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PGE: Generator Launches Climate-Neutrality Plan to 2050

Rating: suspended | current price: PLN 5.66

PGE PW; PGE.WA | Power Utilities, Poland

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PGE today announced a long-term carbon neutrality strategy to 2030, with a vision to 2050. The Generator intends to invest PLN 75 billion in renewable energy sources and distribution infrastructure over the next ten years, and it wants to separate out its coal assets, ideally by the end of 2021, among other actions. The desire to minimize the carbon footprint received an official blessing from state assets and climate ministry officials, also present at today's press conference.

From the point of view of the market, today's announcement might provide a catalyst to reassess PGE's worth based on just its "carbon neutral" assets. However investors should be prepared for pushback from labor unions which could delay the schedule. When it comes to debt, assuming the carbon assets earmarked for carve-out take their debts with them in a proportion equivalent to 3.0x their attributable EBITDA, at its June 2020 6.0x EV/EBITDA ratio this would make PGE worth more than PLN 14 per share. That being said, in order to earn itself a re-rating, PGE should also work on regaining the confidence of minority shareholders, for example by giving a timeline for the reinstatement of dividends – something which it did not do at today's conference.

Actions in Generation

The roadmap towards achieving climate neutrality by 2050 assumes that, by 2030, "zero- and low-emission sources will constitute 85% of the generation portfolio and share of renewable energy will amount to 50% of the total generation." The actions to further these goals will include the **separation or divestment of coal assets** (to quote, the "PGE Group is ready to carry out the transition process of the sector: preparing the conventional electrical power system base to function in a new ownership structure"), **investment in wind farms and solar power stations** (2.5 GW offshore, 1 GW onshore, 3 GW PV), and a **transition of district heating towards low- and zero-emission sources** with a 70% target share in heat production by 2030 (the actions in respect of district heating will be supported by new legislative solutions from deregulation to new tariff-setting rules).

Coal Separation

Ideally, PGE would like to split from coal assets by the end of 2021. According to CEO Wojciech Dąbrowski, after the split it would make sense to merge PGE with Enea and Tauron, though this is an avenue that has to be explored by all three sets of shareholders. Mr. Dąbrowski dodged questions about the estimated value of the coal assets, but he did mention the diminishing profit-generating potential of coal-based power. **The carve-out of coal assets together with their corresponding debts and liabilities is subject to government approval.**

CAPEX/EBITDA

Between 2021 and 2030, PGE intends to spend PLN 75bn on developing renewable energy capacity (50%) and on building transmission infrastructure and low-carbon heating plants. In terms of returns, the Company expects to achieve EBITDA over PLN 5bn in 2025, rising to over PLN 6bn in 2030. **Not including coal, PGE currently achieves EBITDA of approximately PLN 4bn, and its yearly spend in this area is ca. PLN 3bn. With 25% of the PLN 75bn ten-year financing expected to come from aid funds, the actual average annual spend would figure to PLN 5.6bn – a figure which corresponds with expected EBITDA (the goal is to maintain stable debt throughout the transition period).**

Dividend Policy

PGE's main focus right now is on investments and on stabilizing EBITDA. The Company was not able to provide a timeline for the resumption of dividends.

Cost Cuts

As part of its shift toward a more efficient operation, PGE will be aiming to reduce fixed costs by 15% to 2025 and by 25% to 2030 (relative to 2019, not including savings provided by coal separation), in a large part through downsizing.

Distribution and Retail

PGE wants to modernize its power distribution infrastructure and build energy storages (800 MW by 2030). To that end, it will develop a new DSO regulatory model expected to improve future FCFF by PLN 0.7bn.

When it comes to the retail business, PGE wants to maintain customer satisfaction by offering top-quality services, including market access services (1.0 GW in market services). The new services are expected to add PLN 0.4 bn on average per year to the segmental EBITDA.

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

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

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