Industrial | Poland

PKP Cargo

Neutral

TP PLN 78

- **2Q15 adj. net profit estimate of PLN 32m, down 55%YoY**
- **Our 2015-2016 adj.net profit estimates down 30% and 27% to PLN 229m and PLN 279m, 21% and 17% below consensus**
- **2015 adj. P/E of 14.5x and EV/EBIDA of 5.8x**

Vestor DOM MAKLERSKI

equity research

12 August 2015

No visible breakthrough ahead

Despite 2% YoY turnover growth we expect uninspiring quarterly results in 2Q15 with adj.net profit of PLN 32m, down 55% YoY driven by falling freight rates. Due to lower freight rates, salaries hike and lower contribution from AWT we cut our 2015E adj. EBITDA and adj. net profit estimates by 19% and 30% to PLN 721m and PLN 229m, respectively. Our new 2015 EBITDA and net profit estimates are 4.4% and 21.7% below consensus and put PKP Cargo EV/EBITDA and P/E multiples at 5.9x and 14.5x, respectively which we consider fairly rich despite favourable outlook for domestic cargo market. We still expect PKPC's EBITDA to grow by 6.2% YoY in 2016E and 16.8% YoY in 2017E due to further cost cutting initiatives and growth in aggregates transportation volumes. We cut our AWT's expected EBITDA to EUR 20m in 2015E implying acquisition valuation of 2015 EV/EBITDA 7.8x which seems rich and poses new risks given management's M&A oriented growth strategy. On the back of lower earnings estimates we cut our 12m target price of PKP Cargo to PLN 78 a share (from PLN 97) and keep our Neutral rating.

2Q preview: we expect 25% YoY drop of adj. EBITDA to PLN 144m. PKP Cargo finished the 2Q15 with 7.1bn tkm of turnover, which implies 2% YoY growth. Nevertheless we estimate 3% YoY drop in revenues to PLN 1,032m as we expect another 4% QoQ (12% YoY) drop in freight rates. Due to lower revenues we estimate adj. EBITDA of PLN 144m, down 25% YoY and adj. net profit of PLN 32m, down 55% YoY. 2Q reported results will be affected by two major one-offs: 1) PLN 65m cost of the 2nd PDO and 2) estimated PLN 131m non-cash gain on AWT acquisition.

Acquisition of AWT: not a success story. At the end of May PKP Cargo acquired AWT with indicated valuation of 5x 2014 EV/EBITDA. However during recent Investor's Day management indicated that due to lower rates in new contract with NWR and lost Chvaletice contract AWT's EBITDA may be closer to EUR 20m which implies 2015 EV/EBITDA of 7.8x.

Earnings. We cut our 2015E and 2016E adj. EBITDA estimates by 19% to PLN 721m and PLN 843m respectively mostly on the back of lower freight rates and lowered expectations regarding AWT' contribution to consolidated earnings. We note that salaries hike with a cost of PLN 50m will more than offset the second PDO's savings in 2016E. On the bottomline we expect adj. net profit of PLN 229m in 2015E and PLN 279m in 2016E. Our 2015-2016E net profit estimates are 22% and 18% below consensus.

Valuation. On our estimates PKPC is trading at 2015-2016 adj. EV/EBITDA of 5.9x and 5.3x with adj. P/E of 14.5x and 11.9x, respectively, which we find fairly rich. We value PKPC using two methods: 1) DCF for PLN 72 per share and 2) comparable multiples at PLN 62 per share. We assign 100% weight to DCF valuation and set our 12m target price of PLN 78, 4.5% above current market price.

PKP Cargo: Financial summary

		2013	2014	2015E	2016E	2017E
Sales	PLN m	4,797	4,257	4,503	4,847	5,025
EBITDA	PLN m	499	444	788	843	924
Adj. EBITDA	PLN m	708	680	721	843	924
Net profit	PLN m	74	59	309	279	339
Adj.net profit	PLN m	210	250	229	279	339
DY	%	n.a.	3.7%	3.8%	3.5%	0.0%
Adj. P/E	X	n.a.	14.8	14.5	11.9	9.8
Adj. EV/EBITDA	X	n.a.	4.7	5.8	5.2	4.9

Source: Vestor DM research estimates

Company data

Target Price (PLN)	78
Share Price (PLN)	74
Upside	4.5%
Min (52W)	70.6
Max (52W)	90.6
No. of shares, diluted (m)	44.8
Market cap (PLN m)	3 323
Adj.net debt (PLN m)	8
EV (PLN m)	3 331
Avg. 3M turnover (PLN m)	3.6

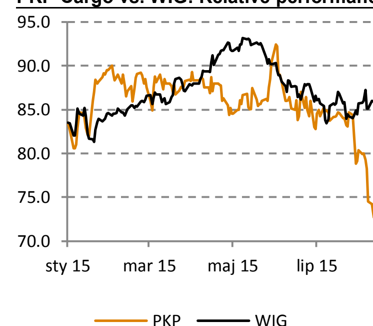
Shareholders

Treasury	33.0%
ING OFE	10.6%
Morgan Stanley	5.3%
OFE Aviva	5.2%
Others	45.9%

Company description

PKP Cargo is the largest Polish and 2nd biggest rail freight operator in the EU with transported volume of 116.7mt and freight turnover of 29.9bn tkm in 2012. Besides rail freight, PKP Cargo provides over 1,000 clients with comprehensive logistic services such as forwarding, siding maintenance and terminal services. In addition to the domestic market, the company is prepared for operation in other rail freight markets such as Germany, Austria, Slovakia, Czech, Belgium and is ready to enter Hungary.

PKP Cargo vs. WIG: Relative performance



Source: Bloomberg

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In preparing this document Vestor 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.
8) Discounted residual income model
9) ROE-P/BV model
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.
The discounted residual income model valuation is based on discounted excess equity flows the company is able to deliver. The main advantage of this method is that it is based on return on equity adjusted by cost of equity. The important disadvantage is that it is based on the income statement so does not include actual cash flows, but may fluctuate depending on accounting method.
The ROE-P/BV model valuation is based on the regression line with valuation-to-book value (P/BV) depending on the return on equity the company is able to deliver. The main advantage of the method is that it includes the correlation of valuation with profitability. The main disadvantage is that it does not fully take into account earnings dynamics.
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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