PKP Cargo (Hold, TP PLN14.2)

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No tangible action-plan on a horizon to mitigate negative effects of falling demand?

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1Q20 results review

Carriage statistics. PKP Cargo reported approx. 19% y/y carriage turnover contraction in 1Q20, in line with our expectations. As we have already pointed out, the fall contrasts with ca. -11% y/y domestic market change in the respective period. We calculate the average distance covered remained roughly stable r/r, despite change to the transport mix. With respect the segments' performance, all the key transportation categories reported significant y/y contraction in 1Q20 (metals & ores and aggregates stood out negatively).

P&L. The reported 1Q20 results were in line with the already reported preliminary data. The lower than anticipated operating margins might be attributable to surprisingly stable q/q labor related costs (no sign of historical pattern). FTEs were down by 282 employees q/q, while the headcount settled close to 23.3k at the end of March. The aforementioned trends seem not to correspond with the dynamic of falling y/y carriage volume in recent months. According to our calculations, the unit revenues came in flattish y/y in 1Q20 but the negative dynamic could increase in coming reporting periods, we estimate.

Capex. Despite recent MB's decision to keep the capex below the quarterly EBITDA, the capital outlays visibly exceeded 1Q20 EBITDA and came at PLN181mn (adjusted for IFRS16).

Cash balance. OCF totalled PLN103mn vs. PLN163mn last year. Both uninspiring EBITDA delivery and high capital outlays drove net debt growth q/q by PLN221mn to PLN2,293mn, implying 3.3x net debt / LTM EBITDA ratio. We estimate the company did not breach the bank covenants at the end of 1Q20, though, we do not exclude such a scenario in coming quarters (should the recent revenues / costs trends continue). Assuming even deeper y/y carriage turnover contraction (presumably in range of –[25%-35%]) in the short run, we see a risk of y/y monthly revenues' decrease by approx. PLN105-125mn y/y translating into visible monthly cash burn (even close to PLN50mn).

Fig. 1. PKP Cargo: 1Q20 results review

PLNmn	1Q19	2Q19	3Q19	4Q19	1Q20	y/y	q/q	1Q20P	% dev.	SANe	Cons.
Sales	1,261	1,164	1,191	1,165	1,036	-17.9%	-11.1%	1,036	0.0%	1,038	1,054
EBITDA	258.5	191.6	263.0	146.8	90.0	-65.2%	-38.7%	90.0	0.0%	118.4	117.7
EBITDA margin	*20.5%*	*16.5%*	*22.1%*	*12.6%*	*8.7%*	*-11.8*	*-3.9*	*8.7%*	*0.0*	*11.4%*	*11.2%*
EBIT	86.9	15.0	80.9	-39.4	-105.6	n.a.	n.a.	-105.6	n.a.	-71.6	-66.3
EBIT margin	*6.9%*	*1.3%*	*6.8%*	*-3.4%*	*-10.2%*	*n.a.*	*n.a.*	*-10.2%*	*n.a.*	*-6.9%*	*-6.3%*
Net profit	53.1	-5.2	50.8	-62.7	-114.4	n.a.	n.a.	-114.4	n.a.	-97.3	-77.2
Net margin	*4.2%*	*-0.4%*	*4.3%*	*-5.4%*	*-11.0%*	*n.a.*	*n.a.*	*-11.0%*	*n.a.*	*-9.4%*	*-7.3%*
Carriage turnover (bn tkm)	7.2	6.6	6.7	6.5	5.8	-19.3%	-10.3%	5.9	-2.1%	5.8	n.a.
Unit revenues	0.175	0.176	0.179	0.180	0.178	1.7%	-0.9%	0.175	2.1%	0.178	n.a.
y/y dynamic	*9.1%*	*5.9%*	*6.6%*	*8.6%*	*1.7%*	*n.a.*	*n.a.*	*-0.4%*	*n.a.*	*1.3%*	*n.a.*
Capex	250	302	250	230	181	-27.4%	-21.4%	n.a.	n.a.	135	n.a.

Source: Company data, Santander Brokerage Poland

PKP Cargo held also an investor teleconference yesterday. There are the key conclusions (we focus on the Q&A session):

- MB is focusing on the cost optimization and plans to utilize / implement: government anti-crisis shield, expenditure rules, reduction of operational costs; the anti-crisis shield is, however, expected to be the highest support in nominal terms among all the initiatives;
- FY20E capex should not exceed 80% of FY20E EBITDA; the benchmark should be monitored on a quarterly basis;
- The supply of rolling stock in Poland is significant; PKP Cargo does not aim to 'devastate' the market with a price-war; PKP Cargo sees risk of falling y/y unit prices in 2020; the company wants to stand out from the competition with its service quality;
- Annual talks with the labor unions referring to the salaries increase were frozen following recent agreement assuming 10% work-load reduction;
- The domestic coal / iron ore market depends highly on the standing of the Polish / EU economy – the pending crisis translates into lowered demand for carriage in those segments; aggregates, thanks to the GDDKiA's and PKP PLK's initiatives, should perform well;
- The key goal is to adapt the structure of the organization to the needs reported by the market / customers; the company counts on itself.

Comment: PKP Cargo reported 1Q20 financial results in line with the already reported preliminary data. FTEs were down by 282 employees' q/q, while the headcount settled close to 23.3k at the end of March. As we have already commented, we fear the aforementioned trends do not to correspond with the dynamic of falling y/y carriage volume in recent months. Unfortunately PKP Cargo might have limited space for other costs categories reduction / optimisation, particularly following effective implementation of cost saving initiatives in 2019 (despite expanding y/y labour costs).

Looking forward, we expect the coming months to bring significant y/y contraction of carriage turnover (in range of -25%-35%). This unfortunately creates downside risks to our current valuation model assumptions. In our opinion the company may be visibly burning cash in April-May period. In the effect, we estimate the government subsidies could cover the cash outflow only in a short period (in range of 2-3 months). We perceive also the target of capex delivery at 80% of the FY20E reported EBITDA may be challenging (unless PKP Cargo targets the capital outlays to come at 80% of the budgeted FY20E EBITDA).

Summing up, it seems there might be no tangible action-plan on a horizon to mitigate negative effects of falling demand. The fact that CEO expects the anti-crisis shield to come in as the highest financial support in the nominal terms is meaningful. In the effect, the indebtedness should grow further in the in the mid run. We reckon the PKP Cargo's assets' base has its intrinsic value but it could be devaluated with a prolonging excessive fixed costs burden. In the effect we perceive the risk/reward for the company as unappealing.

Fig. 2. PKP Cargo: unit service price vs. transport volume on a quarterly basis

	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20	y/y	q/q
Solid fuels	2.6	2.9	2.7	2.4	2.4	2.5	2.4	-10%	-3%
Solid fuels (hard coal)	2.2	2.4	2.3	1.9	2.1	2.1	2.0	-16%	-8%
Aggregates and building materials	2.0	1.8	1.4	1.4	1.3	1.2	0.9	-38%	-27%
Metals and ores	0.9	0.9	0.9	0.8	0.7	0.4	0.5	-47%	10%
Chemical products	0.6	0.5	0.5	0.5	0.5	0.5	0.5	-11%	-4%
Liquid fuels	0.3	0.3	0.2	0.2	0.3	0.3	0.3	4%	-21%
Timber and agricultural produce	0.3	0.4	0.3	0.3	0.2	0.3	0.3	-6%	-7%
Intermodal transport	1.0	1.1	1.0	0.9	1.1	1.0	0.9	-11%	-15%
Other	0.2	0.2	0.1	0.2	0.2	0.2	0.2	18%	-17%
Total	**7.9**	**8.1**	**7.2**	**6.6**	**6.7**	**6.5**	**5.8**	**-19%**	**-10%**
y/y	*0%*	*0%*	*-5%*	*-15%*	*-16%*	*-20%*	*-19%*	*n.a.*	*n.a.*
q/q	*2%*	*2%*	*-11%*	*-8%*	*1%*	*-3%*	*-10%*	*n.a.*	*n.a.*

Source: UTK, Santander Brokerage Poland

Fig. 3. PKP Cargo: financial summary

PLNm	2017	2018	2019	2020E	2021E	2022E
Sales	4,739	5,237	4,866	4,451	4,722	4,755
EBITDA	702	907	860	652	826	851
EBIT	155	278	143	-67	122	157
Net income	82	184	36	-101	53	81
P/E (x)	43.7	13.3	33.2	n.a.	8.3	5.8
EV/EBITDA (x)	5.8	3.9	5.0	5.0	3.9	3.6
DY	0.0%	0.0%	4.2%	0.0%	0.0%	0.0%

Source: UTK, Santander Brokerage Poland

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