



## Utilities

Poland

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## PGNiG and Tauron Buy Vattenfall's Assets

**PGNiG: Current price: PLN 3.98; Target price: PLN 4.83; Rating: Accumulate**

**TAURON: Current price: PLN 5.29; Target price: PLN 9.09; Rating: Buy**

Today's acquisitions of Vattenfall's assets by PGNiG and Tauron can hardly be seen as good for the companies' shareholders, especially in the current macroeconomic environment, which should be advantageous for buyers. In both cases, the price seems high as far as the preliminary absolute valuation of the assets acquired is concerned, as well as in relative terms, because the premiums vs. the current valuations of Polish utilities approach 20-30%. In the case of PGNiG, we estimate the negative impact of the acquisition of Warsaw CHP plants at ca. 4% of its current market cap, although we would like to point out that the Management's outlook on this year's earnings of the acquired company may be overly conservative, in which our view of the transaction could change. As far as Tauron is concerned, based on our absolute valuation of Vattenfall's distribution company we estimate the loss to Tauron's shareholders at ca. PLN 500m, or 6%. In both cases, financing through bank loans should not be a problem, as neither PGNiG nor Tauron have been indebted so far, and their post-acquisition net debt/EBITDA ratios will amount to 0.8 and 1.0 (for 2011 EBITDA forecast). To sum up, the theoretical impact of these acquisitions does not impact our ratings (Buy for TPE and Accumulate for PGN), but merely reduces their upside potential, although in the medium term today's announcements are bound to have a negative effect on the sentiment to both companies.

#### PGNiG buys Vattenfall's CHP plants in Warsaw

PGNiG has decided to buy a 99.8% stake in Vattenfall Heat Poland, whose main assets are the Warsaw CHP plants Żerań (1580 MWt, 386 MWe) and Siekierki (2078 MWt, 620 MWe), a CHP plant in Pruszków (186 MWt, 9.1 MWe) and two heating plants with 465 MWt power each. The price is PLN 2.96bn, which, taking into account the net debt of the acquired company, implies an EV of PLN 3.5bn. In 2010, Vattenfall Heat Poland generated an EBITDA of PLN 431m and a net profit of PLN 278m, which implies EV/EBITDA of 8.1 and P/E of 10.6. The earnings for H1'11 seem to suggest a considerable y/y increase (PLN 312m EBITDA, PLN 209m net profit), but the Management disclosed during the conference that due to seasonal patterns, full-year results are likely resemble the 2010 performance, and the results for H1'11 should not be "doubled" (to us, such an approach seems very conservative given that January 2011 was quite warm, which must have depressed the earnings of the CHP plants, and that Vattenfall has been granted a 5% hike in its heating tariff for H2'11). A certain justification for such a big premium vs. the peer average (ca. 20% according to our calculations) might be the regulated nature of the business and the mechanism of increases by over 50% in VHP's heating tariffs set by the regulator URE for the next 10 years with the objective of matching the benchmark, but we are still unconvinced that the transaction is a good move, especially in the current macroeconomic environment (increased uncertainty) and given the lack of synergies and restructuring opportunities. The finalization of the takeover, scheduled for the end of this year, will mean that PGNiG's estimated FY12 EV/EBITDA ratio will go up from 4.3 to 4.6 (a 7% deterioration), and we estimate the negative impact on MCap at some 4%.

#### Tauron buys Vattenfall Distribution, Vattenfall Sales

Tauron has announced that it is buying Vattenfall's distribution assets (11 TWh), trading companies (6.8 TWh energy sales) and wind farms (30 MW). The price was set at PLN 4.6bn, but when net cash of the acquired companies is taken into account, EV amounts to PLN 3.5bn. In 2010, the companies generated an EBITDA of PLN 388m (77% distribution, 18% sales), which implies an EV/EBITDA multiple of 9.0, while Tauron is currently trading at FY10 EV/EBITDA of 3.5 (4.22 adjusted for long-term contract compensation). This means that the transaction will lead to a significant deterioration in Tauron's multiples; by way of example, for 2012 we get 3.5 EV/EBITDA instead of 2.9. Note that the RAV for the acquired distribution assets is PLN 3bn, which, given the fact that utilities still do not get full return on RAV (the segment's EBIT amounted to PLN 170m in 2010, while the theoretical target is PLN 300m) means that the price should factor in a ca. 15% discount to RAV. If we add to this amount the value of the other segments calculated for a market-level EV/EBITDA of 5, the implied fair value of the transaction (EV) should be PLN 3bn. In this context, the loss of shareholder value can be estimated at ca. PLN 500m, i.e. ca. PLN 0.30 per share (6%), and we will have to adjust our target price for this value once the transaction has been finalized. Of course, at the current market price this does not affect our positive investment rating, but the transaction is bound to worsen investor sentiment to the company, which is weak anyway.

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**List of abbreviations and ratios contained in the report.**

**EV** – net debt + market value (EV – economic value)  
**EBIT** – Earnings Before Interest and Taxes  
**EBITDA** – EBIT + Depreciation and Amortisation  
**PBA** – Profit on Banking Activity  
**P/CE** – price to earnings with amortisation  
**MC/S** – market capitalisation to sales  
**EBIT/EV** – operating profit to economic value  
**P/E** – (Price/Earnings) – price divided by annual net profit per share  
**ROE** – (Return on Equity) – annual net profit divided by average equity  
**P/BV** – (Price/Book Value) – price divided by book value per share  
**Net debt** – credits + debt papers + interest bearing loans – cash and cash equivalents  
**EBITDA margin** – EBITDA/Sales

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**HOLD** – we expect that the rate of return from an investment will range from -5% to +5%  
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