

Wednesday, May 20, 2020 | update

GPW: hold (downgraded)

GPW PW; GPW.WA | Financials, Poland

Return of the Individual Investor

Shares in GPW have outperformed the WIG broad market index by about 20% since our initiating report in January. As operator of the Warsaw Stock Exchange, GPW has directly benefitted from the latest turmoil in global equity markets, which made for record-high trading volumes in the weeks from March through April. This included volumes provided by individual investors, who bring in thicker profit margins through higher trading fees. In addition, the huge volatility in global markets helped to promote Polish derivatives, and the TGE energy exchange as well delivered solid performance in the first quarter of 2020. Looking ahead, however, the outlook is more cloudy. For example, energy use during the worldwide economic lockdown has gone down, and this is bound to reflect on TGE's volumes in the rest of the year. Second, trading activity on the WSE might also be curtailed in the medium term after large withdrawals from equity funds and the interrupted rollout of the national PPK workplace pension scheme, compounded by low confidence in the Polish capital market. Third, GPW is poised to incur higher costs of employment and financing this year than originally forecast, offsetting stronger trading volumes. Further, at the current level GPW's valuation has come close to an all-time high at 13.4x P/E, a ratio which leaves little room for further growth; the upside potential is additionally curbed GPW's unapproachability as a potential acquisition target. We downgrade GPW from buy to hold, and we lower the target price to PLN 41.56 per share.

2020-2021 Forecast Revisions

We have raised our 2020 and 2021 revenue growth projections for GPW by 6.1% and 4.6%, respectively, but at the same time we made upward revisions of 4.5% and 3.2% to the corresponding cost expectations. As a result, we currently expect GPW to increase EBITDA at annual rates of 9.4% in 2020 and 7.5% in 2021. Net profit will most likely post flat growth in 2020 due to higher finance costs related to an overdue VAT case against the IRGIT Commodity Exchange Clearing House.

Lower Trading Volumes in H2 2020

We are anticipating a decline in the trading volumes generated by GPW's financial markets in the second half of 2020, and we see worsened prospects for medium-term volumes due to increased withdrawals from Polish investment funds. Based on these expectations, we revised our long-term volume projections to assume a target annual value of PLN 230bn.

Considering a Worst-Case Scenario

We have constructed a worst-case scenario for GPW where its cost/income ratio takes longer to reach the target 50%, long-term equity trading volumes are lower amid overall subdued sentiment for capital markets, and trading in green certificates ends sooner than the base-case expiry due to an earlier wind-up of the support mechanism. In this scenario our target valuation of GPW would decrease to PLN 35.74, implying a reduce recommendation.

| (PLN m) | 2018 | 2019 | 2020E | 2021E | 2022E |
|---------------|-------|-------|-------|-------|-------|
| Revenue | 346.8 | 336.1 | 339.1 | 349.1 | 356.3 |
| EBITDA | 204.7 | 188.3 | 176.5 | 182.5 | 185.6 |
| EBITDA margin | 59.0% | 56.0% | 52.1% | 52.3% | 52.1% |
| EBIT | 173.0 | 156.3 | 140.7 | 144.4 | 144.9 |
| Net profit | 183.7 | 119.3 | 110.4 | 121.6 | 124.0 |
| P/E | 9.1 | 14.1 | 15.2 | 13.8 | 13.5 |
| P/B | 1.9 | 1.9 | 1.9 | 1.9 | 1.8 |
| EV/EBITDA | 8.5 | 8.8 | 9.4 | 9.0 | 8.7 |
| DPS | 2.20 | 3.18 | 2.40 | 2.50 | 2.60 |
| DYield | 5.5% | 7.4% | 6.0% | 6.3% | 6.5% |

| | |
|---------------|------------|
| Current Price | PLN 40.00 |
| Target Price | PLN 41.56 |
| MCap | PLN 1.68bn |
| Free Float | PLN 1.09bn |
| ADTV (3M) | PLN 4.5m |

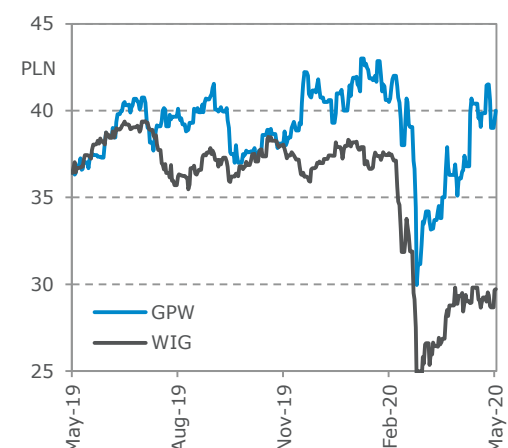
Ownership

| | |
|----------------|--------|
| State Treasury | 35.00% |
| Others | 65.00% |

Business Profile

GPW Group is the biggest exchange operator in the CEE region, managing trading venues for securities and commodities, and offering data services to investors. The Group's key competitive advantages include strong cash flow and high dividends.

GPW vs. WIG



| Name | Target Price | | Recommendation | |
|------|--------------|-------|----------------|-----|
| | new | old | new | old |
| GPW | 41.56 | 47.82 | hold | buy |

| Name | Current Price | Target Price | Upside |
|------|---------------|--------------|--------|
| GPW | 40.00 | 41.56 | +3.90% |

| Forecast Update | 2020E | 2021E | 2022E |
|-----------------|--------|-------|--------|
| Revenue | 6.14% | 4.59% | 1.64% |
| EBITDA | 9.37% | 7.54% | 0.74% |
| Net Profit | -0.89% | 6.69% | -1.73% |

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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

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
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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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%
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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

mBank issued the following investment recommendations for GPW in the 12 months prior to this publication:

| GPW | |
|---------------------|------------|
| Recommendation | buy |
| Date issued | 2020-01-16 |
| Target price (PLN) | 47.82 |
| Price on rating day | 40.85 |

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