Oil & Gas | Poland

PGNiG

Neutral

TP: PLN6.3

Company Update

- **Following strong 1Q results, we upgrade our 2015F EBITDA forecast by 17% to PLN7.7bn (20% above consensus)…**
- **… but due to lack of agreement with Gazprom and accelerating gas market liberalization…**
- **… we see no upside to the current share price. We downgrade the stock from Buy to Neutral.**

Investors DOM INWESTYCYJNY

EQUITY / RESEARCH

15 May 2015

Best case less likely. Downgrade to Neutral

We are downgrading our rating on PGNiG to Neutral from Buy following the news that PGNiG initiated arbitration proceedings against Gazprom. We believe this means that the likelihood of positive outcome in pricing negotiations with Gazprom has decreased. However, we are increasing our 12M TP to PLN6.3 from PLN5.6 on the back of earnings upgrade and higher valuation multiples of comparable companies. Taking into account strong 1Q results, we upgrade our 2015 EBITDA forecast by 17% to PLN7.7bn (20% above consensus). On our new forecasts, PGNiG trades at 2015F and 2016F EV/EBITDA of 5.0x and 5.8x, which we do not find attractive.

Arbitration proceedings against Gazprom. On Wednesday evening PGNiG informed that the 6M negotiation period in the Yamal contract has ended and since the company did not reach an agreement with Gazprom, it has initiated arbitration proceedings regarding price terms of the contract. Even though PGNiG may still continue negotiations with Gazprom regardless of the arbitration proceedings, we think it may take months before the parties reach an agreement.

Following strong 1Q15 results… PGNiG reported strong 1Q15 EBITDA of PLN2.3bn (up 7% YoY), 14% above consensus and 20% above our estimates. Norm. EBITDA reached PLN2.4bn (up 4% YoY), 23% above our estimates due to 106% beat in Trade&Storage and 13% beat in Upstream. Reported NI came in at PLN1.2bn, up 5% YoY, 23% above consensus and 32% above our estimates.

… we upgrade our forecasts for 2015. We upgrade our 2015F norm. EBITDA forecast by 17% to PLN7.7bn (up 3% YoY) as we incorporate 10% higher crude oil production, 22% higher crude oil price, favorable gas tariffs till the end of July and cost savings, which have exceeded our expectations in 1Q15. We do not change our 2016F EBITDA forecast, which comes in at PLN6.6bn, down 14% YoY. Our 2015F and 2016F EBITDA forecasts are 20% and 6% above consensus, respectively, but we think consensus have not yet incorporated the strong 1Q15 results.

Valuation. We value PGNiG using a 70/30% combination of a DCF model and peer comparison to E&P and integrated gas companies. Our 12M target price comes in at PLN6.3, implying 2% upside. On our forecasts, PGNiG trades at 2015F and 2016F EV/EBITDA of 5x and 5.8x, respectively. Despite double-digit discount to peers, we do not find the valuation attractive as we believe the recently announced price discount scheme suggests acceleration of the gas liberalization process.

PGNiG: Financial forecasts and valuation

	2012	2013	2014	2015F	2016F	2017F
Norm. EBITDA (PLNm)	1,413	6,513	7,521	7,719	6,622	6,683
Norm. Net income (PLNm)	-347	2,648	3,776	3,882	3,140	3,169
EV/EBITDA (x)	31.6	6.3	5.2	5.0	5.8	5.7
PER (x)	n/m	13.7	9.6	9.3	11.6	11.5
Dividend yield (%)	0.0	2.1	2.4	3.3	4.4	3.6

Source: Company data, DI Investors estimates.

Throughout this report we are using prices as of 14.05.2015 unless otherwise stated.

Company data

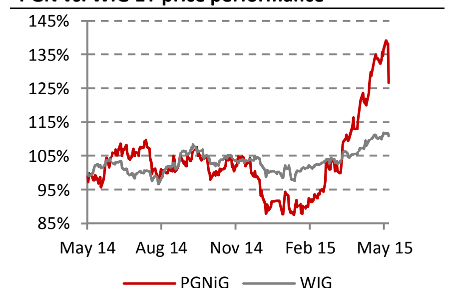
Target Price (PLN)	6.30
Share Price (PLN)	6.15
Upside	2%
Min (52W)	4.2
Max (52W)	6.8
No. of shares (m)	5,900
Market cap. (PLNm)	36,285
Net debt (15F, PLNm)	2,199
EV (15F, PLNm)	38,488
Avg. 3M Turnover (PLNm)	28.8

Shareholders	%
State treasury	72.4
Others	27.6

Company description

PGNiG is the largest natural gas producer and distributor in Poland. In 2014 the company produced 4.5bcm of natural gas and 1.2mt of crude oil. The company's proved gas reserves in Poland come in at 82bcm and the company also holds 10 shale gas exploration licenses. PGNiG sells gas to 6.8m end-customers through 125ths km of distribution network. Apart from its Polish operations, PGNiG holds stakes in oil and gas producing fields in Norway with 2P reserves of 81mboe, and in exploration licenses in 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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2) comparative,
3) target multiple,
4) scenario analysis,
5) dividend discount model (DDM),
6) NAV,
7) Sum of the parts.
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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
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