

## Polish refiners

### IMO 2020 – a less bullish scenario

We resume our coverage of PKN Orlen with a **HOLD** recommendation as we believe the weaker earnings momentum is already discounted in the share price and some EV/EBITDA derating is warranted due to political risk. We resume our coverage of Grupa Lotos with a **SELL** as, in our opinion, the company's multiples are demanding and consensus overestimates the impact of IMO 2020 and the start-up of the Delayed Coking Unit on the company's EBITDA in 2020.

**PKN Orlen: National multi-utility deserves a discount.** PKN's share price has dropped 24% in 1M due to the deterioration of both refining and petchem margins as well as the announcement of the tender offer for Energa. Following strong 9M19 results, we believe the earnings momentum for the coming quarters is less favourable. We forecast normalized EBITDA LIFO in 2020E to come in at PLN8.3bn, down 15% YoY. We expect IMO 2020 to have a negative impact on PKN's refining margin, we also assume lower petchem margin. Based on our forecasts, PKN trades at 2020E and 2021E EV/EBITDA of 5x and 4.8x, respectively, at a 3% premium and 4% discount to peers (vs. historical 9% premium) and vs. the historical average 1YF EV/EBITDA of 5.4x. As we believe the weaker earnings momentum is already discounted in the share price, we resume our coverage with a **HOLD** recommendation and a fair value of PLN74/share.

**Grupa Lotos: IMO 2020 and EFRA overrated.** YTD Lotos's share price is down 1%, largely in line with the WIG index. Lotos posted mixed 9M19 results (weak in Upstream, and decent but below our expectations in Downstream) and the market has been focused on speculation regarding the impact of IMO 2020 and the EFRA project, as well as the acquisition of Lotos by PKN. With 2020 EBITDA consensus of PLN4bn, we believe the impact of the Delayed Coking Unit, which is currently in the start-up phase is overestimated. We forecast the EFRA project to contribute a refining margin of US\$2/bbl and EBITDA of PLN470m in 2020E. However, due to an assumption of lower HSFO and gasoline crack spreads, and just a mild improvement in the diesel crack, we forecast 2020E Downstream normalized EBITDA LIFO of PLN2.4bn, up just 4% YoY, and group EBITDA of PLN3.3bn, 18% below consensus. Based on our forecasts Lotos trades at 2020E EV/EBITDA of 5.2x, at a 12% premium to peers, which we do not find warranted. We resume our coverage with a **SELL** recommendation and Fair Value of PLN70.

**Acquisition of 66% of Lotos by PKN.** Taking into account the ongoing 'stop the clock' procedure, the EC's deadline for publishing its decision regarding the merger is now 2Q20. Due to the EC's comments regarding the wholesale market, we believe the deal seems likely to be either blocked or cleared with severe remedies, which would have a negative impact on results of the combined business. Therefore, we do not incorporate the acquisition into our forecasts.

Figure 1. Polish refiners: Financial forecasts

	2016	2017	2018	2019E	2020E	2021E
<b>PKN</b>						
Norm. EBITDA LIFO (PLNm)	7 953	9 702	8 343	9 716	8 284	8 589
Net income (PLNm)	5 261	6 655	5 556	4 315	3 548	3 598
EV/EBITDA (x)	5.1	3.7	4.4	4.6	5.0	4.8
Dividend yield	2.4%	3.7%	3.7%	4.3%	4.3%	4.9%
<b>Lotos</b>						
Norm. EBITDA LIFO (PLNm)	2 583	3 605	3 059	2 958	3 264	3 188
Net income (PLNm)	1 015	1 672	1 587	1 062	1 516	1 501
EV/EBITDA (x)	7.7	6.0	4.9	6.5	5.2	5.0
Dividend yield	0.0%	1.2%	1.2%	3.5%	4.7%	5.3%

Source: Company, IPOPEMA Research

Oil&Gas

#### PKN Orlen HOLD

Coverage resumption

**FV PLN 74**

9.9% downside

Last price PLN 82.12

#### Grupa Lotos SELL

Coverage resumption

**FV PLN 70**

17.2% downside

Last price PLN 84.58

Prices as of 6 December 2019

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The definitions of terms used in the document include:  
NII - Net interest income - interest income minus interest expense.

## Polish refiners

Net F&C – Net fee and commission income – fee and commission income minus fee and commission expense.

LLP – loan loss provisions – an expense set aside as an allowance for bad loans.

NPL – non-performing loan – loans that are in default or close to be in default.

Cost/Income – operating expenses divided by total banking revenue.

ROE – return on equity – net income (or adjusted net income) divided by the average shareholders' equity.

ROA – return on assets – net income (or adjusted net income) divided by the average assets.

EBIT – earnings before interests and tax.

EBITDA – earnings before interests, tax, depreciation and amortization.

EPS – earnings per share – the net income (or adjusted net income) divided by the number of shares outstanding.

P/E – price to earnings ratio – price divided by earnings per share.

PEG – P/E ratio divided by the annual EPS growth, usually over a certain period of time.

CAGR – compound annual growth rate.

BVPS – book value per share, the book value of the Company's equity divided by the number of shares outstanding.

P/BV – price to book value - price divided by the BVPS.

DPS – dividend per share – dividend of a given year divided by the number of shares outstanding.

DY – dividend yield – dividend of a given year divided by the current price.

DDM – dividend discount model – a fundamental method of valuation based on the assumption that the value of stock equals the sum of all discounted future dividends.

FV – Fair Value, calculated based on valuation methods outlined in the document.

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Rating	Difference between FV and price at recommendation
Buy	Above 10%
Hold	In between (and including) -10% and 10%
Sell	Below -10%

### IPOPEMA Research - Distribution by rating category (Jul 1 – Sep 30, 2019)

	Number	%
Buy	18	58%
Hold	10	32%
Sell	3	10%
Total	31	100%

### Rating History – PKN Orlen

Date	Recommendation	Fair Value	Price at recommendation	Author
2017-02-10	Under review	na	77.30	na
2019-12-09	HOLD	74	82.12	Beata Szparaga-Waśniewska, Robert Maj

### Rating History – Grupa Lotos

Date	Recommendation	Fair Value	Price at recommendation	Author
2017-02-10	Under review	na	40.71	na
2019-12-09	SELL	70	84.58	Beata Szparaga-Waśniewska, Robert Maj