71.9%	65.9%	60.4%	55.3%	50.7%	46.4%	42.5%	42.5%
PV FCF	430	2,105	2,621	2,545	1,621	1,393	1,374	1,325	1,209	1,093	,

	2014F	2015F	2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2023+
WACC	8.4%	8.6%	8.9%	9.2%	9.1%	9.1%	9.1%	9.2%	9.2%	9.2%	9.0%
Cost of debt	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
Risk-free rate	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%
Risk premium	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%
Effective tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Net debt / EV	21.3%	16.9%	11.5%	6.8%	7.1%	7.6%	7.0%	6.6%	6.4%	6.4%	10.0%
Cost of equity	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%	9.5%
Risk premium	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Beta	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0

FCF after the forecast period	1.0%
Terminal value	30,590
Present value of residual value (PV TV)	13,000
Present value of FCF in the forecast period	15,716
Net debt	7,021
Minority interests	1,603
Equity value	20,092
Number of shares (millions)	427.7
Equity value per share (PLN)	47.0
9M cost of equity	7.0%
9M target price (PLN)	50.3
EV/EBITDA ('14) for the target price	6.1
P/E ('14) for the target price	11.3
TV / EV	43%

Sensitivity Analysis

	FCF growth in perpetuity				
	0.0%	1.0%	2.0%	3.0%	4.0%
WACC +1.0 p.p.	43.8	46.7	50.3	54.9	61.1
WACC +0.5 p.p.	45.1	48.4	52.5	57.8	65.1
WACC	46.7	**50.3**	54.9	61.1	69,8
WACC -0.5 p.p.	48.4	52.5	57.8	65.1	75.6
WACC -1.0 p.p.	50.3	54.9	61.1	69.8	82.9

Relative Valuation

We compared PKN's P/E and EV/EBITDA multiples with the multiples of two peer groups projected for fiscal 2014 through 2016. The first group consists of comparable CEE refiners, and the second group are global petrochemicals producers. The valuations of these entities accurately reflect the operational risks entailed in their respective lines of business. The weights assigned to the peer groups are based on segmental contributions to EBITDA. The comparison yielded a per-share valuation of PLN 50.80 for PKN Orlen.

(PLN)	weight	price
Oil refiners	70%	45.3
Petrochemicals producers	30%	63.6
	Relative Valuation	50.8

Multiples Comparison: PKN vs. Oil Refiners

Oil Refiners		P/E				EV/EBITDA			
	Price (local CCY)	2013F	2014F	2015F	2016F	2013F	2014F	2015F	2016F
HELLENIC PETROLEUM	7.1	-	15.0	10.0	8.8	21.1	9.1	7.6	7.5
LOTOS	38.4	42.5	7.3	7.5	5.2	13.2	5.9	5.6	4.2
MOL	13,710	54.1	9.2	6.1	4.9	4.7	3.9	3.2	2.7
MOTOR OIL	8.9	19.3	9.3	8.3	8.7	8.3	6.3	6.1	5.9
NESTEOIL	14.8	9.9	12.1	11.4	10.0	5.7	6.3	6.1	5.8
OMV	33.8	9.1	8.3	8.0	7.2	3.3	3.0	2.9	2.5
SARAS	1.1	-	160.7	26.2	14.1	12.7	6.0	4.7	3.5
OMV PETROM SA	0.5	5.7	5.5	6.1	5.9	3.0	2.8	3.0	2.8
TUPRAS	40.2	9.5	8.2	7.7	6.6	12.1	9.2	5.5	5.2
UNIPETROL	148.5	-	38.2	26.5	-	9.9	7.4	6.9	-
Maximum		54.1	160.7	26.5	14.1	21.1	9.2	7.6	7.5
Minimum		5.7	5.5	6.1	4.9	3.0	2.8	2.9	2.5
Median		9.9	9.2	8.2	7.2	9.1	6.1	5.5	4.2
PKN ORLEN	41.5	100.7	9.3	8.2	6.6	10.5	5.4	4.7	4.0
(premium / discount)		922%	1%	0%	-8%	16%	-12%	-15%	-3%
Implied valuation									
Median		9.9	9.2	8.2	7.2	9.1	6.1	5.5	4.2
Multiple weight			50.0%				50.0%		
Year weight		0.0%	33.3%	33.3%	33.3%	0.0%	33.3%	33.3%	33.3%
Estimated value per share (PLN)		45.3							

Multiples Comparison: PKN vs. Petrochemicals Producers

Petrochemical Companies		P/E				EV/EBITDA			
	Price	2013F	2014F	2015F	2016F	2013F	2014F	2015F	2016F
AXIALL	41.2	11.4	10.9	9.0	-	6.7	6.3	5.8	-
BRASKEM	19.4	24.8	14.2	11.7	7.8	6.0	4.8	4.3	4.1
DOW CHEMICAL	47	20.5	15.8	13.3	11.6	9.3	8.4	7.8	7.1
EASTMAN CHEMICAL	82.8	13.1	11.9	10.9	10.0	8.3	8.0	7.5	7.2
HUNTSMAN	23.3	15.6	10.4	9.0	7.7	7.6	6.3	5.6	5.2
LOTTE CHEMICAL	222.5	19.4	12.8	10.2	8.5	9.3	7.3	6.3	5.4
LYONDELLBASELL	84.5	13.9	11.4	10.2	9.6	7.8	7.1	6.7	6.5
MITSUBISHI CHEMICAL	453.0	29.6	16.5	13.6	11.1	8.9	8.4	7.7	7.2
MITSUI CHEMICALS	269.0	-	-	19.0	13.4	16.4	11.7	9.8	8.7
WESTLAKE CHEMICAL	129.3	15.2	12.9	12.1	-	8.2	7.1	6.7	-
Maximum		29.6	16.5	19.0	13.4	16.4	11.7	9.8	8.7
Minimum		11.4	10.4	9.0	7.7	6.0	4.8	4.3	4.1
Median		15.6	12.8	11.3	9.8	8.3	7.2	6.7	6.8
PKN ORLEN	41.5	100.7	9.3	8.2	6.6	10.5	5.4	4.7	4.0
(premium / discount)		-	-27%	-28%	-32%	28%	-25%	-29%	-40%
Implied valuation									
Median		15.6	12.8	11.3	9.8	8.3	7.2	6.7	6.8
Multiple weight			50.0%				50.0%		
Year weight		0.0%	33.3%	33.3%	33.3%	0.0%	33.3%	33.3%	33.3%
Estimated value per share (PLN)		63.6							

Income statement

(PLN m)	2011	2012	2013	2014F	2015F	2016F	2017F
Revenue	106,973	120,102	113,853	112,544	122,210	125,057	125,610
change	28.0%	12.3%	-5.2%	-1.1%	8.6%	2.3%	0.4%
EBIT	2,066.5	2,024.4	333.0	2,653.2	2,922.9	3,438.3	3,168.2
Refining	2,105.9	926.7	-1,180.0	1,084.8	1,237.8	1,431.0	1,368.7
of which LIFO effects	2,241.0	-154.0	-688.0	297.7	238.0	0.0	0.0
Retail	425.7	647.5	917.0	1,073.1	1,131.0	1,233.1	1,293.5
Petrochemicals	391.0	945.3	1,062.0	957.8	1,051.2	1,094.2	777.2
of which LIFO effects	110.0	-21.0	20.0	0.0	0.0	0.0	0.0
Chemicals*	-377.5	260.0	252.0	234.8	174.6	238.7	277.3
Power Generation	0.0	0.0	0.0	0.0	0.0	104.3	121.1
E&P	0.0	-26.0	-38.0	76.2	108.3	123.6	123.6
Corporate functions	-478.7	-729.1	-680.0	-773.5	-780.0	-786.6	-793.2
LIFO EBIT (adjusted)	820.5	2,541.4	1,145.0	2,355.6	2,684.9	3,438.3	3,168.2
Financing gains / losses	537.0	601.0	-155.0	-247.4	-202.9	-71.7	4.3
Extraordinary gains/losses	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Other	188.3	-0.7	0.0	0.0	0.0	0.0	0.0
Pre-tax profit	2,791.7	2,624.7	178.0	2,405.8	2,719.9	3,366.7	3,172.4
Tax	776.7	454.5	88.0	457.1	516.8	639.7	602.8
Minority interests	-348.4	-174.6	-86.0	44.4	38.3	48.9	54.5
Net profit	2,363.4	2,344.8	176.0	1,904.3	2,164.9	2,678.1	2,515.2
change	-0.3%	-0.8%	-92.5%	982.0%	13.7%	23.7%	-6.1%
margin	2.2%	2.0%	0.2%	1.7%	1.8%	2.1%	2.0%
D&A expenses	2,379.9	2,260.1	2,170.0	2,295.1	2,397.9	2,293.8	2,323.8
EBITDA	4,446.4	4,284.5	2,503.0	4,948.3	5,320.8	5,732.1	5,492.0
change	-19.8%	-3.6%	-41.6%	97.7%	7.5%	7.7%	-4.2%
EBITDA margin	4.2%	3.6%	2.2%	4.4%	4.4%	4.6%	4.4%
Shares at year-end (millions)	427.7	427.7	427.7	427.7	427.7	427.7	427.7
EPS	5.5	5.5	0.4	4.5	5.1	6.3	5.9
CEPS	11.1	10.8	5.5	9.8	10.7	11.6	11.3
ROAE	10.2%	9.2%	0.7%	7.2%	7.7%	9.1%	8.3%
ROAA	4.3%	4.2%	0.3%	3.6%	4.0%	4.9%	4.6%

*We separated Anwil out of the Chemicals segment, the data are estimates

Balance Sheet

(PLN m)	2011	2012	2013	2014F	2015F	2016F	2017F
ASSETS	58,731.5	52,630.8	51,644.0	53,414.5	54,637.5	54,141.4	54,818.4
Fixed assets	28,599.1	26,810.6	26,835.0	28,259.9	28,782.0	28,768.2	28,724.3
Property, plant and equipment	26,578.7	24,743.7	25,294.0	26,710.3	27,233.7	27,224.7	27,182.0
Intangible assets	1,323.0	1,447.3	961.0	969.6	968.2	963.5	962.3
Equity investment	13.1	11.9	12.0	12.0	12.0	12.0	12.0
Other fixed assets	684.3	607.7	568.0	568.0	568.0	568.0	568.0
Current assets	30,132.3	25,820.1	24,809.0	25,154.6	25,855.6	25,373.2	26,094.1
Inventories	16,296.5	15,011.0	13,858.0	14,163.7	13,941.3	13,187.0	12,235.2
Current receivables	8,071.0	8,075.3	7,817.0	7,727.1	8,390.8	8,586.3	8,624.2
Other current assets	355.6	522.4	241.0	241.0	241.0	241.0	241.0
Cash and cash equivalents	5,409.2	2,211.4	2,893.0	3,022.8	3,282.5	3,358.9	4,993.6

(PLN m)	2011	2012	2013	2014F	2015F	2016F	2017F
EQUITY AND LIABILITIES	58,731.5	52,630.8	51,644.0	53,414.5	54,637.5	54,141.4	54,818.4
Equity	24,533.8	26,479.2	25,948.0	27,252.3	28,637.7	29,993.9	30,600.1
Share capital	1,057.6	1,057.6	1,058.0	1,058.0	1,058.0	1,058.0	1,058.0
Other equity	23,476.1	25,421.6	24,890.0	26,194.3	27,579.7	28,935.9	29,542.1
Minority interests	2,264.9	1,827.6	1,603.0	1,647.4	1,685.7	1,734.6	1,789.1
Long-term liabilities	12,120.0	9,196.7	7,943.0	8,353.3	7,246.3	5,590.9	5,590.9
Loans	10,537.8	7,678.4	6,603.0	7,013.3	5,906.3	4,250.9	4,250.9
Other	1,582.2	1,518.2	1,340.0	1,340.0	1,340.0	1,340.0	1,340.0
Current liabilities	19,812.8	15,127.3	16,150.0	16,161.5	17,067.9	16,822.0	16,838.2
Loans	2,459.8	1,294.6	911.0	967.6	814.9	586.5	586.5
Trade creditors	15,092.5	12,655.9	14,143.0	14,097.9	15,157.0	15,139.5	15,155.7
Other	2,260.5	1,176.8	1,096.0	1,096.0	1,096.0	1,096.0	1,096.0
Debt	12,997.6	8,973.1	7,514.0	7,980.9	6,721.1	4,837.4	4,837.4
Net debt*	7,588.4	6,761.7	7,021.0	7,358.0	5,838.7	3,878.4	2,243.7
(Net debt / Equity)	*30.9%*	*25.5%*	*27.1%*	*27.0%*	*20.4%*	*12.9%*	*7.3%*
(Net debt / EBITDA)	1.7	1.6	2.8	1.5	1.1	0.7	0.4
BVPS	57.4	61.9	60.7	63.7	67.0	70.1	71.5

*incl. sales of strategic oil reserves

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Cash Flows

(PLN m)	2011	2012	2013	2014F	2015F	2016F	2017F
Cash flow from operating activities	761.1	3,089.4	5,671.0	4,230.4	5,421.8	5,633.8	5,819.3
Net profit	2,015.0	2,170.2	90.0	1,948.7	2,203.2	2,727.0	2,569.7
D&A expenses	2,379.9	2,260.1	2,170.0	2,295.1	2,397.9	2,293.8	2,323.8
Working capital	-4,803.4	-1,138.7	2,822.0	-260.9	617.7	541.3	930.1
Other	1169.6	-202.2	589.0	247.4	202.9	71.7	-4.3
Cash flow from investing activities	1,497.0	-2,874.9	-2,479.0	-3,720.0	-2,920.0	-2,280.0	-2,280.0
CAPEX	-2,542.4	-2,446.5	-2,400.0	-3,720.0	-2,920.0	-2,280.0	-2,280.0
Equity investment	-121.3	-169.9	-536.0	0.0	0.0	0.0	0.0
Other	4160.8	-258.4	457.0	0.0	0.0	0.0	0.0
Cash flow from financing activities	332.4	-3,411.5	-2,509.0	-380.5	-2,242.1	-3,277.3	-1,904.6
Share issue	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt	870.8	-2,991.3	-1,512.0	466.9	-1,259.7	-1,883.8	0.0
Dividend (buy-back)	0.0	0.0	-642.0	-600.0	-779.5	-1,321.9	-1,908.9
Other	-538.4	-420.2	-355.0	-247.4	-202.9	-71.7	4.3
Change in cash	2,590.5	-3,196.9	683.0	129.8	259.6	76.5	1,634.7
Cash at period-end	5,409.2	2,211.3	2,893.0	3,022.8	3,282.5	3,358.9	4,993.6
DPS (PLN)	0.00	0.00	1.50	1.40	1.82	3.09	4.46
FCF	-3,797.5	74.9	2,301.0	510.4	2,501.8	3,353.8	3,539.3
(CAPEX/Sales)	*2.4%*	*2.0%*	*2.1%*	*3.3%*	*2.4%*	*1.8%*	*1.8%*

Trading Multiples

	2011	2012	2013	2014F	2015F	2016F	2017F
P/E	7.5	7.6	100.7	9.3	8.2	6.6	7.0
P/CE	3.7	3.8	7.6	4.2	3.9	3.6	3.7
P/BV	0.7	0.7	0.7	0.7	0.6	0.6	0.6
P/S	0.2	0.1	0.2	0.2	0.1	0.1	0.0
FCF/EV	*-13.8%*	*0.3%*	*9.6%*	*2.1%*	*10.9%*	*16.0%*	*18.3%*
EV/EBITDA	6.2	6.1	9.6	4.9	4.3	3.7	3.5
EV/EBIT	13.3	13.0	71.9	9.2	7.8	6.1	6.1
EV/S	0.3	0.2	0.2	0.2	0.2	0.2	0.2
DYield	*0.0%*	*0.0%*	*3.6%*	*3.4%*	*4.4%*	*7.5%*	*10.8%*
Price (PLN)	41.5	,	,	,	,	,	,
Shares at year-end (millions)	427.7	427.7	427.7	427.7	427.7	427.7	427.7
MC (PLN m)	17,729	17,729	17,729	17,729	17,729	17,729	17,729
Minority interests (PLN m)	2,265	1,828	1,603	1,647	1,686	1,735	1,789
EV (PLN m)	27,582	26,318	23,953	24,334	22,853	20,942	19,361

List of abbreviations and ratios contained in the report:
EV – net debt + market value
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
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

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BUY – we expect that the rate of return from an investment will be at least 15%
ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from –5% to +5%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
Recommendations are updated at least once every nine months.

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Relative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

Previous ratings issued for PKN Orlen

rating	Accumulate	Buy	Buy
rating day	2013-06-05	2013-07-03	2013-10-21
price on rating day	53.25	48.21	44.70
WIG on rating day	47620.68	45533.94	52587.24

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