Oil & Gas | Poland

PGNiG

Buy

TP: PLN5.6

Company Update

- Lower forecasts for the E&P segment, higher for T&S, Distribution and Heat&Power.
- We forecast 2015F and 2016F EBITDA of PLN6.6bn and PLN6.5bn, respectively, 4% above consensus for both years.
- 2015F and 2016F EV/EBITDA of 4.7-4.6x, at c.20% discount to peers (weighted-average of E&P and integrated gas companies)

14 January 2015

Crude oil collapse is priced in, what is not?

PGNiG, seen as the main E&P play in Poland, suffered from a collapse in crude oil price, with the stock down 12% since July. While such a reaction may seem correct, we believe the share price does not reflect several positive developments, including: acquisition in Norway (NPV positive even at the current oil price), agreement with QatarGas (less negative impact in 2015F), higher than expected distribution and heat tariffs, new dividend policy, and last but not least slow gas market liberalization process. All in all, the aforementioned developments allow us to raise 2015-16F EBITDA by 4-7%. Our 2015-16F EBITDA forecasts are 4% above consensus for both years and translate into EV/EBITDA of 4.7-4.6x, 18-21% discount to peers. We maintain a Buy rating with a new TP of PLN5.6 (down from PLN5.9).

Acquisition in Norway adds PLN0.11/share to our DCF and partially offsets the negative impact of lower crude price (PLN0.8/share). We have cut our crude oil price assumptions by 49% to US$51 for 2015F and by 39% to US$61 for 2016F. Taking into account only the E&P segment, our new macro assumptions reduce our TP by PLN0.8/share. We forecast the recently acquired package of 4 fields in Norway to contribute EBITDA of PLN0.2bn in 2015-16F and calculate its NPV of PLN0.11/share. As a result, we have cut our EBITDA forecast for the E&P segment by 29% to PLN2.9bn in 2015F and by 19% to PLN3.1bn in 2016F.

Despite lower crude oil price, we upgrade our 2015-16 EBITDA. We raise our forecasts for the Trade&Storage segment due to lower than previously expected losses on the QatarGas contract in 2015, slow pace of gas market liberalization and relatively favorable gas tariff for 1-4M15. We also upgrade our forecast for both Distribution and Heat&Power segments due to higher than previously expected tariffs. As a result, we upgrade our EBITDA forecast for 2015F by 4% to PLN6.6bn (4% above consensus). We raise our EBITDA forecast for 2016F by 7% to PLN6.5bn (4% above consensus).

2014-22 Strategy: new 50% payout implies DY of 4.1% in 2015F. We perceive the dividend policy announcement as positive piece of news and believe the remaining goals of the strategy are largely in line with expectations. Based on the 50% dividend payout policy (vs. consensus of 33%), we forecast a dividend yield of 4.2% and 5.6% in 2015F and 2016F, respectively.

Valuation close to E&P peers. On our forecasts, PGNiG trades at 2015F and 2016F EV/EBITDA of 4.7x and 4.6x, respectively, at 21% and 18% discount to peers. We use weighted-average of E&P (2015 EV/EBITDA of 4.3x) and integrated gas companies (6.3x) as the peer group. Our TP based on DCF and peer comparison comes in at PLN5.6 (down from PLN5.9), implying 24% upside.

PGNiG: Financial forecasts and valuation

	2011	2012	2013	2014F	2015F	2016F
Norm. EBITDA (PLNm)	3,446	1,413	6,513	6,900	6,578	6,538
Norm. Net income (PLNm)	1,756	-347	2,648	3,042	3,005	3,031
EV/EBITDA (x)	8.8	24.9	4.9	4.5	4.7	4.6
PER (x)	15.2	n/m	10.1	8.8	8.9	8.8
Dividend yield (%)	2.5	0.0	2.9	3.3	4.1	5.6

Source: Company data, DI Investors estimates.

Throughout this report we are using prices as of 12.01.2015 unless otherwise stated.

Company data

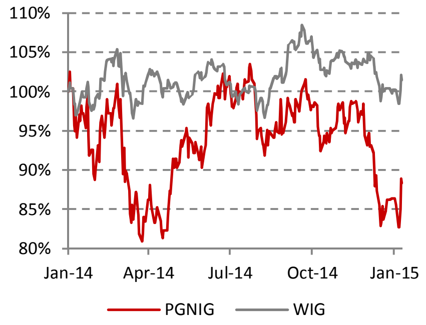
Target Price (PLN)	5.6
Share Price (PLN)	4.5
Upside	24%
Min (52W)	3.97
Max (52W)	5.26
No. of shares (m)	5,900
Market cap. (PLNm)	26,727
Net debt (14F, PLNm)	4,349
EV (14F, PLNm)	31,082
Avg. 3M Turnover (PLNm)	15.6

Shareholders	%
State treasury	72.4
Others	27.6

Company description

PGNiG is the largest natural gas producer and distributor in Poland. In 2013 the company produced 4.6bcm of natural gas and 1.1mt of crude oil. The company's proved gas reserves in Poland come in at 86bcm and the company also holds 15 shale gas exploration licenses. PGNiG sells gas to 6.7m end-customers through 120ths km of distribution network. Apart from its Polish operations, PGNiG holds 12% stake in an oil producing field in Norway, Skarv, and in exploration licenses in Egypt, Libya and Pakistan. In 2012 PGNiG acquired assets of Vattenfall Heat Poland with a total installed capacity of 1GWe and 4.8GWt.

PGN vs. WIG 1Y price performance



Source: Bloomberg, DI Investors

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Over the last three months, DI Investors issued one buy recommendation dated 9th April 2014 with target price PLN5,5 when the current price was PLN4,3 and one buy recommendation, dated 18 June 2014 with target price PLN5,9 when the current price wasPLN5,1.

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In preparing this document DI Investors applied at least two of the following valuation methods:

1) discounted cash flows (DCF),
2) comparative,
3) target multiple,
4) scenario analysis,
5) dividend discount model (DDM),
6) NAV,
7) Sum of the parts.

The discounted cash flows (DCF) valuation method is based on discounting expected future cash flows. The main advantage of the DCF valuation is the fact that this method takes into account all cash streams the issuer is expected to reach and the cost of money over time. From the other hand, DCF valuation method requires a number of assumptions and is very sensitive to changes in parameters used in the in the model. Small changes in inputs can result in large changes in the value of a company.

The comparative valuation method is based on the rule of “one price”. The advantages of this method are small number of parameters that need to be estimated, the fact that there is a relatively large number of indicators for companies being compared, the method is well-known among investors and the valuation is based on current market conditions. From the other hand a valuation derived from the comparative valuation method is considerably sensitive to the valuation of the companies classified as peers and can lead to simplification of the picture of the company.

The target multiple valuation approach is based on the assumption that the value of the company should be equal to pre-specified values of selected price multiples. The advantage of this method is its applicability to each company. From the other hand the target multiple approach is a highly subjective method.

The scenario analysis approach is based on the probability weighted valuation for three sets of assumptions: Bear case (20% probability), base case (60% probability) and bull case (20% probability). The base case is based on the assumptions and estimates which we have included in our financial forecasts and DCF valuation. In the bear/bull case scenarios we have analyzed the valuation sensitivity towards negative/positive changes in various assumptions including market size, market shares, profitability, growth, capex, valuation multiples etc. The advantage of this method is presentation of various scenarios and valuation sensitivity. As an disadvantage we find its complication and sensitivity towards probability weights assumption.

The dividend discount model (DDM) valuation uses predicted dividends that are expected to be paid out by the company and discounts them back to present value. The advantages of the DDM valuation method are its applicability to companies with long-term dividend payout history and the fact that it takes into account real cash streams that are expected to receive by equity-owners. From the other side the DDM valuation method requires a number of assumptions regarding dividend payouts.

The net asset value approach considers the underlying value of the company’s individual assets net of its liabilities. Some of the advantages of the NAV approach are its applicability to asset holding companies and the fact that data required to perform the valuation are usually easily available. From the other hand the valuation derived from net asset value approach does not take into account future changes in sales or income and can understate the value of intangible assets.

The sum of the parts approach values a company by determining what its divisions would be worth if it was broken up and spun off or acquired by another company. The advantage of this method is a possibility to apply different valuation methods to different divisions. As an disadvantage we find scarcity of comparable basis for the respective business lines.

Terminology used in the recommendation:

P/E – price-earnings ratio
PEG - P/E to growth ratio
EPS - earnings per share
P/BV – price-book value
BV – book value
EV/EBITDA – enterprise value to EBITDA
EV – enterprise value (market capitalization plus net debt)
EBITDA – earnings before interest, taxes, depreciation, and amortization
EBIT – earnings before interest and tax
NOPAT – net operational profit after taxation
FCF - free cash flows
ROE – return on equity
WACC - weighted average cost of capital
CAGR – cumulative average annual growth
CPI – consumer price index
COE – cost of equity
L-F-L – like for like

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Accumulate - indicates a stock's total return to exceed more than respective cost of equity over the next twelve months.
Neutral - indicates a stock's total return to be in range of 0% to respective cost of equity over the next twelve months.
Reduce - indicates a stock's total return to be in range of minus respective cost of equity to 0% over the next twelve months.
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