

Wednesday, September 30, 2020 | update

GPW: sell (downgraded)

GPW PW; GPW.WA | Financials, Poland

Is It Lights Out For Guaranteed Power Trade?

GPW has seen revenues from capital markets soar beyond all expectations this year on high volatility, large trading volumes, and increased activity of individual investors, and so we opt to raise our FY2020 revenue estimate by 12.5%, and upgrade the net profit forecast by 25% after taking into account operating leverage. Our updated forecasts also include some inconsequential cost revisions. Looking beyond 2020, however, we see a number of potential setbacks clouding GPW's future prospects. One particularly big one is the potential removal of the requirement for energy companies to sell power through the TGE exchange – a concession that the Polish government might grant to coal mining unions who are demanding that Poland curb power imports and make more electricity domestically by burning coal. The resulting reduction in TGE volumes could lead to lower revenues for GPW from 2021. In the short term, the gap would most likely be filled by higher income from capital markets, but in the long term the negative impact of the lost trading volumes would become more tangible. We assume a 5.6% fall in total revenue as our baseline, and with operating leverage coming into play this indicates a big dent in bottom-line profit. Another reason behind our bearish call is that GPW's P/E ratio has now reached an all-time high at 15.8x, with the 2021E multiple on our estimates hovering around 15.7x. Expected dividend yields have also diminished as a result, with next year's implied payout currently around 5% compared to 6-7% anticipated not long ago. For these reasons, despite strong earnings performance this year, we lower our target price for GPW to PLN 39.19 and we downgrade the stock to sell.

The End of the "Power Exchange Obligation"

Assuming the Polish government yields to the demands of miners and lifts the so-called power exchange obligation, the TGE exchange according to our calculations faces a 5% decrease in trading revenue and a 3% fall in clearing revenues. If utilities remain compelled to sell 30% of their volumes via TGE (our baseline scenario), this implies a long-term revenue loss of 5.6%, with significant implications for GPW's valuation. However even in the best-case scenario where the power exchange obligation is upheld at the current 100% our valuation of GPW would increase to PLN 42.57, implying no more than a reduce recommendation. In terms of total revenues, the complete removal of the TGE obligation implies an 8% topline dent and a target price of PLN 37.79.

Record-High Valuation

GPW is currently trading at 15.8x trailing P/E, which means it has come close to its all-time high valuation of 16.0x, making it an overvalued stock, especially when weighed against the bleak revenue prospects in the event of a curb on TGE power trading. On our estimates, at 15.7x 2021E P/E GPW is currently valued about 50% above the average ratio for the last five years.

(PLN m)	2018	2019	2020E	2021E	2022E
Revenue	346.8	336.1	381.4	355.1	358.4
EBITDA	204.7	188.3	211.8	188.0	187.3
EBITDA margin	59.0%	56.0%	55.5%	52.9%	52.3%
EBIT	173.0	156.3	176.0	149.9	146.6
Net profit	183.7	119.3	138.3	125.9	125.3
P/E	10.8	16.6	14.3	15.7	15.8
P/B	2.2	2.3	2.2	2.1	2.1
EV/EBITDA	9.9	10.3	9.1	10.1	10.1
DPS	2.20	3.18	2.40	2.50	2.60
DYield	5.5%	7.4%	5.1%	5.3%	5.5%

Current Price	PLN 47.10
Target Price	PLN 39.19
MCap	PLN 1.96bn
Free Float	PLN 1.27bn
ADTV (3M)	PLN 6.0-m

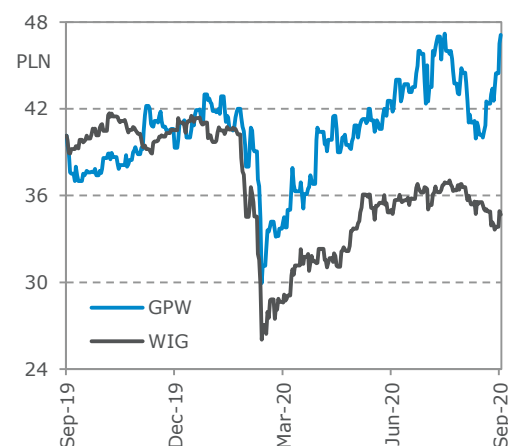
Ownership

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	39.19	41.56	sell	hold

Name	Current Price	Target Price	Upside
GPW	47.10	39.19	-16.8%

Forecast Update	2020E	2021E	2022E
Revenue	+12.47%	+1.71%	+2.27%
EBITDA	+19.99%	+3.00%	+1.66%
Net Profit	+25.25%	+3.56%	-0.67%

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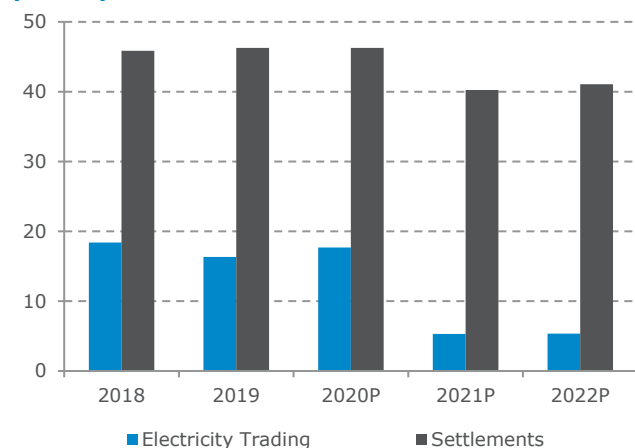
How Lost Electricity Market Volumes Can Impact Revenues

The withdrawal of the "exchange obligation," even before it was promised to coal mining unions late this month, made it into draft legislation tabled in early September by the Climate Ministry.

The negotiations between the government and the miners are still going on as we write this, and so we take as our baseline for GPW models that the proportion of electricity that utilities have to sell via the power exchange will be reduced from 100% to 30%. In the worst-case scenario of zero obligatory trade, GPW would be facing a 5% reduction in revenues due to the loss of volumes alone, plus a decrease of 2-3% stemming from the loss of clearing and settlement fees.

For the purposes of our models, we assume a permanent revenue loss of 5-6% per year from 2021.

Revenues from TGE power trades and clearing fees (PLN m)



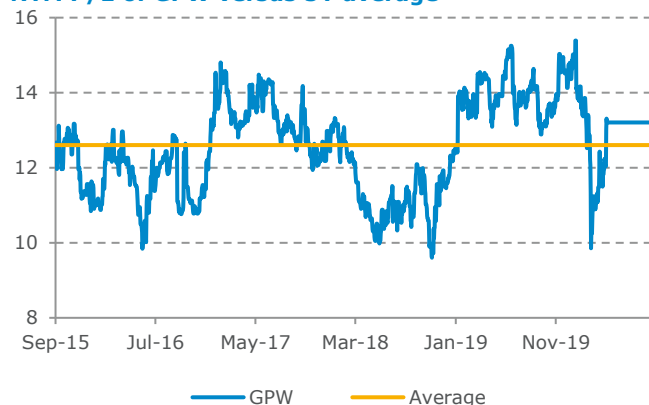
Source: GPW, P - mBank projection

Pumped-Up Valuation

GPW's trading multiples have almost reached their all-time highs with a 2020E P/E of 15.8x and the 2021E ratio even closer to 16x. The P/E NTM ratio comes out above 14x, a level well above the average for the last five years.

Furthermore, GPW's dividend yield is currently less than 6%, a relatively low figure compared to what can be expected from banks next year (provided they are allowed to make shareholder distributions in 2021).

NTM P/E of GPW versus 5Y average



Source: Bloomberg, mBank

Finally, if we compare GPW to other stock market operators, the return on its stock for the year to date is 26.5% compared to an average of 12.5% for the peer group.

No Hike In 2021 DPS

Despite the high profits generated in the first half of 2020, GPW at its last earnings call communicated openly to investors that it was sticking to its dividend policy and would not be paying more than the routine PLN 2.50 per share in 2021, which at the current price level implies a dividend yield of approximately 5%. This is less than an investment GPW could offer in March or April, which leads us to the conclusion that the Company is either trying to thicken its cash cushion for harder times, or, that it is accumulating resources to make acquisitions.

Valuation

We calculated our target price for GPW using DCF valuation and discounted dividends, which yielded a 9-month target value of PLN 39.19.

(PLN)	weight	price
DDM Analysis	50%	34.24
DCF Analysis	50%	39.45
	price	36.85
9M target price		39.19

DCF Valuation

Assumptions:

- The risk-free rate is 3.5%.
- The credit risk premium is 5.0%.
- Beta=1.0x.
- We include a 0.5% premium for GPW Group's status as a state-controlled entity.
- Net cash is adjusted for dividends.
- We assume GPW Group will maintain a net cash position throughout the forecast period.
- The ratio of sales to CAPEX will likely decrease from 2024 to reach 8.0%.
- Terminal value calculations use FY2029E FCF adjusted for PLN 30m in lost cash after the termination of trading in green certificates.
- We assume a perpetuity growth rate of 2.0%.

DCF Model

(PLN m)	2020P	2021P	2022P	2023P	2024P	2025P	2026P	2027P	2028P	2029P	2029+
Revenue	381	355	358	361	359	359	358	357	356	356	
change		-6.9%	0.9%	0.7%	-0.4%	-0.2%	-0.3%	-0.3%	-0.3%	0.0%	
EBITDA	212	188	187	189	196	201	204	204	201	203	
EBITDA margin	55.5%	52.9%	52.3%	52.3%	54.6%	56.0%	57.1%	57.2%	56.4%	57.0%	
D&A expenses	-36	-38	-41	-43	-39	-37	-35	-33	-32	-28	
EBIT	176	150	147	146	157	164	170	171	169	174	
EBIT margin	46.2%	42.2%	40.9%	40.4%	43.6%	45.8%	47.5%	47.9%	47.5%	49.0%	
Tax on EBIT	-37	-31	-31	-31	-33	-35	-34	-34	-34	-35	
NOPLAT	139	118	116	115	124	130	136	137	135	140	
CAPEX	-40	-32	-36	-36	-34	-33	-32	-31	-30	-28	
Working capital	-18	3	0	0	0	0	0	0	0	0	
FCF	117	127	120	122	129	134	139	139	137	140	1,564
WACC	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	
discount factor	0.98	0.90	0.82	0.76	0.69	0.64	0.58	0.54	0.49	0.45	
PV FCF	115	114	99	92	90	85	81	74	67	63	
WACC	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	
Risk-free rate	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%	
Risk premium	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%	
Cost of equity	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	8.5%	
Risk premium	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	

FCF growth after the forecast period	2%
Terminal value	1,564
Present value of terminal value	705
Present value of FCF in the forecast period	880
Net debt	-71
Equity investment	
Equity value	1,656
Million shares outstanding (adj.)	41.97
Equity value per share (PLN)	39.45
9M cost of equity	8.5%
9M target price (PLN)	41.97

EV/EBITDA('20) at target price	7.82
P/E('20) at target price	14.76
TV / EV	43%

Sensitivity Analysis

	FCF growth in perpetuity				
	0.0%	1.0%	2.0%	3.0%	4.0%
WACC +1.0 p.p.	32.14	33.74	35.77	38.45	42.15
WACC +0.5 p.p.	33.42	35.17	37.40	40.35	44.45
WACC	34.80	36.73	39.19	42.49	47.1
WACC -0.5 p.p.	36.31	38.44	41.19	44.9	50.18
WACC -1.0 p.p.	37.96	40.33	43.43	47.67	53.84

Dividend Discount Model

(PLN)	Valuation	(%)
Explicit forecast (2021-22)	4.18	12.2%
Value driver (2023-2029)	11.01	32.2%
Terminal value	19.04	55.6%
Fair value of equity	34.24	
9M cost of equity	8.5%	
Target Price	36.42	

Earnings History and Future Projections

(PLN m)	2017	2018	2019	2020P	2021P	2022P
Revenue	352.0	346.8	336.1	381.4	355.1	358.4
Capital Market	208.8	191.9	185.0	236.3	226.2	227.1
Commodity Market	142.1	153.6	149.9	143.7	127.7	130.1
Other	1.0	1.4	1.2	1.4	1.2	1.2
EBITDA	215.9	204.7	188.3	211.8	188.0	187.3
change	15.6%	-5.2%	-8.0%	12.5%	-11.2%	-0.4%
margin	61.3%	59.0%	56.0%	55.5%	52.9%	52.3%
Depreciation of fixed assets	29.7	31.8	32.0	35.8	38.1	40.7
EBIT	186.2	173.0	156.3	176.0	149.9	146.6
change	15.9%	-7.1%	-9.6%	12.6%	-14.8%	-2.2%
margin	52.9%	49.9%	46.5%	46.2%	42.2%	40.9%
Net financing gains/losses	-5.6	45.3	-16.6	-14.0	-3.5	-1.0
Equity in profits/losses of associates	10.1	10.6	11.3	13.0	13.0	13.0
Pre-tax profit	191.0	226.0	149.8	175.0	159.4	158.6
Tax	-32.3	-42.3	-30.5	-36.8	-33.5	-33.3
Net profit	158.7	183.7	119.3	138.3	125.9	125.3
change	36.3%	15.7%	-35.0%	15.9%	-8.9%	-0.5%
margin	45.1%	53.0%	35.5%	36.3%	35.5%	35.0%
Million shares outstanding at eop (adj.)	42.0	42.0	42.0	42.0	42.0	42.0
EPS	3.8	4.4	2.8	3.3	3.0	3.0
ROE	20.7%	21.8%	13.6%	15.5%	13.7%	13.3%
ROA	13.8%	15.5%	9.6%	10.8%	9.6%	9.4%

Balance Sheet

(PLN m)	2017	2018	2019	2020P	2021P	2022P
ASSETS	1147.1	1217.4	1256.8	1301.6	1318.2	1333.6
Fixed assets	596.4	580.5	590.1	593.3	588.6	587.7
Property, plant and equipment	110.8	108.2	102.0	109.2	107.1	104.3
Intangible assets	268.0	254.6	246.6	242.1	244.2	248.2
Equity investments	207.4	207.3	214.3	214.3	214.3	214.3
Other fixed assets	10.2	10.5	27.2	27.6	23.0	20.8
Current assets	550.7	636.9	666.7	708.3	729.6	745.9
Trade and other receivables	64.1	70.7	47.6	74.2	69.0	69.7
Other current assets	0.1	377.6	337.7	333.4	333.4	333.4
Cash and cash equivalents	486.5	188.7	281.3	300.7	327.1	342.8

(PLN m)	2017	2018	2019	2020P	2021P	2022P
EQUITY & LIABILITIES	1147.1	1217.4	1256.8	1301.6	1318.2	1333.6
Equity	799.5	887.8	873.5	910.9	931.9	948.1
Share capital	798.9	887.2	872.9	910.3	931.3	947.5
Minority interest	0.6	0.6	0.6	0.6	0.6	0.6
Non-current liabilities	270.8	269.0	283.5	283.3	281.8	281.0
Loans	243.6	244.0	244.4	244.4	244.4	244.4
Other	27.2	25.1	39.2	38.9	37.4	36.7
Current liabilities	76.8	60.6	99.8	107.4	104.5	104.5
Loans	2.0	1.9	7.1	6.4	6.0	5.7
Trade payables and other obligations	34.3	22.9	28.7	37.1	34.5	34.8
Other	40.6	35.8	64.0	64.0	64.0	64.0
Debt	245.5	245.9	251.5	250.8	250.4	250.1
Net debt	-240.9	57.2	-29.8	-49.9	-76.8	-92.7
Net Debt / Equity	-30.1%	6.4%	-3.4%	-5.5%	-8.2%	-9.8%
Net Debt/ EBITDA	-112%	28%	-16%	-24%	-41%	-50%
BVPS	19.05	21.15	20.81	21.70	22.20	22.59

Cash Flow

(PLN m)	2017	2018	2019	2020P	2021P	2022P
Cash flow from operating activities	169.9	136.5	191.1	177.8	165.6	162.9
Net profit	158.7	183.7	119.3	138.3	125.9	125.3
D&A expenses	29.7	31.8	37.1	40.8	43.1	45.7
Working capital	-0.4	-26.8	57.3	-18.9	2.9	-0.5
Other	-18.1	-52.1	-22.6	17.6	-6.3	-7.6
Cash flow from investing activities	-186.6	-84.2	44.4	-39.5	-29.9	-36.3
CAPEX	-9.8	-11.5	-16.7	-44.0	-40.0	-44.0
Equity investment	0	0	0.0	1.0	2.0	3.0
Other	-176.9	-72.6	61.2	4.5	10.1	7.7
Cash flow from financing activities	-99.8	-99.7	-142.7	-118.9	-109.3	-110.9
Share issue	0	0	0	0	0	0
Debt	0	0	0	0	0	0
Dividends/Buyback	-90.3	-92.3	-133.4	-100.7	-104.9	-109.1
Other	-9.5	-7.3	-9.2	-18.2	-4.4	-1.8
Change in cash	-116.5	-47.3	92.9	19.4	26.4	15.7
Cash at eop	246.4	188.8	281.3	300.7	327.1	342.8
DPS (PLN)	2.15	2.20	3.18	2.40	2.50	2.60
FCF	229.9	123.2	168.6	117.2	127.1	120.2
CAPEX/Sales	2.8%	3.3%	5.0%	11.5%	11.3%	12.3%

Trading Multiples

	2017	2018	2019	2020P	2021P	2022P
P/E	12.5	10.8	16.6	14.3	15.7	15.8
P/B	2.5	2.2	2.3	2.2	2.1	2.1
P/S	5.6	5.7	5.9	5.2	5.6	5.5
FCF/EV	13.2%	6.1%	8.7%	6.1%	6.7%	6.4%
EV/EBITDA	8.0	9.9	10.3	9.1	10.1	10.1
EV/EBIT	9.3	11.8	12.5	11.0	12.7	12.9
EV/S	4.9	5.9	5.8	5.1	5.4	5.3
DYield	4.4%	5.5%	7.4%	5.1%	5.3%	5.5%
Price (PLN)	47.1	47.1	47.1	47.1	47.1	47.1
Million shares outstanding at eop (adj.)	42.0	42.0	42.0	42.0	42.0	42.0
MC (PLN m)	1976.9	1976.9	1976.9	1976.9	1976.9	1976.9
Minority interest (PLN m)	0.6	0.6	0.6	0.6	0.6	0.6
EV (PLN m)	1736.5	2034.6	1947.7	1927.5	1900.7	1884.8

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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Strong and weak points of valuation methods used in recommendations:

DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.

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

Economic profits – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

Discounted Dividends (DDM) – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.

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 GPW in the 12 months prior to this publication:**GPW**

recommendation	hold	buy
date issued	2020-05-20	2020-01-16
target price (PLN)	41.56	47.82
price on rating day	40.00	40.85

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