ALTA Invest

Oil and Gas Retailer

PETROL D.D.

28th August 2014

www.petrol.si

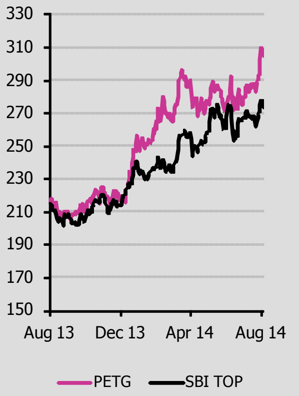
LJSE ticker: PETG
Bloomberg: PETG SV

Target price:
338 EUR

Previous target price:
338 EUR, BUY (16.5.2014)

Recommendation:
BUY

12 months stock performance in EUR



Largest oil retailer on local market.

Utilizing stations for merchandise sales.

Prospects for growth in energy-related businesses.

Ambitious net income growth plan.

Long-term liberalization of markets.

ALTA Invest, investicijske storitve, d.d.
Železna cesta 18
SI-1000 Ljubljana
Slovenia
phone: + 386 1 32 00 300
e-mail: invest@alta.si
http://www.alta.si

Head of Research:
Sašo Stanovnik
saso.stanovnik@alta.si

Institutional Trading:
Darko Jurčević
darko.jurcevic@alta.si

Stock data as of 28.08.2014			
Market price (EUR)	308.9	Market Cap (EUR)	644.5
52 week range (EUR)	205.9-310.0	No. of Shares	2.1
Avg. daily trade vol., EUR(k)	97.83	Free float	71%
Average daily % of stock traded	0.018%	Dividend yield	3.3%

Price performance	3 months	12 months	Multiples:	TTM	2014F
			P/E	11.7	12.1
price change in %	8.0%	41.7%	EV/Sales	0.3	0.3
SBI TOP index change in %	2.6%	29.8%	EV/EBITDA	7.8	8.4
relative to SBI TOP index in %	5.3%	9.2%	EV/EBIT	11.4	13.0

Key figures (According to International Accounting Standards) *Consolidated data in EURm*

Income statement:

million €	FY2012	FY2013	FY2014	FY2015
Sales	3,754.0	3,947.3	3,884.1	4,194.7
Growth yoy	14.8%	5.1%	-1.6%	8.0%
EBITDA	124.6	135.2	125.3	129.5
Margin	3.3%	3.4%	3.2%	3.1%
EBIT	84.9	93.8	80.6	80.0
Margin	2.3%	2.4%	2.1%	1.9%
Net income	53.3	52.8	50.8	53.5
Growth	3.6%	-1.0%	-3.8%	5.5%
EPS	**25.6**	**25.3**	**24.3**	**25.7**

Balance sheet:

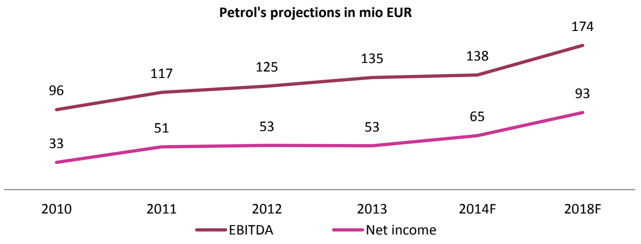
million €	FY2012	FY2013	TTM
Investments	160.6	164.1	168.0
Cash	37.6	69.7	170.6
Debt	633.6	600.3	772.5
Net debt	417.9	366.5	433.8
Equity	435.5	469.6	473.2
Assets	1,571.5	1,620.3	1,702.6
D/E	145.5%	127.8%	163.2%
ROE	12.2%	11.2%	11.1%
ND/EBITDA	3.4	2.7	3.2

Investment Thesis:

- **Largest in Local Market:** On the domestic Slovenian market Petrol has 318 service stations, with a market share of 60% and a good coverage of locations across Slovenia (highways, city and rural). In contrast Petrol's largest local competitor OMV has market share of 23% and 110 stations while MOL has 47 stations. There are several other players, but majority pose virtually no threat due to insignificant market shares, although Mercator (Slovenian biggest food retailer) has incorporated automatic oil station network into its strategy a couple years ago (21 stations; relatively unsuccessful). The Slovenian oil retail market is mature in terms of market share and oil consumption per capita, so there is limited ability to expand volume growth. On the other hand, Petrol has potential to grow by exploiting growth of transportation transit through Slovenia and by increasing sales of supplemental and other merchandise. However both effects depend upon economic conditions. Therefore effects were present during 2012, but not in 2013 as volume sales in Slovenia decreased by 1%, while sales of supplemental merchandize increased by only 0.5%.

  We must also note Petrol Group has substantial 11% market share (second largest) also in neighbouring Croatia in 2013 with 97 stations and with major competitors being INA, Crodux, Tifon (MOL) and Lukoil Croatia.

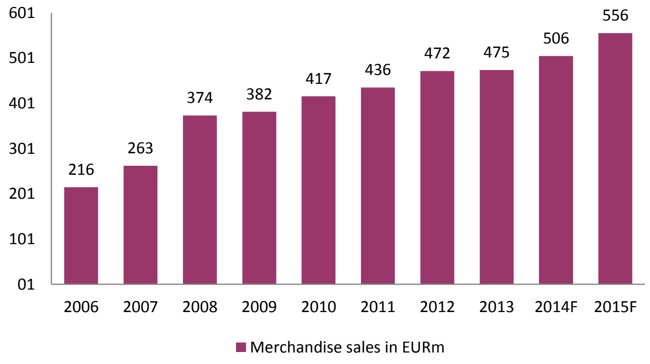
- **Ambitious management guidance:** Overall Petrol's management is planning to significantly expand net profit in future years as they envisioned 12% average yearly growth rate of net profit in 2013 to 2018 period. For EBITDA the annual average planned growth rate is 5.2%. Namely for 2018 they see net profit at EUR 93m and EBITDA at EUR 174m. This is based on average annual growth rate of volume sales by 1.6% and 3.2% average annual growth of merchandise sales. The growth rates of other energy segment should be higher, with electricity sold growth of 14.2% per annum. Overall CAPEX in the period is planned at EUR 308m with 50 more retail stations. This is a decrease in investing activity versus previous 5 year plan, most likely due to more prudent expansion of network which we deem positive.

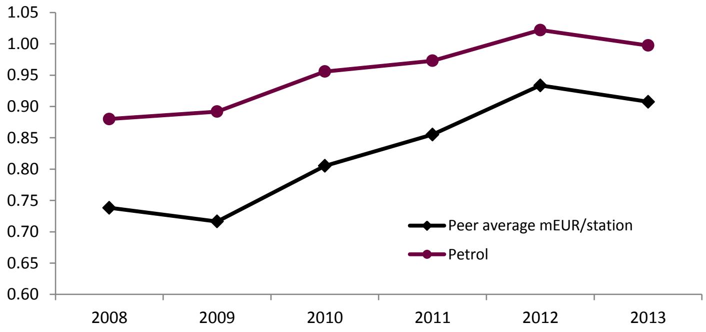


2013 to 2018 strategy is therefore ambitious. In 2012 EBITDA was at EUR 124.6m compared to envisaged EUR 127m while net profit at EUR 53.3m compared to planned EUR 57m. In 2013 EBITDA was at EUR 135.2m compared to envisaged EUR 133m while net profit at EUR 52.8m compared to planned EUR 58m. Therefore past 2 years showed management guidance was roughly met in terms of EBITDA, however they mostly missed in terms of net income. On the other hand lower interest burden should help the bottom line in the future, while also Petrol Group faced adverse economic conditions in the past years that should improve during the next couple of years.

Revenue guidance for 2014 is EUR 3.94 bln with 2.7m tons of petroleum products, 125 million m^3 of natural gas, 75 thousand tons of liquefied petroleum gas and 7.51 TWh of electricity. Additionally they see merchandise sales of EUR 505.5m. EBITDA is guided at EUR 138.2m (+5.5%) while net income at EUR 65.0m (+12.0%). CAPEX is planned at EUR 75m, with roughly equal split between oil business in Slovenia, oil business in SEE and other energy related segments. Network should stand at 484 service stations, with 320 in Slovenia, 101 in Croatia, 37 in BiH, 8 in Serbia and 9 in Monetengro and Kosovo. Given 1H14 Petrol Group is at 48% for petroleum volume and 46% for merchandise sales. If we account for seasonal dynamic volume and energy sales should strike the target, but merchandise sales could pose a miss. Unfortunately with net income at only EUR 24.1 at 1H14 and EBITDA at 42% of planned 2014 amount, we believe profit miss is also ever more likely.

- **Growth prospects in supplemental and other merchandise:** In the last decade, Petrol has managed to achieve good growth by turning its attention towards selling supplemental and other merchandise. We note supplemental and other merchandise consists of automotive products, foodstuffs, hot beverages, accessories, tobacco and lottery products, coupons, cards and loyalty programme merchandise, raw materials, chemical products and wood biomass. In the period 2006 to 2013 average annual growth rate of merchandise revenues was 11.9% while in 2013 the growth rate was only 0.5%, but at least partially the slowdown can be attributed to continuation of recessionary environment in key markets with a slump in consumer spending. However, this also means the slowdown is only temporary until harsh economic conditions are affecting consumer spending and habits. We believe in the mid-term growth will return to approximately 4% (while management is more conservative at 3.2% forecasted CAGR). On one hand the slowdown versus past period is also explained by limited room for expansion (most product and services already included in oil retail network; mature environment), while on the other hand SEE network has room for expanding merchandize sales per station and Petrol in the past showed its strength in marketing merchandise through network and its innovation in placing new products and services. This is seen by comparing Petrols merchandise revenue per station versus average of Casey's General Stores, Pantry, Alimentation Couche Tard, Susser and OMV Slovenia. Of all mentioned only Susser has higher merchandise turnover per station. Here we note a new product quickly normalizes after initial launch, so management must constantly find new products.





- **Growth Prospects in SE Europe through filling station expansion:** Another growth option lies in other SE European markets which are still underdeveloped in terms of sales of petroleum products. The ratio of vehicles per capita in these countries is lower than the European average. In Croatia it is below 400 and around 250 for Serbia and Bosnia and Herzegovina (versus 560 in Slovenia). These markets can enable Petrol to achieve better oil sales volume growth in the next decade, especially if Petrol continues with acquisitions and construction of oil retail network in this region (most of 50 additional stations till 2018 will be allocated in SEE region). Additionally this can boost their merchandise sales where these markets are also lagging behind Slovenia. Here we note oil retail network was especially build in areas where Slovene often travel (tourism), which is an appropriate strategy to ensure good sale of petrol and merchandize (loyalty card and marketing actions will help).

We note that in the last year, the oil volume growth was not so much driven by SEE (+13%), but by EU sales (+44%) which accounts Austria, Czech Republic etc. This is an interesting development most likely attributed to good supply routes. This means Petrol has other sources of growth, however these can be tricky to maintain, which was proven in 1H14 (-5%).

- **Prospects for growth in energy businesses:** Petrol cannot vertically expand in the oil & gas industry, since bigger oil companies have already divided the SE European markets among themselves, so an important stand-alone possibility is expansion into related energy businesses, for example electricity or gas distribution. This strategic orientation has begun years ago, but in 2011 two important steps were taken as Petrol acquired an important parts of Istrabenz's energy division – Istrabenz Gorenje (IGES - production, marketing and distribution of electricity in Slovenia and SEE, also involved in renewable energy sources) and Instalacije d.o.o. (storage capacity for petroleum products; reserves for Republic of Slovenia). Acquisitions in this segment continued in 2012, with a purchase of 85% stake in Beogas Invest d.o.o. a Serbian company that is engaged in gas distribution in Serbia.

	2013	2018
Natural gas sold:	121.8	149m m3
Liquefied petroleum gas sold:	68.5	102 thousand tonnes
Electricity sold:	4.9	9.5 TWh
Heat sold:	67.9	159 thousand MWh

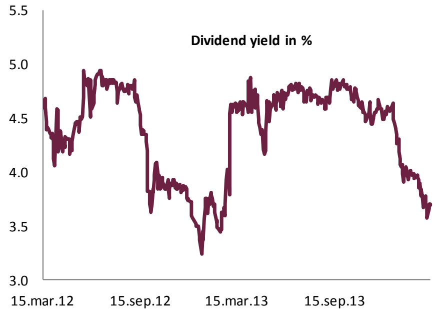
We note that these assets (consolidated, associates and joint ventures) provided Petrol with revenues of EUR 1,064m and net income of EUR 22.1m in 2013 (net margin 2.1%). Petrol is hoping for high future growth of this segment, as shown in their guidance (table above). Peer group multiples in wide industry (electricity, gas) is P/S 0.67 and P/E 12.9 for per partes valuation.

Beside growth outside mature oil retail market of Slovenia, Petrol decision to expand into other energy business was also tied to liberalization of these markets (which created a new growth opportunity; same is expected for some other Ex-Yu countries in combination with EU accession process) and due to cross-selling opportunity (providing one-stop-shopping and integrated full service packages tailor-made to customer requirements). On the later Petrol is currently facing no competition in its markets. This should provide benefits in times of adverse economic environment and increasing pressure for energy savings. With expansion of this segment, ever more economies of scale can also be captured, improving the overall profitability.

- **Geoplin stake:** Petrol has a 32% stake in Geoplin d.o.o., a Slovenian company involved in natural gas distribution that owns around 1,000 km of gas pipeline which are placed through the network that covers regions where major part of industry and population is located. We note in 2012 there were 131,515 natural gas customers and 76 local communities connected to domestic gas transmission network to which 307m Sm^3 natural gas was sold on the wholesale market. As for retail market, 70% of natural gas is sold to industrial customers while the remainder to households. Geoplin has also become the contractual partner of Gazprom as Slovenia and Russia signed an agreement on South stream project. It owns a 50% stake in the company that will invest, develop and operate with the Slovenian share of the South Stream pipeline if project materializes.

Here we must note that Geoplin had EUR 364.3m of revenues in 2013 or down 26% YoY due to adverse economic environment and acceleration in competition pressure (spearheaded by Gen-I, partially owned by Petrol). Reported net income is at EUR 12.1m, also down 13% YoY. The stake is valued at EUR 96.5m Petrol Group books (end 2013). This implies valuation of P/S 0.83, P/E 24.9, which is high but not excessive.

- **Solid dividend yield:** In the last few years shareholders were demanding in terms of dividend payments. In 2012, 2013 and 2014 Petrol paid out dividend of EUR 8.25, 10 and 10.1 per share. Dividend yield therefore varied between 3.6% to 5.0%. Given strong and stabile cash flow from core business, limited CAPEX, management plans for profit growth and good enough balance sheet condition (debt should remain at current levels) we believe dividend yield should remain solid in the



following years.

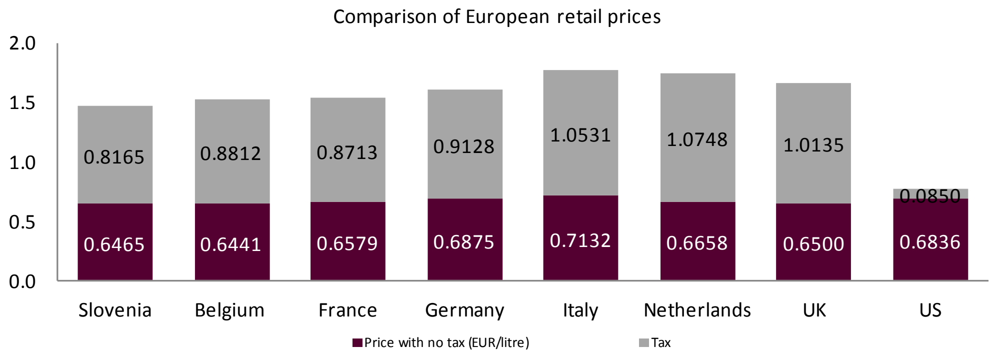
- **Liberalization of markets:** Domestic market (accounting for 57% of volume) has government regulated prices which puts pressure on margins. Liberalization of oil markets, which is believed to be inevitable in the long run (as all EU markets are liberated and Croatia also opened the market just after joining EU) could prove to be a potential upside to the profitability of Petrol since its fixed retail margins are still lagging behind peers. A study made for Petrol estimated that fixed margins on diesel, gasoline and fuel oil amount only to 63%, 81% and 53% of the average European margin respectively (source: Petrol semi-annual report). We note these margins have barely changed since October 2006 (once by 0.9% and in 2011 by 2%) while taxes now encompass 56% of total Motor fuel 95 price.

Our sensitivity analysis shows that the most important element affecting Petrol Group value is this fixed retail margin. Petrol's calculated average fixed margin and its effect on profit can be observed from the table below (2014 estimate).

	Motor fuel	Diesel	Heating oil
Margin (EUR/L)	0.0853	0.07998	0.05265
Share	20.0%	61.0%	19.0%
Sales in m tone	0.30	0.92	0.29
Sales in m litres	401.6	1,094.5	340.9
Portion	21.9%	59.6%	18.6%
Margin calculation	0.01865	0.04765	0.00977
Average margin (EUR/L)			

in EURm	Motor fuel	Diesel	Heating oil
Calculated gross profit	34.3	87.5	17.9
Total gross profit			139.8
after 17% tax			111.8

Marketing margins in the EU show considerable variability between countries and through time. Here we have to point out that most countries do not have such a strict regulation of oil retailing as Slovenia (where margins are fixed at an absolute amount), which means that European margins vary by location and intensity of competition.



An increase in the fixed margins would have an overwhelming effect on Petrol's profitability since the company has no additional costs associated with the increase and therefore the entire after tax amount could be transferred to net income, cash flow and the target price. Here we note that in 2011 fixed margin increased by 2%, giving Petrol Group around EUR 3.5m of after tax profit increase while increasing oil price by only a marginal 0.1 cent. The following table shows the sensitivity of gross and net income to different levels of fixed marketing margins.

Increase	Margin	% European	Gross profit	after tax	Target price
1.0%	0.07683	65.6%	1.4	1.2	351
2.0%	0.07759	66.3%	2.8	2.3	358
3.0%	0.07835	66.9%	4.2	3.5	366
4.0%	0.07911	67.6%	5.6	4.6	373
5.0%	0.07987	68.2%	7.0	5.8	381
10.0%	0.08368	71.5%	14.0	11.6	419
15.0%	0.08748	74.7%	21.0	17.4	456
20.0%	0.09129	78.0%	28.0	23.2	494
25.0%	0.09509	81.2%	34.9	29.0	532

Incremental target price calculation is based on additional free cash flow generated from the increase in margins. Our base case DCF scenario which assumes a 1.0% terminal growth rate and a WACC of 7.0% implies a target price of 343 EUR.

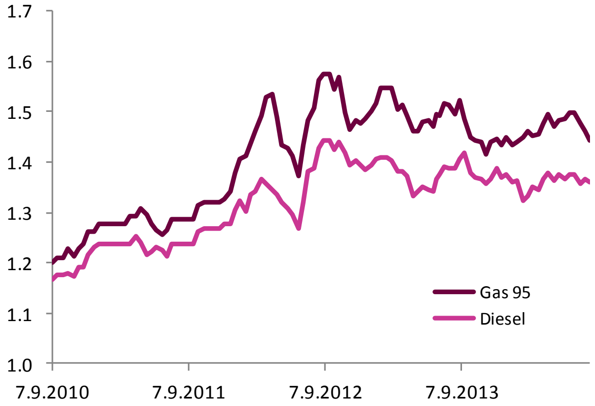
- **Lowering interest expense:** With EUR 772.5m of debt (roughly EUR 600m target debt; current level is distorted by recent bond issue) interest rate for it is having a big impact on profitability. International Bond for nominal value of EUR 265m was issued at 3.4% yield (3.25% coupon rate) in June 2014. This is significantly lower than previous (domestic) bond issues: EUR 50.0m (2009-2014) with 7.57% coupon rate, EUR 33.0m (2011-2016) with 6.75% coupon rate and EUR 30.2m (2012-2017) with 6.0% coupon rate. We believe loan interest rate have similar dynamic while additionally Petrol Group has prudently lowered its dependence on banks with recent bond issue. Effective tax rate, which increased from 3.4% in 2010 to 5.1% in 2012 has started to lower back toward 3.5%. Given EUR 600m of debt the impact (before tax) would be positive in the amount EUR 9.6m, definitely not a negligible amount. This could be a reason why profit growth is seen higher by management than EBITDA growth.

Risks:

- **Weak macroeconomic situation:** IMAD (institute of Macroeconomic Analysis and Development) forecast GDP will expand by only 0.5% in 2014 after 1.1% contraction in 2013. In addition unemployment (registered) will most likely continue to be elevated at 13.6% in 2014, with estimation that personal consumption will fall in 2014 by 0.4% after falling 2.7% in 2013 and 2.9% in 2012. Similarly other institutions predict Slovenian economy to expand by roughly 0.5%. For Croatia (second most important market) estimates are even worse, like recent IMF estimates that GDP will contract from 0.5% to 1.0%. This is not encouraging and will adversely impact Petrol Group on several levels. Firstly sales growth rates are definitely burdened by weak macroeconomic situation, especially for merchandize sales and transit oil product sales. This risk materialized in 2013 especially regarding merchandize sales. Increase in VAT rate from 1.7.2013 definitely did not help. Secondly, the payment discipline is weakened and can impact impairments of receivables from wholesale segment. On 30.06.2014 Petrol Group had EUR 27.9m of receivables up to 30 days overdue (trade balance after allowances), EUR 13.2m of receivables overdue from 31 to 90 days (+EUR 2.3m from 2013 yearend) and EUR 19.6m of receivables more than 90 days overdue. In 1H14 Petrol Group booked EUR 3.7m of allowances with EUR 0.8 being reversed.

- **Only an oil retailer and current environment:** Petrol does not have a refining or E&P segment and is therefore a pure oil retailer without a strategic partner in the form of an integrated oil company. This oil segment has low but relatively stable margins. In recent years retailers in mature markets have been containing costs and lowering gasoline prices as consumers have become more price sensitive (hypermarket retailers and "pay-at-the pump" retailers). A similar trend has been present in Slovenia with Mercator, the largest Slovenian retailer, entering oil retailing a couple of years ago. Petrol has been successfully defying this trend (while Mercator has not been able to get traction in the segment), but pressures will probably increase in the following years. Here we must note the current environment of low or negative GDP growth on one hand and high oil prices on the other is not in favour that this trend of price sensitivity would abate.

- **Transit sales risk and high price of gasoline:** In the past, Petrol proved it can capitalize on volume and revenues because of transit through Slovenia (tourism, logistics etc.). The global downturn reduced the level of transit sales and low levels of transit can be particularly troubling for Petrol, as they affect fuel sales as well as sales of supplemental and other merchandise, two important drivers of revenue. Until the economy picks up, transit sales will be subdued. Here Slovenian excise tax policy is crucial and can hurt or help Petrol. Namely tax represents 56% of gasoline 95 and 49% of diesel retail price. In 2013 prices in Slovenia were higher than Austria, Croatia and Hungary, while lower than in Italy. The environment is therefore predominantly negative for transit sales and this continued in 2014. Additionally high prices of gasoline and diesel are actually negative for Petrol, not only in terms of higher need for NWC financing but also due to credit card fees as Petrol has fixed per litre margins. The higher the



overall billing amount erodes Petrol's margins. Therefore the environment of high oil prices is actually negative for bottom line. Current pricing environment is therefore not beneficial.

in EUR / litre	95	Diesel
Italy	1.811	1.673
Slovenia	**1.463**	**1.365**
Austria	1.619	1.599
Montenegro	1.370	1.270
Croatia	1.419	1.348
Hungary	1.316	1.335
BiH	1.202	1.227

Source: AMZS

- **Expansion in SE and Energy segments can be risky:** Petrol has avoided rushing into SE European markets a decade ago and missed the first mover's advantage. Namely large players have in that time progressed into SE Europe. Petrol's growth is therefore mostly limited to acquisitions which can be difficult or expensive to execute given the high level of governmental intervention and saturation of these markets. Firstly, acquisitions of service stations in these markets may be costly, so investors have to be careful that expanding retail network does not come at the expense of profitability which go hand in hand with impairments. Here we will have to watch acquisition cost for filling stations or construction costs, although so far Petrol proved to be slow and prudent in expansion in the last few years. Secondly, M&A activity already significantly increased goodwill (to EUR 106.8m; although related to other energy segment as well), which could be impaired if valuation assumptions deteriorate. Thirdly, complications are likely, as political /regulatory interference is likely. A nice example is Montenegro Bonus, where Montenegrin government withdrew from the contract with Petrol so plans for significant market share in Montenegro were hampered.

  As for other energy segments, there could be more competition in the future, affecting margins. Foreign competition can gain foothold on the Slovenian market. Local player Gen-I (partially owned by Petrol) was price aggressive in the last years in order to expand market share. Weaker 1H14 margins could be a consequence of pricing wars. On the other hand Energy segment is regulated and demanding in terms of CAPEX. So expansion here is always riskier compared to main business of oil retail and acquisitions can fail.

  Also we must note that since Slovenian state often sees energy infrastructure as strategic (and not available for privatization) Petrol Group ownership of these assets lowers the possibility for Petrol privatization (and speculative price surges).

- **Elevated debt level:** We do not see Petrol's debt as a big concern (EUR 772.5m with EUR 170.6m of debt = EUR 601.9m) since core business is stabile and provides a strong cash flow. Also debt level is mostly associated with previous managements bad decisions while current management is inclined to lower the debt ratios through stabile growth of EBITDA and not lowering the absolute amount of debt. Nevertheless a big chunk of this debt is in our belief unproductive. Firstly Geoplin investment is effective stuck with Petrol owning a third and state being a majority owner. On one side this investment is providing a cash flow in form of dividends, however interest on debt has to be paid as well. Effectively EUR 96.5m on Petrol Group balance sheet does not provide an add-on. Secondly roughly EUR 170m of debt is associated with Istrabenz story – again providing no cash flow as the stake was sold (for undisclosed and possible negligible amount). Therefore while we believe net debt of 3.2 (including all investments) is unproblematic from the level perspective, the reasoning behind it is.

1H14 Results and Recent news

Gross profit stabile with profit only slightly down... however we expected better results.

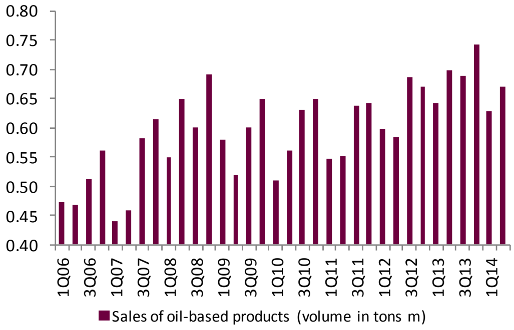
million €	1H13	1H14	YoY	2Q13	1Q14	2Q14	QoQ	YoY
Sales	1,896.6	1,883.8	**-0.7%**	949.6	919.4	964.4	**4.9%**	**1.6%**
EBITDA	59.1	58.7	**-0.7%**	28.7	29.5	29.2	**-0.8%**	**2.0%**
Margin	3.1%	3.1%		3.0%	3.2%	3.0%		
EBIT	38.9	36.9	**-5.1%**	18.5	18.6	18.3	**-1.4%**	**-1.2%**
Margin	2.0%	2.0%		2.0%	2.0%	1.9%		
Net income	24.5	24.1	**-1.5%**	12.0	13.1	11.0	**-16.0%**	**-8.1%**
Margin	1.3%	1.3%		1.3%	1.4%	1.1%		

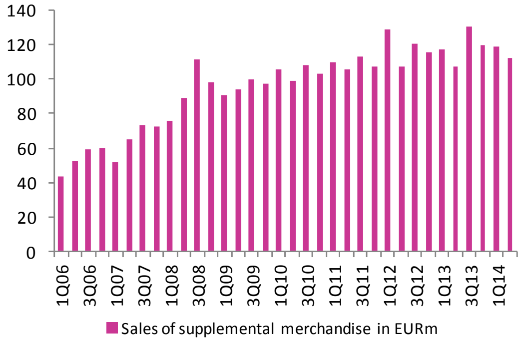
Petroleum sales volume is down 3.2%...

- Sales volume of petroleum products decreased by 3.2% YoY to 1.296m tonnes. This represents a deterioration versus 1Q14 when volume sales decreased by 2.2% YoY. This is a consequence of persisting adverse economic environment on key markets: Slovenia and Croatia.
- Volume wise Slovenia is accounting for 57% of total volume (734.8 thousand tonnes), SEE 26% and EU 17%. In Slovenia Group recorded a 7% YoY decreased in volume, with 3% decrease for motor fuels and a slump of 32% for extra light heating oil (due to mild winter and energy substitution). On EU markets volume of petroleum products sold is down by 5% YoY to 228.4 thousand tons, however we must note Petrol Group was very successful on these markets during 2013 and stated back then that the growth will be hard to sustain. In SEE markets volume increased by 8% YoY to 333.0 thousand tons.
- Additionally management commented results were hampered by severe floods in BiH and Serbia and glaze ice in Slovenia.

...with merchandise sales up by 2.9% YoY.

- Merchandise sales revenues are up 2.9% YoY in 1H14 and down 5.6% QoQ. In Slovenia merchandise sales in up 2% YoY to EUR 205.3m while in SEE markets sales are up by 18% to EUR 20.4m. We note SEE markets are underpenetrated regarding this segment and higher growth rate is a logical consequence.





Therefore gross profit stagnated.

Oil-based products sales and supplemental merchandise sales growth (YoY)

Net income is down only 1.5%, but still a disappointment.

- Sales revenues are down by only 0.7% YoY but this item is relatively unimportant for the profitability of the group. In Slovenia net sales revenues from oil and merchandise sales is down 6% YoY with volume down by 7% YoY. On EU market revenue slump is higher, namely 11% YoY. In SEE markets revenues were up by 8% and somewhat compensated the decrease in other markets regarding petroleum segment.
- In Energy segment net sales revenues amounted to EUR 238.5m in 1H14, which represents a 13% YoY increase. Petrol Group sold 3.7 TWh of electricity (+66%), 39.4 thousand MWh of heat (-4% YoY), 31.3 thousand tons of LPG (-5%) and 62.8m m^3 of natural gas (-14%).

Segmental margin in energy segment is the biggest disappointment.

- Gross profit remained stabile at EUR 157.7m.
- Operating expenses grew by 2.9% YoY negatively affecting margins. The biggest contributors were labour costs which increased by 7.8% YoY to EUR 31.8m and D&A, which increased by 7.7% YoY to EUR 21.8m. Cost of services also increased by 2.4% YoY to EUR 55.3m (like lease payments) which could not be offset by 10% lower cost of materials (EUR 13.8m; mostly lower energy expense) and lower other costs. We note headcount is at 3,914, down by 31 versus the beginning of the year but up by 96 versus the end of 2012 and 18 versus end of 1H13.

- Operating profit decreased by 5.1% to EUR 36.9m. Additionally share of profit from equity accounted investments is also down 7% to EUR 4.8m. EBIT is below our expectations. We should note higher opex was partially balanced out by EUR 1.4m of higher other revenues (reversal of accrued litigation expenses and gain on disposal of fixed assets being the biggest culprit).
- EBITDA amounted to EUR 58.7m, down 0.7% YoY and up 2.0% in 2Q14.
- Net financing expense improved by roughly EUR 1.5m as financial income (in absolute amount) fell less than financial expenses (interest expense is roughly similar YoY at EUR 14.4m). Main benefactor was FX differences. Additionally Group recorded lower effective tax rate (12.0% versus 13.2%).
- All in all net profit attributable to the controlling company amounted to EUR 24.1m, which is down only 1.4% YoY. Net profit is therefore below our expectations of EUR 31.9m or by EUR 7.8m.
- Segment wise we should especially note that while energy segment was strong in terms of top-line growth (in absolute and relative terms), margins plummeted in energy segment and not oil based segment. This was the main culprit for our estimate miss (EUR 5.1m).

Oil based segment:	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14
Sales	818.8	803.2	943.1	894.9	835.7	875.9	915.9	917.4	793.7	851.6
Net profit	7.6	3.2	23.5	1.7	6.1	10.9	16.0	3.0	9.3	10.2
Asset	1235.6	1188.9	1275.2	1240.6	1251.8	1254.7	1170.3	1258.7	1157.8	1313.6
ROA	0.6%	0.3%	1.8%	0.1%	0.5%	0.9%	1.4%	0.2%	0.8%	0.8%
Margin	0.9%	0.4%	2.5%	0.2%	0.7%	1.2%	1.7%	0.3%	1.2%	1.2%
Energy segment:	**1Q12**	**2Q12**	**3Q12**	**4Q12**	**1Q13**	**2Q13**	**3Q13**	**4Q13**	**1Q14**	**2Q14**
Sales	84.4	61.5	66.7	112.9	111.3	73.6	100.8	116.7	125.6	112.8
Net profit	5.3	6.8	-4.6	10.4	6.3	1.1	4.0	5.5	3.7	0.8
Asset	325.6	321.0	314.4	330.9	353.6	348.1	348.2	362.7	373.4	389.0
ROA	1.6%	2.1%	-1.4%	3.1%	1.8%	0.3%	1.1%	1.5%	1.0%	0.2%
Margin	6.3%	11.0%	-6.8%	9.2%	5.6%	1.6%	3.9%	4.7%	2.9%	0.7%

- CAPEX amounted to EUR 27.2m, down 43% YoY. 10% was allocated to Oil and Merchandise segment on the domestic Slovenian market, 54% on the Oil and Merchandise segment for SEE, 29% for energy operations and 7% for upgrading IT and other infrastructure.
- Cash flow from operating activities was negative in the amount of EUR 11.5m and deteriorated severely versus 1H13 when the Group reported EUR 61.9m of positive cash flow. This is a consequence of negative contribution from other liabilities (trade liabilities).
- Intangibles are at EUR 141.7m with equity at EUR 473.2m (stabile versus 31.12.2014).

Bond issuance a major step in financing structure.

- Financial debt surged by EUR 172m against the beginning of the year but this is due bond issue of EUR 265m in June. Bond issue is meant for refinancing activity (lower interest rate; which we deem positive) and ended up in excess cash position (EUR 170.6m). During the year we expect this to balance out and that end debt level will be again around EUR 600m. With all investments (LT and ST) at EUR 199m net debt amounts to EUR 393 (including investments) or EUR 602m (including only cash item).
- Inventory is at EUR 131.9m, receivables at EUR 338.3m and payables at 423.5m. All in all NWC is roughly similar to end year 2013 position with exception of lower operating liabilities. This impacted cash flow position.

Relative valuation:

Peer analysis is problematic due to lack of comparable companies.

	EV/S			EV/EBITDA			EV/EBIT		
Company name	**TTM**	**2014F**	**2015F**	**TTM**	**2014F**	**2015F**	**TTM**	**2014F**	**2015F**
Hellenic Petroleum	0.4	0.3	0.3	23.2	6.4	5.9	neg.	10.4	9.1
OMV AG	0.4	0.4	0.4	3.4	2.6	2.4	8.5	4.4	4.0
Petrol Ofisi	0.2	n.a.	n.a.	10.6	n.a.	n.a.	22.4	n.a.	n.a.
OMV Petrom	1.4	1.3	1.2	3.7	3.9	3.7	6.6	6.5	6.1
Casey's General Stores	0.4	0.4	0.3	9.3	7.9	7.3	14.2	11.7	n.a.
The Pantry	0.2	0.2	0.2	7.0	6.2	5.6	16.5	12.1	10.8
Unipetrol	0.3	0.2	n.a.	7.3	6.8	8.7	20.2	19.1	34.3
PKN Orlen	0.2	0.2	0.2	8.7	5.7	5.2	41.5	11.9	10.4
Alimentation Couche-Tard	0.5	0.5	0.5	12.4	10.3	9.8	19.4	15.8	16.3
Petrol	0.3	0.3	0.2	7.8	8.4	8.1	11.4	13.0	13.1
Average	0.4	0.4	0.4	9.5	6.2	6.1	18.7	11.5	13.0

Trades at discount on P/E and at premium on EV/EBITDA.

	P/S			P/E			P/B		
Company name	**TTM**	**2014F**	**2015F**	**TTM**	**2014F**	**2015F**	**TTM**	**2014F**	**2015F**
Hellenic Petroleum	0.2	0.2	0.2	neg.	11.4	9.7	0.8	0.8	0.7
OMV AG	0.2	0.2	0.2	16.6	7.4	6.7	0.8	0.7	0.7
Petrol Ofisi	0.1	n.a.	n.a.	63.7	n.a.	n.a.	1.2	n.a.	n.a.
OMV Petrom	1.2	1.0	1.0	7.1	6.5	6.4	1.0	0.9	0.8
Casey's General Stores	0.4	0.3	0.3	20.5	17.8	16.5	3.8	3.0	n.a.
The Pantry	0.1	0.1	0.1	neg.	27.1	19.4	1.5	1.4	n.a.
Unipetrol	0.2	0.2	n.a.	neg.	22.6	41.7	n.a.	0.7	0.8
PKN Orlen	0.2	0.2	0.2	neg.	11.7	10.1	0.8	0.7	0.7
Alimentation Couche-Tard	0.4	0.4	0.4	9.5	16.9	15.6	4.3	3.0	2.7
Petrol	0.2	0.2	0.1	11.7	12.1	11.5	1.3	1.2	1.1
Average	0.3	0.3	0.3	23.5	15.2	15.8	1.8	1.4	1.1

Company name	**EBITDA margin TTM**	**EBIT margin (%)**	**Profit margin (%)**	**ROE TTM**	**ROA TTM**	**Assets turnover**	**Div. yield (%)**	**Assets/ Equity**	**Net debt to EBITDA**
Hellenic Petroleum	1.5%	-0.6%	-2.0%	-9.1%	-2.5%	1.25	0.00	3.71	11.40
OMV AG	10.4%	4.2%	1.5%	4.9%	1.8%	1.23	4.22	2.78	1.11
Petrol Ofisi	2.3%	1.1%	0.1%	1.9%	0.4%	3.19	0.00	4.50	6.89
OMV Petrom	38.7%	21.8%	16.4%	14.5%	9.4%	0.57	6.42	1.54	0.71
Casey's General Stores	4.8%	3.1%	1.7%	18.7%	5.9%	3.42	0.75	3.19	1.94
The Pantry	2.6%	1.1%	0.0%	-0.2%	0.0%	4.46	0.00	5.28	4.46
Unipetrol	3.5%	1.3%	-3.0%	n.a.	-6.4%	2.13	0.00	2.02	1.46
PKN Orlen	2.4%	0.5%	-4.4%	-23.7%	-9.7%	2.19	3.60	2.44	2.34
Alimentation Couche-Tard	4.1%	2.6%	2.1%	45.2%	7.7%	3.60	0.41	2.66	1.36
Petrol	3.4%	2.3%	1.3%	11.1%	3.1%	2.31	3.43	3.60	3.22
Average	7.8%	3.9%	1.4%	6.5%	0.7%	2.45	2.85	3.12	3.52

ROE decomposition (company/peer average):

Higher profitability when excluding Petrom.

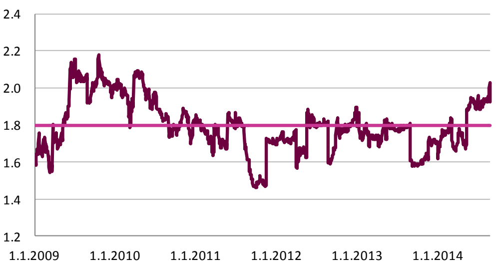
EBITDA margin	3.4%	4.0%
EBIT/EBITDA	68.1%	42.0%
NI/EBIT	57.1%	-30.1%
Profit margin	1.3%	-0.5%
Sales to assets	2.31	2.68
Assets to Equity	3.60	3.32
ROA	3.1%	-0.4%
ROE	**11.1%**	**5.4%**

Peer valuation points to a target price of EUR 310.

Relative valuation points out that Petrol is only slightly undervalued, as relative valuation points to a target price of EUR 310 per share. Among the companies used as peers there is limited comparability to Casey's General, Pantry and ACT because these are North American peers exposed to different pricing mechanisms and regulatory environment. On the other hand these companies are pure oil retailers. Other European oil companies are more comparable in terms of operating environment but are mostly integrated players with distribution networks in liberalized markets. Because these companies have higher margins, Sales multiples have been excluded.

EV/EBITDA

EV/ filling station in EURm



Considering the share of revenues that is contributed by Petrol's filling stations through the sale of oil-based products and supplemental and other merchandise (90%), we can make an approximation of the average value of Petrol's filling station. EV per filling station (479 gas stations) amounts to EUR 2.01m. This confirms peer valuation that at best only mild upside can be found, considering low retail margins in Slovenia and very high utilization for other merchandise.

Management strategy remains ambitious with a 4% CAGR for EBITDA and 9% CAGR for net income.

Our 2014 assumptions were in-line with management guidance…

… but now lowered.

Both don't assume a liberalization of oil market in Slovenia.

Outlook:

- Ambitious management 2013 to 2018 strategic plan envisions the growth of revenues to EUR 4.4bln till 2018, with average yearly growth rate of 2.2%. Oil sales volume should increase at yearly average rate of 1.6% to 3.0m tonnes. EBITDA margin is planned to expand as it should amount to EUR 174m by 2018 with average yearly growth rate of 5.2%. Due to this fact net income should be at EUR 94m by 2018 (CAGR +12%). CAPEX is in the same time frame planned at EUR 308m.
- Revenue guidance for 2014 was at EUR 3.94 bln with 2.7m tons of petroleum products, 125 million m3 of natural gas, 75 thousand tons of LPG and 7.51 TWh of electricity. Additionally they saw merchandise sales of EUR 505.5m. EBITDA was guided at EUR 138.2m (+5.5%) while net income at EUR 65.0m (+12.0%). CAPEX was planned at EUR 75m.
- Management guidance was not changed in interim report, however Slovenian companies rarely change their plans during the year. We believe 1H14 weakness will be hard to completely recoup during 2H14 and earnings miss is becoming ever more possible. As our estimates were roughly similar to managements in our previous report, we have lowered them slightly in terms of margins (energy and merchandise revenues are in-line with expectations). Our new estimates for EBITDA and net income are EUR 125.3m and EUR 50.8m with lower volume target (domestic and EU markets) and lower energy gross margins as the main culprits for downward adjustment in 2014.
- For 2015 and beyond we made little adjustment versus previous report (exception is energy segment margin) as we still believe better domestic consumption and cost optimization measures will accelerate growth. Additionally recent bond issue is in line with thesis that interest expense will lighten severely through refinancing (previously outstanding bonds had significantly higher coupon attached), benefiting net income growth. We should nevertheless note our 2018 targets are conservatively lower than envisioned by management strategy.
- Our DCF calculation is for now calculated without assuming an increase in oil retail margins.
- CAPEX in the period 2014 to 2018 is at EUR 310m, while NWC ratios are steady and stabile.

Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Sales	2,333.9	2,802.8	3,270.4	3,754.0	3,947.3	3,884.1	4,194.7	4,209.3	4,362.9	4,413.2
Sales growth		20.1%	16.7%	14.8%	5.1%	-1.6%	8.0%	0.3%	3.6%	1.2%
EBITDA	84.9	97.4	117.3	124.6	135.2	125.3	129.5	142.5	152.7	165.9
EBITDA margin	3.6%	3.5%	3.6%	3.3%	3.4%	3.2%	3.1%	3.4%	3.5%	3.8%
EBIT	50.8	63.0	81.0	84.9	93.8	80.6	80.0	91.3	100.2	112.3
EBIT margin	2.2%	2.2%	2.5%	2.3%	2.4%	2.1%	1.9%	2.2%	2.3%	2.5%
EBT	14.4	44.9	54.7	68.0	63.4	59.0	64.5	77.0	87.5	101.6
EBT margin	0.6%	1.6%	1.7%	1.8%	1.6%	1.5%	1.5%	1.8%	2.0%	2.3%
Net income	10.4	32.9	51.5	53.3	52.8	50.8	53.5	63.9	72.7	84.4
Net income growth		215.6%	56.4%	3.6%	-1.0%	-3.8%	5.5%	19.4%	13.6%	16.1%

Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Fixed assets	790.4	804.3	983.2	990.4	992.5	1,030.7	1,055.7	1,071.6	1,079.9	1,087.2
PPE	554.8	516.7	601.7	613.8	618.6	649.7	668.3	678.5	681.2	682.9
Intangible assets	22.5	80.0	176.6	180.7	176.3	178.5	179.8	180.4	180.6	180.7
LT-investments	167.2	161.6	158.5	160.0	162.5	167.4	172.4	177.6	182.9	188.4
Other fixed assets	46.0	46.0	46.4	35.8	35.1	35.1	35.1	35.1	35.1	35.1
Current assets	345.1	461.2	553.8	581.1	627.8	618.3	665.5	667.8	691.2	698.9
Inventories	82.0	108.4	100.6	159.7	152.4	149.9	161.9	162.5	168.4	170.4
Trade receivables	248.5	313.1	368.6	352.8	377.9	371.9	401.6	403.0	417.7	422.5
Cash	7.8	17.5	60.7	37.6	69.7	68.6	74.1	74.4	77.1	78.0
ST-investments	3.1	3.8	17.1	4.8	1.6	1.6	1.7	1.7	1.8	1.8
Other current assets	3.7	18.3	6.8	26.2	26.2	26.2	26.2	26.2	26.2	26.2
Total Assets	1,135.5	1,265.5	1,537.0	1,571.5	1,620.3	1,649.0	1,721.2	1,739.4	1,771.0	1,786.1
Debt	498.7	492.1	611.6	633.6	600.3	606.3	600.3	570.3	530.3	479.3
ST-debt	262.1	173.2	238.3	203.9	243.2	245.6	243.2	231.0	214.8	194.2
LT-debt	236.6	318.8	373.3	429.7	357.2	360.7	357.2	339.3	315.5	285.2
Provisions	30.0	6.6	7.0	7.2	8.4	8.4	8.4	8.4	8.4	8.4
Trade payables	218.1	329.8	433.7	465.9	509.8	501.6	541.7	543.6	563.5	570.0
Other liabilities	7.2	32.4	42.9	31.1	34.2	35.5	36.4	36.9	37.2	37.4
Minority intrest	31.3	34.5	30.8	-1.9	-1.9	-2.0	-2.2	-2.4	-2.6	-2.8
Equity	350.2	370.1	410.8	435.5	469.6	499.5	536.3	582.5	634.1	694.5

Year	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Net profit margin	0.4%	1.2%	1.6%	1.4%	1.3%	1.3%	1.3%	1.5%	1.7%	1.9%
Asset turnover	2.06	2.21	2.13	2.39	2.44	2.36	2.44	2.42	2.46	2.47
ROA	0.9%	2.6%	3.3%	3.4%	3.3%	3.1%	3.1%	3.7%	4.1%	4.7%
Equity multiplier	3.24	3.42	3.74	3.61	3.45	3.30	3.21	2.99	2.79	2.57
ROE	3.0%	8.9%	12.5%	12.2%	11.2%	10.2%	10.0%	11.0%	11.5%	12.1%
CAPEX/Depreciation	130.5%	191.3%	226.6%	295.0%	208.2%	169.6%	137.6%	119.8%	105.2%	103.2%
Financial debt/Equity	1.42	1.33	1.49	1.45	1.28	1.21	1.12	0.98	0.84	0.69
Financial debt/Assets	0.44	0.39	0.40	0.40	0.37	0.37	0.35	0.33	0.30	0.27
Net debt/EBITDA	3.77	3.17	3.20	3.46	2.71	2.99	2.67	2.01	1.50	0.97
Working capital/ Sales	5.2%	3.9%	2.9%	2.2%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%
ROIC	5.8%	5.5%	7.4%	6.3%	7.3%	6.3%	5.9%	6.6%	7.2%	8.0%

Discounted Cash Flow Valuation:

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	TV
NOPLAT	69.4	66.4	75.8	83.2	93.2	85.0	85.4	86.5	87.4	88.3	78.4
NOPLAT growth	-11.2%	-4.3%	14.1%	9.8%	12.1%	-8.9%	0.6%	1.2%	1.1%	1.0%	-11.3%
Depreciation	44.7	49.6	51.2	52.5	53.5	53.7	53.9	54.3	54.7	55.2	55.5
Depretiation/Sales	1.1%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%	1.2%
CAPEX	75.8	68.2	61.4	55.2	55.2	56.9	58.6	60.4	62.2	64.0	56.0
CAPEX/Sales	2.0%	1.6%	1.5%	1.3%	1.3%	1.3%	1.3%	1.3%	1.4%	1.4%	1.2%
Change in net working capital	-1.4	7.1	0.3	3.5	1.2	1.0	1.0	1.0	1.0	1.1	1.1
NWC/Sales	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%	2.3%
FCF to firm	**39.7**	**40.6**	**65.3**	**76.9**	**90.4**	**80.7**	**79.7**	**79.3**	**78.9**	**78.4**	**76.8**

FCF valuation	
Value in forecasting period	465
Continuing value	637
Total enterprise value	**1,102**
Net debt	385
Equity value	**717**
No. of shares (in mio)	2
Equity value per share	**343**

WACC	2014	TV
Tax rate	14.0%	17.0%
Cost of debt	3.5%	3.5%
Beta	1.4	1.1
Cost of equity	12.5%	8.5%
Debt/Equity	91.4%	37.0%
WACC	**8.0%**	**7.0%**
Perpetuity growth rate		**1.0%**

DCF valuation target set at EUR 343.

DCF valuation indicates a target price of EUR 343 or slightly down versus previous report. 2014 earnings estimates downgrade and lower envisaged other energy gross margins provided the reason for a downward move, but this was partially offset by lowered WACC. Terminal growth rate is set at 1.0%, WACC at 7.0%. Implied EV/EBITDA is at 8.5.

Sensitivity analysis:

		Sales growth 2019-2023						
		-0.5%	0.0%	0.5%	1.0%	1.5%	2.0%	2.5%
EBITDA margin 2019-2023	2.9%	326.2	322.5	318.1	313.0	307.1	300.3	292.7
	3.1%	335.9	332.4	328.1	323.2	317.4	310.8	303.3
	3.3%	345.6	342.2	338.1	333.3	327.7	321.2	313.9
	3.5%	355.3	352.1	348.1	343.4	338.0	331.6	324.5
	3.7%	365.0	361.9	358.1	353.6	348.3	342.1	335.0
	3.9%	374.7	371.8	368.1	363.7	358.5	352.5	345.6
	4.1%	384.4	381.6	378.1	373.9	368.8	363.0	356.2

		Perpetuity Growth						
		0.1%	0.4%	0.7%	1.0%	1.3%	1.6%	1.9%
Perpetuity EBITDA margin	2.6%	222.9	231.3	240.5	250.6	261.8	274.2	288.1
	2.8%	249.8	259.4	270.0	281.6	294.4	308.6	324.5
	3.0%	276.7	287.6	299.4	312.5	326.9	343.0	360.9
	3.2%	303.6	315.7	328.9	343.4	359.5	377.4	397.3
	3.4%	330.5	343.8	358.4	374.4	392.1	411.7	433.7
	3.6%	357.4	371.9	387.8	405.3	424.6	446.1	470.1
	3.8%	384.3	400.1	417.3	436.3	457.2	480.5	506.5

		Perpetuity Growth						
		0.1%	0.4%	0.7%	1.0%	1.3%	1.6%	1.9%
WACC	5.5%	376.7	396.8	419.5	445.2	474.5	508.4	547.9
	6.0%	348.0	364.8	383.5	404.5	428.1	455.0	485.8
	6.5%	323.8	338.0	353.8	371.2	390.6	412.5	437.1
	7.0%	303.1	315.3	328.7	343.4	359.7	377.8	398.0
	7.5%	285.2	295.8	307.3	320.0	333.8	349.0	365.9
	8.0%	269.5	278.8	288.9	299.8	311.7	324.7	339.0
	8.5%	255.8	264.0	272.8	282.4	292.7	304.0	316.2

Final target price calculation:

Target price set at EUR 338.

Our final target price of EUR 338 is unchanged versus previous report and based on equal weighted methods: relative valuation, a DCF valuation and a scenario predicting a 15% increase in fixed margins in 2017-2018 applied to DCF valuation (therefore effectively built-in probability of this scenario is at 33%). Our target price implies a value of EUR 1.50m per filling station of Petrol or EV of EUR 2.14m per station (10% of Mcap and EV included; other tied to other energy segment). Our target price also implies EV/EBITDA of 8.5 and P/E 13.5 based on TTM results.

Here we note OMV sold its retain operation in Croatia for EUR 100m or EUR 1.59m per filling station. As for Alimentation Couche-Tard acquisition of Statoil Fuel & Retail transaction multiples were: EV/EBITDA 6.9 and P/E 14.7 with EUR 0.94m per station (68% of 2,305 stations company owned). Given this data we find it supportive of our target price, especially since fixed retail margins are trailing European average and can quickly boost Petrol Group bottom line – unfortunately this is in government hands and we do not see any signs for a new coalition to lift margins. Additionally we doubt it will be privatized, although some big investors (banks, Istrabenz etc.) will sooner or later dispose their stake. Therefore a shareholder shift is looming.

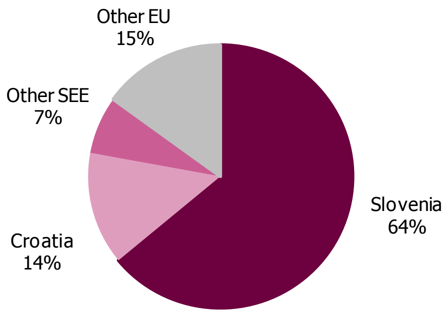
Top5 shareholders:	
SDH	19.8%
KAD	8.3%
NLB d.d.	6.1%
Istrabenz d.d.	4.1%
GB d.d.	4.0%

Brief Company profile

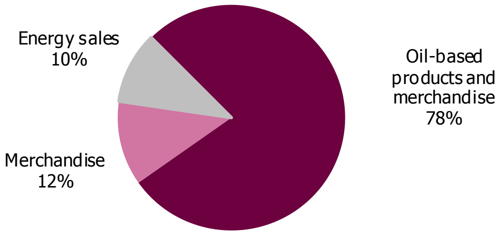
Petrol, the leading Slovenian energy company, is the principal supplier of oil and other energy products for the Slovenian market. Through an extensive network of filling stations, Petrol supplies road users with a broad range of automotive goods and services with a wide selection of household and food products, cigarettes, lottery tickets and other merchandise. The Group is also entering energy related businesses, particularly the sale of gas, heat, electricity and renewable energy sources.

Petrol had a total of 479 filling stations on 30.6.2014 of which 318 are located in Slovenia. The 161 filling stations located abroad are situated in Croatia (99), Bosnia and Herzegovina (37), Serbia (8), Montenegro (9) and Kosovo (8).

Group sales by region (2013)



Group sales by segment (2013)



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Hold	16	25%	2%
Sell	15	23%	12%

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Sašo Stanovnik, Head of research. On the day of the public release, the author of the recommendation held securities of the relevant issuer.

First release of the recommendation was performed on 13.04.2010.
Quarterly updates are planned for data, valuation, target price and recommendation.

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