

- 2Q results were largely in line with expectations. However, Kralupy refinery remains shut down, while Litvinov restart is delayed by 1M.
- On the back of lower throughput and lower model refining margin, we cut our 2016F norm. EBITDA LIFO forecast by 5% to PLN7.4bn (down 26% YoY).
- PKN trades at EV/EBITDA of 5.2x for 2016F, below historical average of 5.8x, but at 12% premium to European peers (vs. historical 7% premium).

Lower TP on weaker macro and shutdowns

Since our last report on PKN dated April 26th, the refining macro has proven weaker than we had expected, Kralupy refinery has been shut down since mid-May, while the restart of the steam cracker in Litvinov has been delayed by one month. As a consequence, we cut our 2016F norm. EBITDA LIFO forecast by 5% to PLN7.4bn (down 26% YoY), but believe both longer shutdowns and weaker macro are already priced in. PKN trades at EV/EBITDA of 5.2x for 2016F and 4.9x for 2017F, at a respective 12% and 6% premium to peers (vs. historical 7% premium), below the historical average 1YF EV/EBITDA of 5.8x. We cut our TP from PLN76 to PLN72, but maintain a Neutral recommendation.

No major surprises in 2Q16 results... 2Q16 EBITDA LIFO came in at PLN2.6bn, up 5% YoY, 2% above our forecasts and 3% below consensus. Norm. EBITDA LIFO reached PLN1.9bn, down 36% YoY, 4% below our forecasts. Refining and petchem were 7% and 6% below our forecasts, respectively. Retail beat our estimates by 9%, Upstream was largely in line.

... but worse outlook for capacity utilization in 3Q16. At the conference call the CFO informed that the steam cracker in Litvinov is to reach 100% capacity utilization in November, one month later than it was previously planned. Also, Kralupy refinery, which remains shut down since May 17 is to be restarted at the end of September. In the petchem segment, a 45-day maintenance shutdown is planned in Plock in 2H16.

Macro update. We raise our Brent crude price assumption by 4% to US\$44/bbl in 2016F and by 2% to US\$48/bbl in 2017F. We cut our estimate of PKN model refining margin (incl. diff.) by 11% to US\$7.7/bbl in 2016F and by 10% to US\$7/bbl in 2017F to reflect the high gasoline stocks as well as the IEA forecast of a record seasonal ramp-up of global throughput in 3Q. On the other hand, we raise our estimate of the model petchem margin by 5% to EUR943/t in 2016F.

2016F norm. EBITDA LIFO cut by 5% to PLN7.4bn. On the back of lower throughput and lower model refining margin, we cut our 2016F norm. EBITDA LIFO forecast by 5% to PLN7.4bn (down 26% YoY). In 2017F, we expect norm. EBITDA LIFO of PLN6.9bn, down 7% YoY. Our reported EBITDA forecasts are 10% and 9% above consensus for 2016F and 2017F, respectively as we incorporate the PLN635m compensation received from insurers in 1H16 and as we expect another PLN600m in 2H16 and PLN1.4bn in 2017F.

Valuation. PKN trades at EV/EBITDA of 5.2x for 2016F and 4.9x for 2017F, a respective 12% and 6% premium to European refiners vs. historical 7% premium to peers and vs. historical 1YF EV/EBITDA of 5.8x. We value PKN using a 50%/25%/25% combination of: (1) target EV/EBITDA multiple; (2) DCF model; and (3) peer comparison to European refiners. Our 12M TP comes in at PLN72 (down from PLN76).

PKN: Financial forecasts and valuation

	2013	2014	2015	2016F	2017F	2018F
Norm. EBITDA (PLNm)	2 444	2 599	8 629	6 894	6 936	6 760
Norm. EBITDA LIFO (PLNm)	3 112	4 992	10 039	7 422	6 936	6 760
Net income (PLNm)	176	-5 811	2 843	4 208	4 044	3 269
EV/EBITDA (x)	14.1	14.0	4.3	5.2	4.9	4.9
PER (x)	142.6	n/m	5.9	9.1	8.3	8.6
Dividend yield	2.3%	2.2%	2.5%	3.0%	3.7%	4.1%

Source: Bloomberg, Vestor DM estimates

Company data

Target Price (PLN)	72.0
Share Price (PLN)	65.7
Upside	9%
Min (52W)	56.5
Max (52W)	85.9
No. of shares (m)	427.7
Market cap. (PLNm)	28,096
Net debt (16F, PLNm)	5,367
EV (16F, PLNm)	35,930
Avg. 3M Turnover (PLNm)	61.8

Shareholders

	%
State Treasury	27.5
ING OFE	9.3
Aviva OFE	7.3
Others	55.9

Company description

PKN Orlen is a leading refining and petrochemical company operating in the CEE. PKN operates 7 refineries, of which 3 are located in Poland (Plock, Trzebinia and Jediczce), another 3 in the Czech Republic (Litvinov, Kralupy and Pardubice) and one in Lithuania (Mazeikiu). Total throughput capacity of PKN comes in at 35.2mt. The company's petrochemical assets are fully integrated with refining and have a capacity of 6.2mt. PKN's retail network comprises 2.7k fuel stations in Poland, Germany, the Czech Republic and Lithuania.

PKN vs. WIG 1Y price performance



Source: Bloomberg, Vestor DM

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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 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

Recommendation definitions: Buy - indicates a stock's total return to exceed more than 1.5x respective cost of equity over the next twelve months. 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. Sell - indicates a stock's total return to be less than minus respective cost of equity over the next twelve months.

List of all recommendations issued by Vestor in the last 12 months:

Company	Report date	Analyst	TP	Current price on publication date	Recommendation	Time
Arteria	2015-07-31	Piotr Raciborski	25.3	16.3	Not rated	12M
PKP Cargo	2015-08-12	Piotr Nawrocki	78.0	74.0	Neutral	12M
Sfinks	2015-09-01	Piotr Raciborski	5.3	3.8	Not rated	12M
DTP	2015-09-02	Michał Fidelus	6.4	4.5	Not rated	12M
Impel	2015-09-03	Piotr Raciborski	41.0	29.3	Not rated	12M
Vantage	2015-09-04	Marek Szymanski	3.7	2.7	Not rated	12M
OT Logistics	2015-09-10	Piotr Nawrocki	337.0	260.0	Not rated	12M
Pekabex	2015-09-10	Piotr Nawrocki	13.4	10.5	Buy	12M
Kredyt Inkaso	2015-09-11	Michał Fidelus	34.0	30.5	Neutral	12M
JHM	2015-09-11	Marek Szymanski	2.5	1.7	Not rated	12M
Polwax	2015-09-14	Wojciech Wozniak	26.1	16.4	Not rated	12M
Marvipol	2015-09-17	Marek Szymanski	10.5	7.0	Not rated	12M
Immobilie	2015-09-18	Piotr Raciborski	3.1	2.3	Not rated	12M
Pharmena	2015-09-18	Beata Szparaga	20.0	18.7	Not rated	12M
Polmed	2015-09-24	Michał Mordel	4.2	3.0	Not rated	12M
Warimpex	2015-10-02	Marek Szymanski	3.7	2.8	Not rated	12M
Altus	2015-10-09	Michał Fidelus	12.6	10.7	Buy	12M
Quercus	2015-10-09	Michał Fidelus	6.6	6.5	Neutral	12M
Dom Development	2015-10-27	Marek Szymanski	53.0	53.0	Neutral	12M
LC Corp	2015-10-27	Marek Szymanski	2.5	1.9	Buy	12M
Robyg	2015-10-27	Marek Szymanski	3.0	2.5	Buy	12M
PKO BP	2015-10-28	Michał Fidelus	30.0	29.5	Neutral	12M

Pekao	2015-10-28	Michal Fidelus	170.0	155.1	Accumulate	12M
BZWBK	2015-10-28	Michal Fidelus	302.0	318.0	Reduce	12M
mBank	2015-10-28	Michal Fidelus	323.0	370.1	Sell	12M
ING	2015-10-28	Michal Fidelus	138.0	125.3	Accumulate	12M
Handlowy	2015-10-28	Michal Fidelus	91.0	83.0	Accumulate	12M
Millennium	2015-10-28	Michal Fidelus	6.3	6.2	Neutral	12M
Getin Noble	2015-10-28	Michal Fidelus	0.74	0.85	Sell	12M
Alior Bank	2015-10-28	Michal Fidelus	85.0	83.3	Neutral	12M
PKP Cargo	2015-11-02	Piotr Nawrocki	60.0	66.4	Reduce	12M
KGHM	2015-11-04	Piotr Nawrocki	107.0	92.0	Buy	12M
Selvita	2015-11-04	Beata Szparaga	24.0	22.5	Not rated	12M
AAT Holding	2015-11-06	Wojciech Wozniak	31.3	22.0	Buy	12M
Arteria	2015-11-10	Piotr Raciborski	23.3	14.9	Not rated	12M
Alior Bank	2015-11-12	Michal Fidelus	83.0	75.5	Accumulate	12M
Impel	2015-11-17	Piotr Raciborski	38.0	26.0	Not rated	12M
DTP	2015-11-19	Michal Fidelus	6.4	4.2	Not rated	12M
Polmed	2015-11-23	Michal Mordel	4.1	3.0	Not rated	12M
PKN Orlen	2015-11-27	Beata Szparaga	83.0	68.9	Buy	12M
Lotos	2015-11-27	Beata Szparaga	34.0	28.9	Accumulate	12M
Vigo	2015-12-04	Piotr Nawrocki	306.0	249.0	Not rated	12M
Marvipol	2015-12-09	Marek Szymanski	10.5	5.8	Not rated	12M
PKO BP	2015-12-11	Michal Fidelus	28.6	25.8	Accumulate	12M
BZWBK	2015-12-11	Michal Fidelus	288.0	268.7	Neutral	12M
mBank	2015-12-11	Michal Fidelus	318.0	313.3	Neutral	12M
Millennium	2015-12-11	Michal Fidelus	5.8	5.2	Buy	12M
Getin Noble	2015-12-11	Michal Fidelus	0.60	0.56	Neutral	12M
PGNIG	2015-12-16	Beata Szparaga	4.6	5.0	Reduce	12M
Sfinks	2015-12-18	Piotr Raciborski	5.3	3.9	Not rated	12M
The Farm 51	2015-12-21	Michal Mordel	17.9	12.7	Not rated	12M
OT Logistics	2015-12-29	Piotr Nawrocki	275.0	166.0	Not rated	12M
PKO BP	2016-01-11	Michal Fidelus	27.0	25.7	Neutral	12M
Pekao	2016-01-11	Michal Fidelus	148.0	133.5	Accumulate	12M
BZWBK	2016-01-11	Michal Fidelus	269.0	260.1	Neutral	12M
mBank	2016-01-11	Michal Fidelus	302.0	295.8	Neutral	12M
ING	2016-01-11	Michal Fidelus	123.0	116.0	Neutral	12M
Handlowy	2016-01-11	Michal Fidelus	74.0	67.6	Accumulate	12M
Millennium	2016-01-11	Michal Fidelus	5.6	5.5	Neutral	12M
Getin Noble	2016-01-11	Michal Fidelus	0.60	0.57	Neutral	12M
Alior Bank	2016-01-11	Michal Fidelus	71.0	62.5	Buy	12M
KGHM	2016-01-12	Piotr Nawrocki	63.0	53.0	Accumulate	12M
Vigo	2016-01-12	Piotr Nawrocki	279.0	229.0	Not rated	12M
Serinus	2016-01-14	Beata Szparaga	2.6	1.6	Buy	12M
Pekabex	2016-01-14	Piotr Nawrocki	14.0	10.3	Buy	12M
KGHM	2016-02-08	Piotr Nawrocki	64.0	62.0	Neutral	12M
Handlowy	2016-02-09	Michal Fidelus	75.0	78.0	Reduce	12M
Kredyt Inkaso	2016-02-16	Michal Fidelus	27.8	21.8	Buy	12M
PGNIG	2016-02-18	Beata Szparaga	4.4	5.2	Sell	12M
Sfinks	2016-03-01	Piotr Raciborski	5.0	4.3	Not rated	12M
PGNIG	2016-03-07	Beata Szparaga	4.4	4.8	Reduce	12M
Kruk	2016-03-08	Michal Fidelus	204.0	189.0	Neutral	12M
KGHM	2016-03-09	Piotr Nawrocki	68.0	73.0	Reduce	12M
Selvita	2016-03-10	Beata Szparaga	26.0	21.2	Not rated	12M
Bumecch	2016-03-16	Wojciech Wozniak	1.1	0.68	Not rated	12M
mBank	2016-03-17	Michal Fidelus	317.0	354.0	Sell	12M
Polwax	2016-03-23	Wojciech Wozniak	26.1	17.6	Not rated	12M
Impel	2016-03-31	Piotr Raciborski	32.5	27.8	Not rated	12M
JHM	2016-03-31	Marek Szymanski	2.3	1.2	Not rated	12M
Vantage	2016-04-01	Marek Szymanski	4.1	2.6	Not rated	12M
K2 Internet	2016-04-01	Adam Siniarski	29.2	19.7	Not rated	12M
Selvita	2016-04-04	Beata Szparaga	27.0	22.9	Not rated	12M
Pekao	2016-04-06	Michal Fidelus	148.0	158.0	Reduce	12M
Marvipol	2016-04-12	Marek Szymanski	10.5	7.0	Not rated	12M
PKO BP	2016-04-21	Michal Fidelus	28.0	26.3	Neutral	12M
Pekao	2016-04-21	Michal Fidelus	147.0	160.6	Reduce	12M
BZWBK	2016-04-21	Michal Fidelus	304.0	288.0	Neutral	12M
mBank	2016-04-21	Michal Fidelus	316.0	331.7	Reduce	12M
ING	2016-04-21	Michal Fidelus	135.0	121.8	Accumulate	12M
Handlowy	2016-04-21	Michal Fidelus	73.0	82.1	Sell	12M
Millennium	2016-04-21	Michal Fidelus	5.3	5.5	Reduce	12M
Getin Noble	2016-04-21	Michal Fidelus	0.58	0.54	Neutral	12M
Alior Bank	2016-04-21	Michal Fidelus	74.0	69.8	Neutral	12M
PKP Cargo	2016-04-21	Piotr Nawrocki	37.0	44.0	Reduce	12M
PKN Orlen	2016-04-26	Beata Szparaga	76.0	70.0	Neutral	12M
Lotos	2016-04-26	Beata Szparaga	33.0	28.9	Accumulate	12M
Soho Development	2016-04-27	Marek Szymanski	3.0	1.4	Not rated	12M
Archicom	2016-05-11	Marek Szymanski	22.5	15.0	Not rated	12M
Handlowy	2016-05-16	Michal Fidelus	73.0	72.0	Neutral	12M
Warimpex	2016-05-19	Marek Szymanski	3.8	2.5	Not rated	12M
OT Logistics	2016-05-23	Piotr Nawrocki	275.0	220.0	Not rated	12M
Altus	2016-05-24	Michal Fidelus	17.3	14.0	Buy	12M
Mex Polska	2016-05-30	Piotr Raciborski	11.2	5.7	Not rated	12M
Vigo	2016-06-01	Piotr Nawrocki	277.0	226.0	Not rated	12M
Pekao	2016-06-14	Michal Fidelus	156.0	146.5	Neutral	12M
Marvipol	2016-06-16	Marek Szymanski	10.5	6.9	Not rated	12M
mBank	2016-06-24	Michal Fidelus	293.0	333.4	Sell	12M
PKP Cargo	2016-06-28	Piotr Nawrocki	36.0	33.0	Neutral	12M
Alior Bank	2016-06-30	Michal Fidelus	62.0	52.2	Buy	12M
The Farm 51	2016-07-08	Michal Mordel	13.8	12.5	Not rated	12M
PGNIG	2016-07-20	Beata Szparaga	5.1	5.6	Reduce	12M

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