

18 January 2024

Price (p)	483.20
Shares in issue (m)	385
Mkt Cap (£m)	1,859
Net debt (£m)	1,356
EV (£m)	3,215
BVPS (p)	328.0

Share price performance

1m	0.9%
3m	13.0%
12m	-25.1%
12 m high/low	695/395
Ave daily vol (30D)	1,094,139

Shareholders

Invesco Ltd	7.7%
Vanguard Group	4.9%
Blackrock Inc	4.9%
Orbis Allan Gray Ltd	4.3%
Schroders Plc	3.9%
Jupiter	3.7%
Dimensional Fund	3.2%
Bank Of America	2.9%
Emirate Abu Dhabi	2.7%
Royal London Asset	2.5%
Total for top 10	40.6%
Free float	99.7%
Source: Bloomberg	18 Jan 24

Next news Finals Q1

Business description

Integrated biomass, hydro and storage IPP



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GOVERNMENT CONSULTS ON BIOMASS

The consultation is out on bridging support for ROC funded biomass units including three units at Drax. Details of the final support package won't be known until after the consultation closes and negotiations take place during 2024, but the very fact that this is being consulted on means support is likely at a level that will deliver a profit to Drax. Even if a final decision runs beyond any election, leaving such a significant amount of low carbon flexible capacity unsupported from 2027 would be a major risk to system security and this is recognised in the consultation paper.

Consultation on Support for ROC Units

The UK Government is consulting on policy support to bridge the period between the end of ROC support for biomass units through to the start of support for Bioenergy with Carbon Capture and Storage (BECCS). The consultation considers four options; a standard unconstrained CfD, a CfD with a collar on energy volumes, an availability payment and a regulated margin delivering a minimum profit. The middle two options and possibly the final could result in lower output levels in order to reduce biomass volumes. However, if this limits the units' ability to provide flexibility services including "constrained on" balancing mechanism running it could be detrimental to energy security so we would expect sensible levels to be set. All options would provide some level of profitability to allow Drax to continue to run the three units out to 2030. The actual level of profitability will be unknown until final arrangements are announced but all are a better outcome than no support.

Support Essential for Maintaining Energy Security

The biomass units at Drax are increasingly critical to delivering security to the GB grid. If Drax closed or mothballed its three ROC units in 2027 this would coincide with the revised closure dates for nuclear plant at Hartlepool and Heysham 1, removing over 4GW of low carbon capacity from the grid. While there is some new build gas generation thanks to the capacity market there is still a net loss of almost 2GW. Additionally, if the units at Heysham 2 and Torness fail to win life extensions the loss rises to over 4GW. This represents "spinning reserve" critical for maintaining system frequency without which connected equipment could be damaged. Eventual conversion to BECCS is key to delivering the UK's legal obligation to a net zero outcome with the technology remaining the only large scale negative emissions technology with near term viability for the UK and indeed globally. Conversion of existing biomass units is recognised in the consultation as the most mature, reliable and cost effective option for delivering BECCS.

£,000 Dec	2021a	2022a	2023e	2024e	2025e	2026e
Sales	5,174	8,159	5,802	6,046	6,075	5,502
EBITDA	370	709	1,158	1,181	1,246	699
PBT	101	405	811	831	922	391
EPS	22.3	85.1	111.5	111.7	174.8	75.3
CFPS	34.7	25.2	64.0	245.3	218.1	118.9
DPS	18.8	21.0	23.1	25.4	27.9	30.7
Net Debt (Cash)	1,170	1,356	1,273	472	-240	-563
Debt/EBITDA	3.2	1.9	1.1	0.4	-0.2	-0.8
P/E	19.9	5.2	4.0	4.0	2.5	5.9
EV/EBITDA	7.8	4.3	2.6	1.8	1.2	1.6
EV/sales	0.6	0.4	0.5	0.5	0.5	0.5
FCF yield	7.8%	5.7%	14.4%	55.3%	49.2%	26.8%
Div yield	4.2%	4.7%	5.2%	5.7%	6.3%	6.9%

FINANCIAL MODEL

FORECAST CHANGES

We have adjusted our forecasts to equate the pricing of the biomass units to be in line with the single CfD unit out to 2030. We have also reflected higher underlying costs in the pellets business offset by better economics in the pumped storage and hydro assets. The biomass unit assumptions clearly only impact FY 27 and beyond.

Key Forecast Changes

	2023 Old	2023 Revised	2024 Old	2024 Revised	2025 Old	2025 Revised
EBITDA	1,158	1,158	1,181	1,066	1,246	1,212
EPS	111.5	115.3	111.7	92.0	174.8	168.6
DPS	23.1	23.1	25.4	25.4	27.9	27.9

Source: Longspur Research

VALUATION IMPACT

We have updated our base case forecast to adjust for our forecast changes and have also increased our WACC from 7.1% to 8.1% reflecting a continued higher interest rate environment and led by recent regulatory costs of capital considerations as summarised by the UK Regulators' Network. Our central case valuation moves to 906p from 1063p as a result of these changes.

Valuation Scenarios

p per share	Incremental	Cumulative
Existing assets	694	755
Pellet expansion – central case	89	844
CCS on two UK units	62	906
Cruachan expansion	77	983
Global BECCS – high case	131	1114

Source: Longspur Research

RISK

The key risks to our valuation are driven by potential policy changes, competition and commodity price risk. Policy risk includes the biomass, BECCS and long duration storage consultations currently underway. We see the signs on these as potentially positive for Drax by creating certainty of income for these activities. Competition always exists but Drax has a strong position both in the UK power market and as a global first mover in BECCS. Commodity price volatility is a big driver of forecasts and there is two-way risk here with positive as well as negative changes possible.

FINANCIAL MODEL

Profit and Loss Account

£,000, Dec	2021a	2022a	2023e	2024e	2025e	2026e
Turnover						
Power Generation	4,682	7,358	4,641	4,541	4,522	3,701
B2B Energy Supply	2,360	4,143	2,816	3,015	3,229	3,458
Pellet production	450	803	691	774	795	781
Central, int gp and depn	-2,318	-4,145	-2,435	-2,496	-2,558	-2,622
Total	5,174	8,159	5,712	5,834	5,988	5,318
Operating profit						
Power Generation	352	679	1,153	1,073	1,217	594
B2B Energy Supply	6	26	55	41	45	49
Pellet production	86	134	101	105	107	100
Central, int gp and depn	-273	-369	-407	-422	-444	-413
Operating profit	170	469	901	797	926	330
P&L Account						
Turnover	5,174	8,159	5,712	5,834	5,988	5,318
Operating Profit	170	469	901	797	926	330
Investment income	0	0	0	0	0	0
Net Interest	-70	-64	-94	-90	-71	-55
Pre Tax Profit (UKSIP)	101	405	808	707	855	274
Goodwill amortisation	0	0	0	0	0	0
Exceptional Items	21	-327	0	0	0	0
Pre Tax Profit (IFRS)	122	78	808	707	855	274
Tax	-12	-67	-364	-353	-206	-61
Post tax exceptionals	-30	72	0	0	0	0
Minorities	1	3	0	0	0	0
Net Profit	80	85	444	354	649	214
Dividend	-71	-80	-87	-96	-106	-116
Retained	9	5	357	258	543	98
EBITDA	370	709	1,158	1,066	1,212	601
EPS (p) (UKSIP)	22.31	85.06	115.32	92.03	168.56	55.55
EPS (p) (IFRS)	20.01	21.25	115.32	92.03	168.56	55.55
FCFPS (p)	34.66	25.20	112.30	70.29	165.19	165.66
Dividend (p)	18.80	21.00	23.10	25.40	27.90	30.70

Source: Company data, Longspur Research estimates

KEY POINTS

- Pricing drops revenue in FY 23 but profitability remains
- Net interest balanced between cashflow and capex
- Higher tax due to windfall tax in FY 23 and FY 24, lower in FY 25 as pricing starts to normalise
- Dividend remains covered throughout

Balance Sheet

£,000, Dec	2021a	2022a	2023e	2024e	2025e	2026e
Fixed Asset Cost	4,166	4,482	5,008	5,387	5,693	5,605
Fixed Asset Depreciation	-1,855	-2,094	-2,351	-2,619	-2,905	-3,177
Net Fixed Assets	2,311	2,388	2,657	2,768	2,788	2,428
Goodwill	416	424	424	424	424	424
Other intangibles	189	142	142	142	142	142
Investments	125	145	145	145	145	145
Stock	501	536	375	383	393	349
Trade Debtors	642	1,227	859	877	901	800
Other Debtors	1,324	1,294	1,194	1,244	1,294	1,294
Trade Creditors	-1,211	-1,528	-1,070	-1,093	-1,121	-996
Other Creditors <1yr	-966	-1,013	-1,013	-1,013	-1,013	-1,013
Creditors >1yr	-767	-877	-877	-877	-877	-877
Provisions	-86	-59	-59	-59	-59	-59
Pension	0	0	0	0	0	0
Capital Employed	2,476	2,680	2,778	2,943	3,018	2,639
Cash etc	317	238	546	628	522	991
Borrowing <1yr	56	67	67	67	67	67
Borrowing >1yr	1,431	1,527	1,576	1,565	991	984
Net Borrowing	1,170	1,356	1,097	1,004	536	59
Share Capital	48	48	48	48	48	48
Share Premium	432	433	433	433	433	433
Retained Earnings	198	194	550	808	1,352	1,449
Other	607	636	636	636	636	636
Minority interest	22	13	13	13	13	13
Capital Employed	2,476	2,680	2,778	2,943	3,018	2,639
Net Assets	1,307	1,324	1,681	1,939	2,482	2,580
Total Equity	1,307	1,324	1,681	1,939	2,482	2,580

Source: Company data, Longspur Research estimates

KEY POINTS

- Working capital remains comfortable across period
- Goodwill increases in FY 21 with pellet acquisition
- Net debt rises with acquisition and then drops with cashflow
- Sale of OCGTs reduces net debt further in FY 26

Cashflow

£,000, Dec	2021a	2022a	2023e	2024e	2025e	2026e
Operating profit	170	469	901	797	926	330
Depreciation	199	239	257	268	286	271
Provisions	-4	-29	0	0	0	0
Other	-42	14	0	0	0	0
Working capital	32	-374	-233	-2	133	154
Operating cash flow	355	320	925	1,064	1,345	755
Tax paid	12	-39	-67	-364	-353	-206
Capex (less disposals)	-209	-173	-426	-429	-356	88
Investments	-20	-8	0	0	0	0
Net interest	-60	-74	-94	-90	-71	-55
Net dividends	-71	-79	-80	-87	-96	-106
Residual cash flow	7	-52	259	93	468	476
Equity issued	2	1	0	0	0	0
Change in net borrowing	363	187	-259	-93	-468	-476
Adjustments	-359	-136	0	0	0	0
Total financing	7	52	-259	-93	-468	-476

Source: Company data, Longspur Research estimates

KEY POINTS

- Working capital negative in FY 23 but some reversal further out
- Capex slightly down in FY 20 as signalled by company
- Sale of OCGTs in FY 26 reflected in capex
- Further capex on pellet business expansion
- Windfall tax outflows in FY 24 and FY 25

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