

Tuesday, September 22, 2020 | update

PGNiG: buy (upgraded)

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

With Re-Rating In View, Buy For Gas Upturn & Cash

Stocks in PGNiG suffered a 15% collapse in the last few days that is not justified by any fundamental change, and that has caused the Company's performance to become completely disengaged from European peers. Meanwhile the EU natural gas market has recovered from a summer slump at a faster-than-expected pace, and price spreads to imported LNG indicate growth potential this heating season. We maintain that the gas market is poised for a continued forward momentum, and we want to point out that, with Yamal contract prices now linked to EU market prices, PGNiG moving forward can deliver greater earnings consistency with 60% of annual EBITDA derived from regulated public utility services. As such, we believe PGNiG, which is currently trading at a shockingly low EV/EBITDA multiple 25% below the 5Y average, is set for a well-deserved re-rating. Another thing to point out is that, predictably, the market's expectations for PGNiG's 2021-22 earnings have gone up more than 10% since June after the Company fulfilled 60% of the consensus EBITDA forecast in the first half of the year. After updating our view to accommodate more optimistic long-term production targets, we raise our target price for PGN to PLN 5.97 and we upgrade the stock to buy.

Natural Gas Momentum Accelerates Beyond Expectations

A sharp rebound in spot gas prices has caused an upward shift in the entire curve in recent weeks, and today contracts for next year's deliveries at €14/MWh are trading closer to our conservative forecast for 2022 (€15), than the cautious estimate for 2021 (€11.8). The key drivers behind our positive view on gas prices remain intact: European gas stocks rose at a relatively slow rate during the summer, production of US gas for exports to the EU is down, and there are disruptions in LNG exports from Australia; meanwhile coal-to-gas switching in the EU power sector continues. Moreover, it is worth noting that prices at European hubs still show discounts relative to the US and Asia – a fact which could gain significance during the winter period (LNG arbitrage).

Ripe For a Re-Rating

PGNiG is currently trading at 3.4x 2021E EV/EBITDA (2020 multiples are affected by the Gazprom payout), a value ~25% below the average for the last five years. This is baffling considering the reformulation of Yamal gas pricing which suggests that, moving forward, the Polish Gas Company will derive 60% of annual EBITDA from public utility services (i.e. from sales margins on gas supplied to end-users, storage fees, distribution, and heat).

Upgraded Production Outlook

On 21 September 2020, PGNiG released an updated production forecast for its Norwegian operations with significantly higher targets through 2027 than we were assuming in our long-term models (we are guessing this was also a positive surprise for other analysts given how tight-lipped PGNiG had been on that subject up to that point). The Norwegian volumes planned in 2025-27 are higher by 0.9bcm than we had anticipated, an amount coming largely from the Gina Krog field (filling gaps left by reduced oil yields), and increasing output achieved from existing fields that are currently in production or under development. The takeaway is that the higher production will not be accompanied by any extra capital spend that we would have to factor into our baseline CAPEX scenario.

(PLN m)	2018	2019	2020E	2021E	2022E
Revenue	41,234.0	42,023.0	34,727.4	33,371.9	36,957.7
EBITDA	7,115.0	5,504.0	12,745.2	7,110.0	7,749.3
EBITDA margin	17.3%	13.1%	36.7%	21.3%	21.0%
EBIT	4,395.0	2,448.0	9,378.3	3,613.2	4,220.9
Net profit	3,212.0	1,371.0	7,290.7	2,936.3	3,258.3
P/E	8.2	19.2	3.6	9.0	8.1
P/CE	4.4	6.0	2.5	4.1	3.9
P/BV	0.7	0.7	0.6	0.6	0.5
EV/EBITDA	3.7	5.5	1.9	3.3	3.1
DPS	0.07	0.11	0.09	0.19	0.25
DYield	1.5%	2.4%	2.1%	4.1%	5.6%

Current Price	PLN 4.56
Target Price	PLN 5.97
MCap	PLN 26.4bn
Free Float	PLN 7.4bn
ADTV (3M)	PLN 50.4m

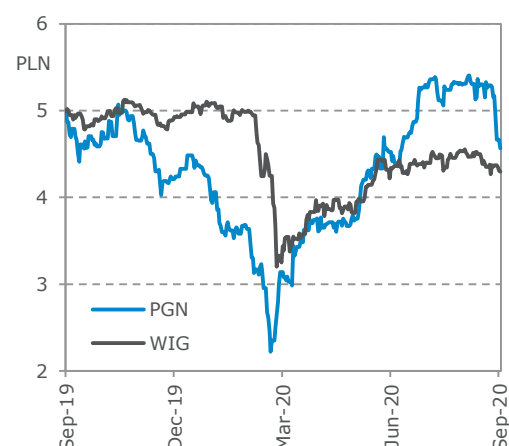
Ownership

State Treasury	71.88%
Others	28.12%

About PGNiG

PGNiG is Poland's largest natural gas company with annual sales exceeding 17-18 billion cubic meters. The Company produces 4.5bcm of gas and 1.3mmt of crude oil per year (including from international deposits, most notably assets in Norway). A key business for PGNiG is distribution, effected through its own transmission infrastructure. As well as natural gas, PGNiG is also a producer of electricity and heat.

PGN vs. WIG



Company	9MTP		Rating	
	new	old	new	old
PGNiG	5.97	5.94	buy	accumulate

Company	Current Price	Target Price	Upside
	4.56	5.97	30.73%

Forecast Update	2020E	2021E	2022E
EBITDA	-0.4%	+0.7%	+0.9%
Net Profit	-0.3%	+0.4%	+0.5%
Brent (USD/bbl)	+0.0%	+0.0%	+0.0%
Gas EU (EUR/MWh)	+0.0%	+0.0%	+0.0%
USD/PLN	+0.0%	+0.0%	+0.0%

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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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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 recommendations for PGNiG in the 12 months prior to this publication:

PGNiG										
recommendation	accumulate	buy	buy	buy	buy	hold	hold	hold	buy	buy
date issued	2020-09-02	2020-08-04	2020-07-02	2020-06-03	2020-04-07	2020-03-23	2020-03-04	2020-01-28	2019-11-06	2019-09-05
target price (PLN)	5.94	5.94	5.23	4.91	4.44	3.24	3.88	4.06	5.64	6.33
price on rating day	5.15	5.10	4.63	4.31	3.48	3.14	3.20	3.86	5.07	4.49

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