Ignitis Grupe

Energy
September 22, 2021

Enlight Research

Baltics - Lithuania
Commissioned Research - Update

Regulatory uncertainty

The regulatory risk in Ignitis Grupe (IGN) may materialize due to the regulators' (NERC) proposed Networks electricity methodology amendment for the new regulatory period starting 2022. On the opposing side is the Lithuanian Finance Ministry who proposed a dividend in August, reflecting different views by the institutions. Investors' share value is now jeopardized by the Lithuanian regulator. We put our estimates "Under review" until we get more regulatory clarity. The potential share price effect is substantial.

What happened?

In August, the Finance Ministry proposed a div. of EUR ~0.60/shr. On 16 September, NERC released a draft regulatory amendment. This must be highly confusing for investors who participated in the IPO last year, and we believe Lithuania's reputation as an investable region is at stake.

Market cap impact

Our estimated negative share price impact is EUR 3.60 per share. This assumes that half of the negative impact from the lower RAB and the LRAIC correction is compensated by the newly proposed tariff compensation component.

Next steps

Stakeholders can submit proposals to NERC's methodology amendment until 23 Sep. (inclusive). NERC will assess the proposals and adopt the amendment no later than 15 Oct. We hope the regulator will minimize the negative financial impact on Ignitis Grupe. Failure to do so could significantly hurt thousands of retail investors, Lithuanian pension assets, as well as institutional investors, including the EBRD, who participated in the IPO.

Key figures (MEUR)

Under review

	2019	2020	2021E	2022E	2023E
Total revenues	1,099	1,223	1,368	1,396	1,461
Total revenue growth	2.7%	11.3%	11.8%	2.1%	4.6%
EBITDA adj.	260	292	323	335	363
EBITDA margin adj.	22.6%	24.8%	23.6%	24.0%	24.9%
EBIT adj.	135	169	184	190	210
EBIT margin adj.	12.3%	13.8%	13.5%	13.6%	14.3%
EV/Sales	2.0	[illegible]	1.8	1.8	1.8
EV/EBITDA adj.	8.3	[illegible]	6.6	6.4	5.9
EV/EBIT adj.	[illegible]	[illegible]	11.7	11.3	10.3
PE adj.	[illegible]	12.3	12.6	11.6	10.8
P/BV	1.2	0.8	0.8	0.8	0.8
EPS adj.	1.43	1.71	1.66	1.81	1.93
EPS growth	nm	19.5%	-2.8%	9.1%	6.9%
Div. per share	0.52	1.14*	1.20	1.26	1.31
Dividend yield	2.5%	5.6%*	5.7%	6.0%	6.3%

Source: Company, Enlight Research, *0.58 to minority shareholders (2.8% yield)

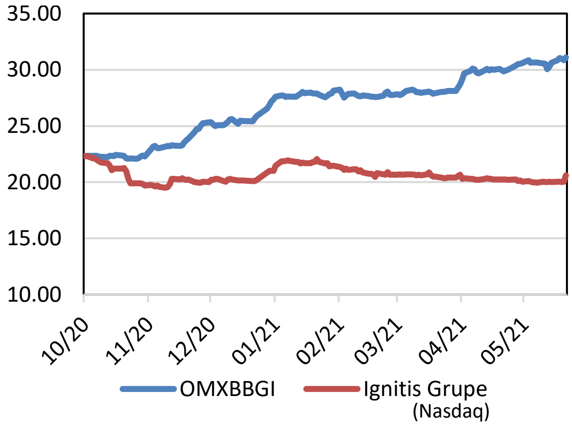
Fair value range (EUR)

Under review

Bull (3.0% div. growth)	30.59
Base (2.5% div. growth)	27.13
Bear (1.0% div. growth)	20.27

Key Data

Price (EUR)	23.25
Ticker	IGN1L
Country	Lithuania
Listed	Vilnius (Lithuania)
Market Cap (EURm)	1,727
Net debt (EURm)	572
Shares (m)	74
Free float	26.92 %



Price range

52-week high	25.50
52-week low	18.40

Analyst

ResearchTeam@enlightresearch.net

Implications of proposed regulatory amendment

Implied effect on share price

Adding the mid-range RAB decrease amount and the LRAIC correction amount as estimated by Ignitis Grupe, results in a sum of EUR 535m or EUR 7.20 per share, which indicate the negative share price effect before the new tariff component. Assuming the new tariff compensation component offsets half of the negative effect, the implied negative effect on the share price is EUR 268m or EUR 3.60 per share.

Potential effect of amendment on Market cap

	MCap value (EURm)	Per share (EUR)
Mid-range lower RAB effect	375	5.05
LRAIC correction for previous periods	160	2.15
Total reduction of market cap	**535**	**7.20**
New tariff compensation component	268	3.60
Total reduction of market cap after new tariff component	**268**	**3.60**

Source: Company, Enlight Research

Implied effect on Financials

For 2021, we estimate a negative effect on the adjusted EBITDA of EUR 44m, which is the amount that must be paid back for the period 2018-21 due to actual investments being below planned investments. For 2022 and 2023, our estimated negative effect on Revenue, EBITDA, and Cash Flow is EUR 30m calculated as the Total effect from Allowed return and Depreciation of EUR 44m plus the revenue adjustment of EUR 16m (160m over 10 years) divided by 2 to compensate for the new tariff compensation tariff component. The estimated 2022, and 2023 negative adjusted EBITDA effect is EUR 14m, calculated as the Revenue impact of negative EUR 30m plus the Revenue effect of EUR 16m (the aim of the adjusted EBITDA is to show the sustainable EBITDA, therefore, the Revenue effect from the previous period is eliminated). Given these adjustments, the implied adjusted EBITDA for 2021 is EUR 277m, which can be compared to our forecast of EUR 321m (Under review), and the guidance of EUR 300-310m given before the proposed amendment. For 2022, and 2023, the implied adjusted EBITDA is EUR 325m (prev. 339m), and EUR 357m (prev. 371m).

Effect of lower RAB

Allowed return impact	Low	Mid	High	Comment
Estimated RAB decline (EURm)	350	375	400	Ignitis estimate in Press release on 17 Sep 2021
WACC	4.16%	4.16%	4.16%	Weighted Networks segment WACC set by the regulator
Impact on Allowed return (EURm)	**15**	**16**	**17**	**Enlight Research estimate (Estimated RAB x WACC)**
Depreciation impact (EURm)				
Depreciation before amendment	67	67	67	Based on PWC/NERC presented change in Depreciation for ESO
Depreciation after amendment	39	39	39	Based on PWC/NERC presented change in Depreciation for ESO
Impact on Depreciation	**28**	**28**	**28**	**Enlight Research estimate (simplification, same for all scenarios)**
Total effect from Allowed return and Deprecation	**42**	**44**	**45**	**Enlight Research estimate**

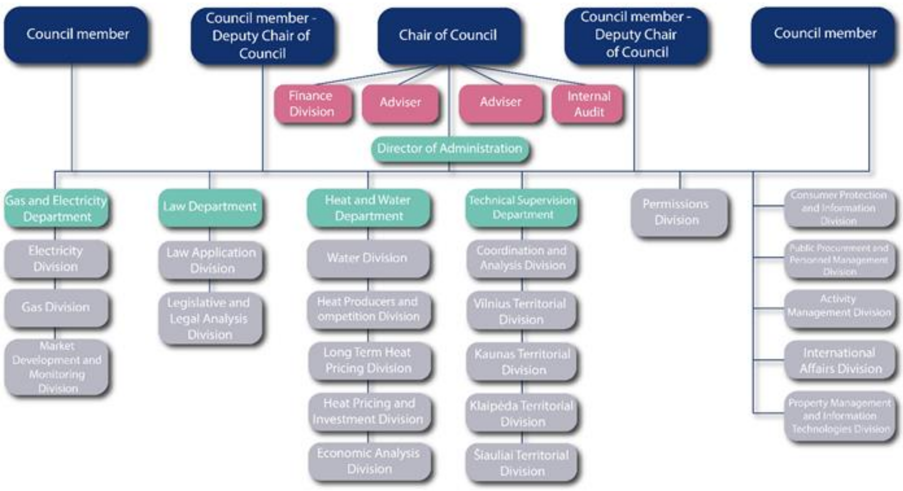
Potential effect of amendment on Financials (EURm)	2021	2022	2023
Revenue	none	-30	-30
adj. EBITDA	-44	-14	-14
EBITDA	none	-30	-30
Cash flow	none	-30	-30
Enlight Research est. adj. EBITDA bef. Amendment (Under review)	321	339	371
Amendment impact	-44	-14	-14
adj. EBITDA after Amendment	277	325	357

Source: Enlight Research

Regulator description

NERC's (National Energy Regulatory Council) organizational structure includes departments with divisions and independent divisions, which are headed by the Director of Administration. The NERC staff is composed of state officials, civil servants and employees working under contracts. The decision-making body of the Regulator is the Council (will decide on proposed regulatory amendment affecting Ignitis Grupe latest on 15 October 2021). NERC is composed of five Council members, who are appointed by the Parliament of the Republic of Lithuania on the nomination of the President of the Republic of Lithuania for a 5-year term.

NERC Organizational chart



Source: NERC

Council members

Chairman of the council: **Renatas Pocius**. Appointed 14 January 2021. Studied at Vilnius Gediminas Technical University: 2000 obtained a bachelor's degree in mechanical engineering in 2003. Master's degree in mechanical engineering. Since 2001 October 16 until 2018 May 31 worked in the State Price and Energy Control Commission. Since 2012 served as the Director of the Gas and Electricity Department of the State Price and Energy Control Commission. As the person responsible for the regulation and supervision of natural gas and electricity monopolies, he led the working group of the largest companies' cost audit and contributed to the transposition of the provisions of the EU 3rd Energy Package into Lithuanian legislation. Actively participated in the discussion of EU energy legislation, as well as issues related to the transposition of the Natural Gas Directive, electricity trading on the Nord Pool exchange.

Deputy chairman of the council: **Jonas Makauskas.** Born in 1980. Appointed 1 July 2019. Studied at Mykolas Romeris University: 2006 obtained a bachelor's degree in law in 2008. - Master's degree in law. 2001-2007 worked as a pre-trial investigation officer in the structural subdivisions of Kaunas City Chief Police Commissariat. 2007-2016 held the position at the Financial Crime Investigation Service under the Ministry of the Interior: Chief Investigator of the Criminal Investigation Division of the Special

Tasks Board, Chief Investigator of the Criminal Investigation Division of the Panevėžys Regional Board, Deputy Head of the Utena County Division, Investigator of Vilnius County Division and Senior Investigator. Has work experience in pre-trial and criminal intelligence investigations related to the activities of energy companies.

Deputy chairman of the council: Donatas Jasas. Born in 1986. Appointed on 1 February 2020. Studied at Kaunas University of Technology: 2009 obtained a bachelor's degree in thermal engineering (specialization - fuel engineering), in 2011. Master's degree in thermal engineering (specialization - thermal energy). 2009-2016 worked for a company providing consultations to Lithuanian and foreign energy sector companies and organizations on energy efficiency, electricity, gas and heat supply, business planning and regulation issues. 2009-2016 was the Deputy Director of the Lithuanian Association of Energy Consultants, responsible for energy regulation issues. Actively contributed to the preparation and improvement of laws and regulations related to energy, renewable resources, the national heat economy development program.

Member of the council: Matas Taparauskas. Appointed on 25 January 2021. He studied at Kaunas University of Technology - 2014. Bachelor's degree in nuclear energy engineering, 2016 holds a Master’s degree in Innovation and Technology Management from ISM University of Management and Economics. 2019–2021 (January) - worked as a chief. consultant Ernst & Young Baltic UAB, where he was responsible for advising companies and state institutions on increasing operational efficiency, changes in the regulatory environment, cost accounting and service pricing, etc. 2013-2019 held the position of the Head of the Heat Producers and Competition Division of NERC, examined the pricing, regulation, investments, their financing and other issues of the infrastructure sectors. Actively contributed to the improvement of the legal framework in order to create a level playing field in the heat sector.

Member of the council: Jelena Diliene. Appointed 14 June 2021. Studied at Vilnius University: 2007-2012. obtained a master's degree in law (specialization - labor law). 2014–2016 worked as the head of the Legal Division of the Environmental Protection Agency. a specialist, where he gained experience in drafting procedural documents, representing an institution in court, analysis and drafting of legal acts. 2016–2019 was Head of the Better Regulation Policy Division. a specialist responsible for the analysis and preparation of draft legal acts, coordination of national measures for reducing administrative burdens on business (assessment of administrative burdens on business, prevention, preparation of trainings, consultations, provision of methodological assistance). 2019–2021 worked as the Head of the Better Regulation Policy Division of the Business Environment Department of the Ministry of Economy and Innovation of the Republic of Lithuania, where she was responsible for better regulation, i.e. measures to help formulate and evaluate public policy decisions (including legal acts). Better regulation ensures the proportionality of legal regulation, the prevention of administrative and adaptation burdens, and the transparency of legal regulation. She was also responsible for shaping the EU's internal market services policy, licensing and competition policy.

Risk factors

Below is a list of risk factors that we have chosen to highlight. It should not be regarded as an extensive list of all risk factors. For more risk factors, we recommend reading the Ignitis Group IPO prospectus, and annual/interim reports.

Regulatory risk

Tariffs for electricity and gas distribution that form Ignitis Group's largest business area are set by the Lithuanian regulator, NERC, based on regulated assets and reasonable rate of return (WACC). Significantly lower allowed return (WACC) could mean that our forecast is too optimistic under all scenarios. Also, lower approved investments could result in lower RAB, which could also affect our forecast negatively.

The new 5-year regulatory period for electricity and gas distribution starts in 2022, and 2024, respectively. There is a risk that the company could be affected by any potential changes implemented by the regulator, as described in this Update.

Expansion risk

The group plans to expand its renewable generation capacity substantially in the coming years. The expansion projects are large in terms of capital expenditure which means delays or lower than planned generation could affect our forecast negatively.

Weather risk

The Green Generation segment is exposed to weather conditions. For example, the water level affects the hydro plants, and the wind level affects the wind farms.

Price risk

The Green Generation segment sells its electricity production on the unregulated market, and hence, the electricity market price has a significant impact on the financial performance. We have assumed unchanged prices compared to our estimated 2020 level.

Deregulation risk

The electricity supply market will be fully deregulated in the years to come, which will most likely result in a decrease in the number of electricity customers. We forecast a decline of 10% over 3 years. If the decline is larger than this, our Customer & Supply segment forecast is most likely too optimistic.

Dividend risk

If for whatever reason (large investments, weak financial performance, regulatory changes), the dividend growth is below our forecast, the dividend yield will most likely be below our forecast.

COVID-19 risk

The Company's direct exposure to COVID-19 is rather limited. However, there is an indirect risk that a COVID-19 induced recession could affect people's ability to pay their electricity and heating bills. Furthermore, the business client demand could fall significantly in the event of a prolonged recession.

Under review

Income Statement	2019	2020	2021e	2022e	2023e
Total revenues	1,099	1,223	1,367	1,396	1,461
Total operating costs	-892	-886	-1,070	-1,082	-1,132
EBITDA	**207**	**337**	**297**	**314**	**329**
Depreciation	-110	-113	-126	-142	-144
Amortizations	0	0	0	0	0
Impairment charges	-14	-9	-11	0	0
EBIT	**83**	**215**	**160**	**172**	**185**
Associated companies'	0	0	0	0	0
Net financial items	-17	-20	-22	-23	-26
Exchange rate differences	0	0	0	0	0
Pre-tax profit (PTP)	**66**	**195**	**138**	**149**	**159**
Net earnings	**57**	**170**	[illegible]	**124**	**134**

Balance Sheet	2019	2020	[illegible]	[illegible]	2023e
Assets					
Cash and cash equivalent	132	659	[illegible]	[illegible]	[illegible]
Receivables	118	128	[illegible]	[illegible]	[illegible]
Inventories	47	33	41	[illegible]	[illegible]
Other current assets	131	166	166	[illegible]	[illegible]
Total current assets	**427**	**987**	**713**	**550**	[illegible]
Tangible assets	2,348	2,560	2,878	3,197	[illegible]
Goodwill & Other Intangibles	143	176	165	165	165
Long-term investments	9	12	12	12	12
Associated Companies	0	0	0	0	0
Other non-current assets	259	228	246	248	252
Total fixed assets	**2,759**	**2,976**	**3,302**	**3,623**	**3,898**
Deferred tax assets	12	6	6	6	6
Total assets	**3,198**	**3,969**	**4,021**	**4,180**	**4,480**
Liabilities					
Non-ib current liabilities	79	52	82	84	88
Short-term debt	243	29	28	31	37
Other current liabilities	158	229	229	229	229
Total current liabilities	**479**	**309**	**339**	**344**	**353**
Long-term IB debt	856	1,275	1,252	1,371	1,622
Convertibles & Lease liabilities	0	0	0	0	0
Other long-term liabilities	421	448	448	448	448
Total long-term liabilities	**1,276**	**1,723**	**1,700**	**1,819**	**2,070**
Total (liabilities)	**1,849**	**2,125**	**2,132**	**2,255**	**2,516**
Deferred tax liabilities	38	52	52	52	52
Provisions	55	41	41	41	41
Shareholders' equity	1,300	1,842	1,888	1,923	1,963
Minority interest (BS)	49	1	1	1	1
Total shareholders equity	**1,349**	**1,844**	**1,889**	**1,924**	**1,964**
Total equity & liabilities	**3,198**	**3,969**	**4,021**	**4,180**	**4,480**

DCF valuation		Cash flow (EURm)	
WACC (%)	5.35%	NPV FCF (2021-2023)	-468
		NPV FCF (2024-2030)	619
Assumptions 2020-2025 (%)		NPV FCF (2031-)	2,598
CAGR Sales growth	6.26%	Non-operating assets	590
Average EBIT margin	13.32%	Interest-bearing debt	-1,304
		Fair value estimate	2,034
		Fair value per share (EUR)	27.39
		Share price (EUR)	20.65

Free Cash Flow	2019	2020	2021e	2022e	2023e
Operating profit	83	215	160	172	185
Depreciation	124	122	137	142	144
Change in wc	-6	12	-13	-10	-13
Other oper. CF items	-23	-67	-28	-28	-30
Operating CF	**177**	**283**	**255**	**276**	**286**
CF from Investments	-347	-260	-444	-462	-415
Other CF items	0	0	0	0	0
Free Cash Flow	**-170**	**22**	**-189**	**-186**	**-129**

Capital structure	2019	2020	2021e	2022e	2023e
Equity ratio	42%	46%	47%	46%	44%
Debt/Equity	81%	71%	68%	73%	84%
Capital invested	2,398	3,146	3,168	3,325	3,621

Profitability	2019	2020	2021e	2022e	2023e
ROE %	4.4%	10.6%	6.1%	6.5%	6.9%
[illegible]	18.8%	27.6%	21.7%	22.5%	22.5%
[illegible]	7.6%	17.6%	11.7%	12.3%	12.7%
[illegible]	5.4%	13.8%	8.3%	8.9%	9.1%

[illegible]	2019	2020	2021e	2022e	2023e
[illegible]	19.8	7.3	13.6	12.3	11.5
P/E adjusted	14.5	12.1	12.5	11.4	10.7
P/Sales	1.0	1.0	1.1	1.1	1.0
EV/Sales	1.9	1.5	1.8	2.0	2.1
EV/EBITDA	10.3	5.6	8.3	8.8	9.2
EV/EBIT	25.6	8.7	15.5	16.1	16.3
P/BV	0.9	0.7	0.8	0.8	0.8

Per share	2019	2020	2021e	2022e	2023e
EPS	1.04	2.88	1.52	1.67	1.80
EPS adjusted	1.43	1.71	1.66	1.81	1.93
CEPS	2.39	3.80	3.43	3.72	3.85
EBITDA/share	2.79	4.54	3.99	4.23	4.43
Capital empl./share	32.94	42.38	42.67	44.78	48.77
Div. per share	0.52	1.14	1.20	1.26	1.31
Payout	50%	40%	79%	75%	73%
Dividend yield	2.5%	5.5%	5.8%	6.1%	6.4%

Shareholders	Capital	Votes
Ministry of Finance	1,105	73.10%
EBRD	17	1.10%

Key people	
CEO	Darius Maikstenas
CFO	Darius Kasauskas
Infra. Develop. Director	Dominykas Tuckus
Org. Develop. Director	Dr. Zivile Skibarkiene
Commerce & Serv.	Vidmantas Salietis
Chairman	Darius Daubaras

P/E Price per share / Earnings per share	**EPS** Profit before extraordinary items and taxes – income taxes + minority interest / Number of shares
P/Sales Market cap / Sales	**DPS** Dividend for financial period per share
P/BV Price per share / Shareholders' equity + taxed provisions per share	**CEPS** Gross cash flow from operations / Number of shares
P/CF Price per share / Operating cash flow per share	**EV/Share** Enterprise value / Number of shares
EV (Enterprise value) Market cap + Net debt + Minority interest at market value – share of associated companies at market value	**Sales/Share** Sales / Number of shares
Net debt Interest-bearing debt – financial assets	**EBITDA/Share** Earnings before interest, tax, depreciation and amortization / Number of shares
EV/Sales Enterprise value / Sales	**EBIT/Share** Operating profit / Number of shares
EV/EBITDA Enterprise value / Earnings before interest, tax, depreciation and amortization	**EAFI/Share** Pre-tax profit / Number of shares
EV/EBIT Enterprise value / Operating profit	**Capital employed/Share** Total assets – non-interest-bearing debt / Number of shares
Div yield, % Dividend per share / Price per share	**Total assets** Balance sheet total
Payout ratio, % Total dividends / Earnings before extraordinary items and taxes – income taxes + minority interest	**Interest coverage (x)** Operating profit / Financial items
Net cash/Share Financial assets – interest-bearing debt / Number of shares	**Asset turnover (x)** Turnover / Balance sheet total (average)
ROA, % Operating profit + financial income + extraordinary items / Balance sheet total – interest-free short-term debt – long-term advances received and accounts payable (average)	**Debt/Equity, %** Interest-bearing debt / Shareholders' equity + minority interest + taxed provisions
ROCE, % Profit before extraordinary items + interest expenses + other financial costs / Balance sheet total – non-interest-bearing debt (average)	**Equity ratio, %** Shareholders' equity + minority interest + taxed provisions / Total assets – interest-free loans
ROE, % Profit before extraordinary items – income taxes / Shareholders' equity + minority interest + taxed provisions (average)	**CAGR, %** Cumulative annual growth rate = Average growth rate per year

Disclaimer

Enlight Research OÜ's main valuation methods are discounted cash flow valuation and peer valuation with common multiples such as Price to Earnings, Enterprise Value to EBITDA, dividend yield etc. Aforementioned methods are used to estimate a company's fair value according to the following three scenarios: Bull (positive), Base (main scenario), and Bear (negative).

This report is commissioned by the company covered in this report which means Enlight Research OÜ receives compensation to write research on the company. The compensation is pre-determined and does not depend on the content in the report. This report is not to be considered investment research under MiFID regulations. Enlight Research OÜ does not issue investment recommendations or advice.

This report is for informational purposes only i.e. it should not be considered as an offer to sell or buy. Investors are encouraged to make their own research and not rely solely on this report when making their investment decisions. The decision to invest or not to invest is fully the responsibility of the investor i.e. Enlight Research OÜ takes no responsibility nor gives any guarantees with regards to investment decisions made by investors. Investing in equities entails risk e.g. the price of an equity decreases. Past performance is not a guarantee for future performance.

This report is based on information and sources that Enlight Research OÜ deemed to be reliable. However, Enlight Research OÜ cannot guarantee the accuracy or completeness of the information. All forward-looking statements and financial forecasts entail uncertainty and are subject to change without notice. Enlight Research OÜ accept no liability for any loss or damage resulting from the use of this report.

The analyst(s) writing this report own shares in the company in this report: Yes

The analyst(s) responsible for this report are not allowed to trade in any financial instruments of the company in this report until one trading day after the analyst report has been published, or if other conflict of interest exist e.g. advisory related.

Investors should assume that Enlight Research OÜ is seeking, or is performing, or have performed advisory services or other revenue generating services for the company in this report. An analyst's compensation is never directly related to advisory projects. An analyst working on advisory projects will be taken over the "Chinese wall" as soon as relevant regulations and/or guidelines require this.

Follow on Twitter

@ResearchEnlight

Contact information

ResearchTeam@EnlightResearch.net