PKP Cargo (Sell, TP PLN12.0)

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Santander Biuro Maklerskie

CEE Equity Research

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Risk of further unit revenues contraction

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2Q20 results review

Carriage. PKP Cargo reported ca. 19% y/y carriage turnover contraction in 2Q20, accordingly to our expectations. Our estimates imply 2.6% y/y increase of the average distance covered last quarter which was presumably attributable to a diverting transport mix. With respect to the key transport segments only intermodal stood positively out with metals and ores (which should be no surprising) performing the worst y/y.

P&L. The reported 2Q20 results corresponded tightly with the already reported preliminary data. From the costs mix perspective, PKP Cargo managed to visibly reduce employee related expenses (by PLN30mn q/q). FTEs were down by 286 employees q/q, while the headcount settled close to ca. 23k at the end of June. The 2Q20 operational margins were inflated by PLN34mn one-off attributable to anti-crisis funds. According to our calculations, the unit revenues contracted 1% y/y in 2Q20 (+1.7% y/y in 1Q20). When adjusted for anti-crisis funds, however, the dynamic settled at -4.6%.

Fig. 1. PKP Cargo: capex quarterly

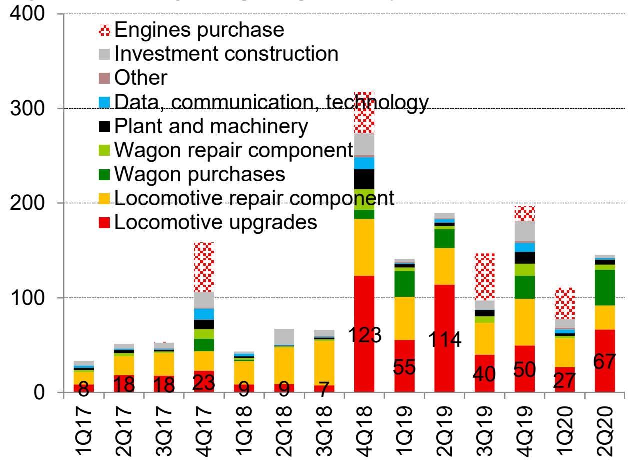
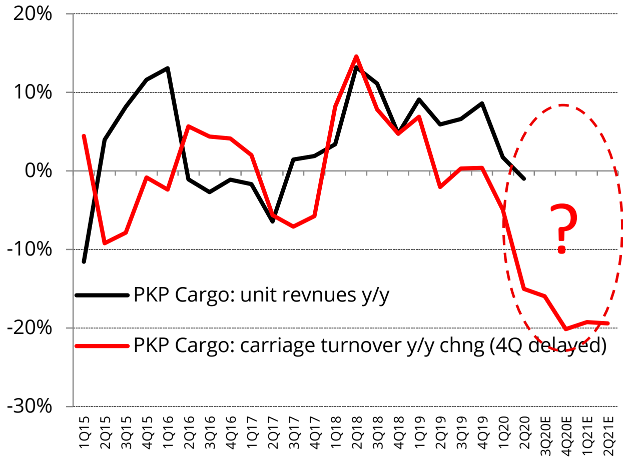


Fig. 2. PKP Cargo: unit revenues vs. carriage turnover



Source: Company data, Santander Brokerage Poland (for both graphs)

Capex. Capital outlays (adjusted for IFRS16) settled at ca. PLN187mn (PLN181mn in 1Q20). The figure came significantly above the quarterly EBTIDA. According to the CEO's comments, PKP Cargo targets capex below 0.8x of the FY20E EBITDA threshold.

Cash flow statement. OCF totalled PLN115mn (PLN218mn in 1H20) vs. PLN193mn last year. We point that the ICF decreased significantly q/q to PLN108mn from PLN243mn in Jan-Mar 2020 period. Looking forward, we expect the cash outflows driven by recent investment in capital assets may increase due to postponed payments. Net debt remained stable q/q (PLN2,290mn EOP 1H20, as we calculate), implying 3.71x net debt / LTM EBITDA ratio in the end of June 2020 vs. 3.32x in the end of March 2020.

Fig. 3. PKP Cargo: 2Q20 results review

PLNmn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	y/y	q/q	2Q20P	% dev.
Sales	1,261	1,164	1,191	1,165	1,036	929	-20.2%	-10.3%	929	0.0%
EBITDA	258.5	191.6	263.0	146.8	90.0	116.7	-39.1%	29.7%	116.8	-0.1%
EBITDA margin	*20.5%*	*16.5%*	*22.1%*	*12.6%*	*8.7%*	*12.6%*	*-3.9*	*3.9*	*12.6%*	*0.0*
EBIT	86.9	15.0	80.9	-39.4	-105.6	-76.4	n.a.	n.a.	-76.3	0.1%
EBIT margin	*6.9%*	*1.3%*	*6.8%*	*-3.4%*	*-10.2%*	*-8.2%*	*n.a.*	*n.a.*	*-8.2%*	*0.0*
Net profit	53.1	-5.2	50.8	-62.7	-114.4	-77.5	n.a.	n.a.	-77.5	0.0%
Net margin	*4.2%*	*-0.4%*	*4.3%*	*-5.4%*	*-11.0%*	*-8.3%*	*n.a.*	*n.a.*	*-8.3%*	*0.0*
Carriage turnover (bn tkm)	7.2	6.6	6.7	6.5	5.8	5.3	-19.4%	-8.2%	5.2	2.0%
Unit revenues	0.175	0.176	0.179	0.180	0.178	0.174	-1.0%	-2.3%	0.178	-2.0%
y/y dynamic	*9.1%*	*5.9%*	*6.6%*	*8.6%*	*1.7%*	*-1.0%*	*n.a.*	*n.a.*	*1.0%*	*n.a.*
Capex	250	302	250	230	181	189	-37.6%	4.1%	130	45.1%

Source: Company data, Santander Brokerage Poland

PKP Cargo held also an investor teleconference mid-day. Following there are the key excerpts:

- CEO is satisfied with the PKP Cargo's operational performance in the stormy and highly adverse business environment triggered by Covid-19 pandemic in 2Q20;
- Company took active (sometimes even aggressive) sales initiatives (particularly on the spot market) to protect its market share and support the financial performance in 2Q20;
- According to CEO, PKP Cargo's key competitors are the companies operating beyond the organizational frames of (either private or State controlled) large capital groups;
- Focus on fossil fuels market is a strategic challenge for the company that must be addressed;
- Domestic railway carriage prices may remain under pressure due to decreased demand; the market is competitive;
- 3Q20E operational margins should be inflated by positive one-offs related to government anti-crisis shield including additional funds for CargoTabor and Cargo Connect (to be fully reported in 3Q20E);
- CEO does not anticipate spectacular market volume rebound in the nearest term;
- FY20E capex should come not higher than 80% of the FY20E EBITDA;
- PKP Cargo has reduced its capex for rolling stock modernization, though, further decrease might be irresponsible;
- CEO does not exclude M&A activity but recent talks regarding assets' purchase in Romania were hibernated in the view of adverse market environment;
- Headcount could decrease further (both on a q/q and y/y) in coming quarters in the view of natural attrition.

Comment: Generally speaking, we reckon the presented full 2Q20 financial figures include neither negative nor positive surprises (nor even unexpected items). Looking forward, we remain concerned with the lowering y/y momentum of the unit revenues (already -4.6% y/y in 2Q20 on the adjusted basis) and increased odds for competitive pressure intensification. Nevertheless, we point that 3Q20E operating margins should be further supported by ca. PLN90mn anti-crisis funds (approx. PLN70mn already paid out to PKP Cargo and approx. PLN15-20mn allocated to CargoTabor / Cargo Connect). Combined the aforementioned with potentially further decreasing headcount and anticipated (though indolent) market rebound, 2H20E might turn visibly better in terms of the both operational and financial performance for the company. We stick to our current FY20E EBITDA assumption close to PLN600mn (adjusted for approx. additional PLN20mn subsidies to be recognised). Unfortunately, we believe the MB's target of FY20E capital outlays below 80% of the FY20E EBITDA might turn too ambitious to meet, especially taking into account already delivered PLN418mn (or PLN370mn when adjusted for IFRS16) capex in 1H20. In the effect, we expect the net debt to remain roughly stable (ca. PLN2.3bn in the end of June 2020) by the end of the year, diverting the focus to the liquidity management. The short- / mid-run FCF profile looks also not appealing in our view. Based on our current calculations, YE20E net debt / LTM EBITDA ratio may settle close to 3.65x (not adjusted for IFRS16).

Summing up, at this point, we reiterate our comments presented at the occasion of release of 1Q20 financial statements and point that in our opinion PKP Cargo's assets has still a significant intrinsic value but it could be devaluated with a prolonging excessive fixed costs burden. For the time being, we continue to assess the risk / reward for the company as unappealing, though, perceive some actions / comments regarding adjustment / optimisation of the assets base (including headcount) to the changed business environment as inevitable steps with potential positive pay-off in the future. Above all, freezing winter, steel production volume rebound or higher inclination of labour unions to participate in company's transformation may surprise positively.

Fig. 4. PKP Cargo: transport turnover on a quarterly basis

	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	y/y	q/q
Solid fuels	2.7	2.4	2.4	2.5	2.4	1.7	-28%	-30%
Solid fuels (hard coal)	2.3	1.9	2.1	2.1	2.0	1.4	-26%	-27%
Aggregates and building materials	1.4	1.4	1.3	1.2	0.9	1.1	-18%	26%
Metals and ores	0.9	0.8	0.7	0.4	0.5	0.5	-33%	10%
Chemical products	0.5	0.5	0.5	0.5	0.5	0.4	-21%	-8%
Liquid fuels	0.2	0.2	0.3	0.3	0.3	0.2	-33%	-37%
Timber and agricultural produce	0.3	0.3	0.2	0.3	0.3	0.2	-4%	-8%
Intermodal transport	1.0	0.9	1.1	1.0	0.9	1.0	11%	19%
Other	0.1	0.2	0.2	0.2	0.2	0.1	-18%	-17%
Total	**7.2**	**6.6**	**6.7**	**6.5**	**5.8**	**5.3**	**-19%**	**-8%**
y/y	*-5%*	*-15%*	*-16%*	*-20%*	*-19%*	*-19%*	*n.a.*	*n.a.*
q/q	*-11%*	*-8%*	*1%*	*-3%*	*-10%*	*-8%*	*n.a.*	*n.a.*

Source: UTK, Santander Brokerage Poland

Fig. 5. PKP Cargo: financial summary

PLNm	2015	2016	2017	2018	2019	2020E	2021E	2022E
Sales	4,554	4,411	4,739	5,237	4,866	4,170	4,453	4,533
EBITDA	705	490	702	907	860	583	705	774
EBIT	56	-132	155	278	143	-130	16	101
Net income	30	-134	82	184	36	-151	-33	37
P/E (x)	32.9	n.a.	43.7	13.3	33.2	n.a.	n.a.	12.0
EV/EBITDA (x)	6.8	6.8	5.8	3.9	5.0	5.6	4.5	3.9
DY	3.1%	0.0%	0.0%	0.0%	4.2%	0.0%	0.0%	0.0%

Source: UTK, Santander Brokerage Poland

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