



An uncharted ocean of possibilities

Pressure on ZE PAK's margins is high in light of current CO2 prices and profitability being called into question, although a part of committed capital may be recovered in the process of optimising and discontinuing current operations. We think that the company's current valuation is focusing on the assessment of chances for an effective transformation and the portfolio of RES projects (a valuable land bank with existing connections). In our opinion, the strategic ultimate (2030) corporate model may facilitate generating PLN 375-425m in EBITDA and PLN 300-350m in FCF annually at the cost of approx. PLN 4-4.5bn. To our mind, the current capitalisation (PLN 526m) adequately discounts the harsh reality and the range of opportunities. As a result, we are maintaining a HOLD recommendation with a TP of PLN 11.1.

A brutal reality...

The latest hike of CO2 prices to EUR 50/t exerted huge pressure on ZE PAK's lignite-fired assets. The current estimated CBS margin on base contracts for 2022 is around PLN 0/MWh which forces significant efforts concerning portfolio. In addition, 2022 will be the last year featuring support on account of terminating long-term contracts (approx. PLN 150-200m annually) but ZE PAK will participate in the capacity market until the end of 2024.

...and a broad range of opportunities

The most interesting opportunities for ZE PAK include in our opinion: 1) benefiting from the National Energy Security Agency or other state or EU transformation support (with an option to divide the company into a green and a black segment); 2) secondary capacity market; 3) the owner's support in further RES projects (cf. the recently concluded PPA for PV). Our valuation does not include the hydrogen-related part of the strategy, although the potential grant of up to PLN 395m in subsidies from the National Recovery Plan for generating hydrogen from biomass could drastically improve the company's outlook.

ZE PAK 2030 – EBITDA PLN 375-425m, FCF PLN 300-350m, CAPEX PLN 4-4.5bn

In its 2030 strategy, ZE PAK assumes it will achieve 200MW of biomass, 630MW of PV, and 438MW in onshore windfarms. We estimate this may permit the company to generate approx. PLN 375-425m in EBITDA and PLN 300-350m in FCF annually at the cost of PLN 4-4.5bn. According to the board announcements, 400MW of RES capacities should be operational in 2023, followed by 1.1GW in 2025. A valuable post-mining land bank with existing connectors may potentially be one of the company's primary competitive advantages as it limits execution risk (especially for PV).

PLN mn	2019	2020	2021F	2022F	2023F
Revenues	2,878	2,207	1,893	2,321	1,931
EBITDA	393	148	80	108	89
EBIT	-424	-291	-50	-19	-47
Net profit	-445	-222	-51	-21	-52
P/E	nm	nm	nm	nm	nm
P/BV	0.3	0.5	0.6	0.6	0.6
EV/EBITDA	1.4	3.7	9.9	7.8	12.7
EPS	-8.76	-4.37	-1.01	-0.41	-1.02
DPS	0.00	0.00	0.00	0.00	0.00
FCF	-	-	-202	-49	-278
CAPEX	31	81	310	100	420

F - forecast by PKO BP Securities

Key data

Market price (PLN)	10.35
Upside	7%
No. of shares (mn)	50.80
Market Cap (PLNm)	525.78
Free float	34%
Free float (PLNm)	179
Free float (USDmn)	48
EV (PLNm)	791.24
Net debt (PLNm)	-184.79

ESG

ESG rating	-
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Dividend

Div yield	0.0%
Ex-div	-

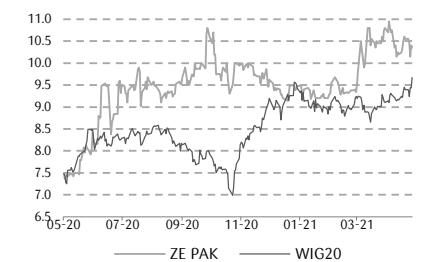
Major Shareholders % of shares

Zygmunt Solorz-Żak	65.96
OFE PZU Złota Jesień	7.56
-	-
-	-
-	-

Previous recomm. Date & target price

Hold	01-10-20	10.20
Sell	24-04-20	6.50

Price performance



	WIG20	Company
1 month	4.9%	-1.4%
3 months	7.4%	12.5%
6 months	25.6%	3.5%
12 months	30.6%	39.9%
Min 52 weeks PLN		7.36
Max 52 weeks PLN		10.95
Av. turnover/day PLN mn		0.15

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Risk factors:

- Regulatory environment
- Electricity prices on a dynamically changing market
- Risk of production volumes
- Failure in executing the ambitious 2030 strategy
- Terms of the potential spin-off of RES operations
- CAPEX and the profitability of new projects connected with the green transformation

Key assumptions:

- ZE PAK will receive PLN 320m in compensation on account of long-term contracts in 2021-22 and PLN 540m from capacity market auctions in 2021-24
- A 70MW PV plant will contribute to ZE PAK's results from 2020 together with 50MW in biomass capacities. We also assume a new large PV plant will be launched in 2024 (180MW).
- The company will gain PLN 106m in revenue from the secondary capacity market in 2023-2024.
- 2021-2024 should feature lower figures of lignite-based generation as presented in the strategy (2.5-3.5TWh) and generation units will only be operated during peak times to a growing extent.
- Against the company's strategy, we assume that Pątnów II will be not aligned to BAT requirements and will cease operations in 2024.
- The company will restructure its mining assets and adapt them to fuel demand.
- The hydrogen project is not included in the valuation and is only treated as a potential growth option. ZE PAK's plans include i.a. hydrogen electrolysis and designing hydrogen-powered buses and boats; the company also applied for PLN 395m in subsidies from the National Recovery Plan for a project involving hydrogen generation from RES (biomass). The draft National Recovery Plan submitted to the EU provides for EUR 800m in support for hydrogen-based technologies in 2021-2016; a detailed distribution of that sum is not known yet.

Valuation

Our valuation is based on the DCF model.

In our opinion, the fair value of ZE PAK's shares amounts to PLN 11.1.

We have modelled the parameters of the model until 2025; following that, we assumed an 2% growth rate in perpetuity due to strong RES portfolio.

We have applied a WACC-based discount rate. The risk-free rate is 2% which reflects the expected yield of 10-year Treasury bonds. Beta has been assumed at 1.8x and the equity risk premium at 5.5%. We have discounted all free cash flows as at 31 December 2020 and added net debt normalised by leasing and CO2 reserves.

DCF model		2020	2021F	2022F	2023F	2024F	2025F	2025F<
PLN mn								
EBIT		-291.1	-50.3	-19.3	-46.8	-25.6	89.4	92.2
Tax rate		19%	19%	19%	19%	19%	19%	19%
NOPLAT		-235.8	-40.7	-15.6	-37.9	-20.7	72.4	74.7
CAPEX		81.2	310.0	100.0	420.0	20.0	20.0	20.0
Depreciation		140.0	130.4	127.1	135.6	141.4	20.6	20.0
Changes in working capital		-248.2	-24.3	54.9	-50.3	-6.1	0.0	0.0
Leases		6.0	6.0	6.0	6.0	6.0	6.0	6.0
FCF		65.2	-202.0	-49.5	-277.9	100.8	67.0	68.7
WACC		11.9%	9.6%	9.2%	7.6%	8.0%	8.4%	7.6%
Discount ratio		0.00	0.91	0.83	0.78	0.72	0.66	
DFCF		0.0	-184.2	-41.3	-215.7	72.4	44.4	
DFCF Sum - Phase I					-324.4			
DFCF Sum - Phase II					817.0			
Enterprise Value (EV)					492.6			
Net debt (excl. Leases, adj. For CO2)					7.6			
Minorities					2			
Fair value					482.8			
Number of shares (million)					50.8			
Fair value per share as at 31.12.2020					9.5			
Target price in 12 mths (PLN)					11.1			
Current price					10.35			
Dividend					0.0			
Expected rate of return					7%			

Source: forecasts of PKO BP Securities

WACC						
	2021F	2022F	2023F	2024F	2025F	2025F<
Risk-free rate	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Equity premium	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
Beta	1.8	1.8	1.8	1.8	1.8	1.8
Debt risk premium	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%
Tax rate	19.0%	19.0%	19.0%	19.0%	19.0%	19.0%
Equity cost	11.9%	11.9%	11.9%	11.9%	11.9%	11.9%
Debt cost	3.2%	3.2%	3.2%	3.2%	3.2%	3.2%
Weight of equity	74.0%	69.2%	50.3%	55.4%	59.4%	50.0%
Weight of debt	26.0%	30.8%	49.7%	44.6%	40.6%	50.0%
WACC	9.6%	9.2%	7.6%	8.0%	8.4%	7.6%

Source: forecasts of PKO BP Securities

Sensitivity

		Growth in Phase II				
		1.0%	1.5%	2.0%	2.5%	3.0%
WACC	6.6%	11.1	12.9	15.2	18.0	21.6
	7.1%	9.5	11.1	12.9	15.2	18.0
	7.6%	8.2	9.5	11.1	12.9	15.2
	8.1%	7.1	8.2	9.5	11.1	12.9
	8.6%	6.1	7.1	8.2	9.5	11.1

Source: PKO BP Securities

Peers valuation

Company	P/E			EV/EBITDA		
	2020	2021F	2022F	2020	2021F	2022F
PGE (Bloomberg)	-	13.1	17.9	4.7	4.2	4.7
Enea (Bloomberg)	30.8	3.2	3.8	3.4	3.5	4.0
Tauron (Bloomberg)	46.5	4.6	3.9	5.1	5.3	5.2
CEZ (Bloomberg)	14.3	16.3	15.4	6.4	6.9	6.8
E.ON	17.5	14.8	12.0	8.6	8.1	7.7
EDF	20.5	16.0	14.2	5.4	5.0	4.7
EDP	20.0	20.4	18.8	9.9	9.7	9.3
Endesa	12.7	13.8	13.4	7.7	7.6	7.4
Enel	16.5	15.5	14.6	8.1	7.8	7.5
Engie	18.1	12.7	11.9	6.4	5.7	5.6
Iberdrola	20.6	19.6	18.0	12.6	11.8	10.8
RWE	17.3	20.1	17.9	5.8	6.1	5.7
Verbund	40.9	40.6	33.6	20.4	19.7	17.0
Median	19.1	15.5	14.6	6.4	6.9	6.8
ZE PAK (PKO BP)	nm	nm	nm	4.1	9.9	7.8
Premium/discount	nm	nm	nm	-36%	44%	14%

Source: Bloomberg, PKO BP Securities

Financial Forecasts

Profit and loss account	2016	2017	2018	2019	2020	2021F	2022F	2023F	2024F
Sales of products, goods and materials	2,705	2,443	2,305	2,878	2,207	1,893	2,321	1,931	1,874
Costs of sold products, goods and materials	-2,241	-2,035	-2,628	-3,186	-2,447	-1,828	-2,226	-1,866	-1,790
Gross profit on sales	463	408	-323	-308	-240	66	94	65	84
EBITDA	594	512	90	393	148	80	108	89	116
Selling costs	-113	-124	-128	-121	-118	-116	-114	-112	-109
Operating profit	371	290	-477	-424	-291	-50	-19	-47	-26
Pre-tax profit	308	259	-515	-440	-303	-52	-21	-53	-33
Income tax	-58	-75	52	-6	77	0	0	0	0
Net profit (loss) attributable to non-controlling interest	3	0	-3	-1	-4	-1	0	-1	-1
Net Profit (loss)	248	183	-460	-445	-222	-51	-21	-52	-32
Balance Sheet	2016	2017	2018	2019	2020	2021F	2022F	2023F	2024F
Fixed assets	3,705	3,451	2,968	2,182	1,857	2,037	2,010	2,294	2,173
Intangible assets	119	7	4	59	52	52	52	52	52
Tangible assets	3,394	3,285	2,791	1,960	1,661	1,840	1,813	2,098	1,976
Other long-term assets	191	160	173	163	145	145	145	145	145
Current assets	1,099	1,007	902	936	1,021	674	720	498	485
Inventories	105	98	109	104	68	51	62	52	50
Receivables	246	253	354	229	385	330	405	337	327
Cash and cash equivalents	427	358	341	415	498	223	182	39	37
Other short-term assets	321	298	97	189	71	71	71	71	71
Total Assets	4,804	4,458	3,870	3,118	2,879	2,711	2,730	2,792	2,658
Equity capital	2,090	2,210	1,687	1,176	949	898	877	825	793
Liabilities	2,715	2,248	2,184	1,942	1,929	1,813	1,852	1,967	1,864
Long-term liabilities	1,447	1,249	974	988	861	834	840	931	869
Loans and borrowings	588	303	59	85	52	24	30	121	59
Other provisions	859	946	915	904	810	810	810	810	810
Short-term liabilities	1,268	1,000	1,210	953	1,068	979	1,013	1,035	995
Loans and borrowings	422	350	361	47	55	13	17	67	33
Other provisions	543	504	694	797	825	825	825	825	825
Trade liabilities and other	427	396	598	695	747	747	747	747	747
Total Equity & Liabilities	4,804	4,458	3,870	3,118	2,879	2,711	2,730	2,792	2,658
Cash flow statement	2016	2017	2018	2019	2020	2021F	2022F	2023F	2024F
Cash flow on operating activity	536	479	367	448	166	102	51	133	115
Cash flow on investment activity	-184	-58	-61	19	-58	-304	-94	-414	-14
Cash flow on financial activity	-387	-447	-325	-356	-25	-6	9	142	-97
Indicators (%)	2016	2017	2018	2019	2020	2021F	2022F	2023F	2024F
ROE	12.5%	8.5%	-23.6%	-31.1%	-20.9%	-5.6%	-2.4%	-6.1%	-4.0%
Net Debt	582.5	294.1	79.0	-283.0	-391.4	-184.8	-135.9	149.8	54.3

Source: forecasts of PKO BP Securities

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min (max) 52 weeks: minimum (maximum) of the market share price during the previous 52 weeks

Capitalisation: product of the share market price and the number of shares

EV: sum of the company's capitalisation and net debt

free float (%): share of the total number of shares decreased by 5% stakes held by one shareholder and own shares held by the company in the total number of shares

Average trading/month: average trading per month calculated as total trading value over previous 12 months divided by 12

ROE: rate of return on equity

ROA: rate of return on assets

EBIT: operating profit

EBITDA: operating profit + depreciation and amortization

EPS: earnings per share

DPS: dividend per 1 share

CEPS: sum of net profit and depreciation and amortization per 1 share

P/E: quotient of share market price and EPS

P/BV: quotient of share market price and book value of one share

EV/EBITDA: quotient of capitalisation increased by the company's net debt and EBITDA

Gross sales margin: relation of gross sales profit to net sales proceeds

EBITDA margin: relation of the sum of operating profit and depreciation to net sales proceeds

EBIT margin: relation of operating profit to net sales proceeds

Net profitability: relation of net profit to net sales proceeds

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Issuer:	Reservation
ZE PAK	-

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The time and date stipulated on the front page of the report are the time and date of completing the process of drafting the Recommendation.

The time and date of the first distribution of the Recommendation are identical with the time and date of delivering this Recommendation in electronic form to customers.

Whenever this Recommendation quotes a price for the financial instrument, it will be understood as the closing price from the last trading day.

The list below sets out all the recommendations drafted by PKO BP Securities in the last 12 months, within the scope of the "Analytic Coverage Support Pilot Programme".

Company	Recommendation	Date of reco.	Target price	Relevant Market Price*	Market cap. (PLN mn)	P/E			EV/EBITDA			Analyst
						2018	2019F	2020F	2018	2019F	2020F	
Asseco SEE	Hold	2020-06-03	41	40,40	2034,3	10,0	16,5	16,3	7,3	9,6	8,1	Małgorzata Żelazko
MLP Group	Buy	2020-07-31	95	76,20	1479,0	6,5	7,8	7,5	26,9	31,4	28,8	Piotr Zybała
Asseco SEE	Hold	2020-08-25	48,5	48,40	2034,3	10,0	16,5	16,3	7,3	9,6	8,1	Małgorzata Żelazko
Apator	Hold	2020-09-18	21,5	21,20	711,19	13,11	9,78	7,58	6,46	6,83	4,78	Piotr Łopaciuk
ZE PAK	Hold	2020-10-01	10,2	10,00	528,3	nm	nm	nm	1,4	3,7	9,9	Andrzej Rembelski
Mabion	Sell	2020-10-13	17	31,80	741,8	nm	nm	nm	0,0	0,0	0,0	Dawid Górzynski
Asseco SEE	Buy	2021-03-04	43,5	37,80	2034,3	10,0	16,5	16,3	7,3	9,6	8,1	Małgorzata Żelazko
Apator	Buy	2021-03-17	28	24,80	711,2	13,1	9,8	7,6	6,5	6,8	4,8	Piotr Łopaciuk
MLP Group	Buy	2021-04-08	92	76,20	1479,0	6,5	7,8	7,5	26,9	31,4	28,8	Piotr Zybała
Mabion	Sell	2021-05-07	38	45,90	741,8	nm	nm	nm	0,0	0,0	0,0	Dawid Górzynski
ZE PAK	Hold	2021-05-10	11,1	10,35	525,8	nm	nm	nm	1,4	3,7	9,9	Andrzej Rembelski

*at the time of publication